

PetroChina

2005

MANAGEMENT'S
DISCUSSION AND
ANALYSIS OF FINANCIAL
CONDITION AND RESULTS
OF OPERATIONS

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the consolidated interim condensed financial statements for the Group and the notes thereto.

Overview

For the six months ended June 30, 2005, the profit before taxation of the Group was RMB85,467 million, representing an increase of 33.7% from the corresponding period of last year. Net profit was RMB61,624 million, representing an increase of 36.1% from the corresponding period of last year. The continued rapid improvement of the Company's operating results was primarily attributable to the optimal use of its competitive edge in upstream activities, streamlining of its downstream structures, speeding up of the construction of pipelines and enhancement of operation management during a period of sustained high oil prices.

For the six months ended June 30, 2005, the Company's basic and diluted earnings per share was RMB0.35.

Comparison between the six-month period ended June 30, 2005 and the six-month period ended June 30, 2004

Consolidated Operating Results

Turnover Turnover increased 41.5% from RMB178,404 million for the six months ended June 30, 2004 to RMB252,489 million for the six months ended June 30, 2005. The growth was mainly attributable to the increases in the prices and sales volume of crude oil, refined oil and petrochemical products, and the increase in the sales volume of natural gas.

Operating Expenses Operating expenses increased 46.3% from RMB114,148 million for the six months ended June 30, 2004 to RMB166,952 million for the six months ended June 30, 2005. The change was mainly attributable to an increase in the purchase costs of raw and auxiliary materials such as crude oil and refined products from external suppliers and an increase in exploration expenses due to increased exploration activities.



PetroChina

2005

MANAGEMENT'S
DISCUSSION AND
ANALYSIS OF FINANCIAL
CONDITION AND RESULTS
OF OPERATIONS

Purchases, Services and Other Expenses Purchases, services and other expenses increased 87.9% from RMB51,272 million for the six months ended June 30, 2004 to RMB96,362 million for the six months ended June 30, 2005. This was primarily due to the increase in the purchase costs of crude oil and refined products resulted from the rise in prices of raw and auxiliary materials for such crude oil and refined products, as well as from our increased consumption of raw materials to meet the rise in output of refinery and petrochemical products. In addition, the increase in trade volume during the period led to a corresponding increase in purchase expenses.

Employee Compensation Costs Employee compensation costs rose 21.4% from RMB10,540 million for the six months ended June 30, 2004 to RMB12,800 million for the six months ended June 30, 2005. This was primarily due to the improvement in the Company's operating results which led to the increase in the wages and welfare expenses of staff and workers; as well as the further development of the Company's retail network which led to the increase in labour service costs.

Exploration Expenses Exploration expenses increased 51.5% from RMB5,630 million for the six months ended June 30, 2004 to RMB8,528 million for the six months ended June 30, 2005. This was mainly due to the Company appropriately increasing its input relating to oil and gas exploration when oil prices were high.

Depreciation, Depletion and Amortization Depreciation, depletion and amortization increased 4.2% from RMB24,746 million for the six months ended June 30, 2004 to RMB25,791 million for the six months ended June 30, 2005. This was mainly attributable to an increase in the amount of property, plant and equipment which led to a corresponding increase in depreciation and depletion.

Selling, General and Administrative Expenses Selling, general and administrative expenses increased 7.8% from RMB12,794 million for the six months ended June 30, 2004 to RMB13,797 million for the six months ended June 30, 2005. This was primarily due to an increase in transportation expenses caused by an increase in the sales volume of refined products.

Taxes other than Income Tax Taxes other than income tax increased 13.2% from RMB9,417 million for the six months ended June 30, 2004 to RMB10,660 million for the six months ended June 30, 2005. The increase was primarily due to an increase in consumption tax and surcharges as a result of an increase in the sales volume of gasoline and diesel oil by the Group's refineries and also an increase in compensation fees for mineral resources due to an increase in crude oil and natural gas revenues.

PetroChina

2005

MANAGEMENT'S
DISCUSSION AND
ANALYSIS OF FINANCIAL
CONDITION AND RESULTS
OF OPERATIONS

Profit from Operations As a result of the factors discussed above, profit from operations increased 33.1% from RMB64,256 million for the six months ended June 30, 2004 to RMB85,537 million for the six months ended June 30, 2005.

Net Exchange Gain The net exchange gain increased from RMB10 million for the six months ended June 30, 2004 to RMB80 million for the six months ended June 30, 2005. This was primarily due to a depreciation of the value of the Japanese Yen and the Euro against Renminbi during the first half of this year.

