PetroChina Company Limited

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

Jiang Jiemin President

The following discussion should be read in conjunction with the consolidated financial statements of the Company and its subsidiaries ("**Group**") and the notes thereto.

Overview

For the twelve months ended December 31, 2005, profit before taxation of the Group was RMB193,822 million, representing an increase of 28.2% compared with the corresponding period in the previous year. Net profit was RMB133,362 million, representing an increase of 28.4% compared with the corresponding period in the previous year. The performance results and the comprehensive strengths of the Group have increased dramatically. The increase in profit was primarily due to the Group's ability to take full advantage of the opportunities presented by persistently high oil prices and strong market demand by strengthening its efforts in exploration and development resulting in a continuous growth of crude oil and natural gas production; stable market supplies resulting from earnest efforts in refining and marketing and an increase in operating efficiency; continuously accelerating the pace of natural gas production; an orderly construction of the infrastructure of crude oil and natural gas pipelines; the strengthening of the management of the operations of the Group and the continuous efforts in technological and managerial innovations.

For the twelve months ended December 31, 2005, the Group's basic and diluted earnings per share were RMB0.75.

Twelve Months Ended December 31, 2005 Compared With Twelve Months Ended December 31, 2004

Consolidated Operating Results

◆ Turnover

Turnover increased 39.0% from RMB397,354 million for the twelve months ended December 31, 2004 to RMB552,229 million for the twelve months ended December 31, 2005. This was primarily due to the increases in the selling prices and sales volume of crude oil, gasoline, diesel and other main products as well as the increase in the sales volume of natural gas.

◆ Operating Expenses

Operating expenses increased 46.2% from RMB246,216 million for the twelve months ended December 31, 2004 to RMB360,058 million for the twelve months ended December 31, 2005. This was primarily due to an increase in the purchase cost of crude oil, refined products and other raw materials and ancillary materials from external suppliers and an increase in the employee compensation costs.

◆ Purchases, Services and Other Expenses

Purchases, services and other expenses increased 75.3% from RMB114,249 million for the twelve months ended December 31, 2004 to RMB200,321 million for the twelve months ended December 31, 2005. This was primarily due to (1) an increase in the purchase expenses of crude oil from external suppliers resulted from an increase in crude oil prices and an increase in the purchase volume of crude oil by the Group's refineries; and (2) an increase in the oil and gas production costs resulted from an increase in the rate of water and tariff of electricity and the prices of other production materials in the PRC as well as an expansion of the production scale of the Group. In addition, the increase in the purchase expenses was also resulted from an increase in the refined product supply operation in the year.

◆ Employee Compensation Costs

Employee compensation costs rose 29.4% from RMB22,934 million for the twelve months ended December 31, 2004 to RMB29,675 million for the twelve months ended December 31, 2005. This was primarily due to an increase in employees' salaries and welfare expenses as a result of strong results of operations achieved by the Group, and an increase in labour costs resulted from further development of the Group's retail network.

◆ Exploration Expenses

Exploration expenses increased 28.8% from RMB12,090 million for the twelve months ended December 31, 2004 to RMB15,566 million for the twelve months ended December 31, 2005. This was primarily due to an appropriate increase in investments in exploration of crude oil and natural gas by the Group in a high oil price environment.

◆ Depreciation, Depletion and Amortization

Depreciation, depletion and amortization increased 6.1% from RMB48,362 million for the twelve months ended December 31, 2004 to RMB51,305 million for the twelve months ended December 31, 2005. This was primarily due to an increase in the provision for depreciation and depletion resulted from an increase in the average amount of property, plant and equipment.

◆ Selling, General and Administrative Expenses

Selling, general and administrative expenses increased 29.1% from RMB28,302 million for the twelve months ended December 31, 2004 to RMB36,538 million for the twelve months ended December 31, 2005. This was primarily due to an increase in transportation and other related costs resulted from an increase in freights for railway transportation in 2005 and an increase in the sales volume of refined and petrochemical products.

◆ Taxes other than Income Tax

Taxes other than income tax increased 18.4% from RMB19,943 million for the twelve months ended December 31, 2004 to RMB23,616 million for the twelve months ended December 31, 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 by the Group's refineries, an increase in compensation fees for mineral resources due to an increase in crude oil and natural gas revenue, and an increase in natural resource tax due to an increase in natural resource tax rates by the PRC government in 2005.

◆ Profit from Operations

As a result of the factors discussed above, profit from operations increased 27.1% from RMB151,138 million for the twelve months ended December 31, 2004 to RMB192,171 million for the twelve months ended December 31, 2005.

◆ Net Exchange Gain

Net exchange gain increased ten times from RMB8 million for the twelve months ended December 31, 2004 to RMB88 million for the twelve months ended December 31, 2005. The increase in net exchange gain was primarily due to the appreciation of Renminbi in 2005.

◆ Net Interest Expenses

Net interest expenses decreased 45.0% from RMB1,523 million for the twelve months ended December 31, 2004 to RMB838 million for the twelve months ended December 31, 2005. This decrease was primarily due to a decrease in interest expenses resulted from the decrease in the average outstanding borrowings and an increase in interest income resulted from sufficient cash flow generated from operating activities.

