PETROCHINA CO LTD
Form 20-F
June 20, 2006

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 20-F
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2005
Commission File Number 1-15006

(Exact name of Registrant as specified in its charter)
PetroChina Company Limited
(Translation of Registrant s name into English)

The People s Republic of China
(Jurisdiction of incorporation or organization)

16 Andelu
Dongcheng District, Beijing, 100011
The People s Republic of China
(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Title of Each class	Name of each exchange on which registered
American Depositary Shares, each representing 100 H Shares, par value RMB 1.00 per share*	New York Stock Exchange, Inc.
H Shares, par value RMB 1.00 per share	New York Stock Exchange, Inc.**

Securities registered or to be registered pursuant to Section 12(g) of the Act.
None
(Title of Class)
Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.
None
(Title of Class)
Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report:

State-owned shares, par value RMB 1.00 per share	157,922,077,818
H Shares, par value RMB 1.00 per share	21,098,900,000***

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes x No o

If this is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes o No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) or the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-acceleranted filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (Check one):

Large Accelerated Filer x Accelerated Filer o Non-Accelerated Filer o

Indicate by check mark which financial statement item the Registrant has elected to follow.

Item 17 o Item 18 x

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

* PetroChina s H Shares are listed and traded on The Stock Exchange of Hong Kong Limited.

** Not for trading, but only in connection with the registration of American Depository Shares.

*** Include 3,123,514,900 H Shares represented by American Depositary Shares.

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CERTAIN TERMS AND CONVENTIONS

Conventions Which Apply to this Annual Report

Unless the context otherwise requires, references in this annual report to:

CNPC or CNPC group are to our parent, China National Petroleum Corporation and its affiliates and subsidiaries, excluding PetroChina, its subsidiaries and its interests in long-term investments, and where the context refers to any time prior to the establishment of CNPC, those entities and businesses which were contributed to CNPC upon its establishment.

PetroChina , we , our , our company and us are to:

PetroChina Company Limited, a joint stock company incorporated in the People s Republic of China with limited liability and its subsidiaries and branch companies, or

the CNPC group s domestic crude oil and natural gas exploration and production, refining and marketing, chemicals and natural gas businesses that were transferred to us in the restructuring of the CNPC group in 1999.

PRC or China are to the People s Republic of China, but do not apply to Hong Kong, Macau or Taiwan for purposes of this annual report.

We publish our consolidated financial statements in Renminbi. The audited consolidated financial statements included in this annual report have been prepared as if the operations and businesses transferred to us from CNPC were transferred as of the earliest period presented or from the date of establishment of the relevant unit, whichever is later, and conducted by us throughout the period. In this annual report, IFRS refers to International Financial Reporting Standards.

Conversion Table

1 barrel-of-oil equivalent	= 1 barrel of crude oil	= 6,000 cubic feet of natural gas
1 cubic meter	= 35.315 cubic feet	
1 ton of crude oil	= 1 metric ton of crude oil	= 7.389 barrels of crude oil (assuming an API gravity of 34 degrees)

Certain Oil and Gas Terms

Unless the context indicates otherwise, the following terms have the meanings shown below:

acreage	The total area, expressed in acres, over which an entity has interests in exploration or production. Net acreage is the entity s interest, expressed in acres, in the relevant exploration or production area.
API gravity	An indication of the density of crude oil or other liquid hydrocarbons as measured by a system recommended by the American Petroleum Institute (API), measured in degrees. The lower the API gravity, the heavier the compound.
condensate	Light hydrocarbon substances produced with natural gas that condense into liquid at normal temperatures and pressures associated with surface production equipment.
crude oil	Crude oil, including condensate and natural gas liquids.

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development cost	For a given period, costs incurred to obtain access to proved reserves and to provide facilities for extracting, treating, gathering and storing the oil and gas.
finding cost	For a given period, costs incurred in identifying areas that may warrant examination and in examining specific areas that are considered to have prospects of containing oil and gas reserves, including costs of drilling exploratory wells and exploratory-type stratigraphic test wells. Finding cost is also known as exploration cost.
lifting cost	For a given period, costs incurred to operate and maintain wells and related equipment and facilities, including applicable operating costs of support equipment and facilities and other costs of operating and maintaining those wells and related equipment and facilities. Lifting cost is also known as production cost.
natural gas liquids	Hydrocarbons that can be extracted in liquid form together with natural gas production. Ethane and pentanes are the predominant components, with other heavier hydrocarbons also present in limited quantities.
offshore	Areas under water with a depth of five meters or greater.
onshore	Areas of land and areas under water with a depth of less than five meters.
primary distillation capacity	At a given point in time, the maximum volume of crude oil a refinery is able to process in its basic distilling units.
proved developed reserves	Reserves that can be expected to be recovered through existing wells with existing equipment and operating methods. Additional oil and gas expected to be obtained through the application of fluid injection or other improved recovery techniques for supplementing the natural forces and mechanisms of primary recovery are included as proved developed reserves only after testing by a pilot project or after the operation of an installed program has confirmed through production response that increased recovery will be achieved.
proved reserves	Estimated quantities of crude oil and natural gas which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions, i.e., prices and costs as of the date the estimate is made. Prices include consideration of changes in existing prices provided only by contractual arrangements, but not of escalations based upon future conditions.
proved undeveloped reserves	Reserves that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion. Reserves on undrilled acreage shall be limited to those drilling units offsetting productive units that are reasonably certain of production when drilled. Proved reserves for other undrilled units can be claimed only where it can be demonstrated with certainty that there is

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	continuity of production from the existing productive formation. Under no circumstances should estimates for proved undeveloped reserves be attributable to any acreage for which an application of fluid injection or other improved recovery technique is contemplated, unless such techniques have been proved effective by actual tests in the area and in the same reservoir.
reserve-to-production ratio	For any given well, field or country, the ratio of proved reserves to annual production of crude oil or, with respect to natural gas, to wellhead production excluding flared gas.
sales gas	Marketable production of gas on an as sold basis, excluding flared gas, injected gas and gas consumed in operations.
water cut	For a given oil region, the percentage that water constitutes of all fluids extracted from all wells in that region.

References to:

BOE is to barrels-of-oil equivalent,

Mcf is to thousand cubic feet, and

Bcf is to billion cubic feet.

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FORWARD-LOOKING STATEMENTS

This annual report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities and Exchange Act of 1934, as amended. These forward-looking statements are, by their nature, subject to significant risks and uncertainties. These forward-looking statements include, without limitation, statements relating to:

the amounts and nature of future exploration, development and other capital expenditures;

future prices and demand for crude oil, natural gas, refined products and chemical products;

development projects;

exploration prospects;

reserves potential;

production of oil and gas and refined and chemical products;

development and drilling potential;

expansion and other development trends of the oil and gas industry;

the planned development of our natural gas operations;

the planned expansion of our refined product marketing network;

the planned expansion of our natural gas infrastructure;

the anticipated benefit from our proposed acquisition of certain overseas assets from CNPC, our parent company;

the plan to continue to pursue attractive business opportunities outside China;

our future overall business development and economic performance;

our anticipated financial and operating information regarding, and the future development and economic performance of, our business;

our anticipated market risk exposure arising from future changes in interest rates, foreign exchange rates and commodity prices; and

other prospects of our business and operations.

The words anticipate , believe , could , estimate , expect , intend , may , plan , seek , will and wou expressions, as they related to us, are intended to identify a number of these forward-looking statements.

By their nature, forward-looking statements involve risks and uncertainties because they relate to events and depend on circumstances that will occur in the future and are beyond our control. The forward-looking statements reflect our current views with respect to future events and are not a guarantee of future performance. Actual results may differ materially from information contained in the forward-looking statements as a result of a number of factors, including, without limitation, the risk factors set forth in this annual report and the following:

fluctuations in crude oil and natural gas prices;

failure to achieve continued exploration success;

failures or delays in achieving production from development projects;

continued availability of capital and financing;

acquisitions and other business opportunities that we may pursue;

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general economic, market and business conditions, including volatility in interest rates, changes in foreign exchange rates and volatility in commodity markets;

liability for remedial actions under environmental regulations;

impact of the PRC s entry into the World Trade Organization;

the actions of competitors;

wars and acts of terrorism or sabotage;

changes in policies, laws or regulations of the PRC;

the other changes in global economic and political conditions affecting the production, supply and demand and pricing of crude oil, refined products, petrochemical products and natural gas; and

the other risk factors discussed in this annual report, and other factors beyond our control.

You should not place undue reliance on any forward-looking statement.

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PART I

ITEM 1 IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

Not applicable. However, see Item 6 Directors, Senior Management and Employees Directors, Senior Management and Supervisors.

ITEM 2 OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3 KEY INFORMATION

Exchange Rates

The noon buying rate in New York City for cable transfers as certified for customs purposes by the Federal Reserve Bank of New York was US$1.00=RMB 7.9990 on June 15, 2006. The following table sets forth the high and low noon buying rates between Renminbi and U.S. dollars for each month during the previous six months:

	Noon buying rate	
	High	Low
	(RMB per US$)	
December 2005	8.0808	8.0702
January 2006	8.0702	8.0596
February 2006	8.0616	8.0415
March 2006	8.0505	8.0167
April 2006	8.0248	8.0040
May 2006	8.0300	8.0005
June 2006 (through June 15)	8.0225	7.9985

The following table sets forth the average noon buying rates between Renminbi and U.S. dollars for each of 2001, 2002, 2003, 2004 and 2005, calculated by averaging the noon buying rates on the last day of each month during the relevant year:

	Average noon buying rate
	(RMB per US$)
2001	8.2770
2002	8.2772
2003	8.2772
2004	8.2768
2005	8.1826

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Selected Financial Data

Historical Financial Information

You should read the selected historical financial data set forth below in conjunction with the consolidated financial statements of PetroChina and their notes and Item 5 Operating and Financial Review and Prospects included elsewhere in this annual report. In 2005, we retroactively restated our prior years consolidated financial statements to reflect the effect as if the refinery and petrochemical operations of Ningxia Dayuan Refinery and Petrochemical Company Limited (Dayuan), Qingyang Refinery and Petrochemical Company Limited (Qingyang) we acquired from CNPC, and the operations of Zhong You Kan Tan Kai Fa Company Limited (Newco), of which we acquired 50% interests and maintain effective control, from China National Oil and Gas Exploration and Development Corporation (CNODC , a wholly-owned subsidiary of CNPC) and its subsidiaries, had always been combined since inception as a result of the application of the accounting treatment to the acquisition discussed below. The selected historical income statement and cashflow data for the years ended December 31, 2003, 2004 and 2005 and the selected historical balance sheet data as of December 31, 2004 and 2005 set forth below are derived from our audited consolidated financial statements included elsewhere in this annual report. The selected historical income statement data and cashflow data for the years ended December 31, 2001 and 2002 and the selected historical balance sheet data as of December 31, 2001, 2002 and 2003 set forth below are derived from our unaudited financial statements, not included in this annual report. The financial information included in this section may not necessarily reflect our results of operations, financial position and cash flows in the future.

We have prepared our consolidated financial statements in accordance with IFRS. IFRS differ materially from the generally accepted accounting principals in the U.S., or US GAAP. For a discussion of significant differences between IFRS and US GAAP, see Note 37 to our consolidated financial statements included elsewhere in this annual report and Item 5 Operating and Financial Review and Prospects Other Information US GAAP Reconciliation .

Pursuant to an acquisition agreement by and between our company and CNPC dated March 28, 2005, we acquired the refinery and petrochemical operations respectively owned by CNPC s wholly-owned subsidiaries, Dayuan and Qingyang, from CNPC for which we paid a cash consideration of RMB 9 million.

The acquisition is deemed a combination of entities under common control since we and the refinery and petrochemical operations of Dayuan and Qingyang are under the common control of CNPC. As a result, we have accounted for the acquisition in a manner similar to a uniting of interests, whereby the assets and liabilities of the refinery and petrochemical operations acquired are accounted for at historical cost to CNPC with net liabilities of RMB183 million as at the effective date. Our prior years consolidated financial statements were restated to give effect to the acquisition in these periods as if the operations of our company and these operations had always been combined in these periods. The difference between the RMB 9 million acquisition price and the net liabilities transferred from CNPC was adjusted against equity.

In August 2005, the shareholders of our company approved the acquisition and transfer agreements relating to our acquisition of a 50% interest of Newco. Newco was established 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 we contributed to Newco our wholly-owned subsidiary, PetroChina International Limited (PTRI), and cash in the amount of approximately RMB20,162 million, which is the difference between the cash contribution of RMB20,741 million payable by us according to the acquisition agreement and the cash consideration of RMB579 million for PTRI receivable by us.

Pursuant to the relevant equity transfer agreement, we shall have the right to appoint four of the seven directors of Newco, which will enable us to maintain effective control over Newco.

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Similar to the accounting method applied in the treatment of the refinery and petrochemical operations acquired by us, our investment in Newco and related acquisition transactions will be accounted for in a manner similar to a uniting of interests since these transactions are among entities under the common control of CNPC. Our prior years consolidated financial statements were restated as if the operations of our company and these operations had always been combined in these periods. The difference between our cash payment of RMB 20,162 million and the net assets of Newco, in an amount of RMB 35,551 million as at the effective date of the purchase and transfer agreement (inclusive of RMB 20,162 million contributed by us and RMB 50 million contributed by CNODC and its subsidiaries as registered capital of Newco), was adjusted against equity as the amount of RMB 20,162 million was paid directly to Newco.

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	Year ended December 31,				
	2001(1)	2002(1)	2003(2)	2004(2)	2005
	RMB	RMB	RMB	RMB	RMB
	(in millions, except for per share and per ADS data)				
Income Statement Data					
IFRS					
Revenues					
Sales and other operating revenues	245,536	249,386	310,431	397,354	552,229
Operating expenses					
Purchases, services and other	(78,737)	(71,383)	(89,741)	(114,249)	(200,321)
Employee compensation costs	(14,833)	(16,665)	(20,044)	(22,934)	(29,675)
Exploration expenses, including exploratory dry holes	(7,361)	(8,203)	(10,624)	(12,090)	(15,566)
Depreciation, depletion and amortization	(34,139)	(37,680)	(42,163)	(48,362)	(51,305)
Selling, general and administrative expenses	(22,765)	(23,930)	(25,982)	(28,302)	(36,538)
Employee separation costs and shutting down of manufacturing assets	(487)	(2,121)	(2,355)	(220)	
Taxes other than income taxes	(14,401)	(15,366)	(16,821)	(19,943)	(23,616)
Revaluation loss of property, plant and equipment			(391)		
Other expenses, net	(32)	(59)	(598)	(116)	(3,037)
Total operating expenses	(172,755)	(175,407)	(208,719)	(246,216)	(360,058)
Income from operations	72,781	73,979	101,712	151,138	192,171
Income from equity affiliates	247	169	933	1,621	2,401
Exchange gain (loss), net	233	(430)	(36)	8	88
Interest income	873	663	973	1,373	1,924
Interest expense	(5,104)	(4,068)	(2,889)	(2,896)	(2,762)
Income before taxes	69,030	70,313	100,693	151,244	193,822
Income taxes	(23,617)	(22,939)	(28,796)	(43,598)	(54,180)
Income for this year	45,413	47,374	71,897	107,646	139,642
Attributable to:					
Shareholders	45,431	46,766	69,835	103,843	133,362
Minority shareholders	(18)	608	2,062	3,803	6,280
	45,413	47,374	71,897	107,646	139,642

Basic and diluted net income per share					
Attributable to shareholders for this year(3)	0.26	0.27	0.40	0.59	0.75
Basic and diluted net income per ADS(4)	25.84	26.60	39.72	59.06	75.44
US GAAP					
Net income	50,895	49,693	75,640	109,051	137,865
Basic and diluted net income per share(3)	0.29	0.28	0.43	0.62	0.78
Basic and diluted net income per ADS(4)	28.95	28.26	43.02	62.02	77.99

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	As of December 31,				
	2001[(1)]	2002[(1)]	2003[(1)]	2004[(2)]	2005
	RMB	RMB	RMB	RMB	RMB
	(in millions, except for per share and per ADS data)				
Balance Sheet Data					
IFRS					
Assets					
Current assets					
Cash and cash equivalents	20,252	19,532	11,613	11,688	80,905
Time deposits mature after three months but within 12 months	3,262	2,621	2,648	1,425	1,691
Investments in collateralized loans	2,636	420	24,224	33,217	235
Accounts receivable	8,265	6,544	4,115	3,842	4,630
Inventories, at net book value	29,117	29,352	30,064	47,377	62,733
Prepaid expenses and other current assets	25,030	19,618	18,845	24,704	25,701
Total current assets	88,562	78,087	91,509	122,253	175,895
Non-current assets					
Property, plant and equipment, less accumulated depreciation, depletion and amortization	372,369	404,135	442,311	485,612	563,890
Long-term investments, at net book value	5,872	6,055	9,405	11,504	13,608
Prepaid operating lease rentals	5,404	6,267	7,286	12,307	16,235
Intangible and other assets	2,379	2,769	3,027	3,020	5,011
Time deposits mature after one year	2,980	3,498	3,485	3,751	3,428
Total non-current assets	389,004	422,724	465,514	516,194	602,172
Total assets	477,566	500,811	557,023	638,447	778,067
Liabilities and shareholders equity					
Current liabilities					
Short-term debt	28,011	23,185	34,328	34,937	28,689
Accounts payable and accrued liabilities	54,888	59,950	66,700	73,072	99,758
Income tax payable	5,676	5,581	12,068	17,484	20,567
Other taxes payable	8,895	5,767	9,251	5,032	4,824
Total current liabilities	97,470	94,483	122,347	130,525	153,838
Non-current liabilities					
Long-term debt	72,042	68,894	51,601	44,648	44,570

Other long-term obligations	1,402	1,707	2,010	2,481	1,046
Assets disposal obligations	544	585	735	919	14,187
Deferred taxes	7,698	10,832	13,436	16,902	20,759
Total non-current liabilities	81,686	82,018	67,782	64,950	80,562
Total liabilities	179,156	176,501	190,129	195,475	234,400
Equity					
Shareholder s equity					
Share capital	175,824	175,824	175,824	175,824	179,021
Retained income	34,105	57,358	88,152	143,115	203,812
Reserves	81,835	84,456	93,952	108,834	132,556
	291,764	317,638	357,928	427,773	515,389
Minority interest	6,646	6,672	8,966	15,199	28,278
Total equity	298,410	324,310	366,894	442,972	543,667
Total liabilities and equity	477,566	500,811	557,023	638,447	778,067
Share capital, issued and outstanding, RMB 1.00 par value					
State-owned shares	158,242	158,242	158,242	158,242	157,922
H shares and ADSs	17,582	17,582	17,582	17,582	21,099
US GAAP					
Property, plant and equipment, less accumulated depreciation, depletion and amortization	313,897	353,932	413,383	452,017	537,106
Total assets	431,511	457,065	528,685	605,018	752,663
Shareholders equity	253,071	284,426	330,520	405,573	499,130

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	As of December 31,				
	2001[(1)]	2002[(1)]	2003[(2)]	2004[(2)]	2005
	RMB	RMB	RMB (in millions)	RMB	RMB
Other Financial Data					
Dividend per share	0.12	0.12	0.18	0.26	0.34
Dividend per ADS	11.98	12.00	17.82	26.34	33.80
Capital expenditures	(62,092)	(75,496)	(86,373)	(98,946)	(124,801)
Cash Flow Data					
IFRS					
Net cash provided by operating activities	83,864	98,989	139,570	141,691	203,885
Net cash used for investing activities	(62,027)	(73,732)	(102,549)	(102,276)	(91,576)
Net cash used for financing activities	(28,817)	(26,488)	(35,593)	(39,586)	(42,634)

Notes:

(1) Certain financial data for these periods and as of these dates are derived from our unaudited consolidated financial statements, not included in this annual report, and were retroactively restated. See the paragraphs preceding these tables for a detailed description.

(2) Certain financial data for these periods and as of these dates are derived from our audited consolidated financial statements, not included in this annual report, and were retroactively restated. See the paragraphs preceding these tables for a detailed description.

(3) Historical income per share for the years ended December 31, 2001, 2002, 2003 and 2004 has been calculated by dividing the net profit by the number of 175,824 million shares issued and outstanding for the periods presented. Historical income per share for the year ended December 31, 2005 has been calculated by dividing the net profit by the weighted average number of 176,770 million shares issued and outstanding for the period presented.

(4) Historical income per ADS for the years ended December 31, 2001, 2002, 2003 and 2004 has been calculated by dividing the net profit by the number of 175,824 million shares issued and outstanding for the periods presented, assuming each ADS represents 100 H shares. Historical income per ADS for the year ended December 31, 2005 has been calculated by dividing the net profit by the weighted average number of 176,770 million shares issued and outstanding for the period presented, assuming each ADS represents 100 H shares.

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Risk Factors

Our business is subject to various changing competitive, economic and social conditions in the PRC. Such changing conditions entail certain risks, which are described below.

Our operations are affected by the volatility of prices for crude oil and refined products. We and China Petroleum and Chemical Corporation, or Sinopec, set our crude oil median prices monthly based on the Singapore trading prices for crude oil. The PRC government publishes the retail median guidance prices for gasoline and diesel based on the FOB Singapore, Rotterdam and New York gasoline and diesel trading prices. Historically, international prices for crude oil and refined products have fluctuated widely in response to changes in many factors, such as global and regional economic and political developments and global and regional supply and demand for crude oil and refined products. We do not have, and will not have, control over the factors affecting international prices for crude oil and refined products. A decline in crude oil prices will reduce our crude oil revenues derived from external customers. If crude oil prices remain at a low level for a prolonged period, our company has to determine and estimate whether our oil and gas assets may suffer impairment losses and, if so, the amount of the impairment losses. An increase in crude oil prices may, however, increase the production costs of refined products. In addition, a decline in refined products prices will reduce our revenue derived from refining operations. An increase in the refined products prices, however, will increase the production costs of chemical products which use refined products as raw materials.

The crude oil and natural gas reserve data in this annual report are only estimates. The reliability of reserve estimates depend on a number of factors, assumptions and variables, such as the quality and quantity of our technical and economic data and the prevailing oil and gas prices applicable to our production, many of which are beyond our control and may prove to be incorrect over time. Results of drilling, testing and production after the date of the estimates may require substantial upward or downward revisions in our reserve data. Our actual production, revenues and expenditures with respect to our reserves may differ materially from these estimates because of these revisions.

Our proved crude oil reserves decreased gradually and modestly from 2001 to 2003 because the decrease in the crude oil reserves in our Daqing and Liaohe oil regions could not be offset by the increase in the crude oil reserves in our oil regions in northwestern China, such as the Xinjiang oil region, the Changqing oil and gas region and the Tarim oil region. Although our proved crude oil reserves increased slightly in 2004 mainly as a result of the increases in the crude oil reserves in our Xinjiang and Changqing oil regions, we cannot assure you that we will be able to increase or maintain our crude oil reserves in the future by our exploration activities in China. We are actively pursuing business opportunities outside China to supplement our domestic resources. For instance, 2005, we acquired certain overseas crude oil and natural gas assets from CNPC. We cannot assure you, however, that we can successfully locate sufficient alternative sources of crude oil supply or at all due to the complexity of the international political, economic and other conditions. If we fail to obtain sufficient alternative sources of crude oil supply, our results of operations and financial condition may be materially and adversely affected.

The United States Securities and Exchange Commission, as required by Section 404 of the Sarbanes-Oxley Act of 2002, adopted rules requiring every public company in the United States to include a management report on such company s internal controls over financial reporting in its annual report, which contains management s assessment of the effectiveness of the company s internal controls over financial reporting. In addition, an independent registered public accounting firm must attest to and report on management s assessment of the effectiveness of the company s internal controls over financial reporting. These requirements first apply to our annual report on Form 20-F for the fiscal year ending December 31,

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2006. Our management may conclude that our internal controls over our financial reporting are not effective. Moreover, even if our management concludes that our internal controls over financial reporting are effective, our independent registered public accounting firm may still be unable to attest to our management s assessment or may issue a report that concludes that our internal controls over financial reporting are not effective. In preparation for the implementation of the requirements of Section 404, we have contributed substantial financial resources and management s time and other resources to undertake company-wide documentation of internal controls, perform the system and process evaluation and test required. During the course of our evaluation, documentation and attestation, we have identified as of the date hereof certain deficiencies that could adversely affect our ability to record, process, summarize and report financial data consistent with our management s assertions in our financial statements. Although we have planned to commence remedial measures to make necessary improvements, we cannot assure you that we will be able to remedy those identified deficiencies in time to meet the deadline imposed by the Sarbanes-Oxley Act for compliance with the requirements of Section 404. We are also in the process of conducting further evaluation of our internal control over financial reporting and may identify other deficiencies that we may not be able to remedy in time by the deadline for compliance with Section 404. If we fail to achieve and maintain the adequacy of our internal controls, we may not be able to conclude that we have effective internal controls, on an ongoing basis, over financial reporting in accordance with the Sarbanes-Oxley Act. Moreover, effective internal controls are necessary for us to produce reliable financial reports and are important to prevent fraud. As a result, our failure to achieve and maintain effective internal controls over financial reporting could result in the loss of investor confidence in the reliability of our financial statements, which in turn could harm our business and negatively impact the trading prices of our ADSs or H shares.

Exploring for, producing and transporting crude oil and natural gas and producing and transporting refined products and chemical products involve many hazards. These hazards may result in:

- fires;
- explosions;
- spills;
- blow-outs; and
- other unexpected or dangerous conditions causing personal injuries or death, property damage, environmental damage and interruption of operations.

Some of our oil and natural gas fields are surrounded by residential areas or located in areas where natural disasters, such as earthquakes, floods and sandstorms, tend to occur more frequently than in other areas. As with many other companies around the world that conduct similar businesses, we have experienced accidents that have caused property damage and personal injuries and death.

Significant operating hazards and natural disasters may cause partial interruptions to our operations and property and environmental damage that could have an adverse impact on our financial condition. On November 13, 2005, an explosion occurred at a dianil plant of Jilin Petrochemical Company, our branch company in Jilin Province. The incident caused serious personal injuries and deaths, loss of property and water pollution of the Songhuajing River. The Chinese government is currently investigating the cause of this incident and we will, in accordance with the result of such investigation, take responsibility for this incident. We cannot assure you that the result of such investigation will not have a material adverse effect on our financial condition or results of operations.

