BUSINESS REVIEW

In 2005, the Chinese economy continued to grow at a steady and rapid rate, with a GDP growth rate of 9.9%, and domestic demand for petroleum and petrochemical products kept increasing. In a market environment characterised with soaring international crude oil price, tight government control of domestic refined oil products prices and volatile petrochemical market, the Company managed to achieve satisfactory operating results, maintained growth in production and profitability and improved asset quality by relying on the collective efforts of its employees, leveraging on its overall advantages, strengthening internal management and optimising production operations with a market-based approach and a focus on profits.

Mr. Wang Tianpu, President

1. Review of Market Environment

(1) Crude oil market

In 2005, international crude oil prices were fluctuating at high levels. The Platts' Brent spot price averaged US$ 54.53 per barrel, up by 42.5% compared with 2004. The domestic crude oil price basically followed the trend in the international market. Average realised crude oil price produced by the Company was RMB 2,664.7 per tonne in 2005, up by 36.2% compared with 2004.

(2) Refined oil products market

In 2005, 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 2005 was 164.44 million tonnes, up by 4.7% compared with 2004. International refined oil prices experienced a significant increase following the trend in the international crude oil market. However, due to tight control over the domestic prices of refined oil products, there was a significant gap between domestic and international prices of refined oil products.

(3) Chemicals market

In 2005, domestic demand for chemicals continued to show a relatively strong growth. According to the Company's statistics, the apparent consumption of synthetic fibers and synthetic rubbers increased by 10.2% compared with 2004 while domestic ethylene equivalent consumption increased by 8.6% compared with 2004. Domestic chemicals prices witnessed a similar trend as that of the international market. However, due to the rise of chemical feedstock prices in the second half of 2005, the gross profit margin of chemicals declined noticeably.

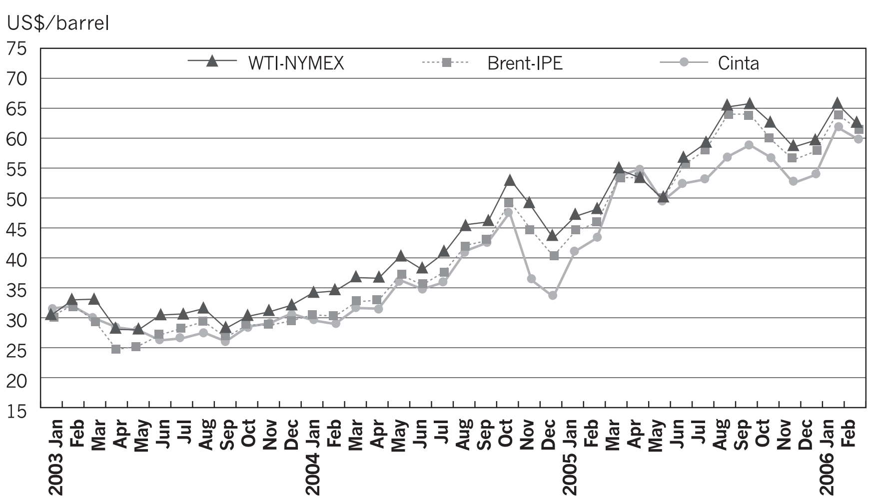
2 Production and Operation

(1) Exploration and production

In 2005, the Company achieved good results in oil and gas exploration and production by intensifying its exploration activities, optimising and adjusting its exploration and production plans.

In connection with exploration activities, the Company attached great importance to new discoveries in both mature and new blocks, completed 15,380 kilometers of 2D seismic and 7,164 square kilometers of 3D seismic, and drilled 545 exploration wells with a total footage of 1,467 kilometers. Relying on theoretical innovation and technological advances, the Company discovered the largest and most aboundant gas field in marine facies carbonate sturcture ever found in China, the Puguang Gas Field. Important discoveries were also made in exploration activities in mature blocks in east China as well as in Junger and Tahe blocks, achieving over 100% replacement of oil and gas reserves and laying a solid foundation for future resources.