◆ Profit Before Taxation

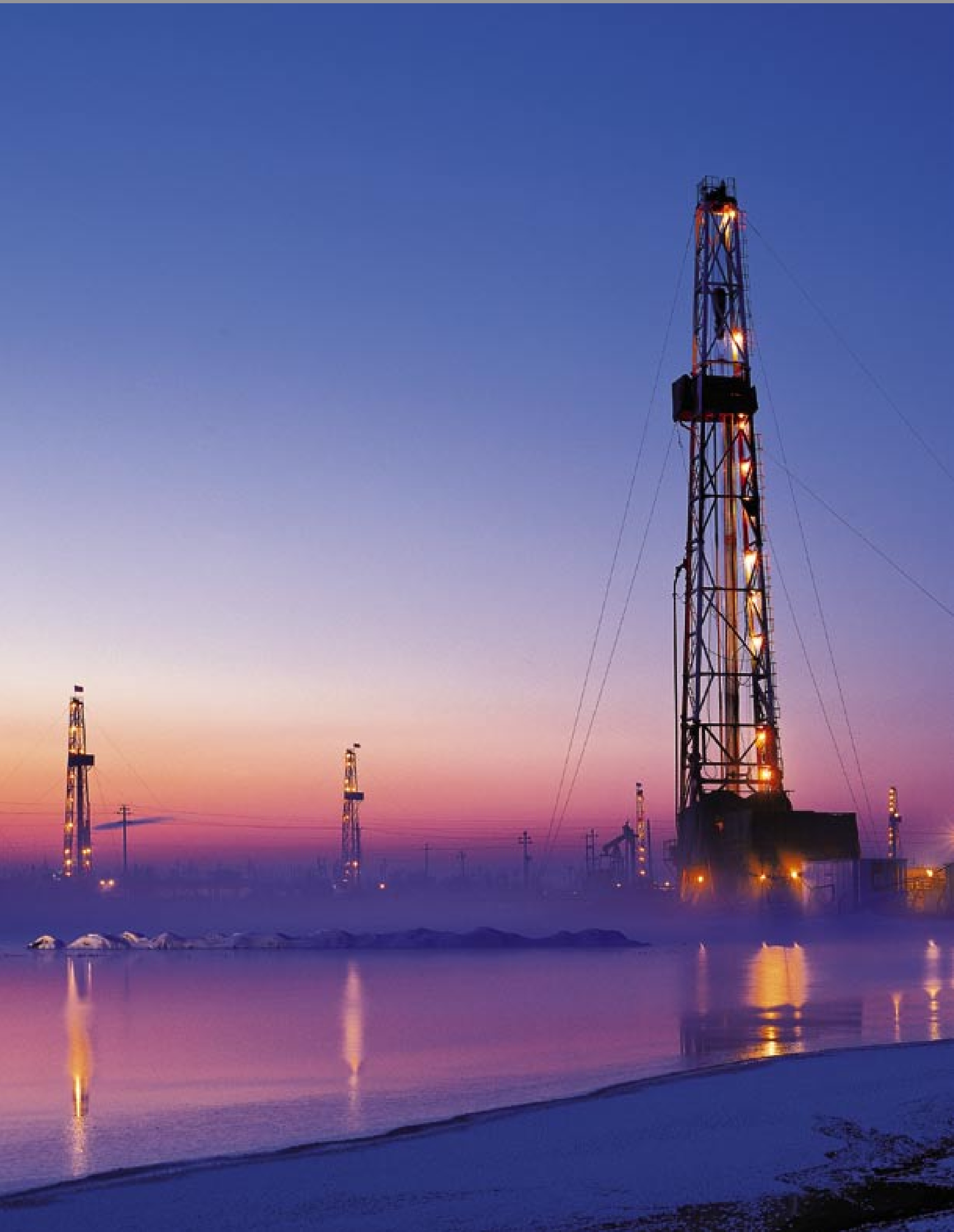
Profit before taxation rose 28.2% from RMB151,244 million for the twelve months ended December 31, 2004 to RMB193,822 million for the twelve months ended December 31, 2005.

◆ Taxation

Taxation increased 24.3% from RMB43,598 million for the twelve months ended December 31, 2004 to RMB54,180 million for the twelve months ended December 31, 2005. The increase was primarily due to an increase in taxable profits.

◆ Net Profit

As a result of the factors discussed above, net profit increased 28.4% from RMB103,843 million for the twelve months ended December 31, 2004 to RMB133,362 million for the twelve months ended December 31, 2005.



Segment Information

The Group operates a wide range of petroleum and related activities through four primary business segments: Exploration and Production Segment, Refining and Marketing Segment, Chemicals and Marketing Segment, and Natural Gas and Pipeline Segment.

Exploration and Production

The business of the Exploration and Production Segment includes the exploration, development, production and marketing of petroleum and natural gas.