Except for limited insurance coverage for vehicles and certain assets that we consider to be subject to significant operating risks, we do not carry any other insurance for our property, facilities or equipment in respect of our business operations. We do not currently carry any third party liability insurance against claims relating to personal injury or death, property or environmental damage arising from accidents on our property or relating to our operations. We also do not currently carry any business interruption insurance. The limited insurance coverage of our assets exposes us to substantial risks and will not cover most losses.

CNPC owns approximately 88.21% of our share capital. This ownership percentage enables CNPC to elect our entire board of directors without the concurrence of any of our other shareholders. Accordingly, CNPC is in a position to:

- control our policies, management and affairs;
- subject to applicable PRC laws and regulations and provisions of our articles of association, determine the timing and amount of dividend payments and adopt amendments to certain of the provisions of our articles of association; and
- otherwise determine the outcome of most corporate actions and, subject to the requirements of the Listing Rules of the Hong Kong Stock Exchange, cause our company to effect corporate transactions without the approval of minority shareholders.

CNPC s interests may sometimes conflict with those of some or all of our minority shareholders. We cannot assure you that CNPC, as controlling shareholder, will always vote its shares in a way that benefits our minority shareholders.

In addition to its relationship with us as our controlling shareholder, CNPC by itself or through its affiliates also provides us with certain services and products necessary for our business activities, such as construction and technical services, production services and supply of material services. The interests of CNPC and its affiliates as providers of these services and products to us may conflict with our interests. Although we have entered into a Comprehensive Products and Services Agreement with CNPC and our transactions with CNPC over the past three years have been conducted on open, fair and competitive commercial terms, we have only limited leverage in negotiating with CNPC and its affiliates over the specific terms of the agreements for the provision of these services and products.

The eastern and southern regions of China have a higher demand for refined products and chemical products than the western and northern regions. Most of our refineries and chemical plants are located in the western and northern regions of China. While we continue to expand the sales of these products in the eastern and southern regions of China, we face strong competition from Sinopec and China National Offshore Oil Corp, or CNOOC. In addition, we incur relatively higher transportation costs for delivery of our refined products and chemical products to certain areas of these regions from our refineries and chemical plants in western and northern China. As a result, we expect that we will continue to encounter difficulty in increasing our sales of refined products and chemical products in these regions.

We are currently constructing and renovating several natural gas pipelines and plan to construct and renovate other natural gas pipelines. In addition, we may, subject to obtaining requisite licenses from the relevant authority, commence offshore crude oil and natural gas exploration and production activities, which could require substantial capital expenditures and investments. We cannot assure you that the cash generated by our operations will be sufficient to fund these development plans or that our actual future capital expenditures and investments will not significantly exceed our current planned amounts. If either of these conditions arises, we may have to seek external financing to satisfy our capital needs. Under such circumstance, our inability to obtain sufficient funding for our development plans could adversely affect our business, financial condition and results of operations.

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We are also subject to a number of risks relating to the PRC and the PRC oil and gas industry. These risks are described as follows:

Our operations, like those of other PRC oil and gas companies, are subject to extensive regulations and control by the PRC government. These regulations and control affect many material aspects of our operations, such as exploration and production licensing, industry-specific and product-specific taxes and fees and environmental and safety standards. As a result, we may face significant constraints on our ability to implement our business strategies, to develop or expand our business operations or to maximize our profitability. Our business may also be adversely affected by future changes in certain policies of the PRC government with respect to the oil and gas industry.

Currently, the PRC government must approve the construction and major renovation of significant refining and petrochemical facilities as well as the construction of significant natural gas and refined product pipelines and storage facilities. We presently have several significant projects pending approval from the relevant government authorities and will need approvals from the relevant government authorities in connection with several other significant projects. We do not have control over the timing and outcome of the final project approvals.

We receive most of our revenues in Renminbi. A portion of our Renminbi revenues must be converted into other currencies to meet our foreign currency obligations. The existing foreign exchange limitations under the PRC laws and regulations could affect our ability to obtain foreign exchange through debt financing, or to obtain foreign exchange for capital expenditures.

Prior to 2005, our company performed capping or plugging on wellheads and surface facilities that could be salvaged for alternative use. For safety reasons, our company also performed capping or plugging on certain wells that were considered to be in areas with extensive human use at the time of the abandonment. Our company, however, did not perform capping or plugging on wells that were neither considered to be in areas with extensive human use nor could be salvaged for alternative use. Consequently, such wellheads and surface facilities were left at their original sites after the wells were retired.

The Environmental Protection Regulation for Oil and Gas Exploration and Production Activities in Heilongjiang Province and *the Environmental Protection Regulation for Oil and Gas Exploration and Production Activities in Gansu Province* were issued in mid and late 2005. Based on our reading of the new provincial regulations and in consultation with the environmental administrative authorities in Heilongjiang and Gansu provinces, we believe that such regulations only apply to the oil and gas properties retired after these regulations were issued in 2005. Accordingly, our company established standard abandonment procedures, requesting that all of its branch and subsidiary companies recognize asset retirement provisions for their currently used oil and gas properties.

Our company believes it had no obligation to adopt such abandonment procedures prior to the issuance of the new regulations in 2005. For the oil and gas properties that were retired prior to the issuance of such regulations, the activities required to retire these assets, at a level that would be in compliance with the regulations and our internal policy, have not been performed. The costs associated with these activities have not been included in the asset retirement obligations accrued during 2005. However, Heilongjiang Province and Gansu Province could enact new regulations, amend the current regulations or retroactively apply the relevant requirements. If any of these regulations is determined to be applicable to assets other than those that were retired subsequent to the dates that these regulations were issued in 2005, we could be required to incur substantial costs associated with such asset retirement obligations. In addition, we cannot assure you that the provincial governments other than Heilongjiang Province and Gansu Province will not

enact new regulations which will require our company to perform additional asset retirement activities related to the assets retired before the establishment of our company s internal policy and areas in which these assets were or continue to be located.

We recently received comments from the Securities and Exchange Commission regarding the costs associated with our asset retirement obligation in our Form 20-F for the fiscal year ended December 31, 2004. We have responded to such comments and our last response letter was filed on May 24, 2006. As of the latest practicable date, we have not received any further comments.

Because PRC laws, regulations and legal requirements dealing with economic matters are relatively new and continue to evolve, and because of the limited volume of published judicial interpretations and the non-binding nature of prior court decisions, the interpretation and enforcement of these laws, regulations and legal requirements involve some uncertainty. We have included the Mandatory Provisions and certain additional requirements that are imposed by the Hong Kong Stock Exchange Listing Rules in our Articles of Association for the purpose of reducing the scope of difference between the Hong Kong company law and the PRC Company Law. However, because the PRC Company Law is different in certain important aspects from company laws in the United States, Hong Kong and other common law jurisdictions and because the PRC securities laws and regulations are still at an early stage of development, you may not enjoy shareholders protections that you may be entitled to in other jurisdictions.

In addition to the adverse effect on our revenues, margins and profitability from any future fall in oil and natural gas prices, a prolonged period of low prices or other indicators would lead to a review for impairment of our oil and natural gas properties. This review would reflect management s view of long-term oil and natural gas prices. Such a review could result in a charge for impairment which could have a significant effect on our results of operations in the period in which it occurs.

See also Item 4 Information on the Company Regulatory Matters , Item 5 Operating and Financial Review and Prospects , Item 8 Financial Information and Item 11 Quantitative and Qualitative Disclosures About Market Risk .

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ITEM 4 INFORMATION ON THE COMPANY
Introduction
History and Development of the Company

Overview of Our Operations

We are one of the largest companies in China in terms of sales. We are engaged in a broad range of petroleum and natural gas 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 marketing of basic petrochemical products, derivative chemical products and other chemical products; and

the transmission and storage of crude oil, refined products and natural gas as well as the sale of natural gas.

We are China s largest producer of crude oil and natural gas. Currently, substantially all of our crude oil and natural gas reserves and production-related assets are located in China. In the year ended December 31, 2005, we had total revenue of RMB 552,229 million and net income of RMB 133,362 million.

Our exploration, development and production activities commenced in the early 1950s, when we conducted exploration activities in the Yumen oil region in northwestern China. The discovery of crude oil in 1959 in northeastern China s Daqing oil region, one of the world s largest oil regions in terms of proved crude oil reserves, marked the beginning of our large-scale upstream activities. Over the past four decades, we have conducted crude oil and natural gas exploration activities in many regions of China. As of December 31, 2005, we had estimated proved reserves of approximately 11,536.2 million barrels of crude oil and approximately 48,123.1 billion cubic feet of natural gas. We believe that we hold production licenses for a majority of China s proved crude oil reserves and proved natural gas reserves. In the year ended December 31, 2005, we produced 822.9 million barrels of crude oil and 1,119.5 billion cubic feet of natural gas for sale, representing an average production of 2.25 million barrels of crude oil and 3.07 billion cubic feet of sales natural gas per day. In 2005, we sold 788.8 million barrels of crude oil and 1,052.2 billion cubic feet of natural gas. Approximately 83% of the crude oil we sold in the year ended December 31, 2005 was supplied to our refineries.

We commenced limited refining activities in the mid-1950s, when we began producing gasoline and diesel at refineries in the Yumen oil region. We now operate 25 refineries located in eight provinces, three autonomous regions and one municipality. In 2005, our refineries processed approximately 752 million barrels of crude oil or an average of 2.06 million barrels per day. In the year ended December 31, 2005, we produced approximately 66.39 million tons of gasoline, diesel and kerosene and sold approximately 75.98 million tons of these products. In the year ended December 31, 2005, approximately 89% of the crude oil processed in our refineries was provided by our exploration and production segment and approximately 10% of the crude oil processed in our refineries was imported. As of December 31, 2005, our retail distribution network consisted of 15,908 service stations that we own and operate, 427 service stations wholly owned by CNPC or jointly owned by CNPC and third parties to which we provide supervisory support and 1,829 franchise service stations.

Our chemicals operations commenced in the early 1950s, when we began producing urea at our first petrochemical plant in Lanzhou in northwestern China. In the early 1960s, we began producing ethylene. We currently produce a wide range of basic and derivative petrochemical products and other chemical products at 12 chemical plants located in five provinces and three autonomous regions in China. Our other segments supply substantially all of the hydrocarbon feedstock requirements of our chemicals operations.

We are China s largest natural gas transporter and seller in terms of sales volume. Our natural gas transmission and marketing activities commenced in Sichuan in southwestern China in the 1950s. In 2005, our sales of natural gas totaled 1,052.2 billion cubic feet, of which 888.8 billion cubic feet was sold through our natural gas and pipeline segment. As of December 31, 2005, we owned and operated regional natural gas pipeline networks consisting of 20,340 kilometers of pipelines, of which 19,212 kilometers were operated by our natural gas and pipeline segment. As of December 31, 2005, we owned and operated a crude oil pipeline network consisting of 9,391 kilometers of pipelines with an average daily throughput of approximately 2.39 million barrels of crude oil. As of December 31, 2005, we also had a refined product pipeline network consisting of 2,462 kilometers of pipelines with an average daily throughput of approximately 32,630 tons of refined products.

We have increased our efforts to pursue attractive business opportunities outside China as part of our business growth strategy to utilize both domestic and international resources to strengthen our competitiveness. In connection with this objective, after our acquisition of Devon Energy Indonesia Limited from Devon Energy Corporation for a price of RMB 2,068 million in April 2002 and our acquisition of a 50% equity interest in Amerada Hess Indonesia Holdings Limited in April 2003, in June 2005, we entered into a capital contribution agreement with CNODC, Central Asia Petroleum Company Limited and Newco, pursuant to which, in December 2005, we acquired a 50% interest in Newco, a subsidiary of CNODC, for a consideration of RMB 20,741 million, which was paid to Newco as our capital contribution. Under this agreement, CNODC, a wholly owned subsidiary of CNPC, transferred certain of its overseas oil and natural gas assets to Newco in November 2005. Following the completion of the transactions contemplated by this agreement, each of CNODC and us obtained a 50% interest in Newco. We have the right to appoint four of the seven directors of Newco, which enables us to maintain effective control over Newco. We also entered into a transfer agreement with Newco in December 2005 to transfer all of our interest in PTRI, the operating entity of our oil and natural gas assets in Indonesia, to Newco for a consideration of RMB 579 million.

Following the completion of the acquisition of Newco through capital contribution, we obtained a 50% interest in the oil and natural gas assets held by Newco in twelve countries, including, among others, Kazakhstan, Venezuela and Peru. The consummation of the transactions described above significantly expanded our overseas operations, effectively increased the level of our oil and gas reserves and production volumes, and streamlined our existing overseas business in Indonesia with the acquired businesses.

CNODC plans to transfer its 50% interest in Newco to CNPC, which will result in CNPC holding the 50% interest in Newco directly.

In addition, we are currently assessing the feasibility of making further investments in international oil and gas markets.

In the year ended December 31, 2005, we imported approximately 184.9 million barrels of crude oil, as compared to 175.1 million and 123.9 million barrels of crude oil in the years ended December 31, 2004 and 2003, respectively.

Acquisitions

Pursuant to our board resolutions dated October 26, 2005, we made an offer to the holders of the A Shares of Jinzhou Petrochemical Co., Ltd. or Jinzhou Petrochemical, to acquire at the purchase price of RMB 4.25 per share 150 million issued and outstanding Jinzhou Petrochemical A Shares. As of December 31, 2005, we acquired 117,486,753 Jinzhou Petrochemical A Shares, representing 14.92% of the total share capital of Jinzhou Petrochemical, for a total cash consideration of approximately RMB 500 million. After the acquisition, we own 95.87% of the total share capital of Jinzhou Petrochemical. Jinzhou Petrochemical was delisted on January 4, 2006 upon approval from the China Securities Regulatory Commission.

Pursuant to our board resolutions dated October 26, 2005, we made separate offers to the holders of the A Shares of Jilin Chemical Industrial Company Limited (Jilin Chemical) and the holders of the H Shares of Jilin Chemical to acquire at the purchase price of RMB 5.25 per share of 200 million outstanding A Shares, and to acquire at the purchase price of HK$2.80 per Jilin Chemical H Share 964.778 million outstanding H Shares (including Jilin Chemical ADSs). By February 2006, we have paid an aggregate of RMB 3,480 million for this transaction. The tender offers were completed in February 2006. The effect of the acquisition of Jilin Chemical will be reflected in our consolidated financial statements ended as of December 31, 2006. Jilin Chemical A Shares, H Shares and ADSs were delisted from the Hong Kong Stock Exchange, Shenzhen Stock Exchange and NYSE on January 23, February 20 and February 15, 2006, respectively.

Pursuant to our board resolutions dated October 26, 2005, we made an offer to the holders of A Shares of Liaohe Jinma Oilfield Co., Ltd. or Liaohe Jinma, to acquire at the purchase price of RMB 8.80 per share 200 million issued and outstanding Liaohe Jinma A Shares. As of December 31, 2005, we acquired 172,315,428 Liaohe Jinma A Shares, representing 15.67% of the total share capital of Liaohe Jinma for a total consideration of approximately RMB 1,519 million. Following the completion of this acquisition, we would own 97.48% of the total share capital of Liaohe Jinma. Upon the approval by China Securities Regulatory Commission, Liaohe Jinma was delisted as at January 4, 2006.

On December 6, 2005, we executed two separate purchase agreements with two wholly-owned subsidiaries of CNPC, Liaohe Petroleum Exploration Bureau and China Petroleum Pipeline Bureau, whereby, we would acquire from the two companies a 15.56% equity interest and a 20.17% equity interest, respectively, in PetroChina Fuel Oil Company (the Fuel Oil Company), a 55.43% subsidiary of our company, with a total cash consideration of RMB 559 million. The Fuel Oil Company principally engages in investing in and developing of fuel oil in the upstream and downstream areas outside the PRC. Upon completion of the above acquisitions, our company s interest in the Fuel Oil Company will be increased and the management of the Fuel Oil Company is expected to be strengthened. This acquisition has been approved by the State-owned Assets Supervision and Administration Commission of the PRC (SASAC) and the relevant parties to the two purchase agreements are in the process of closing the transactions.

Our Corporate Organization and Shareholding Structure

PetroChina was established as a joint stock company with limited liability under the Company Law of the PRC on November 5, 1999 as part of a restructuring in which CNPC transferred to us most of the assets and liabilities of CNPC relating to its exploration and production, refining and marketing, chemicals and natural gas businesses. CNPC retained the assets and liabilities relating to its remaining businesses and operations, including assets and liabilities relating to international exploration and production and refining and pipeline operations. CNPC is our primary provider of a wide range of services and products. On April 7, 2000, PetroChina completed a global offering of H shares and ADSs. In September 2005, PetroChina completed a follow-on offering of over 3 billion H Shares at the price of HK$6.00 per share. Currently, CNPC owns an approximate 88.21% interest in PetroChina.

The following chart illustrates our corporate organization and our shareholding structure:

(1) Indicates approximate shareholding.

(2) Includes subsidiary companies and branches without legal person status.

(3) Represents enterprises directly administered and operated by such segment.

(4) Includes PetroChina Planning & Engineering Institute, PetroChina Exploration & Development Research Institute, Newco, Foreign Cooperation Managing Division, PetroChina International Co., Ltd. and PetroChina Refining & Chemicals Technology Research Center.

The following chart illustrates our management structure:

(1) Includes subsidiary companies and branches without legal person status.

(2) Represents enterprises directly administered and operated by such segment.

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General Information

Our legal name is , and its English translation is PetroChina Company Limited. Our headquarters are located at 16 Andelu, Dongcheng District, Beijing, China, 100011, and our telephone number at this address is (86-10) 8488-6270. Our website address is www.petrochina.com.cn. The information on our website is not part of this annual report.

Launch of New Logo

Effective December 26, 2004, we began using a new logo that is jointly owned by us and CNPC. We have filed an application to register the new logo as a trademark with the State Trademark Bureau of the PRC.

Exploration and Production

We are engaged in crude oil and natural gas exploration, development and production. Substantially all of our total estimated proved crude oil and natural gas reserves are located in China, principally in northeastern, northern, southwestern and northwestern China. The Songliao basin, located in Heilongjiang and Jilin provinces in northeastern China, including the Daqing and Jilin oil regions, accounted for 44% of our proved crude oil reserves as of December 31, 2005 and 45.6% of our crude oil production in 2005. We also have significant crude oil reserves and operations in the area around the Bohai Bay. The Bohai Bay basin includes the Liaohe, Dagang, Huabei and Jidong oil regions and accounted for 19.8% of our proved crude oil reserves as of December 31, 2005 and 20.0% of our crude oil production in 2005. Our proved natural gas reserves and production are generally concentrated in northwestern and southwestern China, specifically in the Erdos, Tarim and Sichuan basins. Our overseas proved crude oil reserves and proved natural gas reserves accounted for 5.2% of our proved crude oil reserves and 1.7% of our proved natural gas reserves as of December 31, 2005 and 5.5% of our crude oil production and 4.2% of our natural gas production in 2005.

We currently hold exploration licenses covering a total area of approximately 438.7 million acres and production licenses covering a total area of approximately 16.2 million acres. In 2005, our exploration and production segment had income from operations of RMB 208,080 million.

To further develop our crude oil and natural gas businesses, we have applied to the Ministry of Land and Resources for oil and gas exploration and production licenses covering the southern part of the South China Sea to commence offshore crude oil and natural gas exploration and production. We cannot assure you that we will ultimately obtain these licenses or that we will have sufficient capital to fund these activities.

Reserves

Our estimated proved reserves as of December 31, 2005 totaled approximately 11,536.2 million barrels of crude oil and approximately 48,123.1 billion cubic feet of natural gas. As of December 31, 2005, proved developed reserves accounted for 79.7% and 41.3% of our total proved crude oil and natural gas reserves, respectively. Total proved hydrocarbon reserves on a barrels-of-oil equivalent basis increased by 2.7% from approximately 19,042.7 million barrels-of-oil equivalent as of the end of 2004 to approximately 19,556.7 million barrels-of-oil equivalent as of the end of 2005, taking account of our overseas crude oil reserves of 601 million barrels and overseas natural gas reserves of 799.8 billion cubic feet, totaling 734.3 barrels-of-oil equivalent. Natural gas as a percentage of total proved hydrocarbon reserves increased from 39.6% as of December 31, 2004 to 41.0% as of December 31, 2005.

The following table sets forth our estimated proved reserves (including proved developed reserves and proved undeveloped reserves) and proved developed reserves of crude oil and natural gas as of December 31, 2003, 2004 and 2005. We prepared our reserve estimates as of December 31, 2003, 2004 and 2005, on the basis of a report prepared by DeGolyer & MacNaughton and Gaffney, Cline & Associates, independent engineering consultants, in accordance with Statement of Financial Accounting Standards No. 69, or SFAS No. 69. Our reserve estimates include only crude oil and natural gas which we believe can be reasonably produced within the current terms of our production licenses. See Regulatory Matters Exploration Licenses and Production

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Licenses for a discussion of our production licenses. Also see Item 3 Key Information Risk Factors for a discussion of the uncertainty inherent in the estimation of proved reserves.

	Crude oil (millions of barrels)	Natural gas[(1)] (Bcf)	Combined[(1)] (BOE, in millions)
Proved developed and undeveloped reserves			
Reserves as of December 31, 2003	11,494.9	41,786.5	18,459.3
Revisions of previous estimates	141.6	82.8	155.4
Extensions and discoveries	573.1	4,405.3	1,307.3
Improved recovery	109.0	43.0	116.2
Production for the year	(817.4)	(1,068.7)	(995.5)
Reserves as of December 31, 2004	11,501.2	45,248.9	19,042.7
Revisions of previous estimates	156.8	212.9	192.3
Extensions and discoveries	605.5	4,004.8	1,273.0
Improved recovery	101.4		101.4
Production for the year	(828.7)	(1,343.5)	(1,052.7)
Reserves as of December 31, 2005	11,536.2	48,123.1	19,556.7
Proved developed reserves			
As of December 31, 2003	9,188.1	13,878.7	11,501.2
As of December 31, 2004	9,067.9	17,254.5	11,943.6
As of December 31, 2005	9,194.8	19,857.8	12,504.4

(1) Represents natural gas remaining after field separation for condensate removal and reduction for flared gas.

The following tables set forth our crude oil and natural gas proved reserves and proved developed reserves by region as of December 31, 2003, 2004 and 2005.

	As of December 31,					
	2003		2004		2005	
	Proved developed and undeveloped	Proved developed	Proved developed and undeveloped	Proved developed	Proved developed and undeveloped	Proved developed
	(millions of barrels)					
Crude oil reserves						
Daqing	4,832.3	4,407.7	4,615.0	4,122.3	4,396.9	3,863.9
Liaohe	1,168.5	965.0	1,123.1	915.1	1,114.6	937.5
Xinjiang	1,186.9	930.9	1,232.1	921.9	1,261.8	1,010.8
Changqing	1,063.6	706.9	1,191.6	769.6	1,267.0	840.6
Jilin	585.9	367.0	643.8	404.4	675.0	472.2
Dagang	452.1	361.0	482.3	402.0	516.1	426.7
Tarim	553.9	342.2	507.6	374.8	543.8	418.1

Huabei	486.1	335.8	510.3	353.9	536.2	381.5
Qinghai	229.7	182.8	226.1	181.2	243.0	185.5
Tuha	206.9	169.2	218.3	168.4	165.0	110.8
Sichuan	7.1	3.9	8.6	5.3	8.0	5.5
Other regions(1)	721.9	415.7	742.4	449.0	808.8	541.7
Total	11,494.9	9,188.1	11,501.2	9,067.9	11,536.2	9,194.8

	As of December 31,					
	2003		2004		2005	
	Proved developed and undeveloped	Proved developed	Proved developed and undeveloped	Proved developed	Proved developed and undeveloped	Proved developed
	(Bcf)					
Natural gas reserves[2]						
Sichuan	8,131.4	4,522.4	8,729.8	4,767.9	9,211.2	5,063.5
Changqing	12,976.3	3,847.6	14,932.7	4,091.3	15,765.6	4,089.8
Xinjiang	1,698.7	1,084.3	1,712.3	1,036.8	1,686.8	1,120.4
Daqing	1,122.9	946.5	1,060.6	879.4	1,936.8	813.3
Qinghai	3,379.7	889.9	4,603.6	1,583.4	4,534.1	1,528.0
Tarim	11,086.6	528.7	10,897.8	2,934.8	11,838.8	5,347.9
Liaohe	571.8	507.5	522.7	455.4	489.8	417.6
Tuha	711.6	430.1	705.3	427.8	677.4	367.8
Huabei	386.0	227.3	375.9	217.5	369.3	211.8
Dagang	609.5	201.9	599.5	186.8	586.9	207.8
Jilin	191.9	134.4	203.9	150.4	187.8	132.7
Other regions[1]	920.1	558.1	904.8	523	838.6	557.2
Total	41,786.5	13,878.7	45,248.9	17,254.5	48,123.1	19,857.8

(1) Represents the Jidong and Yumen oil regions and our overseas oil and gas fields as a result of our acquisition of overseas assets.

(2) Represents natural gas remaining after field separation for condensate removal and reduction for flared gas.

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Exploration and Development

We are currently conducting exploration and development efforts in 11 provinces, two municipalities under the direct administration of the central government and three autonomous regions in China. In September 2002, the State Development Planning Commission, the predecessor of the National Development and Reform Commission, approved our proposal to explore, in cooperation with foreign companies, fifteen additional crude oil and natural gas fields with an aggregate area of 75,071 square kilometers located in Qaidam basin, Erdos basin, Sichuan basin and Xinjiang basin. We believe that we have more extensive experience in the exploration and development of crude oil and natural gas than any of our principal competitors in China. Since early 1950s, we have worked for nearly five decades to develop exploration and recovery technologies and methods tailored to the specific geological conditions in China.

The following table sets forth the number of wells we drilled, or in which we participated, and the results thereof, for the periods indicated.

