

DIRECTORS' REPORT

The Board of Directors of the Company is pleased to present its directors' report for perusal.

1. Review of results of operations and the business prospect of the Company during the reporting period

Please refer to the sections headed "Business Operating Review", "Management's Discussion and Analysis of Financial Position and Results of Operations" and "Chairman's Report" in this annual report.

2. Risk Factors

During the course of its production and operations, the Group actively took various measures to avoid and mitigate all types of risks. However, in practice, it may not be possible to prevent all risks and uncertainties completely.

(1) Industry Regulations and Tax Policies Risk

Like other oil and gas companies in China, the Group's operating activities are subject to extensive regulations and controls by the PRC Government. These regulations and controls, such as by way of issue of exploration and production licences, the imposition of industry-specific taxes and levies and the implementation of environmental policies and safety standards etc., are expected to have impact on the Group's operating activities. Any future changes in the

PRC governmental policies in respect of oil and gas industry may also affect the Group's business operations.

Taxes and levies are one of the major external factors affecting the operations of the Group. The PRC Government is actively progressing taxation reform which may lead to changes in the taxes and levies relating to the operations of the Group, thereby affecting the operating results of the Company.

(2) Price Fluctuations of Crude Oil and Refined Products Risk

The Group is engaged in a wide range of petroleum-related activities. The prices of crude oil and refined products in the international market are affected by various factors such as changes in global and regional politics and economy, the supply and demand conditions of crude oil and refined products and unexpected political events and disputes with international repercussions. The domestic crude oil price is determined with reference to international price of crude oil, and in 2006, the PRC established new refined products pricing mechanism based on macro economic controls. However, as affected by the macro economic controls in the PRC, the prices of domestic refined products were not adjusted in line with the prices in the international market. The Group has not adopted any commodity derivative instruments to hedge against potential price fluctuations of crude oil and refined products. Therefore, the Group is exposed to general price fluctuations of oil and gas commodities in 2008 and thereafter.

(3) Foreign Exchange Rate Risk

The Group conducts its business primarily in Renminbi. Currently, the PRC Government is implementing 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, hence affecting the operating results and financial position of the Group.

(4) Market Competition Risk

The Group has distinctive advantages in resources, and is occupying a leading position in the oil and gas industry in the PRC. At present, major competitors of the Group are other large domestic oil and petrochemical producers and sellers. With the gradual opening up of the domestic oil and petrochemical industry, certain large foreign oil and petrochemical companies have become competitors of the Group in certain regions and segments. The exploration and production business and natural gas and pipeline business of the Group have been in a leading position in China, but the refining and marketing business and the chemicals and marketing business of the Company are facing relatively keen competition.

(5) Uncertainty of the Oil and Gas Reserves

According to industry characteristics and international customs, the crude oil and natural gas reserves data disclosed by the Group are estimates only. The Group has already engaged evaluation companies who are internationally recognised to evaluate the crude oil and natural gas reserves of the Group on a periodic basis. However, the reliability of reserve estimate depends on a

number of factors, assumptions and variables, such as the quality and quantity of technical and economic data, the prevailing oil and gas prices applicable to the production of the Group etc., many of which are beyond the control of the Group and may be adjusted over time. Results of drilling, testing and exploration results after the date of the estimates may also result in revision to the reserves data of the Group.

(6) Hidden Hazards Risks and Force Majeure Risk

Oil and gas exploration, exploitation, storage and transportation and the production, storage and transportation of refined products and petrochemical products are faced with certain risks, which may cause unexpected or dangerous events, such as personal injuries or death, property damage, environmental damage and interruption of operations etc. With the expansion of operations scale and regions, the safety risks faced by the Group also increase accordingly. Meanwhile, new regulations adopted in recent years set out higher standard for safety production. The Group has implemented a strict HSE management system and used its best endeavours to prevent the occurrence of various accidents. However, the Group cannot completely avoid potential financial losses caused by such contingent incidents. In addition, natural disasters such as earthquake, typhoon, tsunami and emergency public health events may cause losses to the properties and personnel of the Group, and may affect the normal operations of the Group.

3. Contingent Liabilities

(1) Bank and other guarantees

Please refer to the paragraph headed "Material Contracts and the performance thereof" under the section headed "Significant Events" in this annual report for details.

(2) 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. 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 of the Group believes that there are no probable liabilities, except for the amounts which have already been reflected in the consolidated financial statements, that will have a material adverse effect on the financial position of the Group.