◆ Turnover

Turnover increased 44.1% from RMB233,948 million for the twelve months ended December 31, 2004 to RMB337,208 million for the twelve months ended December 31, 2005. The increase was primarily due to an increase in the prices and sales volume of crude oil and an increase in the sales volume of natural gas. The average realized crude oil price of the Group in 2005 was US$48.37 per barrel, representing an increase of US$14.65 per barrel or 43.4% from US$33.72 per barrel compared with the corresponding period in the previous year.

Intersegment sales increased 50.4% from RMB180,129 million for the twelve months ended December 31, 2004 to RMB270,943 million for the twelve months ended December 31, 2005. The increase was primarily due to an increase in the prices of crude oil and an increase in the intersegment sales volume of crude oil and natural gas.

◆ Operating Expenses

Operating expenses increased 24.5% from RMB103,735 million for the twelve months ended December 31, 2004 to RMB129,128 million for the twelve months ended December 31, 2005. The increase was primarily due to increases in purchase expenses, exploration expenses and staff costs.

◆ Profit from Operations

Profit from operations increased 59.8% from RMB130,213 million for the twelve months ended December 31, 2004 to RMB208,080 million for the twelve months ended December 31, 2005.

Refining and Marketing

The business of the Refining and Marketing Segment includes refining, transportation, storage and marketing of crude oil and petroleum products.

◆ Turnover

Turnover rose 44.6% from RMB296,427 million for the twelve months ended December 31, 2004 to RMB428,494 million for the twelve months ended December 31, 2005. The increase was due to an increase in the prices and sales volume of key products, of which:

Sales revenue from gasoline increased 43.6% from RMB76,919 million for the twelve months ended December 31, 2004 to RMB110,438 million for the twelve months ended December 31, 2005. The average realized selling price of gasoline surged 19.2% from RMB3,542 per ton for the twelve months ended December 31, 2004 to RMB4,221 per ton for the twelve months ended December 31, 2005, resulting in an increase in revenue by RMB17,763 million. The sales volume of gasoline increased 20.5% from 21.71 million tons for the twelve months ended December 31, 2004 to 26.16 million tons for the twelve months ended December 31, 2005, resulting in an increase in revenue by RMB15,756 million.

Sales revenue from diesel increased 29.5% from RMB136,649 million for the twelve months ended December 31, 2004 to RMB176,999 million for the twelve months ended December 31, 2005. The average realized selling price of diesel increased 17.0% from RMB3,165 per ton for the twelve months ended December 31, 2004 to RMB3,702 per ton for the twelve months ended December 31, 2005, resulting in an increase in revenue by RMB25,674 million. The sales volume of diesel increased 10.7% from 43.18 million tons for the twelve months ended December 31, 2004 to 47.81 million tons for the twelve months ended December 31, 2005, resulting in an increase in revenue by RMB14,676 million.

Sales revenue from kerosene increased 27.2% from RMB5,881 million for the twelve months ended December 31, 2004 to RMB7,480 million for the twelve months ended December 31, 2005.

Intersegment sales revenue increased 51.0% from RMB21,862 million for the twelve months ended December 31, 2004 to RMB33,019 million for the twelve months ended December 31, 2005. The increase was primarily due to an increase in selling prices and intersegment sales volume of key products.

◆ Operating Expenses

Operating expenses increased 57.6% from RMB284,536 million for the twelve months ended December 31, 2004 to RMB448,304 million for the twelve months ended December 31, 2005. The

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increase was primarily due to an increase in the purchase expenses of crude oil and refined products from external suppliers, and an increase in selling and administrative expenses. In addition, the increase in the purchase expenses was also resulted from an increase in the refined product supply operation in the year.

◆ Profit/(loss) from Operations

Loss from operations amounted to RMB19,810 million for the twelve months ended December 31, 2005, while profit from operations amounted to RMB11,891 million for the twelve months ended December 31, 2004. This decrease was primarily due to the increase in the domestic price of refined products being much lower than the increase in the price of crude oil in 2005.

Chemicals and Marketing

The business of the Chemicals and Marketing Segment consists of the production and sale of basic petrochemical products, derivative petrochemical products and other chemical products.

◆ Turnover

Turnover rose 29.4% from RMB57,179 million for the twelve months ended December 31, 2004 to RMB73,978 million for the twelve months ended December 31, 2005. The growth in turnover was primarily due to an increase in the sales volume and selling prices of key chemical products.

◆ Operating Expenses

Operating expenses increased 42.8% from RMB49,524 million for the twelve months ended December 31, 2004 to RMB70,702 million for the twelve months ended December 31, 2005. The increase was primarily due to an increase in the purchase expenses for direct materials and an increase in selling and administrative expenses.

◆ Profit from Operations

Profit from operations decreased 57.2% from RMB7,655 million for the twelve months ended December 31, 2004 to RMB3,276 million for the twelve months ended December 31, 2005. The decrease was primarily due to an increase in the prices of raw materials in 2005.

Natural Gas and Pipeline

The business of the Natural Gas and Pipeline Segment consists of the delivery of natural gas, crude oil and refined products, and the sale of natural gas.

◆ Turnover

Turnover increased 43.6% from RMB18,255 million for the twelve months ended December 31, 2004 to RMB26,214 million for the twelve months ended December 31, 2005. The increase was primarily due to an increase in the sales volume and selling prices of natural gas, and an increase in the volume of natural gas from pipeline transmission and the prices for pipeline transmission.