In oil and gas production, the Company intensified its progressive exploration activities and oil reserve evaluation, and effectively developed proved reserves. Under the high oil price environment, the company actively developed low yield reverves and improved the quality and efficiency of new capacity construction 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 of mature blocks, continually improving recovery rate in mature blocks. In 2005, 2,348 development wells were drilled with total drilling footage of 5,109 kilometers, and new capacities totaling 5.79 million tonnes per annum and 2.1 billion cubic meters per annum. In 2005, the Company's production of crude oil and natural gas reached 278.82 million barrels and 221.9 billion cubic feet, respectively, representing an increase of 1.7% and 7.2%, respectively, compared with 2004.



Price Trend of International Crude Oil

Summary of Operations of the Exploration and Production Segment

	2005	2004	2003	Change from 2004 to 2005 (%)
Crude oil production (mmbbls)	278.82	274.15	270.96	1.70
Natural gas production (bcf)	221.9	207.0	187.7	7.20
Newly added proved reserves of crude oil (mmbbls)	306	284	208	7.75
Newly added proved reserves of natural gas (bcf)	140.6	352.0	(254.3)	(60.05)
Year-end proved reserves of crude oil (mmbbls)	3,294	3,267	3,257	0.83
Year-end proved reserves of natural gas (bcf)	2,951.7	3,033.0	2,887.6	(2.68)
Year-end proved reserves of crude oil and natural gas (mmboe)	3,786	3,773	3,738	0.34

Summary of Production and Operations of Shengli Oil Field

	2005	2004	2003	Change from 2004 to 2005 (%)
Crude oil production (mmbbls)	191.31	189.88	189.25	0.75
Natural gas production (bcf)	31.1	31.8	28.6	(2.20)
Newly added proved reserves of crude oil (mmbbls)	247	225	196	9.78
Newly added proved reserves of natural gas (bcf)	(3.6)	79.9	70.1	(104.51)
Year-end proved reserves of crude oil (mmbbls)	2,362	2,306	2,271	2.43
Year-end proved reserves of natural gas (bcf)	322.4	357.1	308.9	(9.72)
Year-end proved reserves of crude oil and natural gas (mmboe)	2,415	2,366	2,322	2.07

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 2005, the Company actively worked on full-load operations to meet market demand. Crude oil throughput reached 139.94 million tonnes, up by 5.26% compared with 2004. The Company endeavored to reduce crude oil purchase costs by optimising crude oil procurement, allocation and transportation efficiency, and by increasing the processing ratio of high sulphur and heavy crude oil. The Company strived to increase the sales volume of higher value-added products through optimised production plan and product mix. It intensified technical revamping of refining facilities and upgraded gasoline and diesel quality on schedule. The Company also improved its main technical and economic performance indicators in the refining segment by relying on strengthened management and advances in technologies. As a result, both light products yield and overall refining yield went up.

Sources of Crude oil

Unit: million tonnes

	2005	2004	2003	Change from 2004 to 2005 (%)
Self-supplied	28.62	28.14	28.20	1.71
PetroChina Company Ltd.	8.75	10.31	13.08	(15.13)
CNOOC Ltd.	5.05	6.69	5.57	(24.51)
Imported	99.13	89.03	71.14	11.34
Total	141.55	134.17	117.99	5.50

Summary of Production of the Refining Segment

	2005	2004	2003	Change from 2004 to 2005 (%)
Crude throughput (mbbls/day)	2,817.9	2,677.2	2,350.0	5.26
of which sour crude throughput (mbbls/day):	698.8	551.1	478.7	26.80
Refining utilisation rate (%)	94.01	93.43	88.10	0.58 percentage point
Gasoline, diesel and kerosene including jet fuel (million tonnes)	84.53	80.83	69.01	4.58
of which: Gasoline (million tonnes)	22.98	23.58	21.79	(2.54)
Diesel (million tonnes)	54.92	50.89	41.91	7.92
Kerosene including jet fuel (million tonnes)	6.63	6.36	5.31	4.25
Light chemical feedstock (million tonnes)	21.10	17.70	16.46	19.21
Light products yield (%)	74.16	74.02	73.80	0.14 percentage point
Overall refining yield (%)	93.24	93.09	92.63	0.15 percentage point

Note: (1) Crude oil processing volume is converted at 1 tonne to 7.35 barrels.

(2) The operational data for 2003 include operational results of Xi'an Petrochemical and Tahe Petrochemical.

