Business Operating Review and Prospects

Market Review

Crude Oil Market Review

During the first half of 2005, international crude oil prices continued to rise due to high demand and tight supply. Despite various controls and influences, the oil market and prices were subject to significant fluctuations. The international oil prices hit the record high repeatedly. WTI, Brent and Minas crude oil in the first half of the year averaged US$51.49, US$49.65 and US$50.87 per barrel respectively, representing an increase of US$14.68, US$15.99 and US$17.73 per barrel respectively from the first half of 2004. Domestic crude oil prices rose accordingly under the impact of international oil prices. The average realized price was higher than that of the first half of 2004.

Domestic import of crude oil continued to grow during the first half of 2005. Domestic net crude oil import surged 3.2% to 59.81 million tons compared with the corresponding period of last year. Domestic crude oil output and the amount of crude oil processed reached 90.46 million tons and 134 million tons respectively.

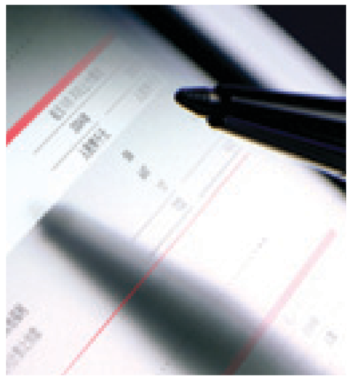
Refined Products Market Review

During the first half of 2005, although the PRC government strengthened control on the domestic macro-economy, demand for refined products still remained relatively high. In general, resources were tight and market prices continued to rise and hit new historical highs repeatedly. From January to June, nominal consumption increased 5.56% to 79.88 million tons compared with the same period of last year. By the end of June 2005, the refined products inventory held by the Company and Sinopec dropped to 7.34 million tons, a reduction of 0.8 million tons compared with the corresponding period of last year.

The PRC government has made appropriate adjustments to the prices of domestic refined products during the first half of 2005. However, under the impact of international oil prices, the average benchmark prices of gasoline and diesel were still higher than the level during the corresponding period of last year.

Chemical Products Market Review

During the first half of 2005, as international oil prices remained high and there was a slow-down in the growth of the domestic economy, the operating results for the petrochemical industry were increasingly divergent. On




the one hand, the upstream raw materials industry maintained a high level of profits due to few new production start-ups; on the other hand, the downstream processing industry recorded a significant slowdown in operating results due to high costs. In general, the petrochemical industry during the first half of 2005 featured a period from an increase in growth to a slight slowdown in growth.

It is estimated that in the second half of the year, with the restructuring of the macro-economy and the implementation of measures relating to restrictions of investment, the growth of the economy will be slowed down. However, a growth rate of approximately 9% will be maintained and the growth in demand for petrochemical products will be greater than the growth of gross domestic product. The fourth quarter of 2005 will be a low season and demand will be lower than that during the first half of 2005. With some new petrochemical facilities in China commencing production, supplies will increase significantly. As a result, it is estimated that petrochemical products will gradually be oversupplied for the second half of 2005. It is inevitable that prices of petrochemical products will be unstable and lower and the overall prices will be lower than those in the first half of 2005.

Business Review

For the six months ended June 30, 2005, total oil and gas output of the Company was 481 million barrels of oil equivalent, including 396.6 million barrels of crude oil and 506.4 billion cubic feet of marketable natural gas, representing an average daily crude oil output of 2.19 million barrels and an average daily marketable natural gas output of 2,798 million cubic feet. A total of 386 million barrels of crude oil and 480.9 billion cubic feet of natural gas were sold during the six months ended June 30, 2005. The Company sold approximately 83.7% of its crude oil to its refineries. During the first half of 2005, lifting cost of the Company was US$5.10 per barrel. For the same period of 2004, lifting cost was US$4.45 per barrel.