◆ Operating Expenses

Operating expenses increased 46.5% from RMB15,720 million for the twelve months ended December 31, 2004 to RMB23,031 million for the twelve months ended December 31, 2005. The increase was primarily due to an increase in expenses for the purchase of natural gas and an increase in depreciation charges.

◆ Profit from Operations

Profit from operations increased 25.6% from RMB2,535 million for the twelve months ended December 31, 2004 to RMB3,183 million for the twelve months ended December 31, 2005.

Liquidity and Capital Resources

For the twelve months ended December 31, 2005, the Group's primary sources of capital were cash generated from operating activities, short-term and long-term borrowings, cash and cash equivalents. The Group's capital was primarily used for operating activities, capital expenditures, repayment of short-term and long-term borrowings and distribution of dividends to shareholders.

As at December 31, 2005, short-term borrowings made up approximately 4.7% of the Group's capital employed as compared with approximately 6.7% as at December 31, 2004. The Group's ability to obtain adequate financing may be affected by the financial position, the results of operations and the conditions of the domestic and foreign capital markets. The Group must seek approvals from the relevant PRC government authorities before raising capital in the domestic and foreign capital markets. In general, the Group must obtain the PRC government's approvals for any project involving significant capital investments in the Refining and Marketing segment, the Chemicals and Marketing segment and the Natural Gas and Pipeline segment.

The Group plans to fund its capital expenditures and related investments principally from cash generated from operating activities, short-term and long-term borrowings, cash and cash equivalents. For the twelve months ended December 31, 2005, net cash generated from operating activities was RMB203,885 million. As at December 31, 2005, the Group had RMB80,905 million in cash and cash equivalents. Cash and cash equivalents were primarily Renminbi (with Renminbi accounting for approximately 79.6%, United States Dollar accounting for approximately 12.3% and Hong Kong Dollar accounting for approximately 8.1%).

The table below sets forth the cash flow of the Group for the twelve months ended December 31, 2005 and 2004, respectively and the cash and cash equivalents as at the end of each period.

	Years ended December 31,	
	2005	**2004**
	RMB million	**RMB million**
Net cash from operating activities	203,885	141,691
Net cash used for investing activities	(91,576)	(102,276)
Net cash used for financing activities	(42,634)	(39,586)
Currency translation differences	(458)	246
Cash and cash equivalents as at the end of year	80,905	11,688

Cash Flows from Operating Activities

The net cash flow of the Group generated from operating activities for the twelve months ended December 31, 2005 was RMB203,885 million, which represents an increase of 43.9% compared with the RMB141,691 million generated for the twelve months ended December 31, 2004. This increase was primarily due to a dramatic increase in profits for the period as well as an increase in the account payables for the period.

For the twelve months ended December 31, 2005, the Group had a working capital of RMB22,057 million compared with a working capital deficit of RMB8,272 million for the twelve months ended December 31, 2004. The increase in working capital was primarily due to an increase in cash and cash equivalents resulted from a dramatic increase in sales revenues for the period, and an increase in inventories resulted from an expansion of the scale of sales and an increase in selling prices.

Cash Used for Financing Activities

The net borrowings of the Group as at December 31, 2005 and December 31, 2004 are as follows:

	Years ended December 31,	
	2005	**2004**
	RMB million	**RMB million**
Short-term borrowings (including current portion of long-term borrowings)	28,689	34,937
Long-term borrowings	44,570	44,648
Total borrowings	73,259	79,585
Less:		
Cash and cash equivalents	80,905	11,688
Net borrowings	(7,646)	67,897

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

	Principal as at December 31, 2005	**Principal as at December 31, 2004**
	RMB million	**RMB million**
To be repaid within one year	15,325	18,962
To be repaid within one to two years	18,373	10,145
To be repaid within two to five years	14,942	27,072
To be repaid after five years	11,255	7,431
	59,895	63,610

Of the total borrowings of the Group as at December 31, 2005, approximately 27.0% were fixed-rate borrowings and approximately 73.0% were floating-rate borrowings. Of the borrowings as at December 31, 2005, approximately 72.1% were denominated in Renminbi, approximately 27.1% were denominated in United States Dollar, approximately 0.2% were denominated in British Pound Sterling, approximately 0.3% were denominated in Japanese Yen, and approximately 0.3% were denominated in Euro.

As at December 31, 2005, the amount of borrowings owed to China Petroleum Finance Company Limited ("**CNPC Finance**") was RMB27,319 million, the amount of borrowings owed to state-owned banks and other state-owned non-banking financial institutions was RMB31,178 million and the amount of borrowings owed to other related parties was RMB62 million.

As at December 31, 2005, the amount of short-term and long-term borrowings owed to CNPC Finance was RMB520 million and RMB26,799 million, respectively.

The net cash used for financing activities of the Group for the twelve months ended December 31, 2005 increased 7.7% compared with the twelve months ended December 31, 2004. The increase was primarily due to an increase in payments of dividends to shareholders of the Company as compared with the corresponding period of last year.