Year		Daqing	Xinjiang	Liaohe	Changqing	Huabei	Dagang	Sichuan	Others(1)	Total
2003	**Net exploratory wells drilled**(2)	291	170	103	371	82	46	25	287	1,375
	Crude oil	140	115	57	128	49	25	0	99	613
	Natural gas	1	11	2	22	0	0	12	5	53
	Dry(3)	150	44	44	221	33	21	13	183	709
	Net development wells drilled(2)	2,986	1,363	547	1,677	244	202	61	1,192	8,272
	Crude oil	2,975	1,354	528	1,489	241	199	8	1,173	7,967
	Natural gas	4	4	8	134	0	3	36	17	206
	Dry(3)	7	5	11	54	3	0	17	2	99
2004	**Net exploratory wells drilled**(2)	221	153	68	427	96	53	32	355	1,405
	Crude oil	85	85	40	201	49	32	4	172	668
	Natural gas	3	0	0	22	0	0	17	9	51
	Dry(3)	133	68	28	204	47	21	11	174	686
	Net development wells drilled(2)	2,857	1,440	622	1,675	224	188	76	1,463	8,545
	Crude oil	2,853	1,440	605	1,597	223	184	6	1,387	8,295
	Natural gas	4	0	13	46	1	3	56	73	196
	Dry(3)	0	0	4	32	0	1	14	3	54
2005	**Net exploratory wells drilled**(2)	250	191	71	456	83	39	58	360	1,508
	Crude oil	78	92	47	200	53	22	0	152	644
	Natural gas	6	1	0	24	0	0	30	15	76
	Dry(3)	166	98	24	232	30	17	28	193	788
	Net development wells drilled(2)	3,722	1,608	563	2,608	250	192	101	2,587	11,631
	Crude oil	3,712	1,604	549	2,364	248	188	6	2,495	11,166
	Natural gas	10	4	12	195	2	4	83	88	398
	Dry(3)	0	0	2	49	0	0	12	4	67

(1) Represents the Jilin, Tarim, Tuha, Qinghai, Jidong and Yumen oil regions.

(2) Net wells refer to the wells after deducting interests of others. No third parties own any interests in any of our wells.

(3) Dry wells are wells with insufficient reserves to sustain commercial production.

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Oil-and-Gas Properties

The following table sets forth our interests in developed and undeveloped acreage by oil region and in productive crude oil and natural gas wells as of December 31, 2005.

			Acreage[1] (thousands of acres)			
	Productive wells[1]		Developed		Undeveloped	
Oil region	Crude oil	Natural gas	Crude oil	Natural gas	Crude oil	Natural gas
Daqing	40,157	144	725.9	61.1	604.6	93.7
Liaohe	17,043	594	170.7	28.0	119.0	12.9
Xinjiang	16,931	75	322.9	38.2	66.8	12.9
Jilin	14,909	45	293.6	19.5	238.3	25.3
Changqing	11,305	665	356.5	1,013.9	391.6	2,054.9
Huabei	5,023	87	103.4	9.3	103.0	6.6
Dagang	3,223	59	93.9	19.2	72.9	20.7
Tuha	1,141	58	36.7	13.4	18.6	19.1
Tarim	661	125	128.1	116.3	52.3	91.7
Sichuan	404	1,084	356.6	398.7	17.6	110.2
Other regions[2]	3,487	221	75.2	35.8	18.4	20.7
Total	114,284	3,157	2,663.5	1,753.4	1,703.1	2,468.7

(1) Includes all wells and acreage in which we have an interest. No third parties own any interests in any of our wells or acreage.

(2) Represents the Qinghai, Jidong and Yumen oil regions.

Approximately 69.7% of our proved crude oil reserves are concentrated in the Daqing, Liaohe and Xinjiang oil regions and the Changqing oil and gas region, and approximately 85.9% of our proved natural gas reserves are concentrated in the Changqing oil and gas region, the Tarim oil region, the Sichuan gas region and the Qinghai oil region. We believe that the Erdos, Junggar, and Songliao basins and Bohai Bay have the highest potential for increasing our crude oil reserve base through future exploration and development, and that the Erdos, Sichuan and Qaidam basins have the highest potential for increasing our natural gas reserve base through future exploration and development.

Production

The following table sets forth our historical average net daily crude oil and natural gas production by region and our average sales price for the periods ended December 31, 2003, 2004 and 2005.

	For the year ended December 31,			
	2003	2004	2005	% of 2005 total
Crude oil production[1]				

(thousands of barrels per day, except percentages or otherwise indicated)				
Daqing	985.3	942.0	915.1	40.59
Liaohe	253.6	245.4	238.2	10.57
Xinjiang	217.2	227.1	238.8	10.59
Changqing	142.8	164.6	191.4	8.49
Tarim	107.5	109.9	122.8	5.45
Huabei	88.4	87.6	88.4	3.92

	For the year ended December 31,			
	2003	2004	2005	% of 2005 total
Jilin	96.7	102.6	112.1	4.97
Dagang	84.7	97.9	102.6	4.55
Tuha	50.7	48.4	45.2	2.01
Other(2)	188.3	199.1	200.0	8.87
Total	2,215.2	2,224.6	2,254.5	100.0%
Annual production (million barrels)	808.6	814.2	822.9	
Average sales price				
(RMB per barrel)	225.2	279.1	396.2	
(US$ per barrel)	27.2	33.72	48.37	
Natural gas production(1)(3)				
(millions of cubic feet per day, except percentages or otherwise indicated)				
Sichuan	849.0	905.7	1,107.9	36.1
Changqing	440.3	651.4	640.7	20.9
Daqing	136.2	135.4	133.8	4.4
Qinghai	122.5	145.5	172.8	5.6
Tuha	82.6	92.2	121.1	3.9
Xinjiang	75.9	95.7	109.8	3.6
Liaohe	57.6	58.7	56.0	1.8
Huabei	45.8	44.2	43.5	1.4
Tarim	34.7	89.2	479.5	15.6
Dagang	27.8	26.5	26.2	0.9
Other(4)	165.2	149.8	175.9	5.8
Total	2,037.6	2,394.3	3,067.2	100.0%
Annual production (Bcf)	743.72	876.3	1,119.5	
Average sales price				
(RMB per Mcf)	19.37	21.11	23.35	
(US$ per Mcf)	2.34	2.55	2.85	

(1) Production volumes for each region include our share of the production from all of our cooperative projects with foreign companies in that region.

(2) Represents production from the Qinghai, Jidong and Yumen oil regions, the Sichuan gas region and our share of overseas production as a result of our acquisition of overseas assets.

(3) Represents production of natural gas for sale.

(4) Represents production from the Jilin, Jidong and Yumen oil regions and our share of overseas production as a result of our acquisition of overseas assets.

In 2005, we supplied approximately 83.0% of our total crude oil sales to our refineries, 8% to Sinopec s refineries, 6% to companies or entities outside China, and the remaining 3% to regional refineries or other entities. We entered into a crude oil mutual supply framework agreement with Sinopec on March 10, 2006 for the supply of crude oil to each other s refineries in 2006. Under this agreement, we agreed in principle to supply 55 million barrels of crude oil to Sinopec, and Sinopec agreed in principle to supply to us approximately 5.2 million barrels of crude oil in 2006 at negotiated prices based on the Singapore market FOB prices for crude oil. See Item 5 Operating and Financial Review and Prospects General Factors Affecting Results of Operations Crude Oil Prices for a detailed discussion of the crude oil premium and discount calculation agreement and its supplemental agreement.

For the years ended December 31, 2003, 2004 and 2005, the average lifting costs of our crude oil and natural production were US$4.39 per barrel-of-oil equivalent, US$4.60 per barrel-of-oil equivalent and US$5.28 per barrel-of-oil equivalent, respectively.

Principal Oil and Gas Regions

Daqing Oil Region

The Daqing oil region, our largest oil and gas producing property, is located in the Songliao basin and covers an area of approximately one million acres. The successful discovery and development of the oil fields in the Daqing oil region marked a critical breakthrough in the history of both our company and the PRC oil and gas industry. In terms of proved hydrocarbon reserves and annual production, the Daqing oil region is the largest oil region in China and one of the most prolific oil and gas properties in the world. We commenced exploration activities in the Daqing oil region in 1955 and discovered oil in the region in 1959. Annual crude oil production volume in the Daqing oil region reached one million barrels per day in 1976 and remained relatively stable until 2002. In 2003, 2004 and 2005, our crude oil production volume in the Daqing oil region fell below one million barrels per day to 985.3 thousand barrels per day, 942.0 thousand barrels per day and 915.1 thousand barrels per day, respectively. As of December 31, 2005, we produced crude oil from 20 fields in the Daqing oil region.

As of December 31, 2005, our proved crude oil reserves in the Daqing oil region were 4,396.9 million barrels, representing 38.1% of our total proved crude oil reserves. The proved crude oil reserves in our Daqing oil region have gradually decreased since 1996 because the crude oil production exceeded the crude oil reserve additions in our Daqing oil region in each year since 1996. As of December 31, 2003, 2004 and 2005, the proved crude oil reserves in our Daqing oil region were 4,832.3 million barrels, 4,615.0 million barrels and 4,396.9 million barrels, respectively. As a result, we decreased the crude oil production in our Daqing oil region over past years, and plan to continue to decrease the crude oil production in our Daqing oil region each year in the next few years. In 2005, our oil fields in the Daqing oil region produced an average of 915.1 thousand barrels of crude oil per day, representing approximately 40.6% of our total daily crude oil production. The crude oil production in our Daqing oil region decreased by 3.1% from 344.8 million barrels in 2004 to 334.0 million barrels in 2005. In 2005, the crude oil reserve-to-production ratio of the Daqing oil region was 13.2 years, compared to 13.4 years in 2004.

The crude oil we produce in the Daqing oil region has an average API gravity of 35.7 degrees. In 2005, the crude oil we produced in the Daqing oil region had an average water cut of 89.78%, increased from the average water cut of 89.1% in 2004.

Because the crude oil in the Daqing oil region is primarily located in large reservoirs with relatively moderate depths of approximately 900 meters to 1,500 meters and with relatively simple geological structures and most of the crude oil produced at Daqing is medium viscosity oil, lifting costs in the Daqing oil region are relatively low among our oil regions. Crude oil produced using enhanced recovery techniques accounted for 25.1%, 25.7% and 26.9% of our crude oil production from the Daqing oil region in 2003, 2004 and 2005, respectively.

Because our oil fields in the Daqing oil region are relatively mature, the difficulty of extracting crude oil from these fields has increased in recent years and is likely to continue to increase gradually in the future. As a result, our lifting costs at these fields increased by 23.6% from US$4.16 per barrel for the year ended December 31, 2004 to US$5.14 per barrel for the year ended

December 31, 2005. However, we have adopted a number of measures to contain the increase in our lifting costs at these fields. Those measures include:

- terminating unprofitable or marginally profitable exploration and production activities;
- reducing expenditures on ancillary ground facilities in the outer areas of the Daqing oil region;
- increasing preventive maintenance to prolong the useful life of our production facilities; and
- applying new technologies to reduce energy consumption.

Although we plan to continue to carry out these measures to contain the increase in our lifting costs, we expect our lifting costs at these fields will continue to increase gradually in the future.

We have an extensive transportation infrastructure network to transport crude oil produced in the Daqing oil region to internal and external customers in northeastern China and beyond. Crude oil pipelines link our oil fields in the Daqing oil region to the port of Dalian and the port of Qinhuangdao in Bohai Bay, providing efficient transportation for selling Daqing crude oil. These crude oil pipelines have an aggregate length of 2,590 kilometers and an aggregate throughput capacity of approximately 900 thousand barrels per day.

Daqing s crude oil has a low sulfur and high paraffin content. As many refineries in China, particularly those in northeastern China, are configured to refine Daqing crude oil, we have a stable market for the crude oil we produce in the Daqing oil region. In 2005, we refined approximately 79.08% of Daqing crude oil in our own refineries, exported approximately 1.19% and sold the remaining portion to Sinopec or local refineries.

Liaohe Oil Region

The Liaohe oil region is one of our three largest crude oil producing properties and is located in the northern part of the Bohai Bay basin. We began commercial production in the Liaohe oil region in 1971. The Liaohe oil region covers a total area of approximately 580,000 acres.

As of December 31, 2005, proved crude oil reserves in the Liaohe oil region were 1,114.6 million barrels, representing 9.7% of our total proved oil reserves. In 2005, our oil fields in the Liaohe oil region produced an average of 238.2 thousand barrels of crude oil per day, representing approximately 10.6% of our total daily crude oil production. In 2005, the crude oil reserve-to-production ratio in the Liaohe oil region was 12.8 years. In 2005, the crude oil we produced in the Liaohe oil region had an average API gravity of 26 degrees and an average water cut of 76.44%. We have proved crude oil reserves in 37 fields in the Liaohe oil region, all of which are currently in production. We produce several varieties of crude oil in the Liaohe oil region, ranging from light crude oil to heavy crude oil and high pour point crude oil.

We have easy access to crude oil pipelines for Liaohe crude oil. The pipelines linking Daqing to Dalian port and Qinhuangdao port pass through the Liaohe oil region. In 2005, we sold about approximately 90.16% of the crude oil we produced at the Liaohe oil region to our own refineries.

Xinjiang Oil Region

The Xinjiang oil region is one of our three largest crude oil producing properties and is located in the Junggar basin in northwestern China. We commenced our operations in the Xinjiang oil region in 1951. The Xinjiang oil region covers a total area of approximately 900 thousand acres.

As of December 31, 2005, our proved crude oil reserves in the Xinjiang oil region were 1,261.8 million barrels, representing 10.9% of our total proved crude oil reserves. In 2005, our oil fields in the Xinjiang oil region produced an average of 238.8 thousand barrels of crude oil per day, representing approximately 10.6% of our total crude oil production. In 2005, the crude oil reserve-to-production ratio at the Xinjiang oil region was 14.5 years. In 2005, the crude oil we produced in the Xinjiang oil region had an average API gravity of 36.8 degrees and an average water cut of 73.54%.

Sichuan Gas Region

The Sichuan gas region is the largest natural gas region in China in terms of annual natural gas production. We began natural gas exploration and production in Sichuan in the 1950s. The Sichuan gas region covers a total area of approximately 2.3 million acres. The natural gas reserve-to-production ratio in the Sichuan gas region was 22.8 years in 2005. As of December 31, 2005, we had 90 natural gas fields under development in the Sichuan gas region.

As of December 31, 2005, our proved natural gas reserves in the Sichuan gas region were 9,211.2 billion cubic feet, representing 19.1% of our total proved natural gas reserves and an increase of 5.5% from 8,729.8 billion cubic feet as of December 31, 2004. In 2005, our natural gas production for sale in the Sichuan gas region reached 404.4 billion cubic feet, representing 36.1% of our total natural gas production for sale and an increase of 22.0% from 331.5 billion cubic feet in 2004.

In 2002, we discovered and proved significant natural gas reserves in Luojiazhai gas field in the Sichuan gas region. As of December 31, 2005, Luojiazhai gas field had a total proved natural gas reserve of 1,143.2 billion cubic feet. Currently, Luojiazhai gas field is the largest gas field in the Sichuan basin. We have developed a broad range of technologies relating to natural gas exploration, production, pipeline systems and marketing activities tailored to local conditions in Sichuan. We intend to continue to increase our natural gas reserves, annual natural gas production and revenues in the Sichuan gas region by adopting advanced technologies.

In November 2002, we obtained approval from the State Development Planning Commission, the predecessor of the National Development and Reform Commission, to construct pipelines to transmit natural gas produced in the Sichuan gas region to major cities in central China. This is known as the Zhong County to Wuhan City natural gas pipeline project. By the end of 2004, we completed the construction and commenced commercial operation of the main line of the Zhong County to Wuhan City natural gas pipeline and its Xiangfan branch pipeline and Huangshi branch pipeline. In addition, we completed the construction of the Xiangtan branch pipeline and commenced the commercial operation of this branch pipeline in July 2005. See Natural Gas and Pipeline Expansion of Our Natural Gas Transmission and Marketing Business for a discussion of the Zhong County to Wuhan City natural gas pipeline project.

Changqing Oil and Gas Region

The Changqing oil and gas region covers parts of Shaanxi Province and Gansu Province and the Ningxia and Inner Mongolia Autonomous Regions. We commenced operations in the Changqing oil and gas region in 1970. In 2005, we produced 69.9 million barrels of crude oil in the Changqing oil and gas region.

In the early 1990s, we discovered the Changqing gas field, which had total estimated proved natural gas reserves of 15,765.6 billion cubic feet as of December 31, 2005, representing 32.8% of our total proved natural gas reserves. In January 2001, we discovered the Sulige gas field with total proved natural gas reserves of 4,290.0 billion cubic feet. In 2005 we produced 233.9 billion cubic feet of natural gas for sale in the Changqing oil and gas region, representing a decrease of 1.9% from 238.4 billion cubic feet in 2004. The establishment of a natural gas pipeline from Shaanxi to Beijing in 1997 has significantly expanded the range of target markets for natural gas produced in the Changqing oil and gas region over the years. The construction of an additional natural gas pipeline from Shaanxi to Beijing, or the second Shaanxi to Beijing natural gas pipeline, which is designed to have an annual throughput capacity of 423.8 billion cubic feet of natural gas, was completed ahead of schedule and it commenced operation in July 2005. See Natural Gas and Pipeline Expansion of Our Natural Gas Transmission and Marketing Business for a discussion of this additional Shaanxi to Beijing natural gas pipeline project.

Tarim Oil and Gas Region

The Tarim oil and gas region is located in the Tarim basin in northwestern China with a total area of approximately 590 thousand acres. As of December 31, 2005, our proved crude oil reserves in the Tarim oil region were 543.8 million barrels. The Kela 2 natural gas field, which we discovered in 1998 in the Tarim oil and gas region, had estimated proved natural gas reserves of approximately 6,235.9 billion cubic feet as of December 31, 2005. As of December 31, 2005, the proved natural gas reserves in the Tarim oil and gas region reached 11,838.8 billion cubic feet, representing 24.6% of our total proved natural gas reserves. Currently, the Kela 2 natural gas field is the largest natural gas field in China in terms of proved natural gas reserves.

In 2005, we produced 175.0 billion cubic feet of natural gas for sale in the Tarim oil and gas region. We have completed the construction of the pipelines to deliver natural gas in the Tarim oil and gas region to the central and eastern regions of China where there is strong demand for natural gas transmitted through our West to East natural gas pipeline project. See Natural Gas and Pipeline Expansion of Our Natural Gas Transmission and Marketing Business for a discussion of our West to East natural gas pipeline project. The commencement of the operation of this West to East natural gas pipeline significantly increased our natural gas production in the Tarim oil and gas region.

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Refining and Marketing

We engage in refining and marketing operations in China through 25 refineries, 22 regional sales and distribution branch companies and one lubricants branch company. These operations include the refining, transportation, storage and marketing of crude oil, and the wholesale, retail and export of refined products, including gasoline, diesel, kerosene and lubricant.

In 2005, our refining and marketing segment had loss from operations of RMB 19,810 million.

The following sets forth the highlights of our refining and marketing segment in 2005:

- as of December 31, 2005, our refineries annual primary distillation capacity totaled 853.1 million barrels of crude oil per year, or 2,337.2 thousand barrels per day;
- we processed 752 million barrels of crude oil, or 2.06 million barrels per day;
- we produced approximately 66.39 million tons of gasoline, diesel and kerosene and sold approximately 75.98 million tons of these products;
- as of December 31, 2005, our retail distribution network consisted of:
  - 15,908 service stations owned and operated by us,
  - 427 service stations wholly owned by CNPC or jointly owned by CNPC and third parties and to which we provide supervisory support, and
  - 1,829 franchise service stations owned and operated by third parties with which we have long-term refined product supply agreements; and
- in 2005, our service stations, which are located throughout China, sold approximately 38.1 million tons of gasoline and diesel, representing 51.5% of the total of these products sold through our marketing operations.

Refining

Our refineries are located in eight provinces, three autonomous regions and one municipality in the northeastern, northwestern and northern regions of China.

Refined Products

We produce a wide range of refined products at our refineries. Some of the refined products are for our internal consumption and used as raw materials in our petrochemical operation. The table below sets forth production volume for our principal refined products for each of the three years ended December 31, 2003, 2004 and 2005.

	Year ended December 31,		
Product	**2003**	**2004**	**2005**
	(in thousands of tons)		
Diesel	33,399.1	38,941.8	43,000.7
Gasoline	18,727.4	20,606.1	21,414.6
Fuel oil	4,571.3	4,290.2	3,816.3
Naphtha	3,602.8	4,942.8	4,872.8
Asphalt	1,870.5	1,946.8	1,484.7
Kerosene	1,759.3	1,961.8	1,970.3
Lubricants	1,192.5	1,467.8	1,528.6
Paraffin	984.9	1,140.0	1,139.3
Total	66,107.8	75,297.3	79,227.3

We generally adjust our product mix to reflect market demand and to focus on the production of high margin products. This has resulted in an overall modest increase in the production of lighter refined products which generally are higher margin products, such as gasoline. Our production volume of lubricants, a high margin product, decreased 12.2% from 1,358.9 thousand tons in 2002 to 1,192.5 thousand tons in 2003, due primarily to the shutting down of inefficient lubricant production facilities in Jilin Petrochemical and Dagang Petrochemical and the maintenance of lubricant production facilities in Daqing Refinery and Daqing Petrochemical. In 2004, we increased our production volume of lubricants to 1,467.8 thousand tons to meet the growing market demands for lubricants. As a result of the optimization of our product mix and the increase in the production of high margin products, we produced 1,528.6 thousand tons of lubricants in 2005. We decreased the production of low margin products, such as fuel oil.

In recent years, we have made significant capital investments in facility expansions and upgrades to improve product quality to meet evolving market demand and environmental requirements in China. In each of the three years ended December 31, 2003, 2004 and 2005, our capital expenditures for our refining and marketing segment were RMB 12,758 million, RMB 17,684 million, and RMB 16,454 million, respectively. These capital expenditures were incurred primarily in connection with our refining facility upgrades and expansion of our refined product retail marketing network and storage infrastructure. We built or renovated 10 refining facilities in 2005, including, among others, the regular pressure reducing unit at Dalian Petrochemical with a designed annual capacity of 10 million tons, the delayed coking unit at Lanzhou Petrochemical with an annual capacity of 1,000 thousand tons and the catalytic reforming unit at Jinzhou Petrochemical with an annual capacity of 600 thousand tons. In 2005, we operated an aggregate of 18,164 service stations. In addition, we have also focused on enhancing our processing technologies and methods. These efforts have enabled us to improve the quality of refined products at our refineries, particularly that of gasoline and diesel. We believe that our refined products generally meet product specification and environmental protection requirements as set by the PRC government, including the specification limiting the olefin and sulfur content in gasoline.

Our Refineries

Most of our refineries are strategically located close to our crude oil storage facilities, along our crude oil and refined product transmission pipelines and/or railways. These systems provide our refineries with secure supplies of crude oil and facilitate our distribution of refined products to the domestic markets. In each of the three years ended December 31, 2003, 2004 and 2005, our exploration and production operations supplied approximately 86%, 84% and 89% respectively, of the crude oil processed in our refineries.

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The table below sets forth certain operating statistics regarding our refineries as of December 31, 2003, 2004 and 2005.

	As of December 31,		
	2003	**2004**	**2005**
Primary distillation capacity[1] (thousand barrels per day)			
Lanzhou Petrochemical[2]	222.7	212.6	212.6
Dalian Petrochemical	212.6	212.6	212.6
Fushun Petrochemical	162.0	186.2	186.2
Daqing Petrochemical	121.5	121.5	121.5
Jinzhou Petrochemical[3]	113.3	127.5	131.6
Jinxi Petrochemical	111.3	131.6	131.6
Jilin Petrochemical[4]	101.2	107.3	141.7
Urumqi Petrochemical	101.2	101.2	101.2
Other refineries	913.9	982.8	1,098.2
Total	2,059.7	2,183.3	2,337.2
Refining throughput (thousand barrels per day)			
Lanzhou Petrochemical[2]	140.5	166.4	178.7
Dalian Petrochemical	187.7	242.3	223.7
Fushun Petrochemical	172.2	181.7	194.4
Daqing Petrochemical	115.5	119.2	125.5
Jinzhou Petrochemical[3]	105.7	120.8	127.9
Jinxi Petrochemical	108.2	123.9	129.2
Jilin Petrochemical[4]	114.6	129.6	138.0
Urumqi Petrochemical	72.7	81.8	85.3
Other refineries	712.3	773.6	858.4
Total	1,729.4	1,939.3	2,061.1
Conversion equivalent[5] (percent)			
Lanzhou Petrochemical[2]	41.9	41.9	53.3
Dalian Petrochemical	54.3	54.3	54.3
Fushun Petrochemical	70.7	70.7	68.5
Daqing Petrochemical	61.0	76.7	76.7
Jinzhou Petrochemical[3]	72.7	63.5	84.6
Jinxi Petrochemical	70.9	60.0	66.2
Jilin Petrochemical[4]	69.8	75.5	61.4
Urumqi Petrochemical	50.0	62.0	62.0
Average of other refineries	39.2	53.7	50.5

[1] Represents the primary distillation capacity of crude oil and condensate.

[2]

Includes Lanzhou Refinery, which was merged into Lanzhou Petrochemical in October 2000 as part of our ongoing restructuring.

(3) Includes a 19.05% minority interest held by unrelated third parties in Jinzhou Petrochemical Company Limited in the relevant periods.

(4) Includes Jilin Chemical Industrial Company Limited, in which we held a 67.29% equity interest in the relevant periods. Data regarding the primary distillation capacity, refining throughput and

conversion equivalent of Jilin Petrochemical includes a 32.71% minority interest held by unrelated third parties in Jilin Chemical Industrial Company Limited in the relevant periods.

(5) Stated in fluid catalytic cracking, delayed coking and hydrocracking equivalent/ topping (percentage by weight), based on 100% of balanced distillation capacity.

In each of the three years ended December 31, 2003, 2004 and 2005, the average utilization rate of the primary distillation capacity at our refineries was 85.6%, 93.2% and 95.5%, respectively. The average yield for our four principal refined products (gasoline, kerosene, diesel and lubricants) at our refineries was 64.5%, 65.6% and 66.7% respectively, in the same periods. Yield represents the number of tons of a refined product expressed as a percentage of the number of tons of crude oil from which that product is processed. In each of the three years ended December 31, 2003, 2004 and 2005, the yield for all refined products at our refineries was 91.5%, 91.5% and 92.3% respectively.

Dalian Petrochemical, Fushun Petrochemical and Lanzhou Petrochemical were our leading refineries in terms of both primary distillation capacity and throughput in 2005. They are all located close to our major oil fields in the northeast and northwest regions of China and produce a wide range of refined products. Lanzhou Petrochemical has a strategic position in our plan to expand our markets in refined product sales in the southwestern and central regions of China. It is located in the northwestern part of China, providing easy access to markets in the southwestern and central regions in China. As of December 31, 2005, these three refineries had an aggregate primary distillation capacity of 223.2 million barrels per year, or 611.4 thousand barrels per day, representing approximately 26.2% of the total primary distillation capacity of all our refineries as of the same date. In 2005, these three refineries processed an aggregate of 217.8 million barrels of crude oil, or 596.8 thousand barrels per day, representing approximately 29.0% of our total throughput in the same period.