Net Interest Expenses Net interest expenses decreased 32.5% from RMB960 million for the six months ended June 30, 2004 to RMB648 million for the six months ended June 30, 2005. The decrease in net interest expenses was primarily due to a decrease in the average proportion of interest-bearing debts which led to the decrease in interest expenses and sufficient cash flow generated from operating activities which led to the increase in interest income.

Profit Before Taxation Profit before taxation rose 33.7% from RMB63,909 million for the six months ended June 30, 2004 to RMB85,467 million for the six months ended June 30, 2005.

Taxation Taxation increased 29.9% from RMB17,899 million for the six months ended June 30, 2004 to RMB23,246 million for the six months ended June 30, 2005. The increase was mainly due to an increase in taxable profits.

Net Profit As a result of the factors discussed above, net profit increased 36.1% from RMB45,276 million for the six months ended June 30, 2004 to RMB61,624 million for the six months ended June 30, 2005.

Segment Information

The Group is engaged in a broad range of petroleum and related activities through its four major business segments: the Exploration and Production segment, the Refining and Marketing segment, the Chemicals and Marketing segment, and the Natural Gas and Pipeline segment.

Exploration and Production

The Exploration and Production segment is engaged in the exploration, development, production and sales of crude oil and natural gas.

Turnover Turnover increased 44.6% from RMB99,526 million for the six months ended June 30, 2004 to RMB143,895 million for the six months ended June 30, 2005. The increase was mainly attributable to the increases in prices and sales volume of crude oil and the increase in sales volume of natural gas. During the



PetroChina

2005

MANAGEMENT'S
DISCUSSION AND
ANALYSIS OF FINANCIAL
CONDITION AND RESULTS
OF OPERATIONS



first half of 2005, our average realized crude oil price was US\$43.42 per barrel, representing an increase of 45.9% from US\$29.76 per barrel for the corresponding period in the first half of 2004.

Intersegment sales increased 51.3% from RMB80,270 million for the six months ended June 30, 2004 to RMB121,484 million for the six months ended June 30, 2005. The increase was mainly due to the increase in prices and sales volume of crude oil and the increase in sales volume of natural gas.

Operating Expenses Operating expenses increased 26.4% from RMB46,825 million for the six months ended June 30, 2004 to RMB59,202 million for the six months ended June 30, 2005. The increase was principally due to the increase in costs of purchase, employee compensation, depreciation and depletion of fixed assets and exploration expenses.

Profit from Operations As a result of the factors discussed above, profit from operations increased 60.7% from RMB52,701 million for the six months ended June 30, 2004 to RMB84,693 million for the six months ended June 30, 2005.

Refining and Marketing

The Refining and Marketing segment is engaged in the refining, transportation, storage and marketing of crude oil and petroleum products.

Turnover Turnover rose 46.1% from RMB137,491 million for the six months ended June 30, 2004 to RMB200,883 million for the six months ended June 30, 2005. The increase was caused by increases in sales

PetroChina

2005

MANAGEMENT'S
DISCUSSION AND
ANALYSIS OF FINANCIAL
CONDITION AND RESULTS
OF OPERATIONS

volume and prices of key refined products as well as the increase of international trading volume and trading revenue.

Revenue from sales of gasoline grew 45.1% from RMB37,621 million for the six months ended June 30, 2004 to RMB54,570 million for the six months ended June 30, 2005. The increase was mainly due to increased prices and sales volume of gasoline. The average realized selling price of gasoline surged 17.3% from RMB3,362 per ton for the six months ended June 30, 2004 to RMB3,943 per ton for the six months ended June 30, 2005. The sales volume of gasoline increased 23.7% from 11.19 million tons for the six months ended June 30, 2004 to 13.84 million tons for the six months ended June 30, 2005.

Revenue from sales of diesel grew 31.0% from RMB62,491 million for the six months ended June 30, 2004 to RMB81,888 million for the six months ended June 30, 2005. The increase was mainly due to increased sales prices and volume of diesel. The average realized selling price of diesel increased 16.2% from RMB2,980 per ton for the six months ended June 30, 2004 to RMB3,463 per ton for the six months ended June 30, 2005. The sales volume of diesel increased 12.7% from 20.97 million tons for the six months ended June 30, 2004 to 23.64 million tons for the six months ended June 30, 2005.

Revenue from sales of kerosene grew 16.2% from RMB2,632 million for the six months ended June 30, 2004 to RMB3,059 million for the six months ended June 30, 2005. The increase was mainly due to increased sales prices of kerosene.