As at December 31, 2005, borrowings of the Group consisted of RMB1,108 million (RMB2,269 million as at December 31, 2004) secured loans (finance leases and bank borrowings), most of which were secured over certain of the Group's property and time deposits with maturities over one year.

As at December 31, 2005, the debt to capitalization ratio (debt to capitalization ratio = interest-bearing debts/(interest-bearing debts + total equity)) was 11.9% (15.2% as at December 31, 2004).

Capital Expenditures

The table below sets out our capital expenditures by the business segments of the Group for the twelve months ended December 31, 2005, the twelve months ended December 31, 2004 and the estimated value for 2006 respectively. For the twelve months ended December 31, 2005, capital expenditures of the Group increased 26.1% to RMB124,801 million from RMB98,946 million for the twelve months ended December 31, 2004. The increase in capital expenditures was primarily due to an increase in expenditures relating to crude oil and natural gas exploration and development and petrochemical projects in 2005 as well as an increase in prices of steel products, fuel oil, water, electricity and other production materials.

	Years ended December 31,					
	2005		**2004**		**2006 (estimated value)**	
Segment	**RMB million**	**%**	**RMB million**	**%**	**RMB million**	**%**
Exploration and Production	83,214*	66.68	62,868*	63.54	93,500*	62.75
Refining and Marketing	16,454	13.18	17,684	17.87	23,700	15.91
Chemicals and Marketing	13,569	10.87	4,319	4.37	15,300	10.27
Natural Gas and Pipeline	11,137	8.92	13,901	14.05	15,300	10.27
Others	427	0.35	174	0.17	1,200	0.80
Total	124,801	100.00	98,946	100.00	149,000	100.00

Note: * If the investments portion related to geological and geophysical exploration costs were included, the capital expenditures and investments for the Exploration and Production segment for 2004 and 2005, and the estimate of the same for the entire 2006 would be RMB70,217 million, RMB92,233 million and RMB104,500 million, respectively.

◆ Exploration and Production

A majority of the Group's capital expenditures is related to the Exploration and Production segment. For the twelve months ended December 31, 2005, capital expenditures in relation to the Exploration and Production segment amounted to RMB83,214 million, including RMB16,499 million for exploration activities and RMB59,113 million for development activities. For the twelve months ended December 31, 2004, capital expenditures in relation to this segment totalled RMB62,868 million, including RMB11,744 million for exploration activities and RMB45,832 million for development activities. The increase in capital expenditures was primarily due to an increase in expenditures relating to oil and gas exploration and development which reflects the targets of the Group in stabilizing the production of crude oil in eastern China, rapidly developing the business in western China and accelerating the development of natural gas business.

The Group anticipates that capital expenditures for the Exploration and Production segment for the twelve months ending December 31, 2006 will amount to RMB93,500 million. Approximately RMB20,000 million will be used for oil and gas exploration, and RMB73,500 million will be used for oil and gas development. Exploration and development will be mainly carried out in seven basins including the Erdos, Junggar, Tarim, Songliao, Sichuan, Bohai Bay and Chaidamu basins.

◆ Refining and Marketing

Capital expenditures for the Group's Refining and Marketing segment for the twelve months ended December 31, 2005 amounted to RMB16,454 million, of which RMB9,565 million was spent on the expansion of the retail sales network of refined products and storage infrastructure facilities for oil products, and RMB6,889 million was spent on renovation of refining facilities. The total capital expenditures of this segment for the twelve months ended December 31, 2004 were RMB17,684 million. The decrease in capital expenditures was primarily due to a decrease in investments in the building up of sales network as compared with that of the corresponding period of last year.

The Group anticipates that capital expenditures for the Refining and Marketing segment for the twelve months ending December 31, 2006 will amount to RMB23,700 million, which include approximately RMB15,200 million for construction and expansion of refining facilities; and approximately RMB8,500 million for investments in the building up of the sales network for refined products.

◆ Chemicals and Marketing

Capital expenditures for the Chemicals and Marketing segment for the twelve months ended December 31, 2005 and 2004 amounted to RMB13,569 million and RMB4,319 million, respectively. The increase was primarily due to an increase in investments in the ethylene projects in Jilin Petrochemical, Lanzhou Petrochemical and Dushanzi Petrochemical and in the PTA projects in Liaoyang Petrochemical.

The Group anticipates that capital expenditures for the Chemicals and Marketing segment for the twelve months ending December 31, 2006 will amount to RMB15,300 million, which is expected to be used primarily for upgrading the ethylene facilities in Jilin Petrochemical, Lanzhou Petrochemical and Dushanzi Petrochemical and the construction of the PTA project in Liaoyang Petrochemical.

◆ Natural Gas and Pipeline

Capital expenditures in the Natural Gas and Pipeline segment for the twelve months ended December 31, 2005 amounted to RMB11,137 million. The Group spent RMB10,413 million of these expenditures on the construction of long distance pipelines, of which RMB6,083 million were spent on the West-East Gas Pipeline project. For the twelve months ended December 31, 2004, capital expenditures in the segment totalled RMB13,901 million. The decrease in capital expenditures was primarily due to a decrease in investments in the second Shaanxi-Beijing Pipeline project.