(3) Marketing and distribution

In 2005, while maintaining full-load operations of its refining facilities to increase production of refined oil products, the Company increased procurement of refined oil products from other sources to meet the market demand. It also endeavored to reduce storage and transportation costs by fully leveraging its modern logistics systems and optimising resource allocation. It further expanded retail and direct sales by improving service-oriented awareness, service quality and standards as well as marketing structure . The sales of refined oil products for 2005 exceeded 100 million tonnes for the first time, representing a year on year increase of 10.54%, of which retail volume increased by 19.29%. The efficiency of petrol stations continued to improve with the annual throughput per petrol station exceeding 2,321 tonnes, up by 15.88% compared with 2004. Retail and direct sales volume of refined oil products accounted for 80.24% of the total domestic sales volume. In addition, the Company is actively marketing its petrol IC cards, which allows customers to use one single card at its petrol stations across the nation.

Summary of Operations of Marketing and Distribution Segment

	2005	2004	2003	Change from 2004 to 2005 (%)
Total domestic sales of refined oil products (million tonnes)	104.56	94.59	75.92	10.54
Of which: Retail volume (million tonnes)	63.52	53.25	38.85	19.29
Direct sales volume (million tonnes)	20.38	19.65	15.33	3.72
Wholesale volume (million tonnes)	20.66	21.69	21.74	(4.75)
Average annual throughput per petrol station (tonne/station)	2,321	2,003	1,686	15.88
Total number of petrol stations under SINOPEC brand	29,647	30,063	30,242	(1.38)
Of which: Number of COCO petrol stations	27,367	26,581	24,506	2.96
Number of franchised petrol stations	2,280	3,482	5,736	(34.52)
Retail volume/total domestic sales volume (%)	60.7	56.3	51.2	4.4 percentage points

(4) Chemicals

In 2005, the Company achieved safe, stable, sustained, full-load and optimal operation of its core facilities. The Company's two major ethylene joint ventures, Shanghai Secco and BASF-YPC, were put into commercial operation on schedule, and as a result, the Company's ethylene capacity significantly increased. The Company produced 5.319 million tonnes of ethylene in 2005, up by 30.56% from 2004. The Company proactively tried to improve its chemicals product mix with more higher value-added products, which allowed the Company to further increase its production of performance compound resins and differential fibres. The Company also established a specialised sales company for chemical products to enhance its overall competitiveness and gradually integrate or centralise its marketing strategies, market development, logistics, resource allocations, sales practices and branding.

Production of Major Chemicals

Unit: 1,000 tonnes

	2005	2004	2003	Change from 2004 to 2005 (%)
Ethylene	5,319	4,074	3,982	30.56
Synthetic resins	7,605	6,221	5,805	22.25
of which: performance compound resins	3,498	3,034	2,707	15.29
Synthetic rubbers	626	561	553	11.59
Monomers and polymers for synthetic fibres	6,725	6,021	5,633	11.69
Synthetic fibre,	1,570	1,654	1,659	(5.08)
of which: differential fibres	811	753	623	7.70
Urea	1,780	2,630	2,028	(32.32)

Note: (1) The operational data for 2003 and 2004 include the production of Maoming Ethylene, and, also that of various chemical assets acquired from Sinopec Group in 2004.

(2) The operational data for 2005 include the production of the two joint venture ethylene facilities, Shanghai Secco and BASF-YPC.

(5) Research and development

In 2005, the Company adhered to the application of research and engineering design into production, focused on technological innovation and development of key technologies, achieved a string of important scientific and technological results and obtained 706 domestic and international patents. The technologies in non-crystal state alloy catalyst and stable magnetic bed reactor were used for commercial application for the first time in the world, generating significant economic benefits due to its lower catalyst consumption. With greater air velocity ratio, which is 5 to 10 times of that of the traditional reactor bed. Its catalyst consumption only accounts for 30% of the amount consumed with traditional technologies. The technology was the only grand prize awarded by the National Technology Invention Prizes in 2005. Another ten technologies including the geo-steering drilling technology, a new catalyst cracking process which can increase production of propylene while reducing olefin content in gasoline, and a 200,000 tonne per annum EB/styrene, were successfully developed and put into commercial application. Breakthroughs were made in researches over 20 technologies, including technologies in the field of oil reserve geophysics. A series of technologies, including a catalytic cracking technology to maximise isoalkane production, and aromatics extraction technology, were applied extensively, generating meaningful economic benefits.