Intersegment sales revenue increased 58.9% from RMB9,504 million for the six months ended June 30, 2004 to RMB15,098 million for the six months ended June 30, 2005. The increase was mainly due to increases in sales volume and sales prices of the key refined products.



PetroChina

2005

MANAGEMENT'S
DISCUSSION AND
ANALYSIS OF FINANCIAL
CONDITION AND RESULTS
OF OPERATIONS

Operating Expenses Operating expenses increased 60.9% from RMB128,507 million for the six months ended June 30, 2004 to RMB206,832 million for the six months ended June 30, 2005. The increase was mainly attributable to the increase of the purchase cost of crude oil, other feedstock and refined products from external suppliers, as well as an increase in the trading volume of petrochemical products which led to a corresponding increase in purchase costs.

Profit from Operations Profit from operations for the six months ended June 30, 2005 was a loss of RMB5,949 million. Profit from operations for the six months ended June 30, 2004 was RMB8,984 million. The decrease was mainly due to the level of increase in refined oil prices is way lower than that of the increase in crude oil prices in China in the first half of the year.

Chemicals and Marketing

The Chemicals and Marketing segment is engaged in the production and sales of basic petrochemical products, derivative petrochemical products and other chemical products.

Turnover Turnover rose 45.6% from RMB25,434 million for the six months ended June 30, 2004 to RMB37,035 million for the six months ended June 30, 2005. The growth in turnover of this segment was principally due to increases in the sales volume and selling prices of key chemical products.

Operating Expenses Operating expenses increased 33.2% from RMB23,481 million for the six months ended June 30, 2004 to RMB31,279 million for the six months ended June 30, 2005. The increase was mainly due to increased expenses in the purchase of raw materials.



PetroChina

2005

MANAGEMENT'S
DISCUSSION AND
ANALYSIS OF FINANCIAL
CONDITION AND RESULTS
OF OPERATIONS

Profit from Operations As a result of the factors discussed above, profit from operations increased 194.7% from RMB1,953 million for the six months ended June 30, 2004 to RMB5,756 million for the six months ended June 30, 2005.

Natural Gas and Pipeline

The Natural Gas and Pipeline segment is engaged in the transmission of natural gas, crude oil and refined products, and the sales of natural gas.

Turnover Turnover increased 33.2% from RMB8,917 million for the six months ended June 30, 2004 to RMB11,874 million for the six months ended June 30, 2005. The increase was primarily due to an increase in the sales volume of natural gas and an increase in the price and volume of natural gas from pipeline transmission.

Operating Expenses Operating expenses increased 35.3% from RMB7,684 million for the six months ended June 30, 2004 to RMB10,396 million for the six months ended June 30, 2005. This was mainly due to increased expenses in the purchase of gas and an increase in depreciation charges caused by the commencement of operation of the western section of the West-East Gas Pipeline.

Profit from Operations As a result of the factors discussed above, profit from operations increased 19.9% from RMB1,233 million for the six months ended June 30, 2004 to RMB1,478 million for the six months ended June 30, 2005.





PetroChina

2005

MANAGEMENT'S
DISCUSSION AND
ANALYSIS OF FINANCIAL
CONDITION AND RESULTS
OF OPERATIONS

Liquidity and Capital Resources

For the six months ended June 30, 2005, the Group's primary sources of funds were cash generated from operating activities, short-term and long-term borrowings. The Group's funds were used for operating activities, capital expenditures, repaying short-term and long-term borrowings and distribution of dividends to shareholders of the Company.

For the six months ended June 30, 2005, short-term debts represented approximately 5.3% of the Group's capital employed as compared with approximately 6.2% for the six months ended June 30, 2004. Our ability to obtain adequate financing may be affected by our financial condition and operating results and the conditions of the domestic and foreign capital markets. We must seek approvals from the relevant PRC government authorities before raising funds in the domestic and foreign capital markets. In general, we must obtain PRC government approvals for any project involving significant capital investments in our Refining and Marketing segment, Chemicals and Marketing segment and the Natural Gas and Pipeline segment.

We plan to fund our capital and related investments principally from the cash generated from operating activities and short-term and long-term borrowings. For the six months ended June 30, 2005, net cash generated from operating activities was RMB92,099 million. As at June 30, 2005, we had cash and cash equivalents of RMB69,857 million. Cash and cash equivalents were mainly denominated in Renminbi (Renminbi accounting for approximately 99.3% and United States Dollar accounting for approximately 0.7%).

