BUSINESS REVIEW

In 2006, the Chinese economy continued to grow at a rapid rate, with a GDP growth rate of 10.7%. The international crude oil prices were fluctuating at a high level, the Chinese government continued its tight control on refined oil product prices, and the petrochemical product prices remained at a high level. Confronted with such volatile market environment, the Company, sticking to the scientific approach to development, managed to expand resources and market, emphasised the implementation of its resource strategies, responded to the market change actively, optimised its refining and chemical production, strengthened the internal management, gave full play to the advantage of the integration and placed emphasis on safe operation, energy conservation, and consumption and cost reduction. With the unified efforts from our employees, we achieved new growth in both our production volume and profit.

1. Review of Market Environment

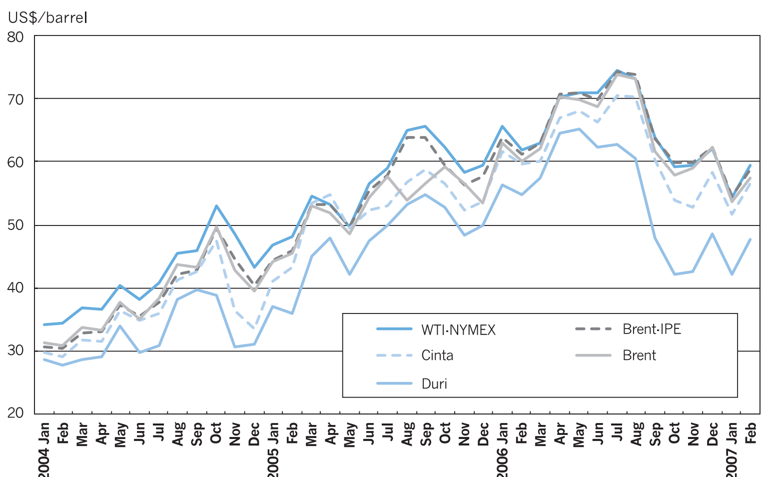
(1) Crude oil market

In 2006, international crude oil prices fluctuated at a high level under the influence of various factors. After the oil price hit record high, it experienced significant decline. The Platts' Brent spot price in 2006 averaged US$ 65.14 per barrel, up by 19.5% compared with 2005. The domestic crude oil price generally followed the trend in the international market. Average realised price of crude oil produced by the Company was RMB 3,194.5 per tonne in 2006, up by 19.9% compared with 2005.

(2) Refined oil products market

In 2006, domestic demand for refined oil products maintained a moderate growth. According to the Company's statistics, the apparent domestic consumption of refined oil products (inclusive of gasoline, diesel and kerosene including jet fuel) in 2006 was 174.40 million tonnes, up by 6.1% compared with 2005. Due to tight control over the domestic prices, there was a significant spread between domestic and international prices of refined oil products.

Mr. Wang Tianpu, President



Price Trend of International Crude Oil

(3) **Chemicals market**

In 2006, domestic demand for chemicals kept growing. The apparent consumption of synthetic resins, synthetic fibers and synthetic rubbers increased by 7.8% compared with 2005 while domestic ethylene equivalent consumption increased by 4.3% over the previous year. Domestic chemicals prices followed a similar trend as that of the international market, with an increase in the overall prices.

2 Production and Operation

(1) Exploration and Production

In 2006, the Company achieved good results in oil and gas exploration and production by intensifying its exploration activities, and optimising its exploration and production plans.

In connection with exploration activities, the Company attached great importance to the deep gas reserviors exploration in the Northeast Sichuan Province and East China and progressive exploration of crude oil in existing blocks and completed approximately 15,175 kilometers of 2D seismic and approximately 7,582 square kilometers of 3D seismic, and drilled 495 exploration wells with a total footage of approximately 1,438.22 kilometers in 2006. New progress has been made in Northeast Sichuan Province, eastern mature blocks and Tahe in the west, placing a basis for the resource replacement in the future.