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 2005, the Company took various measures to reduce cost, such as reducing transportation costs by optimising resource allocation and leveraging on existing logistics system, reducing crude procurement cost by further increasing the processing volume of sour and heavy crude oil and reducing consumption of energy and materials in the production process by optimising operation of the facilities. In 2005, the Company effectively saved RMB 2.762 billion in cost, which exceeded the original target of RMB 2.5 billion by RMB 262 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 638 million, RMB 706 million, RMB 712 million, and RMB 706 million, respectively.

(7) Capital expenditure

In 2005, the Company adjusted and optimised its investment allocation in line with its development strategy and core businesses based on market conditions, and worked for better organisation and implementation of major projects. The total capital expenditure in 2005 was RMB 58.726 billion. Among which, the expenditure for exploration and production segment was RMB 23.095 billion. With the investment, significant amount of oil and gas reserves were discovered in some major exploratory areas, including Jiyang Depression, Tahe and northeast Sichuan. Newly built crude oil and gas production capacity increased by 5.79 million tonnes per annum and 2.1 billion cubic meters per annum respectively. The newly built proved crude oil reserves reached 305.62 million barrels and realised increases in both oil and gas reserves and production. The expenditure for refining segment was RMB 14.127 billion. With the investment, newly added crude oil processing capacity, hydro-fining capacity and coking capacity increased by 6.7 million tonnes per annum, 3.73 million tonnes per annum and 2.8 million tonnes per annum, respectively; the revamping of facilities for upgrading refined oil product quality was completed on schedule and Ningbo-Shanghai-Nanjing pipeline for imported crude oil was completed and put into operation. The expenditure for marketing and distribution segment was RMB 10.954 billion. With the investment, the Southwest refined oil pipeline was fully completed and put into operation, the refined oil products sales network further improved by way of construction, acquisition and renovation of petrol stations. The Company's leading position in the strategic market was further solidified, with a net increase of 786 self-operated petrol stations. The expenditure for chemicals segment was RMB 9.386 billion. With the investment, Maoming Ethylene expansion project, PTA revamping project at Shanghai Petrochemical and Yangzi Petrochemical progressed smoothly, the coal gasification projects for fertiliser production was on schedule. The expenditure for corporate and others was RMB 1.164 billion. With the investment, construction of the information technology systems made new progresses.

In addition, the Company's two large joint ventures, Shanghai Secco and BASF-YPC, with a total capital expenditure of RMB 2.602 billion, were successfully put into commercial operation.

BUSINESS PROSPECT

1 Market Outlook

Looking forward for 2006, China's economy is expected to maintain a stable and rapid growth, which would help sustain a stable growth of domestic demand for oil and petrochemical products, providing good market conditions for the Company. The international crude oil prices are expected to continue to maintain at a high price level. The domestic prices of refined oil products are expected to gradually reflect the international prices following the integrated reform of crude oil pricing mechanism, but currently the refining segment would likely to continue facing challenges. While the prices for chemicals are expected to continue to stay at relatively high level, but due to the expected increase of feedstock cost, the gross profit margin for chemicals segment may experience further decline. Meanwhile, with the opening of the domestic wholesale market of refined oil products, competitions in domestic refined oil products market may be stronger.

2 Production and Operation

Faced with the complicated market environment in 2006, the Company intends to adopt flexible operating strategies and focus on the following areas:

Exploration and production segment: The Company will make further efforts to develop economic reserves, complement the construction of production capacity in new blocks and accelerate construction of natural gas production capacity, trial production and marketing to ensure stable growth of oil and gas production and to improve the recovery rate and commodity rate of oil and gas as well as total production and economic benefits. The

Company plans to produce 39.8 million tonnes of crude oil and 7 billion cubic meters of natural gas in 2006.