For the six months ended June 30, 2005, the Company's refineries processed 379 million barrels of crude oil, representing an average daily processed output of 2.09 million barrels. The Exploration and Production segment provided approximately 84% of the crude oil processed by the Company's refineries. The Company produced approximately 33.32 million tons of gasoline, diesel and kerosene and sold approximately 38.38 million tons of these products. The Company is actively expanding its sales network, and its retail network in particular, in order to maximize the effectiveness from the synergy created by the integration of refining and marketing segment. As at June 30, 2005, there were 17,215 service stations 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 is decreasing constantly, from RMB129 per ton during the first half of 2004 to RMB126 per ton for the same period of 2005.

During the six months ended June 30, 2005, the Company produced 0.941 million tons of ethylene, 1.311 million tons of synthetic resin, 0.629 million tons of synthetic fibre raw materials and polymer, 0.142 million tons of synthetic rubber, and 1.957 million tons of urea.

The Natural Gas and Pipeline segment is the Company's core business segment for development. For the six months ended June 30, 2005, the Company sold 407.4 billion cubic feet of marketable natural gas through its Natural Gas and Pipeline segment. As at June 30, 2005, the Company owned and operated 18,995 kilometres of regional natural gas pipeline network, of which 17,868 kilometres of the pipeline network were operated by the Natural Gas and Pipeline segment. The Company owned and operated 9,167 kilometres of crude oil pipeline and owned 2,460 kilometres of refined product pipeline.

The Second Half of 2005 and Beyond

During the first half of 2005, the Company had captured the opportunity in actively developing its business which resulted in the increase in the overall production targets and achieved a notable increase in its results of operations. The price of the Company's H shares repeatedly hit new record highs and the Company has become the largest companies in Asia in terms of market capitalization. The following exemplifies the excellent operating results: oil and gas exploration continued to make new breakthroughs and showed good development prospects; crude oil output increased steadily, natural gas output continued to grow rapidly; processed crude oil increased steadily and key technological and economic indicators improved continuously; petrochemical production availed itself closely of the market opportunity, and both output and profitability of major petrochemical products were higher than their previous levels for the corresponding period; operational efficiency for sales increased continuously and the ability to secure market share increased steadily; smooth progress of key project construction and a number of projects completed earlier than scheduled and commenced production; international operations developed steadily and profitability increased continuously.

At present, international oil prices remain high but unstable. A strengthened and improved macro-economic control results in a steady and rapid growth of the national economy in China. The Company is developing under favourable internal and external circumstances. During the second half of 2005, the Company will keep a close eye on the macro-economic environments and market changes, promptly adjust production and operation strategies and strengthen measures for protection of key and major sectors. The Company will continue to accelerate its steps for increase of crude oil and natural gas reserves and outputs, to improve its ability to secure resources, to steadily organise production of refined oil and petrochemical products, to increase the operational efficiency of sales business, to improve the operations of overseas projects, to develop new businesses, to achieve better operational results, to speed up technological developments, to increase production and construction efficiency and profitability, to further construct the HSE systems in order to create a favourable environment for development.

For the Exploration and Production segment, the Company will continue to give top priority to oil and gas explorations and risk exploration. The Company will seek to achieve large scale development and aim at exploring reserves through its economies of scale by giving priority to key sectors, careful planning, relying on technologies, strengthening management and increasing profitability. In respect of the development of oil and gas fields, the Company will meticulously plan and co-ordinate each step in its production and operation. The Company will implement various measures for output growth for the attainment of the crude oil output target for the year and to ensure a significant increase of natural gas output.

For the Refining and Marketing segment, the Company will continue to optimise the allocation of resources, control the import of crude oil at reasonable levels, lower the crude oil reserves, optimise production, operation and management, effectively control the cost for purchase of crude oil and the cash processing cost of the Company's refineries, balance the refinery throughput and the profitability, and improve various technological and economic indicators. The Company will strengthen the establishment of refined oil marketing network, optimise marketing strategies, build up marketing management, and endeavour to reduce cash marketing cost and costs for wholesales and retails in order to increase sales revenues and profitability.