Marketing

We market a wide range of refined products, including gasoline, diesel, kerosene and lubricants, through an extensive network of sales personnel and independent distributors and a broad wholesale and retail distribution system across China. As of December 31, 2005, our marketing network consisted of:

approximately 792 regional wholesale distribution outlets nationwide. Substantially all of these outlets are located in high demand areas such as economic centers across China, particularly in the coastal areas, along major railways and along the Yangtze River; and

15,908 service stations owned and operated by us, 427 service stations wholly owned by CNPC or jointly owned by CNPC and third parties that exclusively sell refined products produced or supplied by us and to which we provide supervisory support under contractual arrangement, and 1,829 franchise service stations owned and operated by third parties.

In 2005, we sold approximately 74.0 million tons of gasoline and diesel. The PRC government and other institutional customers, including railway, transportation and fishery operators, are our long-term purchasers of the gasoline and diesel that we produce. We sell gasoline and diesel to these customers at the ex-factory median prices published by the PRC government with an 8% floating range. See Regulatory Matters Pricing Refined Products for a discussion of refined product pricing. In 2005, sales of gasoline and diesel to these customers accounted for approximately 1% and 9% of our total sales of gasoline and diesel, respectively. The following table

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sets forth our refined product sales volumes by principal product category for each of the three years ended December 31, 2003, 2004 and 2005.

Product	Year ended December 31, 2003	2004	2005
	(in thousands of tons)		
Diesel	36,680.7	43,178.3	47,811.0
Gasoline	19,872.5	21,714.2	26,161.6
Fuel oil	5,748.7	5,747.4	6,409.6
Naphtha	4,836.2	5,325.9	5,574.1
Kerosene	1,789.1	2,116.2	2,008.0
Lubricants	1,774.5	1,974.0	2,181.6
Asphalt	1,711.3	2,348.7	2,475.6
Paraffin	1,055.5	1,138.1	1,160.3
Total	73,468.5	83,542.8	93,781.8

Wholesale Marketing

We sell refined products both directly and through independent distributors into various wholesale markets, as well as to utility, commercial, petrochemical, aviation, agricultural, fishery and transportation companies in China. We sold approximately 74.0 million tons of gasoline and diesel through our wholesale operations in 2005, including transfers to our retail operations. We sold approximately 0.83 million tons of gasoline and diesel through our wholesale operations to Sinopec in 2005, representing approximately 1.1% of our total sales of these products in the same period. In 2005, we sold approximately 14.5 million tons of our other principal refined products.

As part of the restructuring of the CNPC group in 1999, we completed the implementation of a plan to consolidate our wholesale operations and reduce distribution layers and the number of wholesale outlets. In 2001, we completed a series of initiatives to change the business scope, adjust the business functions or shut down operations in respect of 558 county level outlets. In addition, we merged 18 municipal level outlets in 2001. In 2002, we continued these initiatives by integrating our markets in Shandong Province and Anhui Province, enhancing our logistics system and shutting down a number of inefficient oil storage facilities. In 2003, we further consolidated our wholesale operations. In 2004, we consolidated our sales operations in the southern and central regions of China, respectively, by establishing a branch company in each area which is fully engaged in sales and marketing. We believe the implementation of this strategy has increased the overall efficiency of our marketing operations.

Retail Marketing

In 2005, we sold approximately 38.1 million tons of gasoline and diesel through our service station network, accounting for 51.5% of the total of these products sold through our marketing operations in the same period. Although sales volumes vary significantly by geographic region, the weighted average sales volume of gasoline and diesel per business day at our service station network in 2003, 2004 and 2005 was 4.9 tons, 5.5 tons and 6.7 tons per service station, respectively.

We sell our refined products to service stations owned and operated by CNPC. These service stations sell exclusively refined products produced or supplied by us in accordance with contractual arrangements between CNPC and us. Under these contractual arrangements, we also provide supervisory support to these service stations.

We currently operate a majority of our service stations under the trade name of . We intend to gradually adopt our new logo for all our service stations in the next few years.

Most of the service stations in our service station network are concentrated in the northern, northeastern and northwestern regions of China where we have a dominant wholesale market position. However, the eastern and southern regions of China have a higher demand for gasoline and diesel. We have made significant efforts in recent years to expand our sales and market share in those regions through expanding the number of our service stations and storage facilities in those regions. As part of our expansion initiatives, on May 14, 2004, we entered into the Joint Venture Contract and the Articles of Association with BP Global Investments Limited, a subsidiary of BP Amoco p.l.c., to form BP PetroChina Petroleum Company Limited in Guangdong Province. We and BP Global Investments Limited hold 51% and 49% equity interests in BP PetroChina Petroleum Company Limited, respectively. We expect that BP PetroChina Petroleum Company Limited will build, acquire and manage approximately 500 service stations in Guangdong Province within three years from its establishment. As of December 31, 2005, BP PetroChina Petroleum Company Limited owned and operated 433 service stations in the eastern and northern regions of Guangdong Province.

We invested a total of RMB 9,565 million in expanding our service station network in 2005, of which 74.6% was invested in the eastern and southern regions of China. In 2005, we sold approximately 17,490 thousand tons of gasoline and diesel through our owned and franchised service stations in these regions, as compared to approximately 9,916 thousand tons and approximately 13,130 thousand tons we sold in 2003 and 2004, respectively.

In 2005, we acquired or constructed an aggregate of 1,247 service stations that are owned and operated by us, of which 995 are in the eastern and southern regions of China. We plan to further increase our retail market share and improve the efficiency of our retail operations, with a continued focus on the eastern and southern regions of China. We plan to invest approximately RMB 8,500 million in 2006 to expand our service station network by adding approximately 910 new service stations.

The following table sets forth the number of the service stations in our marketing network as of December 31, 2005:

Owned and operated by us[(1)]	15,908
Wholly owned by CNPC or jointly owned by CNPC and third parties[(2)]	427
Franchised	1,829
Total	18,164

(1) Includes 433 service stations owned and operated by BP PetroChina Petroleum Company Limited.

(2) These service stations exclusively sell refined products produced or supplied by us. We also provide supervisory support to these service stations.

In order to improve the efficiency and profitability of our existing service station network, we standardize the interior and exterior of our service stations, our service procedures, staff uniforms and the product quality of all our service stations. We are in the process of promoting the use of pre-paid gasoline/diesel filling cards at our service stations. We have equipped 666 service stations located in 14 municipalities with facilities that allow customers to purchase gasoline or diesel with their pre-paid filling cards. In addition to selling gasoline and diesel, we have planned to gradually increase the sale of lubricants and other non-fuel products at our service stations.

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Chemicals and Marketing

Through 12 chemical plants, we produce basic petrochemical products, derivative petrochemical products, and other chemical products. As of December 31, 2005, our chemicals and marketing segment had income from operations of RMB 3,276 million.

Our chemical plants are located in five provinces and three autonomous regions in China. Most of our chemical plants are co-located with our refineries and are also connected with the refineries by pipelines, providing additional production flexibility and opportunities for cost competitiveness. Our exploration and production, refining and marketing, and natural gas and pipeline operations supply substantially all of the hydrocarbon feedstock requirements for our chemicals operations. We believe that the proximity of our refineries to our chemical plants promotes efficiency in production, secures feedstock supply and minimizes the risk of production interruption. Our production capacity and our market share in China for chemical products allow us to solidify our dominant position in the northern and western regions of China. In addition, our stable customer base in the eastern and southern regions of China provides us with the opportunity to expand our market share in these regions.

Our Chemical Products

The table below sets forth the production volumes of our principal chemical products for each of the three years ended December 31, 2003, 2004 and 2005.

	Year ended December 31,		
	2003	**2004**	**2005**
	(in thousand tons)		
Basic petrochemicals			
Propylene	1,833.7	1,969.1	2,493.5
Ethylene	1,817.9	1,845.6	1,887.9
Benzene	683.8	712.7	707.9
Derivative petrochemicals			
Synthetic resin			
Polyethylene	1,208.0	1,309.5	1,355.9
Polypropylene	924.3	986.9	1,142.8
ABS	208.7	228.1	223.0
Other synthetic resin products	35.1	27.6	35.2
Synthetic fiber			
Polyacrylic fiber	83.7	108.1	97.1
Terylene fiber	116.6	94.3	86.2
Other synthetic fiber products	11.4	7.4	6.3
Synthetic rubber			
Styrene butadiene rubber	147.3	190.2	194.4
Other synthetic rubber products	98.8	95.6	87.0
Intermediates			
Alkylbenzene	204.7	194.9	205.7
Other chemicals			
Urea	3,579.6	3,652.3	3,577.6
Ammonium nitrate	46.5	32.0	5.4

We are one of the major producers of ethylene in China. We use the bulk of the ethylene we produce as a principal feedstock for the production of many chemical products, such as polyethylene. In 2001, we implemented a five-year plan to invest RMB 10,000 million to upgrade our

ethylene production facilities at Daqing Petrochemical, Jilin Petrochemical, Liaoyang Petrochemical, Dushanzi Petrochemical and Lanzhou Petrochemical. As of December 31, 2005, we had invested approximately RMB 9,660 million for these upgrade projects. Except for the on-going project at Lanzhou Petrochemical, we have completed all of the other upgrading projects we implemented in 2001. As of December 31, 2005, we had a total ethylene production capacity of 1,850 thousand tons per year. In 2005, the production volume of ethylene increased by 2.3% from 1,845.6 thousand tons in 2004 to 1,887.9 thousand tons. We are currently conducting further upgrading of our ethylene production facilities. We expect to complete the further upgrading of the ethylene production facilities at Lanzhou Petrochemical, Jilin Petrochemical and Liaoyang Petrochemical prior to 2007, which would result in an additional production capacity of 860 thousand tons per year. We expect to have a total ethylene production capacity of 2,710 thousand tons per year in 2007. The expansion and upgrading of the ethylene production facilities at Daqing Petrochemical has been postponed due to changes to the upgrading plan. We expect that the upgrading of the ethylene production facilities at Dushanzi Petrochemical will be completed by 2008. The petrochemical ethylene projects at Fushun Petrochemical and Sichuan Petrochemical have been approved by the National Development and Reform Commission.

In 2005, the monthly average capacity utilization rate at our ethylene production facilities was 102%. The cost of ethylene production is an important component of our overall chemical production costs. Reduction of energy consumption and raw material loss is a key factor in reducing ethylene production costs. After we implemented a series of measures in 2003, 2004 and 2005 to reduce energy consumption, the average energy consumption of our ethylene production facilities decreased from 754.1 kilograms of standard oil per ton in 2003 to 734.3 kilograms in 2004, and increased to 751.5 kilograms in 2005. This is significantly higher than the world average of 500 to 690 kilograms of standard oil per ton. We plan to continue to implement measures to reduce our energy consumption.

In addition, high ethylene percentage loss has also contributed to the relative high cost of our ethylene production. In order to reduce high ethylene percentage loss in our ethylene production, we have implemented a series of measures at our chemical plants in the past two years, such as improving our process management of key units for ethylene production, reducing unplanned temporary interruptions of our chemical facilities and enhancing pyrolysis material composition and production plans. As a result, the average ethylene percentage loss at our chemical plants decreased from 0.57% in 2003 to 0.54% in 2004. The average ethylene percentage loss rate went up to 0.61% in 2005, due to the significant losses resulting from the trial of an upgraded ethylene production facility. However, we believe that our measures will enable us to reduce the cost of our ethylene production without incurring significant capital expenditures.

We produce a number of synthetic resin products, including polyethylene, polypropylene and ABS. As of December 31, 2005, our production capacities for polyethylene, polypropylene and ABS were 1,712.5 thousand tons, 1,483.5 thousand tons and 220 thousand tons, respectively. In 2005, we produced 1,355.9 thousand tons and 1,142.8 thousand tons of polyethylene and polypropylene, respectively, which respectively increased by 3.5% and 15.8% as compared with 2004. In 2005, we produced 223.0 thousand tons of ABS, representing a decrease of 2.2% of production volume from 2004. Currently, China imports significant volumes of these products to meet the domestic demand due to an inadequate supply of high-quality domestically produced polyethylene and polypropylene. We intend to increase the production, and improve the quality, of these products. We are currently building new production facilities with new technology for the production of these products in Daqing Petrochemical, Daqing Refining and Chemical, Jilin Petrochemical, Lanzhou Petrochemical, Dalian Petrochemical and other branch companies to meet this target.

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Sales and Marketing

Our chemical products are distributed to a number of industries that manufacture components used in a wide range of applications, including automotive, construction, electronics, medical manufacturing, printing, electrical appliances, household products, insulation, packaging, paper, textile, paint, footwear, agriculture and furniture industries.

The following table sets forth the sales volumes of our chemical products by principal product category for each of the three years ended December 31, 2003, 2004 and 2005.

	Year ended December 31,		
Product	**2003**	**2004**	**2005**
	(in thousands of tons)		
Derivative petrochemicals			
Synthetic resin			
Polyethylene	1,205.0	1,423.6	1,477.0
Polypropylene	717.2	793.3	972.3
ABS	204.5	231.8	232.0
Synthetic fiber			
Terylene fiber	132.9	103.6	103.3
Polyacrylic fiber	81.2	115.8	95.5
Synthetic rubber			
Butadiene styrene rubber	144.7	187.8	202.2
Intermediates			
Alkylbenzene	110.1	110.9	112.3
Other chemicals			
Urea	3,766.8	3,662.8	3,413.8
Ammonium nitrate	51.1	32.8	4.1

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Natural Gas and Pipeline

We are China s largest natural gas transporter and seller in terms of sales volume, with revenues of RMB 26,214 million and total sales volume of 1,052.2 billion cubic feet in 2005, of which 888.8 billion cubic feet was sold by our natural gas and pipeline segment. In 2005, our natural gas and pipeline segment had income from operations of RMB 3,183 million. We sell natural gas primarily to fertilizer and chemical companies, commercial users and municipal utilities owned by local governments.

The following table sets forth the length of our natural gas pipelines as of December 31, 2003, 2004 and 2005 and the volume of natural gas sold by us in each of the three years ended December 31, 2003, 2004 and 2005.

	As of December 31 or year ended December 31,		
	2003	2004	2005
Length of natural gas pipelines used by our natural gas segment (km)	14,017	17,868	19,212
Total length of natural gas pipelines (km)	15,144	18,995	20,340
Volume of natural gas sold by our natural gas segment (Bcf)	543.4	657.3	888.8
Total volume of natural gas sold(1)(Bcf)	651.0	781.4	1,052.2

(1) Including both the natural gas sold to third parties and the natural gas sold within our company for the production of other products.

Currently, natural gas consumption in China represents 2.6% of China s total primary energy consumption. The PRC government has forecast that natural gas consumption in China will represent 6.7% of China s total primary energy consumption in 2010. We believe this growth will provide us with the opportunity to expand our natural gas business.

In addition, we also conduct the operation of crude oil and refined product transmission and storage infrastructure in the natural gas and pipeline segment.

Our Principal Markets for Natural Gas

In 2005, 43.7%, 19.6%, 17.5%, 2.0%, 1.8% and 15.4% of our natural gas sales were to the southwestern, northern, northwestern, northeastern, central, and eastern regions of the PRC, respectively.

Currently, Sichuan Province and Chongqing Municipality in southwest China are two of our principal markets for natural gas. We sold 388.1 billion cubic feet of natural gas to Sichuan Province and Chongqing Municipality in 2005, as compared to 296.4 billion cubic feet in 2004, representing approximately 36.9% of our total natural gas sales in 2005. We supply natural gas to Sichuan Province and Chongqing Municipality from our exploration and production operations in the Sichuan oil region. Our natural gas pipelines in these areas are well developed, consisting of a natural gas transmission network with a total length of approximately 6,644 kilometers. As these areas lack adequate supply of alternative energy resources, such as coal, we believe that we can further expand our natural gas sales as energy demand increases in these areas.

Beijing Municipality, Tianjin Municipality, Hebei Province and Shandong Province in northern China have high energy consumption levels. These areas are also important markets for our natural gas transmission and marketing business. We sold an aggregate of 167.5 billion cubic feet of natural gas to these areas in 2005, as compared to 140.2 billion cubic feet in 2004. Our natural gas sales to Beijing Municipality increased 18.2% from 93.2 billion cubic feet in 2004 to 110.2 billion cubic feet in 2005. We supply natural gas to Beijing Municipality, Tianjin Municipality and Hebei Province primarily from the Changqing oil region through the Shaanxi to Beijing natural gas pipeline, which is one of

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our natural gas trunk pipelines, and from the Huabei and Dagang oil regions. Currently, we have 2,813 kilometers of natural gas pipelines in these areas.

Henan Province, Anhui Province, Shanghai Municipality and other provinces and cities in the Yangtze River Delta, Wuhan City and other regions in Hubei Province, Hunan Province, Lanzhou City and other areas in Gansu Province, Qinghai Province and Shanxi Province are also natural gas markets we are developing. In 2004, we completed the construction and commenced commercial operation of the mainlines of the West to East natural gas pipeline and the Zhong County to Wuhan City natural gas pipeline, which link our Xinjiang, Changqing and Sichuan gas fields with these areas.

Each year, we must supply natural gas to customers subject to the government-formulated guidance supply plan first as required by the PRC government. We enter into natural gas supply contracts with those customers on the basis of the amount of natural gas to be supplied according to the guidance supply plan for the following year s supply.

We have entered into long-term take-or-pay contracts with 16 municipalities and enterprises in Qinghai Province, Gangsu Province, Shanxi Province and Tianjin Municipality, 25 municipalities and enterprises in Hubei Province and Hunan Province, 17 municipalities in Shandong Province and 41 municipalities and enterprises in Henan Province, Anhui Province, Shanghai Municipality and other provinces located in the Yangtze River Delta. Under these take-or-pay contracts, we have agreed in principle to supply natural gas to these customers in the next 20 to 25 years at prices determined based on the ex-factory prices published by the National Development and Reform Commission, formerly the State Development Planning Commission, supplemented by the pipeline transportation tariffs. See Regulatory Matters Pricing Natural Gas for a discussion of natural gas pricing.

In 2005, we sold 799 billion cubic feet, or 89.9% of the natural gas sales volume of our natural gas and pipeline segment, to customers not subject to the government-formulated guidance supply plan, such as commercial end users and municipal utilities, representing a 37% increase over 2004. We believe that sales volume of our natural gas to customers not subject to the government-formulated guidance supply plan as a percentage of our total sales will continue to increase. See Regulatory Matters Pricing Natural Gas for a discussion of the government-formulated guidance supply plan.

Driven by environmental and efficiency concerns, the PRC government is increasingly encouraging industrial and residential use of natural gas to meet primary energy and environmental protection needs. The PRC government has adopted a number of laws and regulations to require municipal governments to increase the use of clean energy, such as natural gas and liquefied petroleum gas, to replace the use of raw coal. Several municipal governments, including that of Beijing, have adopted policies to facilitate natural gas consumption in order to reduce the air pollution level. The PRC government has also adopted a preferential value-added tax rate of 13% for natural gas production as compared to a 17% value-added tax rate for crude oil production.

We believe that these policies have had a positive effect on the development and consumption of natural gas in many municipalities that are our existing or potential markets for natural gas. We believe that these favorable policies will continue to benefit our natural gas business.

Natural Gas Transmission Infrastructure

As of December 31, 2005, our natural gas and pipeline segment owned and operated approximately 19,212 kilometers of natural gas pipelines in China, which represented the vast majority of China s onshore natural gas pipelines. Our existing natural gas pipelines form regional natural gas supply networks in northwestern, southwestern and northern China as well as the Yangtze River Delta. Our experience in the design, construction management and operation of our existing natural gas pipelines has enabled us to develop relatively advanced technologies and skills in China in long distance pipeline design, construction and automated operational communications. We believe that we will continue to benefit from those technologies and skills in the future expansion of our natural gas pipeline networks and their ancillary facilities.

Expansion of Our Natural Gas Transmission and Marketing Business

In September 2001, we completed the construction of a natural gas pipeline from Sebei, Qinghai Province, to Xining City, Qinghai Province and Lanzhou City, Gansu Province, of which the total length of the main line is approximately 930 kilometers. The capital investment for this project was RMB 2,220 million, which was funded by cash generated by our operations.

In March 2002, we completed the construction, and commenced the operation, of a natural gas pipeline from Cangzhou City to Zibo City with a total length of 213.5 kilometers. We own a 70% interest in this project. An unrelated natural gas company in Shandong Province holds the remaining interest in this project.

In October 2004, we completed the construction of the main line of our West to East natural gas pipeline and commenced commercial operation in December 2004. Our West to East natural gas pipeline project is designed to link our natural gas fields in Xinjiang and Changqing with Henan Province, Anhui Province, Shanghai Municipality and other areas in the Yangtze River Delta. The total length of the main line for the West to East natural gas pipeline project is 3,786 kilometers. As of December 31, 2005, we had invested RMB 31,383 million in this project. We are currently constructing and will continue in the next few years the construction of the branch pipelines and connecting pipelines for the West to East natural gas pipeline project, including the pipeline connecting our West to East natural gas pipeline with the second Shaanxi to Beijing natural gas pipeline. This connecting pipeline starts at Qingshan in Jiangsu Province and ends at Anping in Hebei Province with a total length of 910 kilometers. We commenced the construction of this connecting pipeline at the end of 2004 and completed the construction of the main part of this pipeline in the end of 2005. As of May 31, 2006, we had entered into take-or-pay contracts with 41 subscribers and distributors to supply them with natural gas through the West to East natural gas pipeline. We believe that the successful completion of this natural gas pipeline and associated storage facilities will substantially enhance our ability to capitalize on anticipated growth in demand for natural gas in these regions.

The Zhong County to Wuhan City natural gas pipeline is designed to link the Sichuan gas region with Wuhan City, the other areas in Hubei province and Hunan Province, and has a designed annual throughput capacity of 105.9 billion cubic feet of natural gas. We commenced the construction of the pipeline in August 2003. In December 2004, we completed the construction and commenced commercial operation of the main line of the Zhong County to Wuhan City natural gas pipeline and its Xiangfan branch pipeline and Huangshi branch pipeline. We completed the construction and commenced commercial operation of the Xiangtan branch line in July 2005. As of May 31, 2006, we had entered into take-or-pay contracts with 25 municipalities and enterprises in Hubei Province and Hunan Province to supply them with natural gas to be transmitted through the main line and branch lines of the Zhong County to Wuhan City pipeline.

We completed constructing the second natural gas pipeline from Shaanxi to Beijing Municipality in July 2005. This second Shaanxi to Beijing natural gas pipeline has a total length of 860 kilometers and can be used to deliver natural gas from our Changqing oil and gas region to Shaanxi Province, Shanxi Province, Hebei Province and Beijing Municipality with a designed annual throughput capacity of 423.8 billion cubic feet of natural gas.

Crude Oil and Refined Product Transportation and Storage Infrastructure

In order to improve management effectiveness, operating efficiency and safety of our crude oil and refined product transportation and storage businesses, we transferred the pipeline operations and some storage infrastructure related to the pipeline operations for our crude oil and refined products from the refining and marketing segment to the natural gas segment on January 1, 2001, which was then renamed the natural gas and pipeline segment. See Item 5 Operating and Financial Review and Prospects General Overview .

We have an extensive network for the transportation, storage and distribution of both crude oil and refined products, which covers many regions of China. Our goal is to exploit and optimize our existing infrastructure to further consolidate our presence as the leading integrated oil and gas company in China.

As of December 31, 2005, our crude oil transportation and storage infrastructure consisted of:

9,391 kilometers of crude oil pipelines with an average daily throughput of approximately 2.39 million barrels; and

crude oil storage facilities with an aggregate storage capacity of approximately 15.9 million cubic meters.

We deliver crude oil to customers through our pipeline and storage facility network, through crude oil storage facilities that we lease from third parties and by ships leased by customers. In 2005, approximately 85.74% of our crude oil production was delivered to refineries through our crude oil pipeline network. We believe that our crude oil pipeline network is sufficient for our current and anticipated transportation needs. During the past three years, we have not experienced any delays in delivering crude oil due to pipeline capacity constraints.

Our transportation and storage infrastructure also includes:

2,462 kilometers of refined product pipelines with an average daily throughput of approximately 32,630 tons; and

refined product storage facilities with a total storage capacity of approximately 15.9 million cubic meters.

Most of our refineries are located in the northeastern and northwestern regions of China. Our ability to distribute products through our own product distribution infrastructure to the eastern and southern regions will provide us with greater flexibility in supplying refined products to the domestic markets across China. We plan to continue to enhance our product distribution infrastructure in the northeastern, northwestern, northern and southwestern regions where we already have a significant market share, and to expand our product distribution infrastructure in the eastern and southern regions by acquiring and constructing transportation storage facilities and distribution storage facilities in these regions.

Together with the expansion of our service stations, we expect that our pipelines, primary storage and secondary distribution storage facilities will significantly enhance our existing distribution infrastructure for refined products. We believe that our enhanced distribution infrastructure will help us increase the sales of our refined products.

Competition

As an oil and gas company operating in a competitive industry, we compete in each of our business segments in both China and international markets for desirable business prospects and for customers. Our principal competitors in China are Sinopec, including its subsidiary China National Star Petroleum Corporation, or CNSPC, and China National Offshore Oil Corporation, or CNOOC.

Exploration and Production Operations

We are the largest onshore oil and gas company in China in terms of proved crude oil and natural gas reserves as well as crude oil and natural gas production and sales. However, we compete with Sinopec for the acquisition of desirable crude oil and natural gas prospects. We believe that our experience in crude oil and natural gas exploration and production and our advanced exploration technologies that are suitable for diverse geological conditions in China will enable us to maintain our dominant position in discovering and acquiring desirable crude oil and natural gas prospects in China.

Refining and Marketing and Chemicals and Marketing Operations

We compete with Sinopec in our refining and marketing and chemicals and marketing operations on the basis of price, quality and customer service. Most of our refineries and chemical plants are located in the northeastern, northwestern and northern regions of China where we have the dominant market share for refined products and chemical products. We also sell our refined products and chemical products in the eastern, southern, southwestern and central-southern regions of China, where our products have a considerable market share. The eastern and southern regions of China, where refined products and chemical products are in higher demand, are important markets for our refined products and chemical products. Sinopec has a strong presence in the eastern and southern regions of China in competition with us, and most of Sinopec s refineries, chemical plants and distribution networks are located in these regions in close proximity to these markets. Moreover, as the newly constructed facilities of CNOOC commenced operation, the competition is further intensified. We expect that we will continue to face competition from, among other competitors, Sinopec in increasing our refined products and chemical products sales in these regions. See Item 3 Key Information Risk Factors .

