



BUSINESS OPERATING REVIEW

The Company was established as a joint stock company with limited liability under the laws of the People's Republic of China on November 5, 1999 as part of the restructuring of the CNPC. In the restructuring, CNPC, the parent company of the Company, injected into the Company most of the assets, liabilities and interests of CNPC relating to its domestic exploration and production, refining and marketing, chemicals and natural gas businesses. The American Depositary Shares (the “ADSs”) and H shares of the Company were listed on the New York Stock Exchange, Inc. and the HKSE on April 6, 2000 and April 7, 2000, respectively.



The Company is engaged in a broad range of petroleum related activities, including:

- the exploration, development, production and sales of crude oil and natural gas;
- the refining, transportation, storage and marketing of crude oil and petroleum products;



- the production and sales of basic petrochemical products, derivative petrochemical products and other chemical products; and
- the transmission of natural gas, crude oil and refined products, and the sale of natural gas.

The Company is the largest producer of crude oil and natural gas in the PRC and one of the largest companies in the PRC in terms of sales.

Market Review

◆ Crude Oil Market Review

International crude oil prices remained high for most of 2004 and the annual average oil price soared due to global economic recovery, surging oil demand and the international political climate. The annual average price for WTI, Brent and Minas crude oil was US\$41.52, US\$38.25 and US\$36.97 per barrel respectively, representing an increase of US\$10.47, US\$9.41 and US\$7.47 per barrel respectively over the annual average price in 2003. Corresponding to the rise in international oil prices, domestic crude oil prices also increased. The average realized price for domestic crude oil in 2004 was higher than that of 2003.

Net crude oil imports of China continued to increase in 2004, increased by 41.3% to a net total of 117 million tons compared with the corresponding period in the previous year. The domestic output of crude oil and refined products reached 176 million tons and 259 million tons respectively.

◆ Refined Products Market Review

In general, the domestic market for refined products performed well in 2004, with nominal consumption increasing by 19.1% to 157.05 million tons. Net import of refined products for the whole country climbed to 26.41 million tons, representing an increase of 83.3% over the previous year. As compared with the beginning of 2004, the national inventory level of refined products also increased by approximately 100,000 tons by the end of 2004.

Owing to the adjustment and control of the domestic prices for refined products by the central government in 2004 and the impact of international oil prices, the annual average benchmark prices for both gasoline and diesel were higher than the 2003 level.

◆ Chemical Products Market Review

The rapid global economic development in 2004 brought about a sharp rise in the demand for basic energy resources and chemical materials, which in turn led to a tightened supply of energy, transportation



and chemical materials, and thus a shortage of petrochemical products. On the other hand, international crude oil prices continuously reached new heights, forcing up prices of downstream chemical products. Compared with 2003, the prices of petrochemical products increased by a huge margin and the prices of a majority of chemical products were at a 10-year high.

The Chinese economy grew steadily and rapidly in 2004 under the state's macroeconomic regulation and control. A favourable economic environment helped boost the development of the petrochemical market, especially the demand for plastic and textile products. On the other hand, there was an insufficient domestic petrochemical output as well as a shortage of chemical resources. As a result of the changes in cost and demand, both the price and production of petrochemical products in the domestic petrochemical market increased in 2004.

Company Business Review

◆ Exploration and Production

For the twelve months ended December 31, 2004, total oil and gas output of the Company was 918.6 million barrels of oil equivalent, including 778.4 million barrels of crude oil and 841.2 billion cubic feet of marketable natural gas, representing an average production of 2.13 million barrels of crude oil and 2,305 million cubic feet of natural gas per day. A total of 730.2 million barrels of crude oil and 781.4 billion cubic feet of natural gas were sold. Approximately 82% of the crude oil sold by the Company was purchased by its refineries. In 2004, the listing cost for the oil and gas operations of the Company was US\$4.61 per barrel, representing an increase of 5.0% from US\$4.39 per barrel in 2003.

◆ Refining and Marketing

For the twelve months ended December 31, 2004, the Company's refineries processed 698 million barrels of crude oil, or an average of 1.91 million barrels per day. Approximately 84% of the crude oil processed in the Company's refineries was supplied by the Exploration and Production segment. The Company produced approximately 64.30 million tons of gasoline, diesel and kerosene and sold approximately 67.01 million tons of these products. The Company actively expanded its sales and distribution networks, in particular the retail sales network, by capitalizing fully on the complementary value-added effect of the integration of refining and marketing. As at December 31, 2004, there were 17,403 service stations which were either owned, controlled or franchised by the Company or owned by CNPC but to which the Company provided supervisory support. The cash processing cost of the Company's refineries also decreased from RMB132 per ton to RMB131 per ton.



◆ Chemicals and Marketing

For the twelve months ended December 31, 2004, the Company produced 1.846 million tons of ethylene, 2.527 million tons of synthetic resin, 1.263 million tons of synthetic fibre raw materials and polymer, 0.286 million tons of synthetic rubber, and 3.652 million tons of urea.

◆ Natural Gas and Pipeline

The Natural Gas and Pipeline segment is the Company's core business segment for development. For the twelve months ended December 31, 2004, the Company sold 657.3 billion cubic feet of marketable natural gas through the Natural Gas and Pipeline segment. The Company currently owns and operates 18,995 kilometres of regional natural gas pipeline networks, of which 17,868 kilometres are operated by the Natural Gas and Pipeline segment. As at December 31, 2004, the Company owned and operated 9,167 kilometres of crude oil pipeline and 2,460 kilometres of refined product pipeline.