For the Chemicals and Marketing segment, the Company will avail itself of the market opportunities, organise and optimise operations in a scientific manner and maintain a stable improvement of the operating results. The Company will also make full use of favourable opportunities including the current thriving market demand and the launch of new facilities in the second half of 2005, make best use of its resources, organise a balance allocation of raw materials, increase variety and output of quality products and increase revenue and profitability. The Company will continue to improve marketing network, promote specialized sales effectively, optimise transportation network, increase sales and presales of new products, and increase direct sales of product and maximise sales and profitability.

For the Natural Gas and Pipeline segment, the Company will supply gas through its key gas pipelines, expedite construction of key energy generation projects and form a new energy generation capability. The Company will further co-ordinate natural gas production, transmission and sales and ensure safe operation of pipelines.

In terms of overseas operations, the Company will continue to use its best efforts for exploration in major regions, to actively further risk explorations, to strengthen its capability for securing overseas resources and to enhance the value of the Company. At present, the global oil & gas sector continues to consolidate and the size of acquisitions is also increasing. In order to maintain the growth momentum of our business, we will continue to actively seek opportunities that enhance the medium to long-term growth of our overseas oil and gas production based strictly on our mergers and acquisition evaluation criteria. Also, we will maintain a strong liquidity position and will actively assess the means of financing in capital markets in order to secure the implementation of the internationalization strategy of the group.

In future, the Company will continue to expedite exploration and development of oil and gas, to further improve its ability to secure resources, to make strategically significant discoveries and breakthroughs, to set reserves to a new high and to keep the oil reserves replacement ratio greater than 1. In respect of oil field development, the Company will continuously increase its reserves utilisation rate, capacity utilisation rate and recovery rate, increase the overall development level and ensure a stable and increased crude oil output. In respect of the natural gas sector, the Company will adhere to the policies of "control resources, improve pipeline and network, plan the overall production and sales and ensure safety", maintain a rapid development of natural gas in China and make it the fastest growing sector of the Company. In respect of refining and chemicals sectors, the

Company will follow the policies of "make the refining an excellent and quality sector and make the chemicals a powerful and specialized sector", implement an intensive operation and professional management and realise an integrated and harmonious development of production, sales and research. In respect of the overseas operations, the Company will avail itself of the favourable opportunities, adopt various forms of operation, promote a rapid development of the overseas operations and increase its share in the oil and gas resources in the international market.

The Company will continue to pursue the aim of maximising its benefits and the value for its shareholders and strive to enhance the value of the Company. The Company will further improve its internal control system and supervisory mechanism consistent with the market supervision requirements, invest substantial efforts in system innovations and standardized management and promote a continuous, effective and speedy development of the Company.

Qualified Accountant

In an announcement dated October 18, 2004, the Company announced that it had not been able to find a suitable accountant with professional accounting qualifications recognised to assume the position of qualified accountant as required under Rule 3.24 of the Listing Rules by September 30, 2004. The Company is still in the process of identifying suitable candidates with professional accounting qualifications to assist the Chief Financial Officer to oversee the compliance by the Company of the financial reporting and other related accounting matters. However, despite numerous attempts to find such a candidate, given the importance of the role and the function of the qualified accountant, the Company has still not been able to find a suitable candidate that meets all the requirements in Rule 3.24 of the Listing Rules. The Company is trying its best to identify a candidate with the appropriate qualifications, experience and understanding of the oil and gas industry to act as the joint qualified accountant to assist the Chief Financial Officer of the Company to carry out his duties. The Company will make an application for a 3-year waiver to the HKSE when it has identified the joint qualified accountant.

Disclosure of Other Information

Save as mentioned above, there have been no material changes in respect of matters required to be disclosed under paragraph 40(2) of Appendix 16 to the Listing Rules since the publication of the annual report of the Group for the year ended December 31, 2004.