(3) 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 of the Group believes that any resulting liabilities will not have a material adverse effect on the financial position of the Group.



(4) Leasing of roads, land and buildings

According to the Restructuring Agreement entered into between the Company and CNPC on March 10, 2000, CNPC has undertaken 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 December 31, 2007, CNPC had obtained formal land use right certificates in relation to 27,554 out of the above-mentioned 28,649 parcels of land and 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 management 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 been completed. In the opinion of the management of the Company, the outcome of the above events will not have material adverse effect on the operating results or the financial position of the Group.

(5) 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 China. While the effect of under-insurance on future incidents cannot be reasonably assessed at present, the management of the Group believes that any resulting liabilities may not have material adverse effect on the financial position of the Group.

4. Use of proceeds from fund raising

Unit: RMB million

Total amount of proceeds	In October 2007, the Company issued 4 billion A shares. The total proceeds and net proceeds from such issuance were RMB66,800 million and RMB66,243 million respectively.		Total amount of proceeds used this year	Out of the proceeds raised for the following five projects in the amount of RMB37,770 million, RMB13,943 million were used. Balance of the net proceeds would be used as additional working capital and for general commercial purpose.		
			Accumulated amount of proceeds used	Same as above.		
Committed project	Modification of the project	Proposed investment	Actual investment	Progress as planned	Estimated return	Project return
Project to increase the crude oil production capacity of Changqing Oilfield	No	6,840	2,718	Yes	Internal rate of return above 12%	To be confirmed only upon commissioning
Project to increase the crude oil production capacity of Daqing Oilfield	No	5,930	1,772	Yes	Internal rate of return above 12%	To be confirmed only upon commissioning
Project to increase the crude oil production capacity of Jidong Oilfield	No	1,500	495	Yes	Internal rate of return above 12%	To be confirmed only upon commissioning
Dushanzi Petrochemical's projects - processing and refining sulphur-bearing crude oil imported from Kazakhstan and ethylene technology development projects	No	17,500	8,867	Yes	Internal rate of return above 12%	To be confirmed only upon commissioning
Daqing Petrochemical 1.2 million tons/year ethylene redevelopment and expansion project	No	6,000	91	Yes	Internal rate of return above 12%	To be confirmed only upon commissioning
Total		37,770	13,943		—	—
Projects not progressing as planned and not achieving estimated return	—					
Projects modified and modification procedures	—					
Application and status of unused proceeds	The unutilised portion of the net proceeds of RMB37,770 million from the A share issuance has been deposited into the designated bank accounts maintained by the Company.					

Projects not funded by proceeds from fund raising

Unit: RMB million

Name of project	Total project amount	Progress of project	Project return
Dalian Petrochemical technological development project - processing 20 million tons of imported sulphur-bearing crude oil per year	10,789	Construction of part of the production facilities has been completed and production has commenced.	To be confirmed only upon commissioning
Guangxi Petrochemical project refining 10 million tons of crude oil per year	15,166	Installation of preliminary parts has been completed and construction has commenced.	To be confirmed only upon commissioning
Sichuan Petrochemical project with an ethylene output of 0.8 million tons per year	21,019	Preliminary work of the project has been completed and ordering of equipment has commenced.	To be confirmed only upon commissioning
Fushun Petrochemical one million tons per year ethylene technology development project	12,524	Preliminary work of the project has been completed and ordering of equipment has commenced.	To be confirmed only upon commissioning
Lanzhou-Zhengzhou-Changsha Refined Oil Pipeline	11,429	Installation of preliminary parts has been completed and construction has commenced.	To be confirmed only upon commissioning
Total	70,927	-	

5. Operations of the Board of Directors

(1) The convening of Board meetings and the issues resolved

During the reporting period, the Board of Directors convened 4 regular Board meetings, 3 extraordinary Board meetings and passed 24 resolutions.

a. On March 18, 2007, the Company held the sixth meeting of the third term of its Board of Directors, during which 12 resolutions were passed as follows:

- The resolution on the Company's Financial Statements for year 2006 (including the announcement of the annual results for the year ended December 31, 2006)
- The resolution on the Company's draft profit distribution plan for 2006
- The resolution on the Company's 2006 annual report and 2006 social responsibility report