In oil and gas development, the Company intensified its progressive exploration and oil reserve evaluation, and effectively developed proved reserves. Under the high oil price environment, the Company actively developed low-yield reserves and improved the quality and efficiency in the new blocks to increase oil and gas production. The Company also put a premium on application of new processes and new technologies to the development in mature blocks, so as to continuously improve recovery rate. In 2006, the Company drilled 2,649 development wells with total footage of 5,888.9 kilometers, with newly added capacity of 6.465 million tonnes per annum (tpa) for crude oil and 1.9 billion cubic meters per annum for natural gas. In 2006, the oil and gas production achieved a steady growth, with the crude oil production exceeding 40 million for the first time.

Summary of Operations of the Exploration and Production Segment

	2006	2005	2004	Change from 2005 to 2006 (%)
Crude oil production (mmbbls)	285.19	278.82	274.15	2.3
Natural gas production (bcf)	256.5	221.9	207.0	15.6
Newly added proved reserves of crude oil (mmbbls)	286	306	284	(6.5)
Newly added proved reserves of natural gas (bcf)	161.5	140.6	352.0	14.9
Year-end proved reserves of crude oil (mmbbls)	3,295	3,294	3,267	0.03
Year-end proved reserves of natural gas (bcf)	2,856.7	2,951.7	3,033.0	(3.2)
Year-end proved reserves of crude oil and natural gas (mmboe)	3,771	3,786	3,773	(0.4)

Summary of Production and Operations of Shengli Oil Field

	2006	2005	2004	Change from 2005 to 2006 (%)
Crude oil production (mmbbls)	194.65	191.31	189.88	1.7
Natural gas production (bcf)	28.3	31.1	31.8	(9.0)
Newly added proved reserves of crude oil (mmbbls)	185	247	225	(25.1)
Newly added proved reserves of natural gas (bcf)	19.2	(3.6)	79.9	n/a
Year-end proved reserves of crude oil (mmbbls)	2,352	2,362	2,306	(0.4)
Year-end proved reserves of natural gas (bcf)	313.3	322.4	357.1	(2.8)
Year-end proved reserves of crude oil and natural gas (mmboe)	2,404	2,415	2,366	(0.5)

Note: Crude oil volume is converted at 1 tonne to 7.1 barrels, and gas volume is converted at 1 cubic meter to 35.31 cubic feet

(2) Refining

In 2006, the Company strengthened the operations of its refining facilities, actively organised full-load production to meet market demand. In addition, the Company closely monitored the changes on the international crude oil market, adhered to diversified crude oil sources to reduce the procurement cost of crude oil. The Company also sought to make full use of storage and transportation facilities such as newly built crude oil wharves and pipelines to reduce the storage and transportation cost. Moveover, the Company actively optimised resource allocation and product mix, increased the processing ratio of lower quality crude oil and expanded the sales volume of higher value-added products. As a result, the major economic and technological indicators such as light yield and refining yield further improved. The Company processed 146.32 million tonnes of crude oil in 2006, up by 4.6% over the last year.

Sources of Crude Oil

Unit: million tonnes

	2006	2005	2004	Change from 2005 to 2006 (%)
Internal supplies	29.62	28.62	28.14	3.5
PetroChina Company Ltd.	8.81	8.75	10.31	0.7
CNOOC Ltd.	4.93	5.05	6.69	(2.4)
Imported	101.47	99.13	89.03	2.4
Total	144.83	141.55	134.17	2.3

Summary of Production of the Refining Segment

	2006	2005	2004	Change from 2005 to 2006 (%)
Refinery throughout (thousand bbls/day)	2,946.5	2,817.9	2,677.2	4.6
of which: high sulphur crude oil throughout (thousand bbls/day):	742.5	698.8	551.1	6.3
Refining utilisation rate (%)	94.28	94.01	93.43	0.27 percentage point
Gasoline, diesel and kerosene production (million tonnes)	87.21	84.53	80.83	3.2
of which: Gasoline production (million tonnes)	23.00	22.98	23.58	0.1
Diesel production (million tonnes)	57.86	54.92	50.89	5.4
Kerosene production (million tonnes)	6.35	6.63	6.36	(4.2)
Light chemical feedstock production (million tonnes)	22.74	21.10	17.70	7.8
Light products yield (%)	74.75	74.16	74.02	0.59 percentage point
Refining yield (%)	93.47	93.24	93.09	0.23 percentage point