The table below sets forth our cash flows for the six months ended June 30, 2005 and the six months ended June 30, 2004 and our cash equivalents at the end of each period.

	Six months ended June 30	
	2005	2004
	(RMB million)	(RMB million)
Net cash generated from operating activities	92,099	65,870
Net cash used for investment activities	(30,075)	(26,509)
Net cash used for financing activities	(31,149)	(17,541)
Cash and cash equivalents at the end of each period	69,857	52,726

PetroChina

2005

MANAGEMENT'S
DISCUSSION AND
ANALYSIS OF FINANCIAL
CONDITION AND RESULTS
OF OPERATIONS

Cash Generated from Operating Activities

Our net cash generated from operating activities during the first half of this year increased 39.8% from RMB65,870 million for the six months ended June 30, 2004 to RMB92,099 million for the six months ended June 30, 2005. This substantial increase was mainly attributable to the considerable increase in profits and payables during the period.

As at June 30, 2005, our working capital was RMB25,274 million. As at December 31, 2004, our working capital deficit was RMB4,523 million. The increase in working capital was primarily due to an increase in receivables and prepayments, inventories and cash and cash equivalents.

Cash Used for Financing Activities

Compared with the six months ended June 30, 2004, our net cash used for financing activities increased 77.6% for the six months ended June 30, 2005. This was mainly due to a higher cash dividend paid in respect of the ordinary shares for the first half of this year than that of the corresponding period of last year.

The table below sets out our net borrowings as at June 30, 2005 and December 31, 2004:

	June 30, 2005	December 31, 2004
	(RMB million)	(RMB million)
Short-term borrowings (including current portion of long-term borrowings)	28,303	28,093
Long-term borrowings	35,357	38,769
Total borrowings	63,660	66,862
Less:		
Cash and cash equivalents	69,857	38,982
Net borrowings	(6,197)	27,880



PetroChina

2005

MANAGEMENT'S
DISCUSSION AND
ANALYSIS OF FINANCIAL
CONDITION AND RESULTS
OF OPERATIONS

The maturity profile of the long-term borrowings of the Group is as follows:

	Principal as at June 30, 2005	Principal as at December 31, 2004
	(RMB million)	(RMB million)
To be repaid within one year	15,658	16,769
To be repaid within one to two years	15,771	8,367
To be repaid within two to five years	12,376	23,035
To be repaid after five years	7,210	7,367
	51,015	55,538

Of the total borrowings of the Group as at June 30, 2005, approximately 30.9% were fixed rate loans and approximately 69.1% were floating-rate loans. Of the borrowings as at June 30, 2005, approximately 85.03% were denominated in Renminbi, approximately 13.6% were denominated in US Dollars, approximately 0.39% were denominated in Pound Sterling, approximately 0.51% were denominated in Japanese Yen, and approximately 0.47% were denominated in Euro.

As at June 30, 2005, borrowings owed to China Petroleum Finance Company Limited amounted to RMB24,069 million. Borrowings owed to state-owned banks and other state-owned financial institutions (excluding banks) amounted to RMB32,872 million and borrowings owed to other related parties amounted to RMB15 million.

As at June 30, 2005, short-term borrowings and long-term borrowings owed to China Petroleum Finance Company Limited amounted to RMB490 million and RMB23,579 million respectively.

As at June 30, 2005, loans of the Group consisted of RMB70 million secured loans (finance lease and bank loans) (RMB60 million as at December 31, 2004), of which RMB64 million (RMB39 million as at December 31, 2004) were secured by plant and equipment of the Group valued at RMB72 million (RMB246 million as at December 31, 2004). As ownership of leased assets will be transferred to the lessor in case of default, lease obligations are in fact secured obligations. As at June 30, 2005, finance lease obligations of the Group amounted to RMB6 million (RMB21 million as at December 31, 2004), and were secured with properties, plant and equipment held under finance lease with a book value of RMB113 million (RMB175 million as at December 31, 2004).

PetroChina

2005

MANAGEMENT'S
DISCUSSION AND
ANALYSIS OF FINANCIAL
CONDITION AND RESULTS
OF OPERATIONS

As at June 30, 2005, the debt to capitalization ratio (debt to capitalization ratio = total debts / (total debts + total equity)) was 11.9% (13.3% as at December 31, 2004).