The Group anticipates that capital expenditures for the Natural Gas and Pipeline segment for the twelve months ending December 31, 2006 will amount to RMB15,300 million, which are expected to be used primarily for increasing transmission capacity by the West-East Gas Pipeline project and for construction of underground natural gas storage facilities and pipelines for crude oil and refined products.

◆ Others

Non-segment-specific capital expenditures for the twelve months ended December 31, 2005 and for the twelve months ended December 31, 2004 were RMB427 million and RMB174 million, respectively. These capital expenditures were mainly used for non-segment-specific equipment purchases and research and development activities.

The Group anticipates that its non-segment-specific capital expenditures for the twelve months ending December 31, 2006 will amount to approximately RMB1.2 billion, which is expected to be used primarily for scientific research activities and for construction of ERP and other information system.

Material Investment

The Group did not hold any material external investment for the year ended December 31, 2005.

Material Acquisitions or Disposals

In accordance with the acquisition agreement between the Company and CNPC dated March 28, 2005, the Company acquired the refinery and petrochemical businesses owned by CNPC's wholly-owned subsidiaries, Dayuan and Qingyang, at a consideration of RMB9 million. Under the Listing Rules, the above transaction constitutes a connected transaction of the Company. The details of the transaction were announced on March 30, 2005.

In August 2005, the shareholders of the Company approved the acquisition and transfer agreements relating to the Company's acquisition of a 50% ownership interest in Newco. Newco was formed in 2005 and was wholly owned by CNODC and one of its subsidiaries. Under the terms of the related agreements, CNODC transferred certain oil and gas exploration operations into Newco and the Company contributed to Newco its wholly-owned subsidiary, PetroChina International Limited ("**PTRI**"), and cash amounting to approximately RMB20,162 million, which is the difference between the cash contribution of RMB20,741 million payable by the Company according to the acquisition agreement and cash consideration of RMB579 million for PTRI receivable by the Company.

The Board resolution dated October 26, 2005 approved the Company's acquisition of 150 million outstanding A shares from minority interests of Jinzhou Petrochemical at a price of RMB4.25 per share through tender offers. As at December 31, 2005, the Company acquired 117,486,753 A shares (representing approximately 14.92% of the total share capital of Jinzhou Petrochemical) at a total cash consideration of approximately RMB500 million. After the acquisition, the Company owns 95.87% of the total share capital of Jinzhou Petrochemical. The difference between the acquisition consideration and the book value of the acquired assets and liabilities will be included in the equity interests. Jinzhou Petrochemical was delisted on January 4, 2006 upon approval of the China Securities Regulatory Commission.

The Board resolution dated October 26, 2005 approved the Company's acquisition of 200 million outstanding A shares and 964.778 million H shares (including ADSs) respectively from minority interests of Jilin Chemical Industrial Company Limited ("**Jilin Chemical**") at prices of RMB5.25 per A share and HK$2.80 per H share, respectively, through tender offers. The tender offers were completed in February 2006 and the impacts of the acquisitions will be reflected in the annual consolidated financial statements of the Group as at December 31, 2006.

The Board resolution dated October 26, 2005 also approved the Company's acquisition of 200 million outstanding A shares from minority interests of Liaohe Jinma at a price of RMB8.80 per share through tender offers. As at December 31, 2005, the Company acquired 172,315,428 A shares (representing approximately 15.67% of the total share capital of Liaohe Jinma) at a total cash consideration of approximately RMB1,519 million. Upon completion of the acquisition, the Company owns 97.48% of the total share capital of Liaohe Jinma. The difference between the acquisition consideration and the book value of the acquired assets and liabilities will be recorded in equity interests. Liaohe Jinma was delisted on January 4, 2006 upon approval of the China Securities Regulatory Commission.

The Company has entered into two acquisition agreements with two wholly owned subsidiaries of CNPC, Liaohe Petroleum Exploration Bureau and China Petroleum Pipeline Bureau, on December 6, 2005 for the acquisition of shares representing 15.56% and 20.17%, respectively, from them in Petrochina Fuel Oil Company Limited ("**Fuel Oil Company**"), a 55.43% subsidiary of the Company, for an aggregate cash consideration of RMB559 million. The Fuel Oil Company is principally engaged in the business of investment and development of fuel oil in the upstream and downstream areas in the PRC. Upon completion of the above acquisitions, the Company's interest in the Fuel Oil Company will be increased and it is expected that the management of the Fuel Oil Company will be strengthened.

Events after the Balance Sheet Date

As discussed above, the Company acquired, by tender offers, all the outstanding A shares and H shares (including ADSs) from minority interests of Jilin Chemical. In February 2006 when the relevant offer periods expired, the Company acquired 908,113,053 H shares (including ADSs) and 157,700,200 A shares of Jilin Chemical (representing 29.93% of the total share capital of Jilin Chemical in aggregate) at an aggregate consideration of approximately RMB3,372 million. Jilin Chemical was delisted from the HKSE, the New York Stock Exchange and Shenzhen Stock Exchange on January 23, 2006, February 15, 2006 and February 20, 2006, respectively.