We also face competition from imported refined products and chemical products on the basis of price and quality. As a result of China s entry into the WTO, we expect that competition from foreign producers of refined products and chemical products may increase as tariff and non-tariff barriers for imported refined products and chemical products will be reduced or eliminated over time, including the opening over time of retail and wholesale markets in China for refined products and chemical products to foreign competition. Our ability to compete with foreign producers of refined products and chemical products will depend on our ability to reduce our production costs and improve the quality of our products. See Item 3 Key Information Risk Factors .

Natural Gas and Pipeline Operations

We are the largest supplier of natural gas in terms of volume of natural gas supplied. Currently, we face very limited competition in the supply of natural gas in Beijing Municipality, Tianjin Municipality, Hebei Province, Shanghai Municipality, Jiangsu Province, Zhejiang Province, Anhui Province, Henan Province, Hubei Province, Hunan Province and the northwestern regions of China, our existing principal markets for natural gas. Currently, Sinopec has natural gas fields in Sichuan Province and Chongqing Municipality and sells natural gas to users in Sichuan and Chongqing. We, therefore, have limited competition from Sinopec in our markets in Sichuan Province and Chongqing Municipality. Further, we intend to expand our markets for natural gas into the coastal regions in eastern China where we may face competition from CNOOC and, to a lesser extent, Sinopec. We believe that our dominant natural gas resources base, our relatively advanced technologies and skills in managing long distance pipelines will enable us to continue to be a dominant player in the natural gas markets in China.

Environmental Matters

Together with other companies in the industries in which we operate, we are subject to numerous national, regional and local environmental laws and regulations concerning our oil and gas exploration and production operations, petroleum and petrochemical products and other activities. In particular, these laws and regulations:

- require an environmental evaluation report to be submitted and approved prior to the commencement of exploration, production, refining and chemical projects;

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- restrict the type, quantities, and concentration of various substances that can be released into the environment in connection with drilling and production activities;

- limit or prohibit drilling activities within protected areas and certain other areas; and

- impose penalties for pollution resulting from oil, natural gas and petrochemical operations, including criminal and civil liabilities for serious pollution.

These laws and regulations may also restrict air emissions and discharges to surface and subsurface water resulting from the operation of natural gas processing plants, chemical plants, refineries, pipeline systems and other facilities that we own. In addition, our operations may be subject to laws and regulations relating to the generation, handling, storage, transportation, disposal and treatment of solid waste materials.

We anticipate that the environmental laws and regulations to which we are subject will become increasingly strict and are therefore likely to have an increasing impact on our operations. It is difficult, however, to predict accurately the effect of future developments in such laws and regulations on our future earnings and operations. Some risk of environmental costs and liabilities is inherent in certain of our operations and products, as it is with other companies engaged in similar businesses. We cannot assure you that material costs and liabilities will not be incurred. However, we do not currently expect any material adverse effect on our financial condition or results of operations as a result of compliance with such laws and regulations. We paid pollutant discharge fees of approximately RMB 155 million, RMB 182 million and RMB 199 million in 2003, 2004 and 2005, respectively.

To meet future environmental obligations, we are engaged in a continuous program to develop effective environmental protection measures. This program includes research on:

- reducing sulphur levels in heavy fuel oil and diesel fuel;

- reducing olefin and benzene content in gasoline and the quantity of emissions and effluents from our refineries and petrochemical plants; and

- developing and installing monitoring systems at our pollutant discharge openings and developing environmental impact assessments for major projects.

Our capital expenditures on environmental programs in 2003, 2004 and 2005 were approximately RMB 1,076 million, RMB 1,345 million and RMB 1,633 million, respectively.

On December 23, 2003, a gas blow-out incident occurred at our Luojia No. 16H gas well located in Kaixian County, Chongqing Municipality. The gas blow-out caused the leakage of a large quantity of sulfurated hydrogen, resulting in injuries and death to many residents living in the surrounding areas. The PRC government investigated this gas blow-out and found CNPC, who had provided drilling services to us for the Luojia No. 16H gas well, liable. This incident has not had, and we do not believe it will have, a material adverse effect on our results of operations and financial condition. Because a number of our production facilities are located in populated areas, we have established a series of preventative measures to improve the safety of our employees and surrounding residents and minimize disruptions or other adverse effects on our business. Theses measures include:

- providing each household in areas surrounding our production facilities with printed materials to explain and illustrate safety and protection knowledge and skills; and

- enhancing the implementation of various safety production measures we have adopted previously.

We believe that these preventative measures have helped minimize the possibility of similar incidents resulting in serious casualties and environmental consequences. In addition, the adoption of these preventative measures has not required significant capital expenditures to date, and therefore, will not have a material adverse effect on our results of operations and financial condition.

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On November 13, 2005, an explosion occurred at a dianil plant of Jilin Petrochemical Company, our branch company in the Jilin Province. The incident caused serious water pollution of the Songhuajiang River. The Chinese government is currently investigating the cause of this incident and we will, in accordance with the result of such investigation, take responsibility for this incident. We cannot assure you that the result of such investigation will not have a material adverse effect on our financial condition or results of operations.

We intend to implement the following measures to prevent future occurrences of similar incidents:

- conducting environmental risk monitoring; and
- establishing preventive systems for emergency use at refinery and petrochemical enterprises.

Legal Proceedings

We are not involved in any judicial and arbitral proceedings, the results of which, in the aggregate, would have a material adverse impact on our financial condition.

Properties

Under a restructuring agreement we entered into with CNPC on the date of our establishment in 1999, CNPC undertook to us the following:

- CNPC would use its best endeavours to obtain formal land use right licenses to replace the entitlement certificates in relation to the 28,649 parcels of land, which were leased or transferred to us from CNPC, within one year from August, September and October 1999 when the relevant entitlement certificates were issued;
- CNPC would 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 us are located; and
- CNPC would obtain individual building ownership certificates in our name for all of the 57,482 buildings transferred to us by CNPC, before November 5, 2000.

As of December 31, 2005, CNPC obtained formal land use right certificates for 27,400 of the 28,649 parcels of land and ownership certificates for some buildings. The governmental procedures for the above-mentioned service stations located on collectively owned land have not been completed to date. Our directors believe 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 building ownership certificates have not been obtained or the fact that the relevant governmental procedures have not been completed. Our directors believe that this will not have any material adverse effect on our results of operations and financial condition.

We own substantially all of the equipment and production facilities relating to the business activities of all our segments. We hold production licenses covering all of our interests in developed and undeveloped acreage and productive crude oil and natural gas wells. See Exploration and Production Properties .

Regulatory Matters

Overview

China s oil and gas industry is subject to extensive regulation by the PRC government with respect to a number of aspects of exploration, production, transmission and marketing of crude oil and natural gas as well as production, transportation and marketing of refined products and chemical

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products. The following central government authorities exercise control over various aspects of China s oil and gas industry:

The Ministry of Land and Resources has the authority for granting, examining and approving oil and gas exploration and production licenses, the administration of registration and transfer of exploration and production licenses.

The Ministry of Commerce, which was established in March 2003 to consolidate the authorities and functions of the former State Economic and Trade Commission and the former Ministry of Foreign Trade and Economic Cooperation:

sets the import and export volume quotas for crude oil and refined products according to the overall supply and demand for crude oil and refined products in China as well as the WTO requirements for China;

issues import and export licenses for crude oil and refined products to oil and gas companies that have obtained import and export quotas; and

examines and approves production sharing contracts and Sino-foreign equity and cooperative joint venture contracts.

The National Development and Reform Commission, which was established in March 2003 to consolidate the authorities and functions of the former State Development Planning Commission and the former State Economic and Trade Commission:

has the industry administration and policy coordination authority over China s oil and gas industry;

determines mandatory minimum volumes and applicable prices of natural gas to be supplied to certain fertilizer producers;

publishes guidance prices for natural gas and retail median guidance prices for certain refined products, including gasoline and diesel;

approves significant petroleum, natural gas, oil refinery and chemical projects set forth under the Catalogues of Investment Projects Approved by the Central Government; and

approves Sino-foreign equity and cooperative projects exceeding certain capital amounts.

Exploration Licenses and Production Licenses

The Mineral Resources Law authorizes the Ministry of Land and Resources to exercise administrative authority over the exploration and production of mineral resources within the PRC. The Mineral Resources Law and its supplementary regulations provide the basic legal framework under which exploration licenses and production licenses are granted. The Ministry of Land and Resources has the authority to issue exploration licenses and production licenses. Applicants must be companies approved by the State Council to engage in oil and gas exploration and production activities.

Applicants for exploration licenses must first register with the Ministry of Land and Resources blocks in which they intend to engage in exploration activities. The holder of an exploration license is obligated to make a progressively increasing annual minimum exploration investment relating to the exploration blocks in respect of which the license is issued. Investments range from RMB 2,000 per square kilometer for the initial year to RMB 5,000 per square kilometer for the second year, and to RMB 10,000 per square kilometer for the third and subsequent years. Additionally, the holder has to pay an annual exploration license fee that starts at RMB 100 per square kilometer for each of the first three years and increases by an additional RMB 100 per square kilometer per year for subsequent years up to a maximum of RMB 500 per square kilometer. The maximum term of an exploration license is seven years, subject to twice renewal upon expiration of the original term, with

each renewal being for a two-year term. At the exploration stage, an applicant can also apply for a progressive exploration and production license that allows the holder to test and develop reserves not yet fully proven. The production license has a maximum term of 15 years. Upon the reserves becoming proved for a block, the holder must apply for a full production license in order to begin production. In addition, the holder needs to obtain the right to use that block of land. Generally, the holder of a full production license must obtain a land use rights certificate for industrial land use covering that block of land.

The Ministry of Land and Resources issues production licenses to applicants on the basis of the reserve reports approved by the relevant authorities. Production license holders are required to pay an annual production right usage fee of RMB 1,000 per square kilometer. Administrative rules issued by the State Council provide that the maximum term of a production license is 30 years. In accordance with a special approval from the State Council, the Ministry of Land and Resources has issued production licenses with terms coextensive with the projected productive life of those reservoirs. Each of our production licenses is renewable upon our application 30 days prior to expiration. If oil and gas prices increase, the productive life of our crude oil and natural gas reservoirs may be extended beyond the current terms of the relevant production licenses.

Among the major PRC oil and gas companies, the exploration licenses and production licenses held by PetroChina, Sinopec and CNOOC account for the majority of mining rights in China. Among those companies, PetroChina and Sinopec primarily engage in onshore exploration and production, while CNOOC primarily engages in offshore exploration and production.

Pricing

Crude Oil

PetroChina and Sinopec set their crude oil median prices each month based on the average Singapore market FOB prices for crude oil of different grades in the previous month. In addition, PetroChina and Sinopec negotiate a premium or discount to reflect transportation costs, the differences in oil quality and market supply and demand. The National Development and Reform Commission will mediate if PetroChina and Sinopec cannot agree on the amount of premium or discount.

Refined Products

Prior to October 2001, PetroChina set its retail prices based on the published retail median guidance prices of gasoline and diesel published by the State Development Planning Commission, the predecessor of the National Development and Reform Commission, with an allowable upward or downward adjustment of up to 5%. Since October 2001, PetroChina has set its retail prices within an 8% floating range of the published retail median guidance prices of gasoline and diesel (but after March 26, 2006, the price of diesel for fishing vessels has been set in line with the retail base price published in the current year, with no upward adjustment for the time being). These retail median guidance prices of gasoline and diesel vary in each provincial level distribution region. Since October 2001, the National Development and Reform Commission has published the retail median guidance prices of gasoline and diesel from time to time based on the weighted average FOB Singapore, Rotterdam and New York trading prices for diesel and gasoline plus transportation costs and taxes. Generally, adjustments will be made only if the weighted average prices fluctuate beyond 8% of the previously published retail median guidance price.

PetroChina sets the wholesale prices for its gasoline and diesel on the basis of its retail prices and a discount to its retail prices of at least 4.5% as required by the National Development and Reform Commission.

In addition, the National Development and Reform Commission sets the ex-factory median prices for gasoline and diesel sold to the PRC government and other institutional customers,

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including airlines and railway operators. These ex-factory median prices are calculated with reference to the average FOB Singapore, Rotterdam and New York trading prices for gasoline and diesel in the previous month. PetroChina may set the prices it charges its customers on the basis of the ex-factory median prices set by the National Development and Reform Commission, which may be adjusted upward or downward up to 8%.

Chemical Products

PetroChina determines the prices of all of its chemical products.

Natural Gas

The price of natural gas has two components: ex-factory price and pipeline transportation tariff.

Prior to January 2002, our natural gas price was comprised of wellhead price, pipeline transportation tariff and purification fee. In January 2002, the State Development Planning Commission, the predecessor of the National Development and Reform Commission, merged the purification fee into the wellhead price to establish a unified natural gas ex-factory price.

Prior to December 26, 2005, ex-factory prices varied depending on whether or not the natural gas sold was within the government-formulated natural gas supply plan. For natural gas sold within the government-formulated supply plan, the National Development and Reform Commission fixed ex-factory prices according to the nature of the customers. Most of these customers were fertilizer producers. For natural gas sold to customers not subject to the government-formulated supply plan, the National Development and Reform Commission published median guidance ex-factory prices, and allowed natural gas producers to adjust prices upward or downward by up to 10%.

On December 26, 2005, the National Development and Reform Commission reformed the mechanism for setting the ex-factory prices of domestic natural gas by changing the ex-factory prices to governmental guidance prices, and categorizing domestic natural gas into two categories. On the basis of the ex-factory price set by the government, subject to the negations between the seller and the buyer, the actual ex-factory price of the first category may float upward or downward up to 10%; while the actual ex-factory price of the second category may float upward up to 10% and downward to any level. The price of the first category will be adjusted to the same level as the second category within three to five year. The National Development and Reform Commission does not allow PetroChina and Sinopec to charge different prices towards internal and external enterprises.

PetroChina negotiates the actual ex-factory price with natural gas users within the benchmark price set by the government and the adjustment range.

The National Development and Reform Commission sets the pipeline transportation tariff for the natural gas transported by pipelines constructed prior to 1991. For the natural gas transported by pipelines constructed after 1991, PetroChina submits to the National Development and Reform Commission for examination and approval proposed pipeline transmission tariffs based on the capital investment made in the pipeline, the depreciation period for the pipeline, the ability of end users to pay and PetroChina s profit margin.

Production and Marketing

Crude Oil

Each year, the National Development and Reform Commission publishes the projected target for the production and sale of crude oil by PetroChina, Sinopec and CNOOC, based on the domestic consumption estimates submitted by domestic producers, including PetroChina, Sinopec and CNOOC, the production capacity of these companies as well as the forecast of international crude oil prices. The actual production levels are determined by the producers themselves and may vary from the submitted estimates.

Refined Products

Previously, only PetroChina, Sinopec and joint ventures established by the two companies had the right to conduct gasoline and diesel wholesale business. Other companies, including foreign invested companies, were not allowed to engage in wholesale of gasoline and diesel in China s domestic market. In general, only domestic companies, including Sino-foreign joint venture companies, were permitted to engage in retail of gasoline and diesel. Since January 1, 2005 when the Interim Measures on the Administration of the Refined Products Market became effective, all entities meeting certain requirements are allowed to submit applications to the Ministry of Commerce to conduct gasoline and diesel wholesale and retail businesses.

Natural Gas

The National Development and Reform Commission publishes in each year the production targets for natural gas producers based on the annual production target prepared on the basis of consumption estimates submitted by all natural gas producers such as PetroChina. The National Development and Reform Commission also formulates the annual natural gas guidance supply plan, which requires natural gas producers to distribute a specified amount of natural gas to specified fertilizer producers. The actual production levels of natural gas, except the amount supplied to the fertilizer producers, are determined by the natural gas producers.

Foreign Investments

Cooperation in Exploration and Production with Foreign Companies

Currently, only CNPC and Sinopec have the right to cooperate with foreign companies in onshore crude oil and natural gas exploration and production in China. CNOOC and Sinopec (through its subsidiary CNSPC) have the right to cooperate with foreign companies in offshore crude oil and natural gas exploration and production in China.

Sino-foreign cooperation projects and foreign parties in onshore oil and gas exploration and production in China are generally selected through open bids and bilateral negotiations. Those projects are generally conducted through production sharing contracts. The Ministry of Commerce must approve those contracts.

As authorized by the Regulations of the PRC on Exploration of Onshore Petroleum Resources in Cooperation with Foreign Enterprises, CNPC has the right to enter into joint cooperation arrangements with foreign oil and gas companies for onshore crude oil and natural gas exploration and production. PetroChina does not have the capacity to enter into production sharing contracts directly with foreign oil and gas companies under existing PRC law. Accordingly, CNPC will continue to enter into production sharing contracts. After signing a production sharing contract, CNPC will, subject to approval of the Ministry of Commerce, assign to PetroChina most of its commercial and operational rights and obligations under the production sharing contract as required by the Non-competition Agreement between CNPC and PetroChina. See Item 7 Major Shareholders and Related Party Transactions Contract for the Transfer of Rights under Production Sharing Contracts .

Transportation and Refining

PRC regulations permit foreign minority ownership in pipeline transportation, oil storage facilities and oil jetties. There is no express general restriction on foreign investment in refineries and petrochemical facilities. However, construction of new refinery or ethylene facilities, expansion of existing refinery facilities and upgrading of existing ethylene facilities by increasing annual production capacity of more than 200 thousand tons are subject to the approval of relevant government authorities. The production of ethylene with an annual production capacity exceeding 600 thousand tons must be conducted by companies majority-owned by Chinese entities. Furthermore, when appropriate, projects must receive necessary approvals from relevant PRC government agencies. See Item 3 Key Information Risk Factors .

Import and Export

The import and export of crude oil and the export of refined products is subject to automatic filing and quota control in China. Currently, 25 companies are qualified to import crude oil and 121 companies are qualified to export refined products. The import of refined products was subject to quota and licensing control until the end of 2003. Since January 1, 2004, the import of refined products by state-owned entities has been exempted from import quota, licensing control and is subject to automatic filing control. The Ministry of Commerce sets the annual import and export volumes and quotas for crude oil and refined products by taking into account the supply and demand in China as well as the WTO requirements for China. The Ministry of Commerce is also responsible for issuing import and export licenses for products subject to quotas. Upon receiving quota allocation, refining companies or enterprises can import crude oil through State-authorized import companies. Since December 9, 2005, the export volume of gasoline, kerosene and diesel shall be approved by the Ministry of Commerce and the National Development and Reform Commission and General Administration of Customs.

The PRC government authorities have granted PetroChina the right to conduct crude oil and refined product import and export business. PetroChina holds quota to import and export crude oil and refined products, and conducts import and export of crude oil and refined products through its affiliates, China National United Oil Corporation and PetroChina International Co., Ltd., which are qualified to import and export crude oil and refined products.

Capital Investment and Financing

Capital investments in exploration and production of crude oil and natural gas made by Chinese oil and gas companies are subject to approval by or filing with relevant government authorities. The development of new oil field with an annual production capacity equal to or exceeding one million tons and new natural gas field with an annual production capacity equal to or exceeding two billion cubic meters is required to be approved by the National Development and Reform Commission. Any other development project of crude oil and natural gas needs to be filed with the National Development and Reform Commission. Oil and gas companies need to obtain approval from the National Development and Reform Commission and the State Administration of Foreign Exchange to borrow from foreign banks and foreign governments in connection with those capital investments.

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Taxation, Fees and Royalty

PetroChina is subject to a variety of taxation, fees and royalty. The table below sets forth the various taxation, fees and royalty payable by PetroChina or by Sino-foreign oil and gas exploration and development cooperative projects. Since January 1, 2000, PetroChina and its wholly owned subsidiaries and branch companies have been taxed on a consolidated basis as approved by the Ministry of Finance and the State Taxation Bureau.

Tax item	**Tax base**	**Tax Rate**
Enterprise income tax	Taxable income	Generally at a rate of 33%. However, our qualified branch companies in the west regions of the PRC are entitled to a rate of 15%. Tax concession or exemption enjoyed by any subsidiary or branch company continues to apply.
Value-added tax	Revenue	13% for liquified natural gas, natural gas, liquified petroleum gas, agricultural film and fertilizers and 17% for other items. PetroChina charges value-added tax from its customers at the time of settlement on top of the selling prices of its products on behalf of the taxation authority. The value-added tax paid by PetroChina for purchasing materials to be consumed during the production process and for charges paid for drilling and other engineering services and labor is deducted from output value-added tax payable by PetroChina. Since March 14, 2006, the rebate of the value-added tax paid in connection with export of gasoline has been suspended.
	Sales volume	5% for the Sino-foreign oil and gas exploration and development cooperative projects. However input value-added tax cannot be deducted.

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Tax item	Tax base	Tax Rate
Business tax	Revenue from transportation services	3%
Consumption tax	Aggregate volume sold or self-consumed	RMB 277.6 per ton for gasoline; since January 1, 1999, RMB 388.64 per ton for leaded gasoline. RMB 117.6 per ton for diesel. Since April 1, 2006, RMB 277 per ton for naphtha and levied at the rate of 30% of the taxable amount for the time being. No consumption tax will be levied on those specified in the 2005 production and supply plan approved by the State Administration of Taxation. Since April 1, 2006, RMB 256.4 per ton for solvent naphtha and levied at the rate of 30% of the taxable amount for the time being. No consumption tax will be levied on those specified in the 2005 production and supply plan approved by the State Administration of Taxation. Since April 1, 2006, RMB 225.2 per ton for lubricants and levied at the rate of 30% of the taxable amount for the time being. Since April 1, 2006, RMB 101.5 per ton for fuel oil and levied at the rate of 30% of the taxable amount for the time being. Since April 1, 2006, RMB 124.6 per ton for aviation kerosene and not levied for the time being.
Resource tax	Aggregate volume sold or self-consumed	Since July 1, 2005, resource tax applicable to crude oil of our company was adjusted upward from the original RMB 8 to 30 per ton to RMB 14 to 30 per ton, and the resource tax for natural gas was adjusted from the original RMB 2 to 15 per thousand cubic meter to RMB 7 to 15 per thousand cubic meter.

		The actual applicable rate for each oil field may differ depending on the resource differences, volume of the exploration and production activities and costs required for the production at the particular oil field.
Compensatory fee for mineral resources	Revenue	1% for crude oil and natural gas
Special fee for oil sales	Sales amount above certain threshold	Effective March 26, 2006, levied on the crude oil sold at or above US$40/barrel, with a five-level progressive tax rates, varying from 20% to 40%

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Tax item	Tax base	Tax Rate
Exploration license fee	Area	RMB 100 to 500 per square kilometer per year
Production license fee	Area	RMB 1,000 per square kilometer per year
Royalty fee(1)	Production volume	Progressive rate of 0 12.5% for crude oil and 0 3% for natural gas

(1) Payable only by Sino-foreign oil and gas exploration and development cooperative projects. The project entity of those cooperative projects is not subject to any other resource tax or fee.

The PRC Highway Law, as amended on October 31, 1999, provides that the PRC government will collect funds for highway maintenance by imposing fuel taxes. The State Council will formulate specific implementation methods and procedures for the imposition of fuel tax. The State Council has not yet announced or published any specific rate, implementation method or procedure for the imposition of the tax.

Environmental Regulations

China has adopted extensive environmental laws and regulations that affect the operation of the oil and gas industry. There are national and local standards applicable to emissions control, discharges to surface and subsurface water and disposal, and the generation, handling, storage, transportation, treatment and disposal of solid waste materials.

The environmental regulations require a company, such as us, to register or file an environmental impact report with the relevant environmental bureau for approval before it undertakes any construction of a new production facility or any major expansion or renovation of an existing production facility. The new facility or the expanded or renovated facility will not be permitted to operate unless the relevant environmental bureau has inspected to its satisfaction that environmental equipment that satisfies the environmental protection requirements has been installed for the facility. A company that wishes to discharge pollutants, whether it is in the form of emission, water or materials, must submit a pollutant discharge declaration statement detailing the amount, type, location and method of treatment. After reviewing the pollutant discharge declaration, the relevant environmental bureau will determine the amount of discharge allowable under the law and will issue a pollutant discharge license for that amount of discharge subject to the payment of discharge fees. If a company discharges more than is permitted in the pollutant discharge license, the relevant environmental bureau can fine the company up to several times the discharge fees payable by the offending company for its allowable discharge, or require the offending company to close its operation to remedy the problem.

ITEM 4A UNRESOLVED STAFF COMMENTS

We do not have any unresolved Staff comments that are required to be disclosed under this item.

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ITEM 5 OPERATING AND FINANCIAL REVIEW AND PROSPECTS

General

You should read the following discussion together with our consolidated financial statements and their notes included elsewhere in this annual report. Our consolidated financial statements have been prepared in accordance with IFRS, which differ in many material respects from US GAAP. Note 37 to our consolidated financial statements included elsewhere in this annual report and the section headed Other Information US GAAP Reconciliation summarize the significant differences between IFRS and US GAAP as they relate to us.

In accordance with an acquisition agreement between CNPC and us dated September 26, 2002, we acquired from CNPC the assets, liabilities and interests related to CNPC s refined products marketing enterprises consisting primarily of service stations and related facilities for RMB 3,200 million. The acquisition is a combination of entities under common control since the CNPC s refined products marketing enterprises and us are under the common control of CNPC. As a result, we have accounted for the acquisition in a manner similar to a uniting of interests, whereby the assets and liabilities of the marketing enterprises acquired are accounted for at historical cost to CNPC with net liabilities of RMB 2,956 million at the effective date. Our prior years consolidated financial statements were restated in 2002 to give effect to the acquisition in such periods as if the operations of our company and these marketing enterprises have always been combined in such periods. The difference between RMB 3,200 million paid and the net liabilities transferred from CNPC has been adjusted against equity.

Pursuant to an acquisition agreement by and between our company and CNPC dated March 28, 2005, we acquired the refinery and petrochemical businesses respectively owned by CNPC s wholly-owned subsidiaries, Dayuan and Qingyang, from CNPC for which we paid a cash consideration of RMB 9 million.