Note: Refinery throughout is converted at 1 tonne to 7.35 barrels

(3) Marketing and distribution

In 2006, the Company endeavored to expand the retail and direct sales of refined oil products and optimised the marketing structure, and as a result, retail sales volume of refined oil products increased significantly. In addition, the Company gathered resources from multiple channels, strengthened the coordination among different regions, optimised resource allocation to ensure market supply. Furthermore, the Company optimised its marketing network and further increased the number of company-operated service stations. The average pumped volume per station was further increased. Sinopec cards were widely accepted, and customers can use one single card at Sinopec stations across the nation. At the same time, the Company reinforced its non-fuel business. "Drive Through" restaurants jointly managed by the Company and McDonald's have begun to offer services in selected service stations. In 2006, the Company's sales volume of refined oil products increased to 112 million tonnes, up by 6.8% compared with 2005, of which retail volume was 72.16 million tonnes, up by 13.6% over 2005.

Summary of Operations of Marketing and Distribution Segment

	2006	2005	2004	Change from 2005 to 2006 (%)
Total domestic sales of refined oil products (million tonnes)	111.68	104.56	94.59	6.8
Of which: Retail volume (million tonnes)	72.16	63.52	53.25	13.6
Direct sales volume (million tonnes)	18.95	20.38	19.65	(7.0)
Wholesale volume (million tonnes)	20.57	20.66	21.69	(0.4)
Average annual throughput per service station (tonne/station)	2,577	2,321	2,003	11.0
Total number of service stations under SINOPEC brand	28,801	29,647	30,063	(2.9)
Of which: Number of company-operated service stations	28,001	27,367	26,581	2.3
Number of franchised service stations	800	2,280	3,482	(64.9)
Retail volume/total domestic sales volume (%)	64.6	60.7	56.3	3.9 percentage points

(4) Chemicals

In 2006, the Company leveraged on the advantage of the centralised sales of chemical products, unified its marketing operation, coordinated the production and sales closely and endeavored to achieve good match between volume and price. As a result, the sales volume of the chemical products increased at a steady rate. The sales volume of the chemical products reached 29.56 million tonnes, the sales of the chemical products through centralised network reached 19.58 million tonnes in 2006, representing an increase of 8.5% compared with 2005. The Company enhanced its efforts to tap the potentials of the chemical facilities, paid great attention to the chemical production and ensured the full-load operation of the key chemical facilities, bringing the production of the major chemical products to a record high. In 2006, the Company produced 6.163 million tonnes of ethylene, up by 15.9% compared with 2005.

Production of Major Chemicals **Unit: 1,000 tonnes**

	2006	2005	2004	Change from 2005 to 2006 (%)
Ethylene	6,163	5,319	4,074	15.9
Synthetic resins	8,619	7,605	6,221	13.3
Synthetic rubbers	668	626	561	6.7
Monomers and polymers for synthetic fibres	7,242	6,725	6,021	7.7
Synthetic fibre	1,502	1,570	1,654	(4.3)
Urea	1,609	1,780	2,630	(9.6)

Note: The operational data for 2005 and 2006 include the production of the two joint venture ethylene facilities, Shanghai Secco and BASF-YPC

(5) Research and development

In 2006, the Company focused on the development needs of the core business and strengthened research on the key technologies, obtaining a number of significant achievements. The Company applied for 842 domestic patents and obtained 703 of them. “Formation Mechanism for Gas Reserviors in Deep Marine Carbonate Strata, exploration technology and Discovery of Puguang Gas Field” attained the first Prize of National Science & Technology Progress Awards, and another eight technologies obtained the Second Prize of National Science & Technology Progress Awards and two technologies won the Second Prize of National Technology Invention Awards. The Company continued the theory and technology research of the marine facies oil and gas exploration, expanding its exploration business. The Company is technically ready to upgrade its refined oil product specification to Euro IV. 10 million tpa refinery and 1 million tpa ethylene project with proprietary technologies is under construction, which indicates the proprietary technologies and engineering capacity of the Company has already reached a new level.