Foreign Exchange Rate Risk

The PRC government reformed the Renminbi exchange rate regime on July 21, 2005. A managed floating exchange rate regime under which the exchange rate for Renminbi is adjusted with reference to a basket of currencies and based on the demand and supply for Renminbi is implemented. However, the exchange rate for Renminbi in the capital account is yet to be liberalized. The exchange rates of Renminbi are affected by the domestic and international economic and political environment, and the supply and demand for Renminbi. In future, the exchange rate of Renminbi against other currencies may differ from the current ones significantly. As Renminbi is the base currency of the Company and most of its consolidated entities, the fluctuation of exchange rates of Renminbi may have positive or negative impact on the results of operations of the Group. An appreciation of Renminbi against United States Dollar will decrease the turnover of the Group but may lower the cost incurred by the Group in acquiring imported raw materials and equipment. A devaluation of Renminbi against United States Dollar may not have a negative impact on the Group's turnover but may increase the cost incurred by the Group in acquiring imported materials and equipment as well as the foreign currency-denominated obligations of the Group. The results of operations and the financial position of the Group may also be affected by fluctuations in exchange rates against Renminbi of a number of other foreign currencies.

Commodity Price Risk

The Group is engaged in a broad range of petroleum related activities. The hydrocarbon commodity markets are influenced by the global as well as regional supply and demand conditions. The prices of onshore crude oil are determined with reference to international prices of crude oil. A decline in the prices of crude oil and refined products could adversely affect the Group's financial performance. The Group historically has not used commodity derivative instruments to hedge against potential price fluctuations of crude oil and refined products. Therefore, during 2004 and 2005, the Group was exposed to the general price fluctuations of broadly traded oil and gas commodities.

Industry Risk

Like other oil and gas companies in China, the Group's operating activities are subject to regulation and control by the PRC government in many aspects. This 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 etc, is expected to have an impact on the Group's operating activities. As a result, the Group may be subject to fairly significant restrictions when implementing its business strategy, developing and expanding its business or maximizing its profitability. Any future changes in the PRC governmental policies on the oil and gas industry may also affect the Group's business operations.

Employees and Employee Compensation

◆ Number of employees

As at December 31, 2005 and December 31, 2004, the Group had 439,220 and 424,175 employees, respectively. The table below sets out the number of employees by business segment as at December 31, 2005:

Segment	Number of Employees	Percentage of total (%)
Exploration and Production	247,258	56.3
Refining and Marketing	117,260	26.7
Chemicals and Marketing	60,272	13.7
Natural Gas and Pipeline	10,760	2.5
Other *	3,670	0.8
Total	439,220	100.00

Notes: * "Other" includes staff of the Company's headquarters, specialized subsidiaries, Exploration & Development Research Institute, Planning & Engineering Institute, Oil Refining and Petrochemical Technological Research Centres and other units.

◆ Employee Compensation

The total employee compensation payable by the Group for the twelve months ended December 31, 2005 was RMB19,351 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 best results.

The Company's senior management remuneration system links senior management financial interests (including those of executive directors and supervisors) with the Group's results of operations and the market performance of its shares. All members of the senior management 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 in their compensation 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.

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

Details of the directors' and supervisors' emoluments as at December 31, 2005 and December 31, 2004 were as follows (for remuneration for each of the directors and supervisors on a named basis, please see note 10 to the consolidated financial statements of the Group in this annual report):

	2005	2004
	RMB'000	RMB'000
Fee for directors and supervisors	897	120
Salaries, allowances and other benefits	4,031	2,012
Contribution to retirement benefit scheme	57	43
	4,985	2,175

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

	2005	2004
	Number	Number
Nil-RMB1,000,000	25	24

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

◆ Training Programs

The training program of the Company for 2005 has been geared towards achieving the development strategy and operating objectives of the Company. In line with the strategic requirement for "a strong corporation with highly talented personnel", the Company has targeted high-calibre, skilful and international staff in its training program with a focus on the training of the "core" and "backbone" personnel and strived to build a proficient operating and management team, a technology innovation team and a skilful operators' team to ensure the supply of talents required for the continuous and stable development of the Company.

◆ Medical Insurance

Since October 1, 2002, the Company's headquarters and its regional branches based in Beijing have joined the basic medical insurance scheme organized by the Beijing Municipality, making contributions at 9% of the total basic salaries of the employees. Other local subsidiaries and branches of the Group have also participated in their respective local basic medical insurance schemes.

As basic medical insurance is organized by local authorities, the dates of implementation, rates of contribution and reimbursement methods vary with the localities. The rate of contribution is generally set at 6% to 10% of the total basic salaries of the employees.

In accordance with the relevant regulations of the PRC government, the Group has given permission to local subsidiaries and branches which have participated in local basic insurance schemes to establish a supplemental medical insurance scheme from 2002. Contributions to the schemes are set at no more than 4% of the total salaries and will be booked as cost.