The acquisition is deemed a combination of entities under common control since we and the refinery and petrochemical operations of Dayuan and Qingyang are under the common control of CNPC. As a result, we have accounted for the acquisition in a manner similar to a uniting of interests, whereby the assets and liabilities of the refinery and petrochemical operations acquired are accounted for at historical cost to CNPC with net liabilities of RMB 183 million as at the effective date. Our prior years consolidated financial statements were restated to give effect to the acquisition in these periods as if the operations of our company and these operations had always been combined in these periods. The difference between the RMB 9 million acquisition price and the net liabilities transferred from CNPC was adjusted against equity.

In August 2005, the shareholders of our company approved the acquisition and transfer agreements relating to our acquisition of a 50% interest of Newco. Newco was established 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 we contributed to Newco our wholly-owned subsidiary, PetroChina International Limited (PTRI), and cash in the amount of approximately RMB 20,162 million, which is the difference between the cash contribution of RMB 20,741 million payable by us according to the acquisition agreement and the cash consideration of RMB 579 million for PTRI receivable by us.

Pursuant to the relevant equity transfer agreement, we shall have the right to appoint four of the seven directors of Newco, which will enable us to maintain effective control over Newco.

Similar to the accounting method applied in the treatment of the refinery and petrochemical businesses acquired by us, our investment in Newco and related acquisition transactions will be accounted for in a manner similar to a uniting of interests since these transactions are among entities under common control of CNPC. Our prior years consolidated financial statements were restated as if the operations of our company and these businesses had always been combined in these periods. The difference between our cash payment of RMB 20,162 million and the net assets

of Newco in an amount of RMB 35,551 million as at the effective date of the purchase and transfer agreement (including RMB 20,162 million contributed by us and RMB 50 million contributed by CNODC and its subsidiaries to the registered capital of Newco) was adjusted against equity as the amount of RMB 20,162 million was paid directly to Newco.

Overview

We are engaged in a broad range of petroleum and natural gas 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 marketing of basic petrochemical products, derivative chemical products and other chemical products; and
- the transmission of natural gas, crude oil and refined oil products as well as sale of natural gas.

We are China s largest producer of crude oil and natural gas and are one of the largest companies in China in terms of sales. In the year ended December 31, 2005, we produced approximately 822.9 million barrels of crude oil and approximately 1,119.5 billion cubic feet of natural gas for sale. Our refineries also processed approximately 752 million barrels of crude oil in the year ended December 31, 2005. In the year ended December 31, 2005, we had total revenue of RMB 552,229 million and net income of RMB 133,362 million.

Factors Affecting Results of Operations

Our results of operations and the period-to-period comparability of our financial results are affected by a number of external factors, including changes in the prices of crude oil, refined products, natural gas and chemical products, decrease in our crude oil reserves in China and fluctuations in exchange rates and interest rates.

Crude Oil Prices

Our results of operations are substantially affected by crude oil prices. From June 1998 to March 2001, the PRC government published benchmark prices for crude oil in China which were adjusted on a monthly basis to equal Singapore market FOB prices for similar grades of crude oil, supplemented by an amount equal to the customs duty payable on the import of crude oil. Since March 2001, the PRC government has ceased publishing benchmark prices for crude oil in China and we and Sinopec have set our crude oil median prices monthly based on the Singapore market FOB prices for crude oil. Our actual realized crude oil prices include a premium on, or discount from, the median prices which primarily reflects transportation costs, differences in oil quality and market supply and demand conditions.

Prior to September 1, 1999, the premiums and discounts applied to our crude oil sales were largely determined through negotiations between CNPC and Sinopec, our largest customer. Since September 1, 1999, these discounts or premiums has been determined in accordance with a crude oil premium or discount calculation agreement and its supplemental agreement we entered into with Sinopec. These agreements establish premiums or discounts which effect adjustments to the benchmark prices. These agreements do not obligate either party to purchase or sell any crude oil and is thus subject to renegotiation. Under these agreements, the National Development and Reform Commission, formerly the State Development Planning Commission, will mediate if we cannot agree with Sinopec on the premium or discount applicable to a particular crude oil purchase. The table below sets forth the median prices for our principal grades of crude oil in 2003, 2004 and 2005 and the negotiated premiums or discounts applicable to those grades of crude oil since June 2002.

		Median prices for principal grades of crude oil (RMB/barrel)			Premium/(discount) (RMB/barrel)		
Grade of crude oil	Benchmark	Year 2003 average	Year 2004 average	Year 2005 average	2003	2004	2005
Daqing	Minas	240.8	300.7	430	(0.3)	0	(4.4)
Jidong	Minas	240.8	300.7	430	(0.3)	0	(4.4)
Huabei	Minas	240.8	300.7	430	1	1.3	(3.0)
Dagang	Cinta	237.0	290.5	412	1.4	1.4	(1.8)
Tarim	Minas	240.8	300.7	430	(33.7)	(34.6)	(34.9)
Tuha	Tapis	247.0	329.2	457	(25.5)	(25.5)	

In 2005, the median prices for our principal grades of crude oil and crude oil produced in our Daqing oil region were RMB 417 per barrel and RMB 430 per barrel, respectively.

Increases or decreases in the price of crude oil in China have a significant effect on the revenue from our exploration and production segment. As a result, the revenue from our exploration and production segment increased 44.1% from RMB 233,948 million in the year ended December 31, 2004 to RMB 337,208 million in the year ended December 31, 2005. In the year ended December 31, 2005, our average realized selling price for crude oil was RMB 396 per barrel, increased by 41.9% from RMB 279 per barrel in the year ended December 31, 2004. See Item 4 Information on the Company Regulatory Matters Pricing for a more detailed discussion of current PRC crude oil pricing regulations.

Refined Product Prices

Until June 5, 1998, the State Development Planning Commission, the predecessor of the National Development and Reform Commission, set wholesale and retail prices for our major refined products (gasoline, diesel and kerosene). However, during the first six months of 1998, due to then prevailing market conditions and increased smuggling of refined products, actual wholesale prices in the refined products market were lower than the wholesale prices set by the PRC government. In June 1998, the State Development Planning Commission pegged the prices of refined products of gasoline and diesel to the FOB Singapore trading prices, supplemented by transportation costs, customs duties, insurance charges, taxes and difference between the prices of wholesale and retail. Prior to October 2001, the State Development Planning Commission published from time to time retail median gasoline and diesel guidance prices for major cities and provinces. Once published, the retail median prices remained unchanged until either we or Sinopec requested an adjustment and demonstrated that the cumulative change of the FOB Singapore gasoline or diesel trading price from the then applicable retail median guidance price exceeded 5%. Since October 2001, the State Development Planning Commission or the National Development and Reform Commission has adjusted such retail median prices from time to time to reflect the FOB Singapore, Rotterdam and New York trading prices for gasoline and diesel, supplemented by transportation costs and taxes. See Item 4 Information on the

Company Regulatory Matters Pricing for a more detailed discussion of current PRC refined products pricing regulations.

Prior to October 2001, based on the published median gasoline and diesel guidance prices, we and Sinopec set our respective retail prices with an allowable upward or downward adjustment of up to 5% in individual markets. Since October 2001, we and Sinopec have set our retail prices within an 8% floating range of the published median gasoline and diesel guidance prices. We determine the prices of other refined products with reference to the published median guidance prices of gasoline and diesel. Our retail prices may differ from those of Sinopec within a given market. Our average realized selling prices tend to be higher in the western and northern regions of China, where we dominate the market, as compared to our average realized selling prices in the eastern and southern regions, where Sinopec has a stronger presence.

The following table sets forth the retail median prices for 90(#) gasoline and 0(#) diesel published by the State Development Planning Commission or the National Development and Reform Commission from January 2005 to May 2006 when such adjustments were made.

Date	90(#) Gasoline	0(#) Diesel
	(RMB/ton)	(RMB/ton)
March 23, 2005	4,572	
May 10, 2005		3,960
May 23, 2005	4,422	
June 25, 2005	4,622	4,110
July 23, 2005	4,922	4,360
March 26, 2006	5,172	4,510
May 24, 2006	5,672	5,010

Chemical Product Prices

We determine and set the prices of all chemical products produced by our chemicals business segment.

Natural Gas Prices

Prior to January 2002, our natural gas price was comprised of wellhead price, pipeline transportation tariff and purification fee. Since January 2002, the State Development Planning Commission, the predecessor of the National Development and Reform Commission, has merged the purification fee into the wellhead price to establish a unified natural gas ex-factory price. As a result of the price merger, our natural gas price is comprised of the ex-factory price and pipeline transportation tariff.

Prior to December 26, 2005, ex-factory prices varied depending on whether the natural gas sold was within the government-formulated natural gas supply plan. For natural gas sold within the government-formulated supply plan, the National Development and Reform Commission fixed ex-factory prices according to the nature of the customers. Most of these customers were fertilizer producers. For natural gas sold to customers not subject to the government-formulated supply plan, the National Development and Reform Commission published median guidance ex-factory prices, and allowed natural gas producers to adjust the prices upward or downward by up to 10%.

On December 26, 2005, the National Development and Reform Commission reformed the mechanism for setting the ex-factory prices of domestic natural gas by changing the ex-factory prices to governmental guidance prices, and categorizing the domestic natural gas into two tiers. On the basis of the ex-factory price set by the government, subject to the negotiations between the seller and the buyer, the actual ex-factory price of the first tier may float upward or downward of up to 10%; while the actual ex-factory price of the second tier may float upward of up to 10% and downward to any level. The price of the first tier will be adjusted to the same level as the second tier within three to five years.

PetroChina negotiates the actual ex-factory price with natural gas users on the basis of the benchmark price set by the government and the adjustment range.

The National Development and Reform Commission sets the pipeline transportation tariff for the natural gas transported by pipelines constructed prior to 1991. For natural gas transported by pipelines constructed after 1991, PetroChina submits to the National Development and Reform

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Commission for examination and approval proposed pipeline transmission tariffs based on the capital investment made in the pipeline, the depreciation period for the pipeline, the ability of end users to pay and PetroChina s profit margin.

We sell our natural gas at prices which exceed our production and transportation costs.

The results of operations of these segments will be impacted to the extent that our prices do not vary to reflect increases or decreases in our costs. See Item 4 Information on the Company Regulatory Matters Pricing for a further discussion of these pricing controls.

Foreign Currency Exposure

For a discussion of the effect of exchange rate fluctuations on our results of operations, please see Item 11 Quantitative and Qualitative Disclosures About Market Risk Foreign Exchange Rate Risk .

Interest Rate Exposure

For a discussion of the effect of interest rate changes on our results of operations, please see Item 11 Quantitative and Qualitative Disclosures About Market Risk Interest Rate Risk .

Critical Accounting Policies

The preparation of our consolidated financial statements requires our management to select and apply significant accounting policies, the application of which may require management to make judgments and estimates that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities as of the date of our financial statements, and the reported amounts of revenue and expenses during the reporting period. Notwithstanding the presentation of our principal accounting policies in Note 3 to our consolidated financial statements included elsewhere in this annual report, we have identified the accounting policies below as most critical to our business operations and the understanding of our financial condition and results of operations presented in accordance with IFRS. Although these estimates are based on our management s best knowledge of current events and actions, actual results ultimately may differ from those estimates.

Accounting of Oil and Gas Exploration and Development Activities

We use successful efforts method of accounting, with specialized accounting rules that are unique to the oil and gas industry, for oil and gas exploration and production activities. Under this method, geological and seismic costs incurred are expensed prior to the discovery of proved reserves. However, all costs for developmental wells, support equipment and facilities, and mineral interests in oil and gas properties are capitalized. Costs of exploratory wells are capitalized as construction in progress pending determination of whether the wells find proved reserves. The costs of exploratory wells will be further capitalized pending determination of whether the wells find sufficient economically exploitable reserves. For exploratory wells located in regions that do not require substantial capital expenditures before the commencement of production, the evaluation of the economic benefits of the reserves in such wells will be completed within one year following the completion of the exploration drilling. Where such evaluation indicates that no economic benefits can be obtained, the relevant costs of exploratory wells will be converted to dry hole exploration expenses. For wells that found economically viable reserves in areas where a major capital expenditure would be required before production can begin, the related well costs remain capitalized only if additional drilling is under way or firmly planned. Otherwise the well costs are expensed as dry holes. Our company has no costs of unproved properties capitalized in oil and gas properties.

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Oil and Gas Reserves

The estimation of the quantities of recoverable oil and gas reserves in oil and gas fields is integral to effective management of our exploration and production operations. Because of the subjective judgments involved in developing and assessing such information, engineering estimates of the quantities of recoverable oil and gas reserves in oil and gas fields are inherently imprecise and represent only approximate amounts.

Before estimated oil and gas reserves are designated as proved , certain engineering criteria must be met in accordance with industry standards and the regulations of the United States Securities and Exchange Commission. Proved oil and gas reserves are the estimated quantities of crude oil, natural gas and natural gas liquids which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. Therefore, these estimates do not include probable or possible reserves. Our proved reserve estimates are updated annually by an independent, qualified and experienced oil and gas reserve engineering firm in the United States. Our oil and gas reserve engineering department has policies and procedures in place to ensure that these estimates are consistent with these authoritative guidelines. Among other factors as required by authoritative guidelines, this estimation takes into account recent information about each field, including production and seismic information, estimated recoverable reserves of each well, and oil and gas prices and operating costs as of the date the estimate is made. Prices include consideration of changes in existing prices provided only by contractual arrangements, but not on escalations based upon future conditions. Therefore, as prices and cost levels change from year to year, the estimate of proved reserves also changes. We have no costs of unproved properties capitalized in oil and gas properties.

Despite the inherent imprecision in these engineering estimates, estimated proved oil and gas reserve quantity has a direct impact on certain amounts reported in the financials statements. In addition to the capitalization of costs related to oil and gas properties on the balance sheet discussed earlier, estimated proved reserves also impact the calculation of depreciation, depletion and amortization expenses of oil and gas properties. The cost of oil and gas properties is amortized at the field level on the unit of production method. Unit of production rates are based on the total oil and gas reserves estimated to be recoverable from existing facilities based on the current terms of our production licenses. Our reserve estimates include only crude oil and natural gas which management believes can be reasonably produced within the current terms of the production licenses that are granted by the Ministry of Land and Resources, ranging from 30 years to 55 years from the effective date of issuance in March 2000, renewable upon application 30 days prior to expiration. Consequently, the impact of changes in estimated proved reserves is reflected prospectively by amortizing the remaining book value of the oil and gas property assets over the expected future production. If proved reserve estimates are revised downward, earnings could be effected by higher depreciation expense or an immediate write-down of the property s book value had the downward revisions been significant. See Property, Plant and Equipment below. Given our large number of producing properties in our portfolio, and the estimated proved reserves, it is unlikely that any changes in reserve estimates will have a significant effect on prospective charges for depreciation, depletion and amortization expenses.

In addition, due to the importance of these estimates to better understanding the perceived value and future cash flows of a company s oil and gas operations, we have also provided supplemental disclosures of proved oil and gas reserve estimates prepared in accordance with authoritative guidelines elsewhere in this annual report.

Property, Plant and Equipment

We record property, plant and equipment, including oil and gas properties, initially at cost less accumulated depreciation, depletion and amortization. Cost represents the purchase price of the asset and other costs incurred to bring the asset into existing use. Subsequent to their initial recognition, property, plant and equipment are carried at revalued amount, being the estimated fair value at the date of the revaluation less accumulated depreciation and impairment losses. Revaluations are performed by independent qualified valuers on a regular basis to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date. Revaluation surpluses pertaining to revalued assets depreciated or disposed of are retained in the revaluation reserve and will not be available to offset against possible future revaluation losses. As disclosed in Note 17 to our consolidated financial statements included elsewhere in this annual report, our property, plant and equipment, excluding oil and gas reserves, were revalued as of June 30, 1999. Subsequently, our refining and chemical production equipment was revalued as of September 30, 2003.

Depreciation, depletion and amortization to write off the cost or valuation of each asset, other than oil and gas properties, to its residual value is calculated using the straight-line method over the estimated useful live of such asset as follows:

Land and buildings	25-40 years
Plant and machinery	10-15 years
Equipment and motor vehicles	3-16 years

We do not provide depreciation for construction in progress until it is completed and ready for use.

The useful lives of non-oil-and-gas properties are estimated at the time these purchases are made after considering future changes, business developments and our strategies. Estimated production lives for oil aid gas properties are also made after considering the specific factors discussed under Oil and Gas Reserves above. Should there be unexpected adverse changes in these circumstances or events, which include, among others, declines in projected operating results and negative industry or economic trends we would be required to assess the need to shorten the useful lives and/or make impairment provisions.

In performing this impairment assessment, we review internal and external sources of information to identify indications of these unexpected adverse changes. The sources utilized to identify indications of impairment are often subjective in nature and require us to use judgment in applying such information to our businesses. Our interpretation of this information has a direct impact on whether an impairment assessment is performed as at any given balance sheet date. Such information is particularly significant as it relates to our oil and gas properties. If an indication of impairment is identified, the recoverable amount of each cash generating unit is estimated, which is the higher of its fair price net of selling cost and its value in use, which is the estimated net present value of future cash flows to be derived from the continuing use of the asset and from its ultimate disposal. To the extent the carrying amount of a cash generating unit exceeds the recoverable amount, an impairment loss is recognized in the income statement.

Depending on our assessment of the overall materiality of the asset under review and complexity of deriving reasonable estimates of the recoverable value, we may perform such assessment utilizing internal resources or we may engage external advisors to advise us in making this assessment. Regardless of the resources utilized, we are required to make many assumptions in making this assessment, including our utilization of such asset, plans to continue to produce and develop proved and associated probable or possible reserves, the cash flows to be generated based on assumptions for future commodity prices and development costs, appropriate market discount rates and the projected market and regulatory conditions. Changes in any of these assumptions could result in a material change to future estimates of the recoverable value of any asset.

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Provision for Asset Decommissioning

Provision for decommissioning and restoration is recognized in full on the installation of oil and gas properties. The amount recognized is the present value of the estimated future expenditure determined in accordance with local conditions and requirements. A corresponding addition to the related oil and gas properties of an amount equivalent to the provision is also created. This is subsequently depreciated as part of the capital costs of the oil and gas properties. Any change in the present value of the estimated expenditure other than the one due to passage of time which is regarded as interest cost, is reflected as an adjustment to the provision and oil and gas properties.

Impairment of Accounts Receivable

Accounts receivables are recognised initially at fair value and subsequently measured at amortised costs, using the effective interest method, less provision made for impaired accounts. Accounts where there are indications that a receivable may be impaired or not collectible, a provision would be recorded based on best estimates to reduce the receivable balance to the amount that is expected to be collected. Factors considered in making a provision include the historical payment and collection experience, debtors credit worthiness and appropriate discount rates. The recording of provisions requires the application of judgments about the ultimate resolution of these accounts receivable. As a result, provisions are reviewed at each balance sheet date and adjusted to reflect our current best estimates.

Deferred Tax Assets

We are required to exercise considerable judgment in making provisions for deferred tax under the liability method. Under this method, deferred income tax is provided for temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. Specifically, we must make estimates of projected capital expenditures to be incurred and the resulting incremental timing difference that such capital expenditures would generate for the determination of the amount of temporary difference that will be recovered. We use currently enacted tax rates to determine deferred income tax. If these rates change, we would have to adjust our deferred tax in the period in which these changes happen through the income statement.

The principal temporary differences arise from depreciation on oil and gas properties and equipment and allowances for impairment of receivables, inventories, investments and property, plant and equipment. Deferred tax assets relating to the carry-forward of unused tax losses are recognized to the extent that it is probable that future taxable income will be available against which the unused tax losses can be utilized.

Revenue Recognition

Sales are recognized upon delivery of products and customer acceptance, if any, or performance of services, net of sales taxes and discounts. Revenues are recognized only when we have transferred to the buyer the significant risks and rewards of ownership of the goods in our normal operations, and when the amount of revenue and the costs incurred or to be incurred in respect of the transaction can be measured and collected reliably.

We sell part of the natural gas produced by us under take-or-pay contracts entered into with our customers. Customers who entered into such a take-or-pay contract are required to buy or pay for the minimum amount of natural gas specified in the contract. Revenues from the sale and transportation of natural gas under take-or-pay contracts are recognized under the above accounting policies. Any advance payment for natural gas that has not been consumed will be recorded as deferred revenue until the natural gas has been actually consumed.

We entered into a Crude Oil Mutual Supply Framework Agreement with Sinopec, which can be characterized as a buy/sell contract, and recognized the revenue derived from this agreement in our

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consolidated statements of income. Since the transactions under the agreement are separately invoiced and settled and cannot be offset with each other, they were not treated as non-monetary transactions as defined in APB Opinion No. 29 Accounting for Non-monetary transactions . In February 2005, the U.S. Securities and Exchange Commission issued a letter to the oil and gas industry requesting additional disclosures regarding buy/sell contracts. Accordingly, we have reviewed such transactions and estimated that, if we are required to report the net amount of such buy/sell contracts, our reported amount in the line items of Sales and other operating revenues and Purchase, services and other for the year ended December 31, 2004 and 2005 would be reduced by RMB 2,217 million and RMB 1,384 million, respectively. No change will occur to our net income as a result of this.

In addition to the above significant accounting policies and estimates, in connection with the preparation and reconciliation of our financial statements in accordance with US GAAP, we believe the following additional accounting estimate is also critical.

One-time Compensatory Payments for Staff Housing

As disclosed in Note 37(b) to our consolidated financial statements included elsewhere in this annual report, certain of our employees who joined the workforce prior to December 31, 1998 and have housing conditions below local standards are to be reimbursed for such differences. These one-time compensatory payments have been borne or are to be borne by our State-owned shareholder, CNPC. Under IFRS, such direct payments to employees or reimbursements will not be recorded in our consolidated income statement. US GAAP contain no such exemption but require this principal shareholder s action on our behalf to be recorded in the consolidated income statement. During the year ended December 31, 2002, we and CNPC completed the process of estimating the amounts payable to qualified employees at the level of the affected business units as a whole. We have reflected this best available estimate of such payments in determining our net income for the year ended December 31, 2002, under US GAAP. Since this amount is borne by our State-owned shareholder, a corresponding amount has been included as an addition to the other reserves in our shareholders equity. This estimate did not significantly change in 2004 and 2005. The estimation process of such payments down to level of the individual employees is still on going. Actual results may differ from these estimates at the time when more information becomes available.

For detailed discussions of significant differences between IFRS and US GAAP, see Note 37 to our consolidated financial statements included elsewhere in this annual report and the section headed Other Information US GAAP Reconciliation below.

Acquisitions

Acquisitions of Overseas Assets

In April 2002, we acquired Devon Energy Indonesia Limited from Devon Energy Corporation for a price of RMB 2,068 million. Devon Energy Indonesia Limited holds interests in a number of crude oil and natural gas exploration and production project in Indonesia, including a 30% interest in an oil and gas production sharing contract relating to the Jabung block located in Sumatra, Indonesia. In April 2003, we acquired a 50% equity interest in Amerada Hess Indonesia Holdings Limited, which holds a 30% interest in the oil and gas production sharing contract relating to the Jabung block, for a price of RMB 679 million.

In June 2005, we entered into a capital contribution agreement with CNODC, Central Asia Petroleum Co., Ltd. and Newco, whereby, in December 2005 we acquired a 50% interest in Newco, a subsidiary of CNODC, for a consideration of RMB 20,741 million which was paid to Newco as our capital contribution. Upon consummation of the transaction, we obtained a 50% interest in certain overseas oil and gas assets transferred by CNODC to Newco. We also entered into a transfer agreement, pursuant to which, in December 2005, we transferred all of our interest in PTRI to

Newco for a consideration of RMB 579 million. See Item 4 Information on the Company Introduction History and Development of the Company Overview of Our Operations.

Upon completion of the acquisition and transfer, we obtained control over Newco by having the right to appoint four of the seven directors. Our investment in Newco and the transfer of PTRI to Newco will be accounted for in a manner similar to a uniting of interests since these transactions are among entities under common control by CNPC. Our consolidated financial statements will be restated as if operations of PetroChina and Newco had always been combined.

We plan to continue to pursue attractive opportunities outside China as part of our business growth strategy to utilize both domestic and international resources to strengthen our competitiveness. As we continue to implement this strategy, we expect that acquisitions of overseas assets will over time have a material effect on our results of operations and financial condition.

Pursuant to our company s board resolutions dated October 26, 2005, our company made an offer to the minority holders of the A Shares of Jinzhou Petrochemical Co., Ltd. or Jinzhou Petrochemical, to acquire at the purchase price of RMB 4.25 per share 150 million issued and outstanding Jinzhou Petrochemical A Shares. As of December 31, 2005, our company acquired 117,486,753 Jinzhou Petrochemical A Shares, representing 14.92% of the total share capital of Jinzhou Petrochemical, for a total cash consideration of approximately RMB 500 million. After the acquisition, our company owns 95.87% of the total share capital of Jinzhou Petrochemical. The difference between the consideration for this acquisition 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 from the China Securities Regulatory Commission.

Pursuant to our company s board resolutions dated October 26, 2005, our company made offers to the holders of the A Shares of Jilin Chemical Industrial Company Limited (Jilin Chemical) and the holders of the H Shares of Jilin Chemical respectively to acquire at the purchase price of RMB 5.25 per share of 200 million outstanding A Shares, and to acquire at the purchase price of HK$2.80 per Jilin Chemical H Share of the 964.778 million outstanding H Shares (including Jilin Chemical ADSs). By February 2006, we have paid an aggregate of RMB 3,480 million for this transaction. The tender offers were completed in February 2006. The effect of the acquisition of Jilin Chemical will be reflected in our company s consolidated financial statements ended as of December 31, 2006. Jilin Chemical A Shares, H Shares and ADSs were delisted from the Hong Kong Stock Exchange, Shenzhen Stock Exchange and NYSE on January 23, February 20 and February 15, 2006, respectively.

Pursuant to our company s board resolutions dated October 26, 2005, our company made an offer to the holders of A Shares of Liaohe Jinma Oilfield Co., Ltd. or Liaohe Jinma, to acquire at the purchase price of RMB 8.80 per share 200 million issued and outstanding Liaohe Jinma A Shares. As of December 31, 2005, our company acquired 172,315,428 Liaohe Jinma A Shares, representing 15.67% of the total share capital of Liaohe Jinma for a total consideration of approximately RMB 1,519 million. Following the completion of this acquisition, our company would own 97.48% of the total share capital of Liaohe Jinma. The difference between the consideration for this acquisition and the book value of the acquired assets and liabilities was included in the equity interests. Upon the approval by China Securities Regulatory Commission, Liaohe Jinma was delisted as at January 4, 2006.