Information technologies were applied to improve management. Applications of ERP and other IT systems are playing increasingly important roles in the Company’s business development and operation management.

(6) Cost saving

In 2006, the Company took various measures to reduce cost, such as optimising resource allocation and leveraging on existing logistics system, reducing transportation cost, further increasing the processing volume of lower quality crude oil, reducing the procurement cost of crude oil and consumption of energy and materials in the production process by optimising operation of the facilities. In 2006, the Company effectively saved RMB 2.781 billion in cost, which exceeded the original target of RMB 2.5 billion by RMB 281 million. Of the total cost saved, the exploration and production segment, the refining segment, the marketing and distribution segment and the chemicals segment achieved cost saving of RMB 720 million, RMB 721 million, RMB 561 million, and RMB 779 million, respectively.

(7) Capital expenditure

In 2006, the total capital expenditure of the Company was RMB 79.82 billion. Among which, the expenditure for exploration and production segment was RMB 31.73 billion. With the investment, oil and gas exploration in Northeast Sichuan and the preparations of "Sichuan-to-East China Gas Project" were fully started, the oil and gas production and construction in Tahe in the west, Shengli Chenbei Offshore in the east and Daniudi Gasfield made smooth progress. The newly built crude oil and natural gas capability hit 6.465 million tonnes and 1.9 billion cubic meters per annum respectively. The expenditure for refining segment was RMB 21.97 billion. The newly added comprehensive crude oil processing capability reached 14.7 million tonnes per annum. The newly built and revamped projects such as Hainan Refinery and Guangzhou Refinery have been completed and put into operation. Yanshan Refinery Upgrading Project has also been completed, and Cezi Island Wharf and Yizheng-Changling Crude Oil Pipeline projects have been put into operation. Construction of Qingdao Refinery is going smoothly. The expenditure for marketing and distribution segment was RMB 11.32 billion. With the investment, the Company has further improved its refined oil products sales network through construction, acquisition and renovation of service stations. In 2006, the Company had 811 service stations newly added to its network. The expenditure for chemicals segment was RMB 12.63 billion. The newly added production capacity of ethylene, PTA, and styrene-butadiene rubber was 750,000 tpa, 450,000 tpa and 100,000 tpa respectively. Maoming ethylene revamping project has been completed and put into operation and the chemical fertilizer revamping projects in Anqing, Hubei and Baling were completed and successfully commissioned. The Fujian Integrated Project, Tianjin Ethylene and Zhenhai Ethylene are progressing on schedule. The expenditure for corporate and others was RMB 2.17 billion, which was used for the upgrading of IT systems and construction of R&D infrastructures.

In addition, the capital expenditure for the three oil production companies acquired by the Company in 2006 was RMB 3.36 billion. The Company's joint ventures had capital expenditures of RMB 260 million in 2006.

BUSINESS PROSPECTS

Looking forward for 2007, China's economy is expected to maintain a stable and rapid growth, which would help sustain a reasonable growth of domestic demand for oil and petrochemical products. The crude oil prices are expected to continue to maintain at a high level and the prices of most of petrochemical products are expected to stay at relatively high level. In addition, with the full opening of the domestic market of refined oil products, competitions in domestic refined oil products market may be intersified.

Under such market environment, the Company will continue to take flexible operation strategies, further strengthen internal management, and endeavor to organise production and reduce energy and materials consumption. In particular, the Company intends to focus on the following areas:

Exploration and production segment:

In connection with the exploration and production, the Company will make further efforts to implement oil and gas resource strategies and accelerate the exploration and production of natural gas in Northeast and West Sichuan to expand the results of the exploration. In addition, the Company expects to keep stable production in mature blocks in east China, accelerate the development of oil fields in west China and expand the natural gas business, to maintain stable increase of oil and gas production. The Company plans to produce 291.1 million barrels of crude oil and 282.48 billion cubic feet of natural gas in 2007.