- The resolution on the Company's 2006 President Work Report
- The resolution on the assessment of the completion of performance targets by the President's Work Team for 2006 and the formulation of performance contract for 2007
- The resolution on the proposal to request the Company's general meeting to authorise the Board of Directors to determine the distribution of the Company's interim profits for 2007
- The resolution on the proposal to request the Company's general meeting to authorise the Board of Directors to arrange for the issue of new shares by the Company and for their listing
- The resolution on the formation of a special committee of the Board of Directors regarding the application for issue of new shares by the Company and their listing and the authorization of such committee to deal with related matters
- The resolution on the disposal of equity interest in China National United Oil Corporation

- The resolution on the formation of an independent committee of the Board of Directors and the appointment of an independent financial advisers regarding the equity interest transfer of China National United Oil Corporation
- The resolution on the authorization of short-term investment quota for 2007
- The resolution on convening of the Annual General Meeting for 2006

b. On June 19, 2007, the Company held the seventh meeting of the third term of its Board of Directors, during which 3 resolutions were passed as follows:

- The resolution on the appointment of Vice President, Chief Financial Officer and Chief Engineer as recommended by the President
- The resolution on the public offering of shares domestically
- The resolution on convening of Extraordinary General Meeting for 2007

c. On August 22, 2007, the Company held the eighth meeting of the third term of its Board of Directors, during which 3 resolutions were passed as follows:

- The resolution on the interim financial statement of 2007 (including the announcement of the interim results for six months ended June 30, 2007)
- The resolution on the Company's interim profit distribution plan for 2007
- The resolution on the acquisition of the assets engaged in risk management service assets of Xinjiang Petroleum Administration Bureau and the Command Department of Tuha Petroleum Exploration and Exploitation

d. On November 20, 2007, the Company held the ninth meeting of the third term of its Board of Directors, during which 3 resolutions were passed as follows:

- The resolution on the Company's budget for 2008
- The resolution on the Company's investment plan for 2008
- The resolution on the appointment of Vice President recommended by the President

Reference can be made to the announcement regarding the resolution on the appointment of Vice President recommended by the President published on the websites of the Shanghai Stock Exchange and the Hong Kong Stock Exchange on November 23, 2007.

e. The first Extraordinary Meeting of the Board of Directors was held on April 24, 2007 by way of circulation of written resolution, and the resolution on the approval and authorization of the Secretary of the Board of Directors to sign the 20-F form for 2006 was passed during the meeting.

f. The second Extraordinary Meeting of the Board of Directors was held on May 16, 2007 by way of circulation of written resolution, and the resolution on the election of Chairman was passed during the meeting.

g. The third Extraordinary Meeting of the Board of Directors was held on December 27, 2007 by way of circulation of written resolution, and the resolution on matters related with the capital injection in CNPC Exploration and Development Company Limited was passed at the meeting.

Reference can be made to the announcement of the resolution published on the websites of the Shanghai Stock Exchange and the Hong Kong Stock Exchange on December 27, 2007 and in China Securities Journal, Shanghai Securities Journal and Securities Times on December 28, 2007.

(2) Members of the Board of Directors and attendance rate of Directors

Position	Name	Attendance Rate (%)
Chairman	Jiang Jiemin	100
Executive Director	Duan Wende	100 (100 of which by proxy)
Non-executive Directors	Zheng Hu	100 (25 of which by proxy)
	Zhou Jiping	100
	Wang Yilin	100
	Zeng Yukang	100 (50 of which by proxy)
	Gong Huazhang	100 (25 of which by proxy)
	Jiang Fan	100
	Chee-Chen Tung	100
Independent Non-executive Directors	Liu Hongru	100
	Franco Bernabè	100 (25 of which by proxy)

Note: Mr Chen Geng retired from his office as Director with effect on May 16, 2007. During the reporting period, Mr Chen Geng attended one meeting of the Board of Directors and attained a 100% attendance rate.

(3) The implementation of AGM resolutions by the Board of Directors

All members of the Board of Directors have conscientiously and tirelessly performed their duties, implemented the resolutions passed at the AGM and accomplished all tasks as authorized by the AGM according to the relevant laws, regulations and rules of the respective jurisdictions where Company shares are listed and the provisions as set out in the Company's Articles of Association.

(4) Work of the special committees of the Board of Directors

a. Audit Committee

During the reporting period, the Audit Committee held five regular meetings of which one of the meetings were held by way of written resolution.