On December 6, 2005, our company executed two separate purchase agreements with two wholly-owned subsidiaries of CNPC, Liaohe Petroleum Exploration Bureau and China Petroleum Pipeline Bureau, whereby, our company would acquire from the two companies a 15.56% equity interest and a 20.17% equity interest, respectively, in PetroChina Fuel Oil Company (the Fuel Oil Company), a 55.43% subsidiary of our company, with a total cash consideration of RMB 559 million. The Fuel Oil Company is principally engages in investing in and developing of fuel oil in the upstream and downstream areas outside the PRC. Upon completion of the above acquisitions, our company s interest in the Fuel Oil Company will be increased and the management

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of the Fuel Oil Company is expected to be strengthened. This acquisition has been approved by the State-owned Assets Supervision and Administration Commission of the PRC (SASAC) and the relevant parties to the two purchase agreements are currently closing the transactions.

Operating Results

The following discussion is based on our historical results of operations. As a result of the factors discussed above, such results of operations may not be indicative of our future operating performance.

Our income statement for each of the three years ended December 31, 2003, 2004 and 2005 is summarized in the table below.

	Year ended December 31,		
	2003	2004	2005
	in million RMB	in million RMB	in million RMB
Total revenues	310,431	397,354	552,229
Operating expenses	(208,719)	(246,216)	(360,058)
Income from operations	101,712	151,138	192,171
Exchange gain (loss), net	(36)	8	88
Interest expense, net	(1,916)	(1,523)	(838)
Income from equity affiliates	933	1,621	2,401
Income before income taxes	100,693	151,244	193,822
Income Taxes	(28,796)	(43,598)	(54,180)
(Income) loss applicable to minority interests	(2,062)	(3,803)	(6,280)
Net income	69,835	103,843	133,362

The table below sets forth our revenues by business segment for each of the three years ended December 31, 2003, 2004 and 2005 as well as the percentage changes in revenues for the periods shown.

	2003	2004	2004 vs. 2003	2005	2005 vs. 2004
	(RMB in millions, except percentages)				
Sales and other operating revenues					
Exploration and production	185,782	233,948	25.9%	337,208	44.1%
Refining and marketing	224,177	296,427	32.2%	428,494	44.6%
Chemicals and marketing	39,211	57,179	45.8%	73,978	29.4%
Natural gas and pipeline	15,067	18,255	21.2%	26,214	43.6%
Total	464,237	605,809	30.5%	865,894	42.9%
Less intersegment sales	(153,806)	(208,455)	35.5%	(313,665)	50.5%

Consolidated net sales from operations	310,431	397,354	28.0%	552,229	39.0%

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The table below sets forth our operating profits by business segment for each of the three years ended December 31, 2003, 2004 and 2005, as well as the percentage changes in operating income for the periods shown. Other income from operations shown below consists of research and development, business services and infrastructure support to our operating business segments.

	2003	2004	2004 vs. 2003	2005	2005 vs. 2004
	(RMB in millions, except percentages)				
Income (loss) from operations					
Exploration and production	95,230	130,213	36.7%	208,080	59.8%
Refining and marketing	4,701	11,891	152.9%	(19,810)	
Chemicals and marketing	1,041	7,655	635.4%	3,276	(57.2)%
Natural gas and pipeline	1,922	2,535	31.9%	3,183	25.6%
Other	(1,182)	(1,156)	(2.2)%	(2,558)	121.3%
Total	101,712	151,138	48.6%	192,171	27.1%

Year Ended December 31, 2005 Compared to Year Ended December 31, 2004

Consolidated Results of Operation

Overview

For the year ended December 31, 2005, our total revenue was RMB 552,229 million, representing an increase of 39.0% from the year ended December 31, 2004. Our net income in the year ended December 31, 2005 was RMB 133,362 million, increased 28.4% from the year ended December 31, 2004. Our basic and diluted earnings per share for the year ended December 31, 2005 was RMB 0.75, representing an increase of 27.1% from RMB 0.59 for the year ended December 31, 2004.

Total Revenue. Total Revenue increased 39.0% from RMB 397,354 million for the year ended December 31, 2004 to 552,229 million for the year ended December 31, 2005. The increase was primarily due to the increases in the sales prices and sales volume of the principal products, such as crude oil, gasoline and diesel, as well as increases in the sales volume of natural gas. The average realized selling price for crude oil increased 43.4% from US$33.72 per barrel for the year ended December 31, 2004 to US$48.37 per barrel for the year ended December 31, 2005.

Operating Expenses. Operating expenses increased 46.2% from RMB 246,216 million for the year ended December 31, 2004 to RMB 360,058 million for the year ended December 31, 2005. This increase was due primarily to (i) a 75.3% increase in purchases, services and other expenses, (ii) a 29.4% increase in employee compensation costs, (iii) a 28.8% increase in exploration expenses, (iv) a 6.1% increase in depreciation, depletion and amortization and (v) a 29.1% increase in selling expenses and in general and administrative expenses.

Purchases, Services and Other Expenses. Purchases, services and other expenses increased 75.3% from RMB 114,249 million for the year ended December 31, 2004 to RMB 200,321 million for the year ended December 31, 2005. This increase was due primarily to (i) increases in the processing volume at our refineries and the increase of crude oil prices, as we purchased 157 million barrels of crude oil, 15.7 million tons of refined products and 1,706 thousand tons of chemical products in 2005, as compared to 121.8 million barrels of crude oil, 12.0 million tons of refined products and 990 thousand tons of chemical products in 2004; the average purchase price of the crude oil in 2005 was RMB 423 per barrel, representing a 30.6% increase from 2004, (ii) increases in the prices of other raw materials such as water and electricity, and (iii) the expansion of our production scale. The increase in our refined product supply operation in 2005 also contributed to the increase in purchase, services and other expenses.

Employee Compensation Costs. Employee compensation costs increased 29.4% from RMB 22,934 million for the year ended December 31, 2004 to RMB 29,675 million for the year ended December 31, 2005. This increase was due primarily to an increase of RMB 4,992 million in salaries and other benefits with the improvement of our operating results and an increase in labor costs as a result of the expansion of our retail distribution network.

Depreciation, Depletion and Amortization. Depreciation, depletion and amortization increased 6.1% from RMB 48,362 million for the year ended December 31, 2004 to RMB 51,305 million for the year ended December 31, 2005. This increase was due primarily to an increase of RMB 4,020 million in the allocation of depreciation and depletion expenses as a result of the increase in the average balance of the assets, and a decrease of RMB 1,720 million in the depreciation expenses as a result of fixed asset disposals and a decrease in the provisions for impairment.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased 29.1% from RMB 28,302 million for the year ended December 31, 2004 to RMB 36,538 million for the year ended December 31, 2005. This increase was due primarily to an increase of RMB 2,580 million in transportation expenses as a result of our increased sales volume of refined products and the increased railway transportation price, as well as an increase of RMB 720 million in repair expenses and lease expenses.

Exploration Expenses. Exploration expenses increased 28.8% from RMB 12,090 million for the year ended December 31, 2004 to RMB 15,566 million for the year ended December 31, 2005. This increase was due primarily to increased expenditures in exploration activities for the purpose of increasing our crude oil and gas reserves.

Taxes Other than Income Taxes. Taxes other than income taxes increased 18.4% from RMB 19,943 million for the year ended December 31, 2004 to RMB 23,616 million for the year ended December 31, 2005. This increase was due primarily to an increase of RMB 1,309 million in consumption tax as a result of increased sales volume of gasoline and diesel, an increase of RMB 951 million in resources compensation fees as a result of increased revenues from crude oil and natural gas, as well as an increase of RMB 504 million in resources tax as a result of the government s upward adjustment to the tax rate.

Income From Operations. As a result of the factors discussed above, income from operations increased 27.1% from RMB 151,138 million for the year ended December 31, 2004 to RMB 192,171 million for the year ended December 31, 2005.

Net Exchange Gain. Net exchange income increased from RMB 8 million for the year ended December 31, 2004 to RMB 88 million for the year ended December 31, 2005. This increase was due primarily to the appreciation of RMB in 2005.

Net Interest Expense. Net interest expense decreased 45.0% from RMB 1,523 million for the year ended December 31, 2004 to RMB 838 million for the year ended December 31, 2005. This decrease was due primarily to a decrease of RMB 134 million in the interest expenses resulted from the decrease in the average outstanding balance of interest-bearing debts and an increase of RMB 551 million in the interest income as a result of sufficient cashflow derived from operating activities.

Income Before Income Taxes. Income before income taxes increased 28.2% from RMB 151,244 million for the year ended December 31, 2004 to RMB 193,822 million for the year ended December 31, 2005.

Income Taxes. Income taxes increased 24.3% from RMB 43,598 million for the year ended December 31, 2004 to RMB 54,180 million for the year ended December 31, 2005, due primarily to the increase in the taxable income.

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Net Income. As a result of the factors discussed above, net income increased 28.4% from RMB 103,843 million for the year ended December 31, 2004 to RMB 133,362 million for the year ended December 31, 2005.

Exploration and Production

Sales and Other Operating Revenue. Sales and other operating revenue increased 44.1% from RMB 233,948 million for the year ended December 31, 2004 to RMB 337,208 million for the year ended December 31, 2005. This increase was due primarily to increases in the price and sales volume of crude oil, as well as an increase in sales volume of natural gas. Our average realized selling price of crude oil for the year ended December 31, 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 for the year ended December 31, 2004. In 2005, we sold 788.8 million barrels of crude oil, representing an increase of 21.5 million barrels as compared with 2004. Our exploration and production segment sold 1,049.4 billion cubic feet of natural gas in the year ended December 31, 2005, as compared to 810.4 billion cubic feet of natural gas in the year ended December 31, 2004.

Intersegment sales increased 50.4% from RMB 180,129 million for the year ended December 31, 2004 to RMB 270,943 million for the year ended December 31, 2005. This increase was due primarily to an increase in the price of crude oil and an increase of intersegment sales volume of crude oil and natural gas. Sales of crude oil to Sinopec increased 14.9% from 24,053 million in 2004 to 27,640 million in 2005 as a result of the increase in the price of crude oil.

Operating Expenses. Operating expenses increased 24.5% from RMB 103,735 million for the year ended December 31, 2004 to RMB 129,128 million for the year ended December 31, 2005. This increase was due primarily to (i) an increase of RMB 13,543 million in purchase expenses, and (ii) an increase of RMB 3,822 million in exploration expenses resulting from the increase of the investment in the hydrocarbon exploration for the purpose of increasing hydrocarbon reserve, and (iii) an increase of RMB 3,221 million in salaries and other benefits.

Income From Operations. As a result of the factors discussed above, income from operations increased 59.8% from RMB 130,213 million for the year ended December 31, 2004 to RMB 208,080 million for the year ended December 31, 2005.

Refining and Marketing

Sales and Other Operating Revenue. Sales and other operating revenue increased 44.6% from RMB 296,427 million for the year ended December 31, 2004 to RMB 428,494 million for the year ended December 31, 2005. This increase was due primarily to increases in the prices and the sales volumes of our products.

Sales revenue from gasoline increased 43.6% from RMB 76,919 million for the year ended December 31, 2004 to RMB 110,438 million for the year ended December 31, 2005. The average realized selling price of gasoline increased 19.2% from RMB 3,542 per ton for the year ended December 31, 2004 to RMB 4,221 per ton for the year ended December 31, 2005, which contributed RMB 17,763 million to the increase of gasoline sales revenue. We sold approximately 26,160 thousand tons of gasoline for the year ended December 31, 2005, representing an increase of 20.5% from approximately 21,710 thousand tons for the year ended December 31, 2004, which contributed RMB 15,756 million to the increase of gasoline sales revenue.

Sales revenue from diesel increased 29.5% from RMB 136,649 million for the year ended December 31, 2004 to RMB 176,999 million for the year ended December 31, 2005. The average realized selling price of diesel increased 17.0% from RMB 3,165 per ton for the year ended December 31, 2004 to RMB 3,702 per ton for the year ended December 31, 2005, which contributed RMB 25,674 million to the increase of diesel sales revenue. Sales volume of diesel increased from 43,180 thousand tons for the year ended December 31, 2004 to 47,810 thousand tons for the year ended December 31, 2005, representing an increase of 10.7%, which contributed RMB 14,676 million to the increase of diesel sales revenue.

Sales revenue from kerosene increased 27.2% from RMB 5,881 million for the year ended December 31, 2004 to RMB 7,480 million for the year ended December 31, 2005.

Intersegment sales revenue increased 51.0% from RMB 21,862 million for the year ended December 31, 2004 to RMB 33,019 million for the year ended December 31, 2005, due primarily to increases in the prices and intersegement sales volume of our principal products.

Operating Expenses. Operating expenses increased 57.6% from RMB 284,536 million for the year ended December 31, 2004 to RMB 448,304 million for the year ended December 31, 2005. This increase was due primarily to (i) an increase of RMB 141,600 million in purchasing crude oil and refined oil, and (ii) an increase of RMB 5,354 million in sales and administrative expenses. In 2005, we purchased 744 million barrels of crude oil, representing an increase of 58 million barrels as compared with 2004. The average purchase price of crude oil was RMB 409 per barrel, which was an increase of RMB 116 per barrel as compared with 2004. As a result, our expenses for purchased crude oil in 2005 were RMB 304,400 million, representing an increase of RMB 103,200 million as compared with 2004. In addition, the increase in our sales volume of refined products in 2005 also contributed to the increase in the operating expenses.

Income/(Loss) From Operations. As a result of the factors discussed above, in the year ended December 31, 2005 we suffered a loss of RMB 19,810 million from operations while in the year ended December 31, 2004 we realized an income of RMB 11,891 million from operations, due primarily to the fact that, in 2005, the price increase of crude oil exceeded that of refined oil products in China.

Chemicals and Marketing

Sales and Other Operating Revenue. Sales and other operating revenue increased 29.4% from RMB 57,179 million for the year ended December 31, 2004 to RMB 73,978 million for the year ended December 31, 2005. This increase was due primarily to increases in the prices and sales volumes of chemical products. The average realized selling prices of polyethylene, polyester, styrene butadiene rubber and urea in 2005 increased 13.9%, 3.4%, 9.6% and 17.4%, respectively, from 2004. Our chemicals and marketing segment sold 13,113 thousand tons of chemical products for the year ended December 31, 2005, representing an increase of 10.5% from the year ended December 31, 2004.

Operating Expenses. Operating expenses increased 42.8% from RMB 49,524 million for the year ended December 31, 2004 to RMB 70,702 million for the year ended December 31, 2005, due primarily to an increase of RMB 11,892 million in the purchase expenses of direct materials and an increase of RMB 782 million in the sales and administrative expenses.

Income From Operations. As a result of the factors discussed above, income from operations decreased 57.2% from RMB 7,655 million for the year ended December 31, 2004 to RMB 3,276 million for the year ended December 31, 2005 due primarily to the increase in the prices of the raw materials.

Natural Gas and Pipeline

Sales and Other Operating Revenue. Sales and other operating revenue increased 43.6% from RMB 18,255 million for the year ended December 31, 2004 to RMB 26,214 million for the year ended December 31, 2005, due primarily to increases in the sales volume and selling price of natural gas, as well as increases in the transmission volume and transmission price of natural gas. Our natural gas and pipeline segment sold 888.81 billion cubic feet natural gas in the year ended December 31, 2005, representing an increase of 231.51 billion cubic feet from 657.3 billion cubic feet in the year ended December 31 2004, which resulted in an increase in sales revenue of

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RMB 4,020 million. In 2005, our average realized selling price of natural gas was US$2.12 per thousand cubic feet, representing an increase of US$0.09 as compared with 2004. The increase of RMB 2,848 million in our income from pipeline transmission of natural gas in 2005 was attributable to an increase in the pipeline transmission volume of natural gas from 616.0 billion cubic feet in 2004 to 820.9 billion cubic feet in 2005, and an increase in the transmission price of natural gas from RMB 5.6 per thousand cubic feet in 2004 to RMB 7.7 per thousand cubic feet in 2005.

Operating Expenses. Operating expenses increased 46.5% from RMB 15,720 million for the year ended December 31, 2004 to RMB 23,031 million for the year ended December 31, 2005, due primarily to (i) an increase of RMB 3,479 million in purchase expenses of natural gas primarily as a result of the increase of 235.1 billion cubic feet in the natural gas purchase volume, as well as the increase of the average purchase price of natural gas from RMB 14.6 per thousand cubic feet in 2004 to RMB 14.7 per thousand cubic feet in 2005, and (ii) an increase of RMB 1,833 million in depreciation expenses.

Income From Operations. As a result of the factors discussed above, income from operations increased 25.6% from RMB 2,535 million for the year ended December 31, 2004 to RMB 3,183 million for the year ended December 31, 2005.

Year Ended December 31, 2004 Compared to Year Ended December 31, 2003

Consolidated Results of Operation

Overview

For the year ended December 31, 2004, our total revenue was RMB 397,354 million, representing an increase of 28% from the year ended December 31, 2003. Our net income in the year ended December 31, 2004 was RMB 103,843 million, increased 48.7% from the year ended December 31, 2003. Our basic and diluted earnings per share for the year ended December 31, 2004 was RMB 0.59, representing an increase of 47.5% from RMB 0.40 for the year ended December 31, 2003.

Total Revenue. Total Revenue increased 28% from RMB 310,431 million for the year ended December 31, 2003 to 397,354 million for the year ended December 31, 2004. The increase was due primarily to increases in our realized selling prices of crude oil, gasoline, diesel and chemical products, as well as increases in the sales volume of natural gas, refined products and chemical products. The average realized selling price for crude oil increased 24.0% from US$27.20 per barrel for the year ended December 31, 2003 to US$33.72 per barrel for the year ended December 31, 2004.

Operating Expenses. Operating expenses increased 18.0% from RMB 208,719 million for the year ended December 31, 2003 to RMB 246,216 million for the year ended December 31, 2004. This increase was due primarily to (i) a 27.3% increase in purchases, services and other expenses, (ii) a 14.4% increase in employee compensation costs, (iii) a 13.8% increase in exploration expenses, (iv) a 14.7% increase in depreciation, depletion and amortization and (v) an 18.6% increase in taxes other than income tax.

Purchases, Services and Other Expenses. Purchases, services and other expenses increased 27.3% from RMB 89,741 million for the year ended December 31, 2003 to RMB 114,249 million for the year ended December 31, 2004. This increase was due primarily to increases in our purchase expenses of crude oil, refined products and chemical products associated with increases in the prices and purchase volume of crude oil and refined products as well as increases in the purchase volume of chemical products as we increased our production and sales of these products in 2004. In 2004, we purchased 121.8 million barrels of crude oil, 12.0 million tons of refined products and 990 thousand tons of chemical products, as compared to 89.5 million barrels of crude oil, 9.6 million tons of refined products and 27 thousand tons of chemical products in 2003.

Employee Compensation Costs. Employee compensation costs increased 14.4% from RMB 20,044 million for the year ended December 31, 2003 to RMB 22,934 million for the year ended December 31, 2004. This increase was due primarily to an increase of RMB 2,033 million in salaries and other benefits with the increase in our operating results in 2004 and an increase of RMB 691 million in employee compensation costs as a result of the expansion of our retail distribution network.

Depreciation, Depletion and Amortization. Depreciation, depletion and amortization increased 14.7% from RMB 42,163 million for the year ended December 31, 2003 to RMB 48,362 million for the year ended December 31, 2004. This increase was due primarily to an increase of RMB 4,530 million in depreciation and depletion relating to the newly acquired assets.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased 8.9% from RMB 25,982 million for the year ended December 31, 2003 to RMB 28,302 million for the year ended December 31, 2004. This increase was due primarily to an increase of RMB 1,230 million in transportation expenses a result of our increased sales volume of refined products and an increase of RMB 760 million in repairment expenses.

Exploration Expenses. Exploration expenses increased 13.8% from RMB 10,624 million for the year ended December 31, 2003 to RMB 12,090 million for the year ended December 31, 2004. This increase was due primarily to increased expenditures in exploration activities for the purpose of increasing our crude oil and gas reserves.

Expenses Relating to the Shutting Down of Manufacturing Facilities and Units. Expenses relating to shutting down of manufacturing facilities and units decreased by 90.7% from RMB 2,355 million for the year ended December 31, 2003 to RMB 220 million for the year ended December 31, 2004. The expenses related to shutting down low efficiency assets in our refining and marketing segment and our chemicals and marketing segment in 2004 amounted to RMB 192 million and RMB 28 million, respectively.

Taxes Other than Income Taxes. Taxes other than income taxes increased 18.6% from RMB 16,821 million for the year ended December 31, 2003 to RMB 19,943 million for the year ended December 31, 2004. This increase was due primarily to an increase of RMB 1,201 million in consumption tax as a result of increased sales volume of gasoline and diesel and an increase of RMB 272 million in resources compensation fees as a result of increased revenues of crude oil.

Income From Operations. As a result of the factors discussed above, income from operations increased 48.6% from RMB 101,712 million for the year ended December 31, 2003 to RMB 151,138 million for the year ended December 31, 2004.

Net Exchange Gain (Loss). Net exchange loss for the year ended December 31, 2003 was RMB 36 million. Net exchange gain for the year ended December 31, 2004 was RMB 8 million. The changes in the loss and gain were due primarily to a decrease in the average outstanding balance of foreign exchange borrowings in 2004.

Net Interest Expense. Net interest expense decreased 20.5% from RMB 1,916 million for the year ended December 31, 2003 to RMB 1,523 million for the year ended December 31, 2004. This decrease was due primarily to a decrease in the average outstanding balance of interest-bearing debts as a result of sufficient cash flow derived from operating activities.

Income Before Income Taxes. Income before income taxes increased 50.2% from RMB 100,693 million for the year ended December 31, 2003 to RMB 151,244 million for the year ended December 31, 2004.

Income Taxes. Income taxes increased 51.4% from RMB 28,796 million for the year ended December 31, 2003 to RMB 43,598 million for the year ended December 31, 2004, due primarily to an increase in income before income taxes.

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Net Income. As a result of the factors discussed above, net income increased 48.7% from RMB 69,835 million for the year ended December 31, 2003 to RMB 103,843 million for the year ended December 31, 2004.

Exploration and Production

Sales and Other Operating Revenue. Sales and other operating revenue increased 25.9% from RMB 185,782 million for the year ended December 31, 2003 to RMB 233,948 million for the year ended December 31, 2004. This increase resulted primarily from an increase in the average realized selling price of crude oil and an increase in sales volume of natural gas by our exploration and production segment in 2004. Our average realized selling price of crude oil for the year ended December 31, 2004 was US$33.72 per barrel, representing an increase of 24.0% from US$27.20 per barrel for the year ended December 31, 2003. Our exploration and production segment sold 810.4 billion cubic feet of natural gas in the year ended December 31, 2004, as compared to 651.0 billion cubic feet of natural gas in the year ended December 31, 2003.

Intersegment sales increased 37.2% from RMB 131,336 million for the year ended December 31, 2003 to RMB 180,129 million for the year ended December 31, 2004. This increase resulted primarily from an increase in the average selling price of crude oil and an increase of sales volume of natural gas.

Sales of crude oil to Sinopec decreased 3.8% from RMB 25,008 million for the year ended December 31, 2003 to RMB 24,053 million for the year ended December 31, 2004. This decrease was due primarily to a decrease in our sales volume to Sinopec.

Operating Expenses. Operating expenses increased 14.6% from RMB 90,552 million for the year ended December 31, 2003 to RMB 103,735 million for the year ended December 31, 2004. This increase was due primarily to (i) an increase of RMB 3,057 million in purchase expenses for import of crude oil, (ii) an increase of RMB 1,140 million in exploration expenses as a result of increased expenditures in exploration activities for the purpose of improving recovery of crude oil and gas reserves, (iii) an increase of RMB 2,013 million in depletion and depreciation charges and (iv) an increase of RMB 1,246 million in salaries and other benefits.

Income From Operations. As a result of the factors discussed above, income from operations increased 36.7% from RMB 95,230 million for the year ended December 31, 2003 to RMB 130,213 million for the year ended December 31, 2004.

Refining and Marketing

Sales and Other Operating Revenue. Sales and other operating revenue increased 32.2% from RMB 224,177 million for the year ended December 31, 2003 to RMB 296,427 million for the year ended December 31, 2004. This increase was due primarily to increases in the selling prices and the sales volumes of our principal refined products.

Sales revenue from gasoline increased 28.0% from RMB 60,073 million for the year ended December 31, 2003 to RMB 76,919 million for the year ended December 31, 2004 due primarily to increases in the selling prices and the sales volume of gasoline. The average realized selling price of gasoline increased 17.2% from RMB 3,023 per ton for the year ended December 31, 2003 to RMB 3,542 per ton for the year ended December 31, 2004. We sold approximately 21.7 million tons of gasoline for the year ended December 31, 2004, representing an increase of 9.0% from approximately 19.9 million tons for the year ended December 31, 2003.

Sales revenue from diesel increased 36.2% from RMB 100,336 million for the year ended December 31, 2003 to RMB 136,649 million for the year ended December 31, 2004 due primarily to increases in the selling prices and the sales volume of diesel. The average realized selling price of diesel increased 15.7% from RMB 2,735 per ton for the year ended December 31, 2003 to RMB 3,165 per ton for the year ended December 31, 2004. We sold 43.2 million tons of diesel for

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the year ended December 31, 2004, representing an increase of 17.7% from 36.7 million tons for the year ended December 31, 2003.

Sales revenue from kerosene increased 42.6% from RMB 4,125 million for the year ended December 31, 2003 to RMB 5,881 million for the year ended December 31, 2004 due primarily to increases in the selling prices and sales volume of kerosene. The average realized selling price of kerosene increased 20.5% from RMB 2,306 per ton for the year ended December 31, 2003 to RMB 2,779 per ton for the year ended December 31, 2004. The sales volume of kerosene increased 16.7% from approximately 1.8 million tons for the year ended December 31, 2003 to approximately 2.1 million tons for the year ended December 31, 2004.

Intersegment sales revenue increased 29.6% from RMB 16,867 million for the year ended December 31, 2003 to RMB 21,862 million for the year ended December 31, 2004, due primarily to increases in the selling prices and sales volume of our refined products.

