

BUSINESS OPERATING REVIEW

The Company was established as a joint stock limited company with limited liability under the laws of the PRC on November 5, 1999 as part of the restructuring of CNPC. In the restructuring, CNPC, the parent company of the Company, injected into the Company most of the assets, liabilities and interests of CNPC relating to its domestic exploration and production, refining and marketing, chemical products and natural gas businesses. The ADSs and H shares of the Company were listed on the New York Stock Exchange, Inc. and the HKSE on April 6, 2000 and April 7, 2000 respectively.

The Company is engaged in a broad range of petroleum-related activities, including:

- the exploration, development, production and sale of crude oil and natural gas;
- the refining, transportation, storage and marketing of crude oil and petroleum products;
- the production and sale of basic petrochemical products, derivative petrochemical products and other chemical products; and
- the transmission of natural gas, crude oil and refined products and sale of natural gas.

The Company is the largest producer of crude oil and natural gas in the PRC and one of the largest companies in the PRC in terms of sales.

Market Review

◆ Crude Oil Market Review

International crude oil prices remained high for the most of 2003 due to international military, political, economic and other factors. The annual average price remained at a fairly high level for the most of 2003. The annual average price for WTI, Brent and Minas crude oil was US\$31.05 per barrel, US\$28.84 per barrel and US\$29.50 per barrel respectively, representing a respective increase of US\$4.86 per barrel, US\$3.76 per barrel and US\$3.78 per barrel over the annual average price in 2002. Corresponding to the rise in international oil prices, domestic crude oil prices had increased. The average realised price for domestic crude oil in 2003 was higher than the 2002 level.

Net crude oil imports continued to increase in 2003, rising by 33.43% over the previous year to a net total of 82.99 million tons. The domestic output of crude oil and refined products reached 169 million tons and 243 million tons respectively.

◆ Refined Products Market Review

In general, the domestic market for refined products fared well in 2003, with nominal consumption increasing by 8.1% to 131.91 million tons. Save in the second quarter, when the consumption of refined products decreased due to the outbreak of severe acute respiratory syndrome (SARS), the demand for refined products was strong in the other three quarters as a result of the persistent growth in the domestic economy. Net import of refined products for the whole country climbed to 14.41 million tons, increasing 49.30% over the

previous year. As compared with the beginning of 2003, the national inventory of refined products declined by approximately 1.4 million tons at the end of 2003.

Owing to the adjustment and control of the domestic prices for refined products by the central government in 2003 and affected by the prices in the international markets, the annual average reference medium guidance prices for both gasoline and diesel were higher than the 2002 level.

◆ Chemical Products Market Review

In 2003, despite the impacts of the war in Iraq and the outbreak of SARS, the shortage of basic energy became more acute as the global economy began to recover and grew at an increasing speed. Accordingly, the prices for all chemical products had a fairly substantial increase compared with 2002.

At the beginning of 2003, the overall inventory in China was at a relatively low level. The fast development of the global economy led to a rapid development of China's real estate, automobile and other industries. The increase in demand for chemical products outpaced the increase in gross domestic product(GDP), and there was a relatively large increase in the exports of plastic and textile products. As a result, despite the increase in imports compared with the previous year, the limited growth in domestic production capacity failed to satisfy the increased demand, thus leading to a shortage of resources for the chemical products market.

With the incoming of labour-intensive enterprises to the PRC and increased investments in industries in 2003, there was a corresponding increase in the demand for chemical products. Until the large-scale ethylene production projects in the Middle East commence production, there will be a shortage of chemical products in China, leading to a fluctuated but rising trend for the prices of such products.

Company Business Review

◆ Exploration and Production

For the twelve months ended December 31, 2003, the Company's total annual output of oil and gas amounted to 890.1 million barrels of oil equivalent, including 774.9 million barrels of crude oil and 691.3 billion cubic feet of marketable natural gas, representing an average production of 2.12 million barrels of crude oil and 1.894 billion cubic feet of marketable natural gas per day. A total of 726 million barrels of crude oil and 651 billion cubic feet of natural gas were sold. Approximately 73% of the crude oil sold by the Company was purchased by its refineries. In 2003, the Company's lifting cost (inclusive of overseas business) was US\$4.39 per barrel (US\$4.36 per barrel if exclusive of overseas business; for the same period in 2002, the lifting cost was US\$4.34 per barrel if inclusive of overseas business, and US\$4.32 per barrel if exclusive of overseas business), representing an increase of 1.15% compared with the year 2002.

◆ Refining and Marketing

For the twelve months ended December 31, 2003, the Company's refineries processed 621 million barrels of crude oil, or an average of 1.70 million barrels per day. Approximately 86% of the crude oil processed in the Company's refineries was supplied by the exploration and production segment. The Company produced approximately 52.79 million tons of gasoline, diesel and kerosene and sold approximately 58.34 million tons of these products. The Company actively expanded its sales and distribution networks, in particular the retail distribution network, by capitalising fully on the complementary value-added effect of the integration of refining and marketing. As at December 31, 2003, there were 15,231 service stations either owned, controlled or franchised by the Company or owned by CNPC but to which the Company provides supervisory support. The Company's cash processing costs declined steadily from RMB136 per ton to RMB132 per ton.

◆ Chemicals and Marketing

For the twelve months ended December 31, 2003, the Company produced 1.818 million tons of ethylene, 2.369 million tons of synthetic resin, 0.212 million tons of synthetic fibres, 0.246 million tons of rubber, and 3.58 million tons of urea.

◆ Natural Gas and Pipeline

The natural gas and pipeline segment is the Company's core business segment for development. For the twelve months ended December 31, 2003, the Company sold 543.4 billion cubic feet of marketable natural gas through the natural gas and pipeline segment. The Company currently owns and operates 15,144 kilometres of regional natural gas pipeline networks, of which 14,017 kilometres are operated by the natural gas and pipeline segment. As at December 31, 2003, the Company owned and operated a crude oil pipeline network of 9,141 kilometres and a refined products pipeline of 2,276 kilometres.