On March 17, 2007, for the sixth meeting of the third term of the Board of Directors, the Audit Committee reviewed the Company's Financial Statements for 2006 (including the announcement of the annual results for the year ended December 31, 2006), the Company's Draft Profit Distribution Plan for 2006, Report on the Company's Continuing Connected Transactions in 2006, Assessment Report on Internal Control Test, the Company's Audit Work Report, Resolution on the Appointment of International and Domestic Accounting Firm for 2007, Resolution on the Transfer of shareholding of China United Oil Corporation Limited, PricewaterhouseCoopers' Report to the Audit Committee of the Board of Directors and prepared the Audit Opinion of the Audit Committee of the Board of Directors on the Financial Statements for 2006 and the Audit Opinion of the Audit Committee of the Board of Directors on the draft Profit Distribution Plan for 2006.

On June 18, 2007, for the seventh meeting of the third term of the Board of Directors, the Audit Committee reviewed the Report on Internal Control System Operation, The Company's Internal Audit Work Report, Proposal on the Audit Fee of PricewaterhouseCoopers for 2007, PricewaterhouseCoopers' Report to the Audit Committee of the Company's Board of Directors and prepared the Audit Opinion of the Audit Committee of the Board of Directors.

On August 21, 2007, for the eighth meeting of the third term of the Board of Directors, the Audit Committee reviewed the Company's Interim Financial Statements for 2007 (including the publication of annual results for the six months ended June 30, 2007), the Company's Draft Interim Profit Distribution Plan for 2007, Report on Internal Control System Operation, The Company's Internal Audit Work Report, PricewaterhouseCoopers' Report to the Audit Committee of the Company's Board of Directors and prepared the Audit Opinion of the Audit Committee of the Board of Directors on the Interim Financial Statements for 2007 and the Audit Opinion of the Audit Committee of the Board of Directors on the Draft Interim Profit Distribution Plan for 2007.

On November 19, 2007, for the ninth meeting of the third term of the Board of Directors, the Audit Committee reviewed the Report on Internal Control System Operation, the Company's Internal Audit Work Report, PricewaterhouseCoopers' Report to the Audit Committee of the Company's Board of Directors and prepared the Audit Opinion of the Audit Committee of the Board of Directors.

On April 30, 2007, for the Extraordinary Meeting of the Board of Directors, the Audit Committee reviewed and passed the Report on the U. S. Exchange Visit for the Audit Personnel on Sarbanes-Oxley Act and Anti-Abusive Practice by way of written resolution.

b. Investment and Development Committee

On March 15, 2007, for the sixth meeting of the third term of the Board of Directors, the Investment and Development Committee reviewed the Resolution on the Authorization of Short-term Investment Quota for 2007 and prepared the Opinion of the Investment and Development Committee of the Board of Directors on the Authorization of Short-term Investment Quota for 2007.

On November 19, 2007, for the ninth meeting of the third term of the Board of Directors, the Investment and Development Committee reviewed the Resolution on the Company's Investment Plan for 2008 and prepared the Opinion of the Investment and Development Committee of the Board of Directors on the Company's Investment Plan for 2008.

c. Examination and Remuneration Committee

On March 15, 2007, for the sixth meeting of the third term of the Board of Directors, the Examination and Remuneration Committee reviewed the Report on Assessment of the Completion of Performance Targets by the President's Work Team for Year 2006 and the Formulation of Performance Contract for Year 2007 and prepared the Opinion of the Examination and Remuneration Committee of the Board of Directors on the Report on Assessment of the Completion of Performance Targets by the President's Work Team for Year 2006 and the Formulation of Performance Contract for Year 2007.

d. Health, Safety and Environment Committee

On March 17, 2007, for the sixth meeting of the third term of the Board of Directors, the Health, Safety

and Environment Committee reviewed the Company's Health, Safety and Environment Work Report for 2006 and prepared the Opinion of the Health, Safety and Environment Committee of the Board of Directors on the Company's Health, Safety and Environment Work Report for 2006.

During the reporting period, for the attendance of the Audit Committee meetings, reference can be made to the "Audit Committee" section under the Corporate Governance Structure of this Annual Report. All members of the Investment and Development Committee, Examination and Remuneration Committee and Health, Safety and Environment Committee attended all meetings as convened by these special committees.

6. Results

The results of the Group for the year ended December 31, 2007 prepared in accordance with IFRS are set out in the Consolidated Profit and Loss Account on page 174.

The financial condition of the Group as at December 31, 2007 are set out in the Consolidated Balance Sheet prepared in accordance with IFRS on page 175.

The Consolidated Cash Flows Statement of the Group for the year prepared in accordance with IFRS is set out in the statement on page 177.