Refining segment: The Company intends to optimise the existing systems while increasing throughput of sour and heavy oil to reduce crude oil costs. It intends to more efficiently utilise the capacity of large wharfs, ports and pipeline transportation to reduce transportation costs. It intends to optimise the processing plans of each refinery to strive for more flexible adjustment of processing volume in line with the demand of each regional market and the overall situations of crude supply and demand, while endeavoring to adjust product mix and increase production of higher value-added products. The Company plans to process 146 million tonnes of crude oil in 2006.

Marketing and distribution segment: The Company intends to better deploy its marketing networks to improve service quality and increase the percentage of retail and direct sales. Moreover, it intends to better deploy its refined oil product pipelines to reduce storage and transportation costs. The Company plans to have a total sales volume of refined oil products of 110 million tonnes, including a retail sales volume of 66.2 million tonnes.

Chemicals segment: The Company intends to strengthen its management to ensure safe, stable and high load operation of its chemical facilities, and intends to produce more higher value-added products. Priority will be given to test run and commercial operation of those revamping facilities including Maoming Ethylene revamping. It intends to fully leverage on the strengths of its chemicals sales subsidiary to improve competitiveness by optimising operational process, improving sales networks and solidifying the linkage between production and sales. In 2006, the Company plans to produce 5.92 million tonnes of ethylene, 8.15 million tonnes of synthetic resins, 0.6 million tonnes of synthetic rubbers, 1.53 million tonnes of synthetic fibers and 7.14 million tonnes of synthetic fiber monomers and polymers.

Research and development: In line with the needs of production and development, the Company intends to further refine exploration technologies for uncovering operational process oil and gas in the mature blocks in eastern China, strengthen its research over key technologies, and accelerate theoretical innovation as well as key technological innovation in marine facies oil and gas exploration in western China. The Company also intends to intensify its efforts in technologies for enhancing the quality of gasoline and diesel and production technologies for increasing higher value-added new chemical products, while accelerating application of technological achievements and providing technical support for improving the Company's core competitiveness.

Cost saving: In 2005, the Company intends to rely on scientific and technological advancement and reinforced management practices to deepen reforms and enhance operating efficiency. It plans to achieve a cost saving of RMB 2.5 billion, among which exploration and production segment plans to achieve a cost saving of RMB 600 million, refining segment RMB 600 million, chemicals segment RMB 700 million, and marketing and distribution segment RMB 600 million.

Capital expenditure: The Company's planned capital expenditure is RMB 70 billion for 2006. The projected expenditure for exploration and production segment is RMB 29.8 billion, for refining segment is RMB 14.6 billion, for chemicals segment is RMB 12.5 billion, for marketing and distribution segment is RMB 11 billion and for corporate and others is RMB 2.1 billion. The capital expenditure will be primarily invested in the following activities within each of the various segments: in the exploration and production segment, the Company will continue to pursue the principle of "coordination of reserves, production, investment and returns", under which the concept of oil reserve management will be strengthened, construction of oil and gas production capacity in western China and development of Puguang Gas Field in northeastern Sichuan will be accelerated. The Company will also endeavor to enhance overall deployment of its production capacity, increase the production in low-yield reserves and maintain a positive balance between the production and newly found reserves. In the refining segment, the Company will continue to refine and accelerate construction of crude oil pipeline and related receiving and unloading facilities, ensure the smooth progress of the revamping efforts at refining facilities in Guangzhou, Yanshan and other areas aimed at upgrading oil product quality, and push forward Qingdao oil refining project and Fujian integrated project. In the chemicals segment, the Company will focus on the successful commencement of operation of the revamped facilities at Maoming Ethylene, the PX and PTA facilities at Yangzi Petrochemical and three fertiliser facilities, and the orderly commencement of construction of the ethylene facilities at Fujian, Tianjin and Zhenhai. In the marketing and distribution segment, the Company will continue to optimise and adjust the sales network, accelerate construction of refined oil product pipelines, and construct more petrol stations in central cities, new urban districts and along expressways.

Employee reduction: The Company plans to reduce its number of employee by over 6,000 employees in 2006 so that the total number of employee will be controlled at approximately 358,500 as of the end of 2006, which would make the total employees reduction exceed 150,000 since the establishment of the Company.

In 2006, the Company will strive to overcome various difficulties and meet operational objectives of 2006 in line with the operating policies set forth by the Board of Directors, and will endeavor to set new records, deliver sound performances in its business operations and maintain sustainable development.