Operating Expenses. Operating expenses increased 29.6% from RMB 219,476 million for the year ended December 31, 2003 to RMB 284,536 million for the year ended December 31, 2004. This increase was due primarily to (i) increases in purchase prices and purchase volumes of crude oil and refined products, (ii) an increase in employee salary and benefits and (iii) an increase in sales and administrative expenses. Our purchase expenses of direct materials increased by RMB 58,363 million in 2004, of which RMB 57,629 million was due to the increases in crude oil purchase prices and purchase volume. Salary and benefits increased by RMB 1,130 million and sales and administrative expenses increased by RMB 1,870 million in 2004.

Income From Operations. As a result of the factors discussed above, income from operations increased 152.9% from RMB 4,701 million for the year ended December 31, 2003 to RMB 11,891 million for the year ended December 31, 2004.

Chemicals and Marketing

Sales and Other Operating Revenue. Sales and other operating revenue increased 45.8% from RMB 39,211 million for the year ended December 31, 2003 to RMB 57,179 million for the year ended December 31, 2004. This increase was due primarily to increases in the selling prices and sales volumes of chemical products. The average realized selling prices of synthetic resin, synthetic fibres, rubber and urea were RMB 8,257, RMB 11,434, RMB 10,703 and RMB 1,274 per ton, respectively, for the year ended December 31, 2004, representing increases of 39.1%, 27.6%, 22.3% and 16.6%, respectively, from the year ended December 31, 2003. Our chemicals and marketing segment sold 11,867 thousand tons of chemical products for the year ended December 31, 2004, representing an increase of 9% from the year ended December 31, 2003.

Operating Expenses. Operating expenses increased 29.7% from RMB 38,170 million for the year ended December 31, 2003 to RMB 49,524 million for the year ended December 31, 2004, due primarily to an increase of RMB 7,464 million in the purchase expenses of direct materials and an increase of RMB 1,080 million in the sales and administrative expenses.

Income From Operations. As a result of the factors discussed above, income from operations increased by RMB 6,614 million from RMB 1,041 million for the year ended December 31, 2003 to RMB 7,655 million for the year ended December 31, 2004.

Natural Gas and Pipeline

Sales and Other Operating Revenue. Sales and other operating revenue increased 21.2% from RMB 15,067 million for the year ended December 31, 2003 to RMB 18,255 million for the year ended December 31, 2004, due primarily to increases in natural gas sales revenue and pipeline transmission revenue as a result of increases in the sales volume and the pipeline transmission volume of natural gas. Our natural gas and pipeline segment sold 657.3 billion cubic feet natural gas in the year ended December 31, 2004, representing an increase of 21% from 543.4 billion cubic feet in the year ended December 31 2003, which resulted in an increase in sales revenue of RMB 1,931 million. The increase of RMB 1,055 million in our income from pipeline transmission of natural gas in 2004 was attributable to an increase in the pipeline transmission volume of natural gas from 520.3 billion cubic feet in 2003 to 616.0 billion cubic feet in 2004.

Operating Expenses. Operating expenses increased 19.6% from RMB 13,145 million for the year ended December 31, 2003 to RMB 15,720 million for the year ended December 31, 2004, due primarily to (i) an increase of RMB 1,402 million in purchase expenses of natural gas primarily as a result of the increase of 110.4 billion cubic feet in the natural gas purchase volume and (ii) an increase of RMB 1,102 million in depreciation expenses.

Income From Operations. As a result of the factors discussed above, income from operations increased 31.9% from RMB 1,922 million for the year ended December 31, 2003 to RMB 2,535 million for the year ended December 31, 2004.

Liquidity and Capital Resources

Our primary sources of funding include cash generated by operating activities, short-term and long-term borrowings and cash and cash equivalents. Historically, our primary uses of funds were for operating activities, capital expenditures, repayment of short-term and long-term borrowings and distributions of dividends to shareholders. Our payments to CNPC are limited to dividends and payments for services provided to us by CNPC. In the year ended December 31, 2005, we distributed as dividends 45% of our reported net income. We expect that we will continue to distribute as dividends approximately 40% to 50% of our reported net income for all years. See Item 8 Financial Information Dividend Policy for a discussion of factors which may affect the determination by our board of directors of the appropriate level of dividends.

We finance a significant portion of our business operations with short-term borrowings, including short-term debt obtained from PRC State-owned banks. As of December 31, 2005, short-term debt comprised approximately 4.7% of our capital employed as compared to approximately 6.7% as of December 31, 2004. Our financing ability may be limited by our financial condition, our results of operations and the international and domestic capital markets. Prior to accessing the international and domestic capital markets, we must obtain approval from the relevant PRC government authorities. In general, we must obtain PRC government approval for any project involving significant capital investment for our refining and marketing, chemicals and marketing and natural gas and pipeline segments. For a more detailed discussion of factors which may affect our ability to satisfy our financing requirements, see Item 3 Key Information Risk Factors .

We plan to fund the capital and related expenditures described in this annual report principally through cash generated by operating activities, short-term and long-term borrowings and cash and cash equivalents. Net cash generated by operating activities in the year ended December 31, 2005 was RMB 203,885 million. As of December 31, 2005, we had cash and cash equivalents of RMB 80,905 million. While each of the projects described in this annual report for which significant capital expenditures will be required is important to our future development, we do not believe that failure to implement any one of these projects would have a material adverse effect on our financial condition or results of operations. If the price of crude oil undergoes a steep decline in the future, it is likely that we would delay or reduce the scale of the capital expenditures for our exploration and production segment.

Our shareholders approved at our shareholders meeting held on May 28, 2003 the proposed issuances of our corporate bonds in the principal amount of up to RMB 1,500 million and RMB 4,000 million to PRC citizens and enterprises. Upon the grant of PRC government approval, we issued a portion of these corporate bonds in the principal amount of RMB 1,500 million in October 2003. We received RMB 1,500 million in net proceeds from this issuance. We used the proceeds received from the issuance of these corporate bonds for various crude oil and natural gas exploration projects in a number of our oil and gas regions, as well as for upgrading refining facilities in Daqing Petrochemical and constructing the natural gas pipeline from Zhong County to Wuhan City. However, the issuance of the remaining portion of these corporate bonds will be subject to market conditions. We cannot assure you that we will complete the issuance of the remaining portion of these corporate bonds in accordance with the terms approved by our shareholders. However, we do not believe failure to complete the issuance of the remaining portion of these corporate bonds would have a material adverse effect on our financial condition. In addition, we consider from time to time opportunities to fund our capital needs by accessing the domestic equity capital markets.

We currently do not have any outstanding options, warrants or other rights for any persons to require us to issue any common stock at a price below its market value. We do not currently intend to issue any such rights or to otherwise issue any common stock for a price below its market value.

In addition, we did not have for the year ended December 31, 2005, and do not currently have, any transactions, arrangements or other relationships with unconsolidated entities or other persons that are reasonably likely to materially affect the liquidity or availability of or requirements for our capital resources.

The table below sets forth our cash flows for each of the three years ended December 31, 2003, 2004 and 2005 and our cash equivalents at the end of each period.

	Year ended December 31,		
	2003	**2004**	**2005**
	(RMB in millions)		
Net cash generated by operating activities	139,570	141,691	203,885
Net cash used for investing activities	(102,549)	(102,276)	(91,576)
Net cash used for financing activities	(35,593)	(39,586)	(42,634)
Currency translation difference	19	246	(458)
Cash and cash equivalents at the end of period	11,613	11,688	80,905

Our cash and cash equivalents increased by RMB 69,217 million from RMB 11,688 million as of December 31, 2004 to RMB 80,905 million as of December 31, 2005, representing a 592.2% increase over 2004.

Cash Generated by Operating Activities

Our net cash flow generated by operating activities was RMB 203,885 million for the year ended December 31, 2005, representing an increase of RMB 62,194 million from RMB 141,691 million for the year ended December 31, 2004, due primarily to an increase of RMB 31,996 million in income for the year and an increase of RMB 22,089 million in our accounts payable.

We had a working capital balance of RMB 22,057 million for the year ended December 31, 2005, compared with the working capital deficit of RMB 8,272 million for the year ended December 31, 2004. This increase in working capital balance was due primarily to (i) the increase in our cash and cash equivalents as a result of a substantial increase of RMB 154,875 million in our sales revenue and (ii) an increase of RMB 15,356 million in inventory, as a result of the expansion of our sales and an increase in the purchase price.

Our net cash generated by operating activities was RMB 141,691 million for the year ended December 31, 2004, representing an increase of RMB 2,121 million from RMB 139,570 million for the year ended December 31, 2003, due primarily to an increase of RMB 86,923 million in sales revenue which was partially offset by an increase of RMB 24,508 million in our purchase expenses, a decrease of RMB 22,566 million in working capital deficit and an increase of RMB 14,802 million in income tax expense.

We had a working capital deficit of RMB 30,838 million as of December 31, 2003 and RMB 8,272 million as of December 31, 2004. This decrease in working capital deficit was due

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primarily to an increase of RMB 17,313 million in inventory and an increase of RMB 8,993 million in investments in collaterized loan.

Our notes and other receivables include notes receivable from customers. Other receivables represent advances to employees, non-trade related receivables from other companies, and receivables from government agencies. Allowance for doubtful accounts were primarily related to other receivables which we estimated to be uncollectible. Our notes receivable do not include past due customer amounts and, as a majority portion of our notes receivable are approved by banks, we do not have special arrangements with respect to extended payment terms on notes receivable.

Cash Used for Financing Activities

Our net borrowings as of December 31, 2003, 2004 and 2005 were as follows:

	December 31,		
	2003	2004	2005
	(RMB in millions)		
Short-term debt (including current portion of long-term debt)	34,328	34,937	28,689
Long-term debt	51,601	44,648	44,570
Total debt	85,929	79,585	73,259
Less:			
Cash and cash equivalents	11,613	11,688	80,905
Time deposits with term exceeding three months within one year	2,648	1,425	1,691
Investments in Collateralized Loans	24,224	33,217	235
Time deposits exceeding one year	3,485	3,751	3,428
Net debt	43,959	29,504	(13,000)

See Note 23 to our consolidated financial statements included elsewhere in this annual report for information regarding the maturity profile of debt, currency and interest rate structure.

The debts which were guaranteed by CNPC amounted to RMB 853 million, RMB 756 million and RMB 674 million in each of the three years ended December 31, 2003, 2004 and 2005, respectively. CNPC and we have undertaken to the Hong Kong Stock Exchange that we will continue to, on a best endeavor basis, approach each lender with respect to these guaranteed debts with a view toward obtaining the unconditional release of such guarantees.

Of the total debts outstanding as of December 31, 2005, approximately 27.0% were fixed-rate loans and approximately 73.0% were floating-rate loans. Of the total debts outstanding as of December 31, 2005, approximately 72.1% were denominated in Renminbi, approximately 27.1% were denominated in the U.S. dollar and approximately 0.8% were denominated in other major foreign currencies.

Our debts included short-term and long-term debts owed to China Petroleum Finance Company Limited of RMB 29,575 million, RMB 29,932 million and RMB 27,319 in each of the three years ended December 31, 2003, 2004 and 2005, respectively. The amount of such short-term debts in each of the three years ended December 31, 2003, 2004 and 2005 were RMB 1,885 million, RMB 4,351 million and RMB 520 million, respectively. The amount of such long-term debts in each of the three years ended December 31, 2003, 2004 and 2005 were RMB 27,690 million, RMB 25,581 million and RMB 26,799 million, respectively. These debts were unsecured with interest bearing at below the prime rate as published by the People s Bank of China. We also maintain a portion of our deposits at China

Petroleum Finance Company Limited at the same deposit interest rate for commercial banks published by the People s Bank of China.

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Our net cash used for financing activities increased 7.7% from RMB 39,586 million for the year ended December 31, 2004 to RMB 42,634 million for the year ended December 31, 2005. This increase resulted primarily from the following:

- a decrease in new long-term debts leading to a decrease of RMB 2,939 million in cash inflow;
- an increase in the repayment of short-term debts leading to an increase of RMB 10,667 million in cash outflow; and
- an increase in the distribution of dividends leading to an increase of RMB 19,339 million in cash outflow;

These changes were offset primarily by the following:

- our follow-on offering of H shares leading to an increase of RMB 19,692 million in cash inflow.
- an increase in new short-term debts leading to an increase of RMB 3,906 million in cash inflow; and
- a decrease in the repayment of long-term debts leading to a decrease of RMB 9,156 million in cash outflow.

Our net cash used for financing activities increased 11.2% from RMB 35,593 million for the year ended December 31, 2003 to RMB 39,586 million for the year ended December 31, 2004. This increase resulted primarily from the following:

- an increase in the repayment of long-term debts leading to an increase of RMB 20,377 million in cash outflow;
- an increase in the distribution of dividends leading to an increase of RMB 4,650 million in cash outflow; and
- a decrease in new short-term debts leading to a decrease of RMB 417 million in cash inflow;

These changes were offset primarily by the following:

- an increase in new long-term debts leading to an increase of RMB 14,206 million in cash inflow; and
- a decrease in the repayment of short-term debts leading to a decrease of RMB 7,045 million in cash outflow.

As at December 31, 2005, our debts consisted of RMB 1,108 million secured debts (including financing leases and bank loans), of which RMB 61 million of bank loans were secured by our plants and equipment in the aggregate value of RMB 75 million.

Our debt to capital employed ratio (calculated by dividing interest-bearing debts by the aggregate of interest-bearing debts and shareholder s equity) as of December 31, 2005 was 11.9%, as compared to 15.2% as of December 31, 2004.

Capital Expenditures and Investments

Our net cash used for investing activities includes capital expenditures and investments, offset by proceeds from the sale of assets and dividends received. The table below sets forth our capital expenditures and investments (including non dry hole exploration expenses) by business segment for each of the years ended December 31, 2003, 2004 and 2005 as well as those anticipated for the year ending December 31, 2006. Actual capital expenditures and investments for periods after January 1, 2006 may differ materially from the amounts indicated below.

	2003		2004		2005		2006 anticipated	
	(RMB in millions)	%	(RMB in millions)	%	(RMB in millions)	%	(RMB in millions)	%
Exploration and production	61,982	67.15	70,217	66.06	92,223	68.92	104,500	65.31
Refining and marketing	12,758	13.82	17,684	16.64	16,454	12.30	23,700	14.81
Chemicals and marketing	3,898	4.22	4,319	4.06	13,569	10.14	15,300	9.56
Natural gas and pipeline	13,530	14.66	13,901	13.08	11,137	8.32	15,300	9.56
Corporate and other	138	0.15	174	0.16	427	0.32	1,200	0.76
Total	92,306	100.0	106,295	100.0	133,820	100.0	160,000	100.0

Our capital expenditures and investments increased 25.89% from RMB 106,295 million for the year ended December 31, 2004 to RMB 133,820 million for the year ended December 31, 2005. This increase was due primarily to an increase of RMB 22,016 million in capital expenditures and investments in exploration activities and a decrease of RMB 1,230 million in capital expenditures and investments in constructing our sales network of refined products. Taking into account the exclusion of the investments relating to the non-dry hole exploration expenses, our capital expenditures for the years ended 2003, 2004 and 2005 would have been RMB 86,373 million, RMB 98,946 million and RMB 124,801 million, respectively.

As of December 31, 2005, the capital expenditures contracted for at the balance sheet date but not recognized in our consolidated financial statements were approximately RMB 13,365 million.

Exploration and Production

A majority of our capital expenditures and investments relate to our exploration and production segment. Our capital expenditures and investments for the segment for the year ended December 31, 2005 totaled RMB 92,233 million, including RMB 25,518 million for exploration activities and RMB 59,113 million for development activities. Our capital expenditures and investments for the year ended December 31, 2004, totaled RMB 70,217 million, including RMB 19,093 million for exploration activities and RMB 45,832 million for development activities. The increase in our capital expenditures and investments from the year ended December 31, 2004 to the year ended December 31, 2005 was due primarily to increased capital expenditures for crude oil exploration activities in our Daqing, Tarim and Changqing oil regions and increased capital expenditures for natural gas exploration activities in our Tarim, Sichuan and Erdos basins. Taking into account the exclusion of the investments relating to the non-dry hole exploration expenses, the capital expenditures of our exploration and production segment for the years ended December 31, 2003, 2004 and 2005 would have been RMB 56,049 million, RMB 62,868 million and RMB 83,214 million, respectively.

Our anticipated capital expenditures and investments for our exploration and production segment for the year ending December 31, 2006 amount to RMB 104,500 million. Approximately RMB 31,000 million is expected to be used for exploration activities and approximately RMB 73,500 million for development activities. We plan to focus our exploration efforts in Erdos, Junggar, Tarim, Songliao, Sichuan, Bohai Bay and Qaidam basins.

Refining and Marketing

Our capital expenditures for our refining and marketing segment for each of the three years ended December 31, 2003, 2004 and 2005 were RMB 12,758 million, RMB 17,684 million and RMB 16,454 million, respectively. The decrease in 2005 is due primarily to a decrease of RMB 2,164 million in our investment in the construction of our sales network.

Our anticipated capital expenditures for our refining and marketing segment for the year ending December 31, 2006 amount to RMB 23,700 million, which include:

approximately RMB 15,200 million for the construction and expansion of our refining facilities; and

approximately RMB 8,500 million for the construction of our sales network for finished oil products.

Chemicals and Marketing

Our capital expenditures for our chemicals and marketing segment for each of the three years ended December 31, 2003, 2004 and 2005 were RMB 3,898 million, RMB 4,319 million and RMB 13,569 million, respectively. The increase in 2005 was due primarily to the increased capital expenditures for the ethylene projects in Jilin Petrochemical, Lanzhou Petrochemical and Dushanzi Petrochemical and for the PTA projects in Liaoyang Petrochemical.

Our anticipated capital expenditures for our chemicals and marketing segment for the year ending December 31, 2006 amount to RMB 15,300 million, which mainly include capital expenditures for upgrading the ethylene facilities in Jilin Petrochemical, Lanzhou Petrochemical and Dushanzi Petrochemical and for the construction of the PTA project at Liaoyang Petrochemical.

Natural Gas and Pipeline

Our capital expenditures for our natural gas and pipeline segment for each of the three years ended December 31, 2003, 2004 and 2005 were RMB 13,530 million, RMB 13,901 million and RMB 11,137 million, respectively. The decrease in 2005 resulted primarily from decreased capital expenditures for the second Shaanxi-Beijing natural gas pipeline.

Our anticipated capital expenditures for our natural gas and pipeline segment for the year ending December 31, 2006 amount to approximately RMB 15,300 million. Of this amount, RMB 800 million is expected to be invested in pipelines for the transmission of crude oil, RMB 1,300 million in the pipelines of refined products and RMB 13,200 million in natural gas pipelines. See Item 4 Information on the Company Natural Gas and Pipeline Expansion of Our Natural Gas Transmission and Marketing Business for a more detailed discussion of the expansion plans of our natural gas and pipeline segment.

Corporate and Other

Our non-segment-specific capital expenditures and investments for each of the three years ended December 31, 2003, 2004 and 2005 were RMB 138 million, RMB 174 million and RMB 427 million, respectively. Our non segment-specific capital expenditures and investments related primarily to purchase of non-segment-specific equipment and research and development activities.

Our anticipated non-segment-specific capital expenditures and investments for the year ending December 31, 2006 amount to RMB 1,200 million. These planned capital expenditures and investments mainly include capital expenditures for scientific research activities and the construction of the ERP information system.

Off-Balance Sheet Arrangements

There are no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

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Long-Term Contractual Obligations and Other Commercial Commitments and Payment Obligations

The tables below set forth certain information in connection with our long-term contractual obligations and other commercial commitments outstanding as of December 31, 2005.

	Payment due by period				
Contractual obligations	Total	Less than 1 year	1-3 years	3-5 years	After 5 years
	(RMB in millions)				
Long-term debt	59,895	15,325	29,766	3,549	11,255
Capital lease obligations	0	0	0	0	0
Operating leases	94,990	3,208	5,153	5,363	81,266
Capital commitments	13,365	7,241	6,099	5	20
Unconditional purchase obligations	2,553.3	2,232.8	231	64.1	25.4
Other long-term obligations	0	0	0	0	0
Total contractual cash obligations	170,803.3	28,006.8	41,249	8,981.1	92,566.4

	Amount of commitment expiration per period				
Other commercial commitments	Total amounts committed	Less than 1 year	1-3 years	3-5 years	Over 5 years
	(RMB in millions)				
Lines of credit	0	0	0	0	0
Standby letters of credit	0	0	0	0	0
Guarantees	187	11	101	22	53
Total commercial commitments	187	11	101	22	53

We are obligated to make annual payment with respect to our exploration and production licenses to the Ministry of Land and Resources. The table below sets forth the estimated amount of the annual payments in the future five years:

Year	Annual payment
	(RMB in millions)
2006	681
2007	712
2008	712
2009	712
2010	850

We sell a substantial portion of our natural gas under long-term take-or-pay contracts. Under these contracts, the customers are required to take or pay, and we are obligated to deliver, minimum quantities of natural gas annually.

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As of December 31, 2005, our future minimum delivery commitments under such take-or-pay contracts are as follows:

	Quantities (billion of cubic feet)
2006	451
2007	583
2008	639
2009	704
2010	583
2011 and thereafter	5,528

Oil-and-Gas Assets Retirement Obligation

Before the issuance of two provincial regulations, *the Environmental Protection Regulation for Oil and Gas Exploration and Production Activities in Heilongjiang Province* and *the Environmental Protection Regulation for Oil and Gas Exploration and Production Activities in Gansu Province,* which set forth specific abandonment and disposal processes for oil and gas exploration and production activities in 2005, our company was neither legally obligated to, nor was our company under the constructive obligation, to take any abandonment measures for its retired oil and gas properties located in China. In 2005, our company established standard abandonment procedures, including plugging all retired wells, dismantling all retired metering stations and other related facilities and performing site restoration, in response to the issuance of two provincial regulations which set forth specific abandonment and disposal processes for oil and gas exploration and production activities. As a result, our company became legally obligated to take abandonment measures for its retired oil and gas properties located in the two provinces where the new regulations were enacted, and is under the constructive obligation to take abandonment measures for its retired oil and gas properties located in other provinces where comparable regulations were not enacted. An obligation of RMB 13.2 billion was recorded at the end of 2005 and did not have a material impact on our company s 2005 financial results.

The estimated average future annual charge, including depreciation and accretion expenses, to the consolidated statement of income of our company arising from the recording of this provision is estimated to be less than RMB 2.0 billion. We do not expect this charge to have a material impact on the results of operations and financial condition of our company.

The average annual cash outflow resulting from performing all standard abandonment procedures established by our company in 2005 for all oil and gas properties is estimated to be less than RMB 2.0 billion. We do not expect this cash outflow to have a material impact on the liquidity of our company.

Research and Development

We have a research and development management department, directly under which there are three research institutions. Except for our branch companies which are engaged in marketing activities, each of our branch companies has its own research and development management department. Most of our branch companies have their own research institutions. Our research and development management departments are mainly responsible for managing and coordinating the research and development activities conducted by each of the research institutions. As of December 31, 2005, we had 22,218 employees engaged in research and development functions.

In 2005, we applied for 188 patents and 135 trademarks in China. We obtained patent rights for 238 patents in the same period.

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In each of the three years ended December 31, 2003, 2004 and 2005, our total expenditures for research and development were approximately RMB 2,442 million, RMB 2,977 million and RMB 3,195 million, respectively.

Exploration and Production

China s major oil and gas fields are characterized by a broad range of geological conditions, and a majority of China s oil and gas fields are in continental sedimentary basins with complex structures. We have developed effective exploration and production techniques and methods that are suitable for these geological conditions. Our research and development efforts with respect to our exploration and production business focus on:

- geological structures of crude oil and natural gas reserves;
- oil and gas exploration and development;
- oil and gas production and pipeline transportation; and
- monitoring of the environment.

Refining and Chemicals

In order to organize and coordinate our research and development activities related to our refining and chemicals businesses, we established PetroChina Refining & Chemicals Technology Research Center in July 2003, which is responsible for developing research strategies of our refining and chemicals, as well as managing and coordinating to finish leading and major research projects and cooperation research with domestic or foreign entities. We have established four research and development centers in Daqing Petrochemical, Liaoyang Petrochemical, Lanzhou Petrochemical and Jilin Petrochemical to carry out the research and development of certain of our major refining and chemicals research projects. In order to enhance our competitiveness and develop core technologies, we are integrating the resources of our down-stream scientific research and development system in the near future.

Trend Information

Streamlining of Production Facilities

We plan to continue to streamline our production facilities within the next several years to further improve our operating efficiency and competitiveness by consolidating or shutting down some of our production facilities. We do not believe that the implementation of such plans will have a material adverse impact on our financial position, although we believe that it could have a material adverse effect on our results of operations because we would be required under our accounting policies to recognize in our income statement any impairment loss or impairment provision associated with shutting down our production facilities. See General Critical Accounting Policies and General Factors Affecting Results of Operations above for a detailed discussion of other trend information.

Other Information

Inflation

Inflation or deflation has not had a significant impact on our results of operations for the year ended December 31, 2005.

Non-Exchange Traded Contracts

We did not engage for the year ended December 31, 2005, and do not currently engage, to a material extent, in any trading activities involving commodity contracts that are accounted for at fair value but for which a lack of market price quotations makes it necessary to apply fair value estimation techniques.

Related Party Transactions

For a discussion of related party transactions, see Item 7 Major Shareholders and Related Party Transactions Related Party Transactions and Note 34 to our consolidated financial statements included elsewhere in this annual report.

US GAAP Reconciliation

We prepared our consolidated financial statements in accordance with IFRS. This basis of accounting may differ from US GAAP. Such differences involve methods for measuring the amounts shown in the financial statements, as well as additional disclosures required by US GAAP.

A summary of the principal differences and additional disclosures applicable to us is set out below:

Revaluation of Property, Plant and Equipment

As described in Note 17 to the consolidated financial statements, the property, plant and equipment, excluding oil and gas reserves, transferred to our company by CNPC were appraised as of June 30, 1999, as required by the relevant PRC regulations, by a firm of independent valuers registered in the PRC, China Enterprise Appraisal. As at September 30, 2003, a revaluation of our company s refining and chemical production equipment was undertaken by a firm of independent valuers registered in the PRC, China United Assets Appraiser Co., Ltd, on a depreciated replacement cost basis.

The June 1999 revaluation resulted in RMB 80,549 million in excess of the prior carrying value and a revaluation loss of RMB 1,122 million on certain property, plant and equipment.

The September 2003 revaluation resulted in RMB 872 million in excess of the carrying value of certain property, plant and equipment immediately prior to the revaluation and a