Capital Expenditures

The table below sets out our capital expenditures by business segments for each of the six months ended June 30, 2005 and the six months ended June 30, 2004. During the first half of 2005, capital expenditures increased 10.1% from RMB28,691 million for the six months ended June 30, 2004 to RMB31,592 million for the six months ended June 30, 2005. The increase in capital expenditure was primarily due to the appropriate increase in input relating to oil and gas exploration and development when oil prices were high. Further, the price of production raw materials, such as steel, fuel, water and electricity, increased which led to an increase in investment.

	First half of 2005		First half of 2004		Estimate for the year of 2005	
	(RMB million)	%	(RMB million)	%	(RMB million)	%
Exploration and Production	20,630*	65.3	19,146*	66.7	61,160*	62.7
Refining and Marketing	4,614	14.6	4,526	15.8	14,590	15.0
Chemicals and Marketing	2,633	8.3	1,062	3.7	8,350	8.6
Natural Gas and Pipeline	3,651	11.6	3,905	13.6	12,400	12.7
Others	64	0.2	52	0.2	1,000	1.0
Total	31,592	100.0	28,691	100.0	97,500	100.0

Note:* If geological and geophysical exploration costs were included, the capital expenditures and investments for the Exploration and Production segment for the first half of 2004 and the first half of 2005, and the estimate of the same for the entire 2005 would be RMB21,646 million, RMB24,028 million and RMB66,660 million, respectively.

Exploration and Production

The majority of the Group's capital expenditures is related to the Exploration and Production segment. For the six months ended June 30, 2005, capital expenditures in relation to exploration and production amounted to



PetroChina

2005

MANAGEMENT'S
DISCUSSION AND
ANALYSIS OF FINANCIAL
CONDITION AND RESULTS
OF OPERATIONS

RMB20,630 million, including RMB3,727 million for exploration activities and RMB15,953 million for development activities. For the six months ended June 30, 2004, capital expenditures in relation to this segment totalled RMB19,146 million, including RMB3,665 million for exploration activities and RMB14,481 million for development activities. The increase in capital expenditures was mainly due to the increased expenditures relating to oil and gas exploration and development.

It is estimated that for the twelve months ending December 31, 2005, capital expenditures of the Group in the Exploration and Production segment will amount to RMB61,160 million. Approximately RMB10,960 million is expected to be used for oil and gas exploration, and approximately RMB50,200 million will be used for oil and gas development. Exploration and development is expected to be mainly carried out in the Erdos, Junggar, Tarim, Songliao, Sichuan and Bohai Bay basins.

Refining and Marketing

For the six months ended June 30, 2005, capital expenditures of the Group in the Refining and Marketing segment amounted to RMB4,614 million, of which RMB2,487 million was spent on the expansion of the retail marketing network of our refined products and storage infrastructure facilities, and RMB1,181 million was spent on upgrading our refining facilities. For the six months ended June 30, 2004, capital expenditures for this segment totalled RMB4,526 million. The capital expenditures during this period were basically the same as that during the same period last year.

It is estimated that capital expenditures of the Group for the Refining and Marketing segment for the twelve months ending December 31, 2005 will amount to RMB14,590 million, including approximately RMB7,250 million to be spent on construction and expansion of refining facilities; and approximately RMB7,340 million to be spent on investments in our refined product retail marketing network.

Chemicals and Marketing

For the six months ended June 30, 2005, capital expenditures in the Chemicals and Marketing segment were RMB2,633 million, compared with RMB1,062 million for the six months ended June 30, 2004. The increase in capital expenditures was mainly because the ethylene upgrading and expansion project of Lanzhou Petrochemical Company, the propylene projects of Daqing Refinery and Petrochemical Company and Dalian Petrochemical Company and the PTA project of Liaoyang Petrochemical Company, amongst other projects, were in their peak construction period.

PetroChina

2005

MANAGEMENT'S
DISCUSSION AND
ANALYSIS OF FINANCIAL
CONDITION AND RESULTS
OF OPERATIONS

It is estimated that for the twelve months ending December 31, 2005, capital expenditures of the Group in the Chemicals and Marketing segment will amount to RMB8,350 million. The capital expenditures are expected to mainly be used for upgrading ethylene facilities in Daqing, Jilin, Lanzhou and Dushanzi, and the PTA project of Liaoyang Petrochemical Company.

Natural Gas and Pipeline

For the six months ended June 30, 2005, capital expenditures in the Natural Gas and Pipeline segment amounted to RMB3,651 million. RMB3,375 million of these expenditures was spent on construction of long distance pipelines and RMB2,327 million of such amount was spent on the West-East Gas Pipeline project. For the six months ended June 30, 2004, capital expenditures in the segment totalled RMB3,905 million. The decrease in capital expenditures was mainly due to a dramatic decrease in expenditures relating to the second Shaanxi-Beijing Pipeline Project.

