

Business Operating Review and Prospects

Business Operating Review

The Company has achieved satisfactory results in each of its segments for the six months ended June 30, 2003.

For the six months ended June 30, 2003, the Company's total output of oil and gas amounted to the equivalent of 444.7 million barrels (including 3.36 million barrels of equity oil production from abroad), including 386.4 million barrels of crude oil and 349.5 billion cubic feet of marketable natural gas, representing an average production of 2.1349 million barrels of crude oil and 1.931 billion cubic feet of marketable natural gas per day. It sold 359.8 million barrels of crude oil and 331.5 billion cubic feet of natural gas. Approximately 73% of the crude oil sold by the Company was purchased by its refineries. For the six months ended June 30, 2003, the Company's lifting cost increased to US\$4.35 per barrel, representing an increase of 1.99% in comparison with the six months ended June 30, 2002.

For the six months ended June 30, 2003, the Company's refineries processed 297.1 million barrels of crude oil, or an average of 1.6414 million barrels per day. Approximately 88% of the crude oil processed in the Company's refineries was supplied by the exploration and production segment. The Company produced approximately 25.48 million tons of gasoline, diesel and kerosene and sold approximately 28.35 million tons of these products. The Company is actively expanding its sales and distribution networks, in particular the retail distribution network, by capitalising fully on the complementary value-added effect of the integration of refining and marketing. As at June 30, 2003, there were 13,868 service stations either owned, controlled or franchised by the Company or owned by CNPC but to which the Company provides supervisory support. The Company's unit cash processing costs were RMB132 per ton, which were lower than the cash processing costs of RMB137 per ton for the first half of last year.

For the six months ended June 30, 2003, the Company produced 0.869 million tons of ethylene, 1.099 million tons of synthetic resin, 0.11 million tons of synthetic fibres, 0.112 million tons of synthetic rubber, and 1.928 million tons of urea. For the six months ended June 30, 2003, there has been significant improvement in the operating results of the chemicals and marketing segment through improved technology, the adjustment of product mix and the production of higher value-added output.

The natural gas and pipeline segment is the Company's core business segment for development. In the six months ended June 30, 2003, the Company produced 349.5 billion cubic feet of marketable natural gas, of which 280.3 billion cubic feet was sold through the natural gas and pipeline segment.

To create higher value for shareholders, the Company had continued to improve the return on and the growth prospects of its upstream business, and will actively expand its overseas oil exploration and exploitation business. In April 2003, the Company acquired 50% interests in Amerada Hess Indonesia Holdings Co., a subsidiary of an American company Amerada Hess, which holds 30% interests in the Jabung block, for US\$82 million. In relation to this acquisition, we entered into take or pay agreements with a number of Singaporean customers to supply them with natural gas from Indonesia.

Prospects for the Second Half of 2003 and Beyond

The Company had achieved encouraging results in the first half of 2003 by calmly reacting to the sudden outbreak of SARS in the PRC and overcoming the adverse effects of the event through effective organisation. For the second half of 2003, the Company intends to continue to enhance exploration and exploitation work to ensure the continuous increase in oil and gas output; improve the allocation of resources and the marketing network; increase the profitability of the refining business; and carefully organise the construction of key pipeline projects to ensure that they commence operation strictly in accordance with schedule.

For the exploration and production segment, the Company will continue to give top priority to the exploration of resources in order to find new oil and gas resources and ensure the continuous increase in oil and gas output. The Company will continue to control and reduce oil and gas exploration costs, increase the exploration success rate and increase the overall benefits from exploration. The increase of reserves, output and efficiency will remain as the target of oil and gas production. Emphasis will be put on the tapping of resource potentials when effecting the comprehensive adjustments required for existing oilfields in the east, the water-cut level will be checked in order to increase the recovery rate. The production of oilfields in the west and new blocks in the east will be sped up, so as to realise the substitution of production capacity for the mature oilfields and ensure a steady increase in the output of oil and gas.

For the refining and chemicals segment, the Company will continue to restructure its refining business and improve the allocation of resources. It will continue to promote technological advancement and quality improvement, as well as to speed up the construction of its refining bases and the implementation of key technological upgrading projects. There will be improved production, operation and management for the refining business. Timely adjustments will be made to the product mix and facilities will be put into and out of service in accordance with market demand, so that facilities with high efficiency will operate at full-load and both output and revenue can be increased.

For the marketing segment, the Company will continue to improve its marketing networks and distribution systems with the aim of increasing its share in the end-user market and continuously increasing its market share. The Company will strive to increase sales, revenue and efficiency through the improvement of product distribution and modes of transportation, a strict control of costs and expenses and a reduction in marketing expenses.

For the natural gas and pipeline segment, the Company intends to ensure that projects are completed and commence operation strictly in accordance with schedule and that various tasks are completed with good quality, high efficiency and safety through careful organisation and the setting of reasonable progress for construction. The eastern section of the West-East gas pipeline project is expected to commence operation in the fourth quarter this year. The major welding works of the western section is expected to be completed by the end of this year. The full-scale construction of the Zhong-Wu pipeline is expected to commence. The review of the preliminary design and the design of construction drawings for the second Shaanxi-Beijing gas pipeline will be completed. Construction will commence on the controlling works for the Yellow River Tunnel and the Daliang Tunnel and preparations is expected to be completed for the commencement of work on the entire pipeline.

For its overseas business, the Company will continue to achieve active and stable growth by actively seeking new opportunities to expand while overseeing the operations of existing overseas projects.

Looking forward, the Company will continue to strive to develop its core businesses and give top priority to resources exploration. It will strive to increase the reserves and output of oil and gas, realise a positive cycle of resource substitution and speed up the growth in its natural gas business. The Company intends to enhance the structural adjustment and the construction of the marketing network, increase its market share and steadily increase its profitability. The Company will also assume an active role in the competition in the international market for oil and gas resources, speed up the expansion of its overseas business and strive to achieve a new and bigger break-through in the development of new areas.

The Company's management will persist in enhancing the Company's value and strive to maximise benefits and value for its shareholders. It intends to put substantial efforts into technological innovation and management innovation and promote the continuous, effective and speedy development of the Company.