7. Profit Distribution Plan from the Board of Directors

The Board recommends to pay final dividends of RMB0.156859 per share (inclusive of applicable tax) based on 45% of the net profit of the Group for the twelve months ended December 31, 2007 under IFRS less the interim dividends for 2007 paid on September 28, 2007. The proposed final dividends are subject to equity holders' review and approval at the forthcoming annual general meeting

to be held on May 15, 2008. The final dividends will be paid to equity holders whose names appear on the register of members of the Company at the close of business on May 28, 2008. The register of members of H shares will be closed from May 22, 2008 to May 28, 2008 (both days inclusive) during which period no transfer of H shares will be registered. In order to qualify for the final dividends, holders of H shares must lodge all transfer documents together with the relevant share certificates at Hong Kong Registrars Limited no later than 4:00 p.m. on May 21, 2008. Equity holders of A shares whose names appear on the register of members of the Company maintained at China Securities Depository and Clearing Corporation Limited Shanghai Branch Company at the close of trading on the Shanghai Stock Exchange in the afternoon of May 28, 2008 are eligible for the final dividends.

In accordance with the relevant provisions of the Company's Articles of Association, dividends payable to the Company's equity holders shall be declared in Renminbi. Dividends payable to the holders of A shares shall be paid in Renminbi while dividends payable to the holders of H shares shall be paid in Hong Kong Dollars. The amount of Hong Kong Dollars payable shall be calculated on the basis of the average of the closing exchange rate for Renminbi to Hong Kong Dollar as announced by the People's Bank of China for the week prior to the declaration of the dividends.

8. Five-Years Financial Summary

A summary of the results and of the assets and liabilities of the Group for the last five financial years is set out on page 5.

9. Bank Loans and Other Borrowings

Details of bank loans and other borrowings of the Company and the Group as at December 31, 2007 are set out in note 28 to the financial statements prepared in accordance with IFRS in this annual report.

10. Interest Capitalisation

Interest capitalisation for the Group for the year ended December 31, 2007 was RMB1,734 million.

11. Fixed Assets

Changes to the fixed assets of the Company and the Group during the year are summarised in note 16 to the financial statements prepared in accordance with IFRS in this annual report.

12. Land Value Appreciation Tax

No land value appreciation tax was payable by the Group during the year.

13. Reserves

Details of changes to the reserves of the Company and the Group for the year ended December 31, 2007 are set out in note 30 to the financial statements prepared in accordance with IFRS in this annual report.

14. Distributable Reserves

As at December 31, 2007, the reserves of the Company that can be distributed as dividend were RMB228,016 million.

15. Statutory Common Welfare Fund

Details of the statutory welfare fund, such as the nature, application and movements and the basis of calculation (including the percentage and profit figure used for calculating the amounts) are set out in note 30 to the financial statements prepared in accordance with IFRS in this annual report.

16. Management Contract

During the year, the Company did not enter into any management contracts concerning the management or administration of its overall business or any of its material business, nor did any such management contract exist.

17. Major Suppliers and Customers

CNPC is the Group's largest supplier of goods and services and the aggregate purchase attributable to CNPC was 39% of the total purchase of the Group for 2007. The aggregate purchase attributable to the five largest suppliers of the Group was 47% of the Group's total purchase.

The aggregate revenue derived from the major customers is set out in note 37 to the financial statements prepared in accordance with IFRS in this annual report. The aggregate revenue derived from the five largest customers was less than 30% of the Group's total sales.

Save as disclosed above, none of the Directors, Supervisors and their associates or any shareholder (who to the knowledge of the Directors were holding 5% or more of the Company's share capital) had any interest in any of the above-mentioned suppliers and customers.

18. Repurchase, Sale or Redemption of Securities

The Company or any of its subsidiaries did not sell any securities of the Company, nor did it repurchase or redeem any of the securities of the Company during the twelve months ended December 31, 2007.

19. Trust Deposits and Irrecoverable Overdue Time Deposits

As at December 31, 2007, the Company did not have any trust deposits or irrecoverable overdue time deposits.

20. Pre-emptive Rights

There is no provision regarding pre-emptive rights under the Articles of Association of the Company or the PRC laws.

21. Sufficiency of Public Float

Based on the information that is publicly available to the Company and within the knowledge of the Directors, the Directors confirm that the Company has maintained the amount of public float as required under the Listing Rules during the reporting period.

22. 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.

By Order of the Board
Jiang Jiemin
Chairman
Beijing, the PRC
March 19, 2008