It is estimated that for the twelve months ending December 31, 2005, capital expenditures of the Group in the Natural Gas and Pipeline segment will amount to RMB12,400 million, of which approximately RMB7,000 million will be invested in the West-East Gas Pipeline project, the Zhongxian-Wuhan pipeline, and the second Shaanxi-Beijing pipeline and approximately RMB5,400 million is expected to be invested in natural gas storage infrastructure facilities and other natural gas, crude oil and refined product transmission pipelines.

Others

The Group's non segment-specific capital expenditures for the six months ended June 30, 2004 and for the six months ended June 30, 2005 were RMB52 million and RMB64 million respectively. These capital expenditures were mainly used for non segment-specific equipment purchases and research and development activities.

It is estimated that the Group's non segment-specific capital expenditures for the twelve months ending December 31, 2005 will amount to RMB1,000 million. These capital expenditures are expected to be used for the construction of water and power supply systems, roads and telecommunications system for the benefit of various segments.

Material Investment

For the six months ended June 30, 2005, the Group did not hold any material investment.



PetroChina

2005

MANAGEMENT'S
DISCUSSION AND
ANALYSIS OF FINANCIAL
CONDITION AND RESULTS
OF OPERATIONS

Material Acquisition or Disposal

Under an acquisition agreement between the Company and CNPC dated March 28, 2005, the Company has acquired the petroleum and natural gas-related refinery and petrochemical businesses respectively owned by CNPC's wholly-owned subsidiaries, Ningxia Dayuan Refinery and Petrochemical Company Limited and Qingyang Refinery and Petrochemical Company Limited. The Company has paid RMB9.14 million in cash as consideration for the acquisition. Pursuant to the Listing Rules, the acquisition constitutes a connected transaction of the Company, and the details of the transaction were announced on March 30, 2005.

Post-Balance Sheet Events

The Company signed an acquisition agreement ("Acquisition Agreement") and an equity transfer agreement ("Transfer Agreement") with wholly owned subsidiaries of CNPC on June 9, 2005. Under the Acquisition Agreement, the Company agreed to acquire a 50% equity interest in 中油勘探開發有限公司 (Zhong You Kan Tan Kai Fa Company Limited) ("Newco"), which is currently 100% held by two wholly owned subsidiaries of CNPC, at a total consideration of approximately RMB20,741 million. The Company also agreed to enter into the Transfer Agreement at the same time with the Acquisition Agreement pursuant to which the Company has agreed to transfer the equity interest in PetroChina International Ltd, a wholly owned subsidiary of the Company, to Newco for the price of RMB579 million.

As the acquisition and equity transfer constitute connected transactions of the Company, approval of the relevant regulatory authorities and the independent shareholders of the Company were required. The two agreements were approved by the independent shareholders of the Company in a general meeting held on August 16, 2005.

When the Acquisition Agreement and the Transfer Agreement are completed, the Company and China National Oil and Gas Exploration and Development Corporation ("CNODC") will each hold 50% equity interests in Newco. CNODC intends to transfer its 50% equity interests in Newco to CNPC at nil consideration. The Company will be entitled to appoint four out of the seven directors of Newco and will therefore have actual control over Newco. As the Company's investment in Newco and the transfer of equity interests in PetroChina International Ltd to Newco are considered transactions under CNPC's common control, the pooling of interests method is adopted for the necessary accounting treatments. The consolidated financial statements of the Company will be re-presented on the basis that the Company and Newco had already been consolidated.

PetroChina

2005

MANAGEMENT'S
DISCUSSION AND
ANALYSIS OF FINANCIAL
CONDITION AND RESULTS
OF OPERATIONS

Foreign Exchange Rate Risk

From July 21, 2005, the PRC government has reformed the Renminbi exchange rate regime and implemented a regulated floating exchange rate regime based on market supply and demand with reference to a basket of currencies. However, Renminbi is still regulated in capital projects. The exchange rates of Renminbi are affected by domestic and international economic developments and political changes, and supply and demand for Renminbi. Future exchange rates of Renminbi against other currencies could vary significantly from the current exchange rates. As Renminbi is the base currency of the Company and most of its consolidated entities, the fluctuation of the exchange rate of Renminbi may have positive or negative impacts on the results of operations of the Group. An appreciation of Renminbi against United States Dollar may decrease the Group's turnover, but the cost for acquiring imported materials and equipment may be reduced. A devaluation of Renminbi against United States Dollar may not have a negative impact on the Group's turnover but may increase the cost for acquiring imported materials and equipment as well as the debt obligations denominated in foreign currencies of the Group. The results of operations and the financial position of the Group may also be affected by fluctuations in exchange rates of a number of other foreign currencies against Renminbi.