Contingent Liabilities

Information on the Group's contingent liabilities as at December 31, 2005 is as follows:

- Bank and other guarantees

As at December 31, 2005, the Group had contingent liabilities in respect of guarantees made to CNPC Finance, a subsidiary of CNPC, from which it is anticipated that no material liabilities will arise.

	2005	2004
	RMB million	RMB million
Guarantees of borrowings of associates	187	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 operations of the oil and gas industry. The outcome of environmental liabilities under proposed or future environmental legislation cannot reasonably be estimated at present, and could be material. Under existing legislation, however, management believes that there are no probable environmental liabilities, except for the amounts which have already been reflected in the financial statements, that will have a material adverse effect on the financial position of the Group.

- Legal contingencies

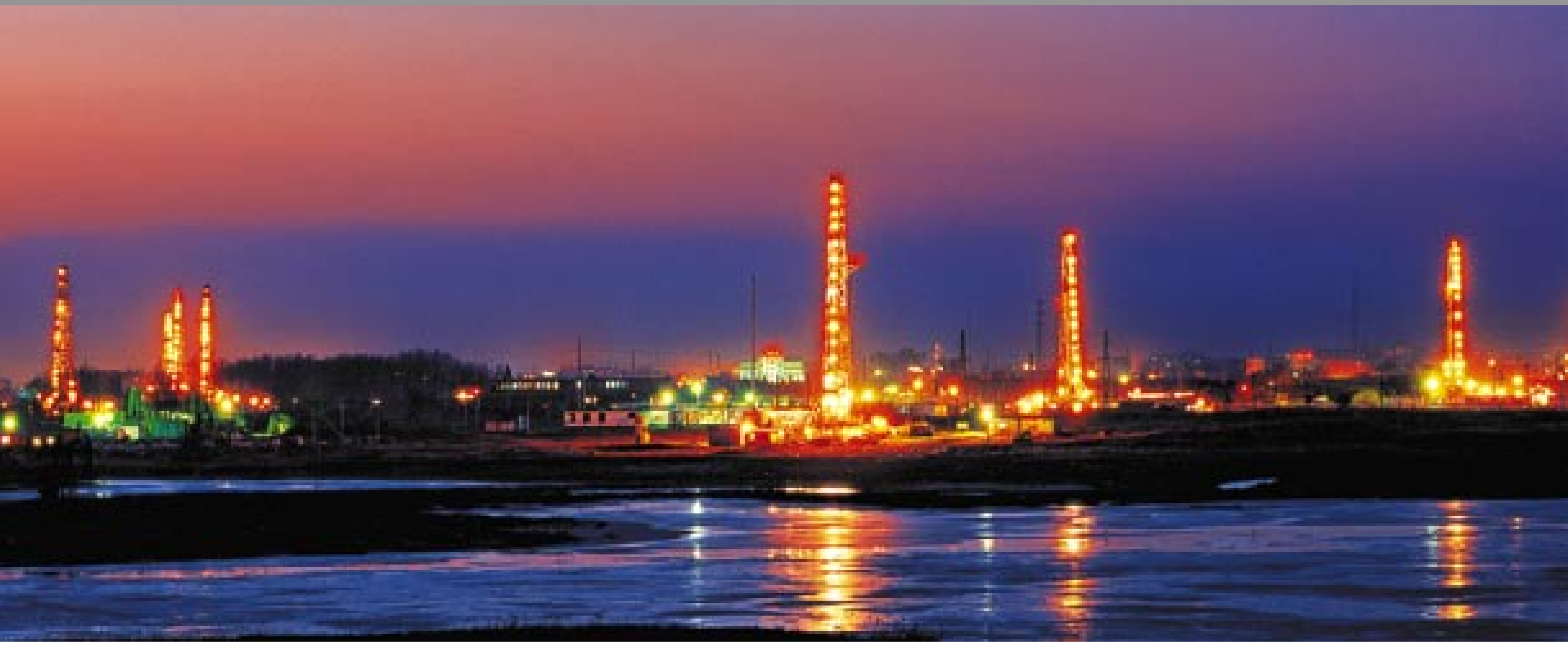
The Group is the named defendant in certain insignificant lawsuits as well as the named party in other proceedings arising in the ordinary course of business. While the outcome of such contingencies, lawsuits or other proceedings cannot be determined at present, management believes that any resulting legal liabilities 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 the following:

- 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 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 December 31, 2005, CNPC had obtained formal land use right certificates in relation to 27,400 out of the above-mentioned 28,649 parcels of land, some building ownership certificates for the above-mentioned buildings, but has completed none of 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 the 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 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 property, facilities or equipment with respect to 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 coverage is not customary in the PRC. While the effect of under-insurance on future incidents cannot be reasonably assessed at present, management believes that it may have a material impact on the results of operations but will not have a material adverse effect on the financial position of the Group.

◆ Others

On November 13, 2005, explosions occurred at the dianil plant of a branch of the Company located in the Jilin Province. The impact of the accident is undergoing government investigation. The incident shows that the Company needs further strengthening of its operational safety and environmental protection. The Company has realized the seriousness of the issue and has stepped up its efforts in securing operational safety and environmental protection. The Company will bear resultant liabilities caused by the explosions based on the results of the investigation.