Refining segment: The Company intends to put more efforts to optimise the operations and realise its potentials, and it will leverage the potentials of the facilities, optimise resource protfolio, increase the processing volume of lower quality crude oil to reduce the purchase cost of crude oil. In addition, by relying on the technological advancement, the Company will focus on the research of specific technologies to save energy, reduce consumption and increase the utilisation efficiency of resource. And the Company will optimise production scheme, adjust product structures, make efforts to increase the production of the higher value-added products. Furthermore, it will purchase crude oil carefully and adhere to the diversity of the crude oil resource, ensuring crude oil supply. The Company plans to process 156 million tonnes of crude oil in 2007.

Marketing and distribution segment: The Company intends to further improve its service and marketing network to expand total sales and retail sales volume. The Company will monitor the market dynamics closely, balance the resources from an overall perspective, optimise resource allocation, enhance the operation efficiency of the refined oil products pipelines, reduce the transportation cost and actively promote the use of cleaner fuel. The Company plans to have a total sales volume of refined oil products of 117 million tonnes, including a retail sales volume of 75 million tonnes.

Chemicals segment: The Company intends to strengthen its management to enhance operational level of its chemical facilities, and intends to ensure safe and full-load production of the facilities. In addition, the Company will further optimise regional resources, optimise internal-supply of the chemical feedstock, respond to market change flexibly, actively produce products well received by the market, leverage the advantages of the centralised sales, expand market steadily and increase the sales volume of the products. The Company plans to produce 6.45 million tonnes of ethylene, 19.13 million tonnes of synthetic resins, rubbers and fibers in 2007.

Research and development: In line with the needs of production and development, the Company intends to further focus its R&D strength on key technologies, and it will place more emphasis on developing the core technologies such as marine facies oil and gas exploration, increase reserve and stabilise production in the oil fields in the east, lower quality crude oil processing, utilisation of natural gas and production of cleaner fuels and supreme-performance synthetic materials, with a view to sharpening the Company's competitive edge. Moreover, the Company intends to enhance its efforts to promote the results of mature technologies, improve the production technology level, reduce the production cost, further integrate technological resource, manage to improve equipment for scientific research and improve development efficiency of scientific research.

Cost saving: In 2007, the Company intends to rely on scientific and technological advancement and reinforce management practices to deepen reforms and enhance operating efficiency. It plans to achieve a cost saving of RMB 2.6 billion, among which exploration and production segment plans to achieve a cost saving of RMB 700 million, refining segment RMB 600 million, chemicals segment RMB 600 million, and marketing and distribution segment RMB 700 million.

Capital expenditure: The Company will continue to uphold the guideline of "Spend reasonably in light of the income, control the total expenditure, make centralised decisions, adjust the structure, optimise project and increase return" and endeavor to realise effective development of the Company. According to present macro-economy and market situation, the Company's planned capital expenditure is RMB 110.06 billion for 2007. The projected expenditure for exploration and production segment is RMB 53.1 billion used to speed up the construction process of "Sichuan-to-East China Gas Project" project and strengthen the oil and gas exploration and production in Northeast Sichuan, Ordos, Tahe Oil field and Southern Tianshan Mountain. The projected capital expenditure for refining segment is RMB 22.7 billion which is primarily planned for Qingdao Refinery Project, Bohai Bay crude oil terminal, expansion and revamping of Gaoqiao, Yanshan Refining Project. The projected capital expenditure for chemicals segment is RMB 19.46 billion which is planned for Fujian, Tianjin and Zhenhai's ethylene projects and to promote the expansion, revamping and auxiliary facilities construction for monomers of synthetic fibre and organic materials in Yangzi, Shanghai and Jinling Petrochemical. The projected capital expenditure for marketing and distribution segment is RMB 12 billion which is planned to optimise and improve the marketing network of refined oil products and accelerate the construction of the pipelines and oil storage for the refined oil products. The projected capital expenditure for corporate and others is RMB 2.8 billion.

In 2007, the Company, in line with the operating policies set forth by the Board of Directors, will deepen reform, accelerate adjustment, intensify management, make greater progress, fully reach various production and operation targets and strive to obtain better performance in production and operation, enhancing the Company's overall competitiveness and ability of making sustainable profit.