Commodity Price Risk

The Group is engaged in a wide range of petroleum-related activities. The global oil and gas market is affected by international political, economic and military developments and global demand for and supply of oil and gas. As the prices of Chinese crude oil and refined products are determined by reference to international benchmark prices, fluctuations of prices of crude oil and refined products in the international market will directly or indirectly, affect prices of Chinese crude oil and refined products. A decrease in the prices of crude oil and refined products could adversely affect the Group's financial position. The Group has not used derivative instruments to hedge against potential price fluctuations of crude oil and refined products. Accordingly, the Group is exposed to general price fluctuations of oil and gas commodities in 2005 and will remain to be so exposed thereafter.

Industry Risk

Like other oil and natural gas companies in China, the Company's operating activities are subject to regulation and control by the PRC government in many aspects. Regulation and control, such as by way of grant of exploration and production licences, the imposition of industry-specific taxes and levies and the implementation of environmental and safety standards, is expected to have an impact on the Company's business operations. As a result, the Company may be subject to relatively significant restrictions when implementing its business strategy, developing and expanding its business or maximising its profitability. Any future changes in PRC governmental policies on the crude oil and natural gas industry may also affect the Company's business operations.



PetroChina

2005

MANAGEMENT'S
DISCUSSION AND
ANALYSIS OF FINANCIAL
CONDITION AND RESULTS
OF OPERATIONS

Employees

Number of Employees

As at June 30, 2004 and June 30, 2005, the Group had 422,288 and 423,200 employees respectively. The table below sets out the number of employees of business segments as at June 30, 2005:

	Number of Employees	% of total
Exploration and Production	235,794	55.7
Refining and Marketing	115,535	27.3
Chemicals and Marketing	58,916	13.9
Natural Gas and Pipeline	10,150	2.4
Others*	2,805	0.7
Total	423,200	100.0

* Including staff of Company headquarters, business segment head offices, PetroChina Exploration & Development Research Institute, PetroChina Planning & Engineering Institute and Oil Refining and Petrochemical Technological Research Centres.



PetroChina

2005

MANAGEMENT'S
DISCUSSION AND
ANALYSIS OF FINANCIAL
CONDITION AND RESULTS
OF OPERATIONS

Employee Compensation

For the six months ended June 30, 2005, the total employee compensation payable by the Group was RMB8,048 million, being the total salaries of employees during the reporting period. Compensation of employees is determined according to industry practice and the actual conditions of the Group, and is based on the principles of attracting and retaining high calibre personnel, and motivating all staff for the realization of the best results.

The Company's senior management remuneration system links senior management members' financial interests (including those of executive directors and supervisors) with the Company's operating results and the market performance of its shares. The senior management members have entered into performance contracts with the Company. Under this system, the senior management members' compensation has three components, namely, fixed salaries, performance bonuses and stock appreciation rights. The variable components account for approximately 70% to 75% of the senior management officers' total potential compensation, including approximately 0% to 25% forming the performance bonus component and approximately 50% to 70% forming the stock appreciation rights component. Variable compensation rewards are linked to the attainment of specific performance targets, such as net profit, return on capital and cost reduction targets. The chart below sets forth the components of the total potential compensation for key officers.

	Fixed salary (%)	Stock appreciation rights (%)	Performance bonus (%)
Chairman	30	70	0
President	25	60	15
Vice-President	25	60	15
Departmental General Manager	25	50	25

Details of the emoluments of directors and supervisors as at June 30, 2005 and June 30, 2004 are as follows:

	Six months ended June 30, 2005 (RMB'000)	Six months ended June 30, 2004 (RMB'000)
Directors and supervisors emoluments	62	58
Salaries, allowances and other benefits	927	647
Contribution to retirement benefit scheme	28	17
	<u>1,017</u>	<u>722</u>



The number of directors and supervisors whose emoluments fall within the following band (including directors and supervisors whose term expired during the current period):

	As at June 30, 2005	As at June 30, 2004
	Number	Number
Nil – RMB1,000,000	20	24

Upon exercise of their share options, senior management staff will not receive any shares in the Company. Instead, they will receive, by way of stock appreciation rights, a monetary sum which is calculated on the basis of the share price of the H shares listed on the HKSE.

Workforce Reduction Plan

During the period from 1999 to 2002, a total of 58,300 people were laid off, which has met the target of laying off 50,000 employees originally committed by the Company.

The Company does not have any plan for any substantial reduction of its workforce in the next few years, but will continue to keep a strict control on the total number of employees. Workforce required for new projects or expanded production capacity will first be obtained by way of tapping existing resources and making use of any spare capacity.

Training Programmes

In order to satisfy the needs for developing the Company into a major and internationally competitive oil company, this year the Company focuses on training high-level, high-skilled and international talents in its training programme. The Company will focus on the training of core employees, actively implement the strategy of a strongly manpowered enterprise, continue to build up the operating and management team, the technology renovation team and the skillful operators' team so as to achieve an overall improvement in the quality of its staff and ensure the supply of talents required for the continuous, steady, rapid and co-ordinated development of the Company.

Contingent Liabilities

Information on the Group's contingent liabilities as of June 30, 2005 is as follows:

PetroChina

2005

MANAGEMENT'S
DISCUSSION AND
ANALYSIS OF FINANCIAL
CONDITION AND RESULTS
OF OPERATIONS

Bank and other guarantees

As at June 30, 2005, the Group had contingent liabilities in respect of bank and other guarantees and other matters arising in the ordinary course of business from which it is anticipated that no material liabilities will arise.

	June 30, 2005	December 31, 2004
	RMB million	RMB million
Guarantees in respect of borrowings of associated companies	211	203

Environmental Liabilities

CNPC and the Group have operated in China for many years. China has adopted extensive environmental laws and regulations that affect the operation of the oil and gas industry. Future environmental legislation cannot reasonably be estimated at present, but such legislation could have a significant impact. However, under existing legislation, except for the amounts which have already been included in the financial statements, the management believes that there is no liabilities for environment obligations that may have a material adverse effect on the financial position of the Group.

Legal contingencies

The Group is the named defendant in certain insignificant lawsuits as well as the named party in other proceedings arising in the ordinary course of business. While the outcome of such contingencies, lawsuits or other proceedings cannot be determined at present, the management believes that any potential liabilities which may arise will not have a material adverse effect on the financial position of the Group.

Leasing of land, roads and buildings

According to the restructuring agreement entered into between the Company and CNPC in 1999 upon the formation of the Company, CNPC has undertaken to the Company as follows:

- CNPC will use its best endeavours to obtain formal land use right certificates to replace the entitlement certificates in relation to the 28,649 parcels of land which were leased or transferred to the Company from CNPC, within one year from August, September and October 1999 when the relevant entitlement certificates were issued;



- CNPC will complete, within one year from November 5, 1999, the necessary governmental procedures for the requisition of the collectively-owned land on which 116 service stations owned by the Company are located; and
- CNPC will obtain individual building ownership certificates in the name of the Company for all of the 57,482 buildings transferred to the Company by CNPC, before November 5, 2000.

As at June 30, 2005, CNPC obtained formal land use right certificates in relation to 26,549 out of the above-mentioned 28,649 parcels of land, and some building ownership certificates for the above-mentioned buildings, but did not complete the necessary governmental procedures for the above-mentioned service stations located on collectively-owned land. The directors of the Company confirm that the use of and the conduct of relevant activities at the above-mentioned parcels of land, service stations and buildings are not affected by the fact that the relevant land use right certificates or individual building ownership certificates have not been obtained or the fact that the relevant governmental procedures have not yet been completed. In the management's opinion, the outcome of the above events will not have a material adverse effect on the results of operations or the financial position of the Group.

Group insurance

Except for limited insurance coverage for vehicles and certain assets subject to significant operating risks, the Group does not carry any other insurance for its property, facilities or equipment for its business operations. In addition, the Group does not carry any third-party liability insurance against claims relating to personal injury, property and environmental damages or business interruption insurance since such insurance coverages are not customary in China. While the effect of under-insurance on future incidents cannot be reasonably assessed at present, the management believes that it may have a material impact on the operating results but will not have a material adverse effect on the financial position of the Group.

Others

In December 2003, a gas blow-out incident occurred at one of the gas wells of the Group. The blow-out caused the leakage of a large quantity of sulfurated hydrogen, causing injuries and deaths to many residents living in the surrounding area. As a result of an investigation conducted by the PRC government, CNPC, which provided the Company with drilling services for the well, was held liable for this blow-out. The incident has not had, and the Company does not believe it will have, a material adverse effect on the results of operations and financial position of the Group.