

PETROCHINA CO LTD
Form 20-F
May 11, 2007

Table of Contents

**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, 2006
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 No

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 No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of 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 No

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

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

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

Item 17 Item 18

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 No

* 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 Depositary Shares.

*** Includes 3,166,123,000 H Shares represented by American Depositary Shares.

Table of Contents**Table of Contents**

		Page
	<u>Certain Terms and Conventions</u>	3
	<u>Forward-Looking Statements</u>	6
Part I	Item 1 <u>Identity of Directors, Senior Management and Advisors</u>	8
	Item 2 <u>Offer Statistics and Expected Timetable</u>	8
	Item 3 <u>Key Information</u>	8
	<u>Exchange Rates</u>	8
	<u>Selected Financial Data</u>	9
	<u>Risk Factors</u>	13
	Item 4 <u>Information on the Company</u>	18
	<u>Introduction</u>	18
	<u>Exploration and Production</u>	25
	<u>Refining and Marketing</u>	36
	<u>Chemicals and Marketing</u>	43
	<u>Natural Gas and Pipeline</u>	47
	<u>Competition</u>	50
	<u>Environmental Matters</u>	51
	<u>Legal Proceedings</u>	52
	<u>Properties</u>	53
	<u>Regulatory Matters</u>	53
	Item 4A <u>Unresolved Staff Comments</u>	60
	Item 5 <u>Operating and Financial Review and Prospects</u>	61
	<u>General</u>	61
	<u>Operating Results</u>	69
	<u>Liquidity and Capital Resources</u>	79
	<u>Off-Balance Sheet Arrangements</u>	85
	<u>Long-Term Contractual Obligations and Other</u>	
	<u>Commercial Commitments and Payment Obligations</u>	85
	<u>Research and Development</u>	86
	<u>Trend Information</u>	87
	<u>Other Information</u>	87
	Item 6 <u>Directors, Senior Management and Employees</u>	93
	<u>Directors, Senior Management and Supervisors</u>	93
	<u>Compensation</u>	100
	<u>Board Practices</u>	101
	<u>Employees</u>	102
	<u>Share Ownership</u>	103
	Item 7 <u>Major Shareholders and Related Party Transactions</u>	104
	<u>Major Shareholders</u>	104
	<u>Related Party Transactions</u>	104
	<u>Loans or Guarantees with Related Parties</u>	110

Table of Contents

		Page
	<u>Item 8</u>	<u>Financial Information</u> 110
		<u>Financial Statements</u> 110
		<u>Significant Changes</u> 111
	<u>Item 9</u>	<u>The Offer and Listing</u> 112
		<u>Nature of the Trading Market and Market Price</u>
		<u>Information</u> 112
	<u>Item 10</u>	<u>Additional Information</u> 113
		<u>Memorandum and Articles of Association</u> 113
		<u>Material Contracts</u> 118
		<u>Exchange Controls</u> 119
		<u>Taxation</u> 119
		<u>Significant Differences in Corporate Governance</u>
		<u>Practices</u> 125
		<u>Documents on Display</u> 125
	<u>Item 11</u>	<u>Quantitative and Qualitative Disclosures About Market</u>
		<u>Risk</u> 126
	<u>Item 12</u>	<u>Description of Securities Other Than Equity Securities</u> 130
Part II	<u>Item 13</u>	<u>Defaults, Dividends Arrearages and Delinquencies</u> 130
	<u>Item 14</u>	<u>Material Modifications to the Rights to Security Holders</u> 130
	<u>Item 15</u>	<u>Controls and Procedures</u> 130
	<u>Item 16A</u>	<u>Audit Committee Financial Expert</u> 130
	<u>Item 16B</u>	<u>Code of Ethics</u> 131
	<u>Item 16C</u>	<u>Principal Accountant Fees and Services</u> 131
	<u>Item 16D</u>	<u>Exemptions from Listing Standards for Audit</u>
		<u>Committees</u> 132
	<u>Item 16E</u>	<u>Purchases of Equity Securities by the Issuer and</u>
		<u>Affiliated Purchasers</u> 132
Part III	<u>Item 17</u>	<u>Financial Statements</u> 132
	<u>Item 18</u>	<u>Financial Statements</u> 132
	<u>Item 19</u>	<u>Exhibits</u> 132
	<u>EX-1.1 ARTICLES OF ASSOCIATION</u>	
	<u>EX-1.2 ARTICLES OF ASSOCIATION</u>	
	<u>EX-4.1 MANAGEMENT PERFORMANCE</u>	
	<u>CONTRACT</u>	
	<u>EX-4.2 CRUDE OIL MUTUAL SUPPLY</u>	
	<u>FRAMEWORK AGREEMENT</u>	
	<u>EX-4.19 SHARE PURCHASE AGREEMENT</u>	
	<u>EX-8.1 LIST OF SUBSIDIARIES</u>	
	<u>EX-12.1 CERTIFICATION OF CEO</u>	
	<u>REQUIRED BY SECTION 302</u>	
	<u>EX-12.2 CERTIFICATION OF CFO</u>	
	<u>REQUIRED BY SECTION 302</u>	
	<u>EX-13.1 CERTIFICATION OF CEO</u>	
	<u>REQUIRED BY SECTION 906</u>	
	<u>EX-13.2 CERTIFICATION OF CFO</u>	
	<u>REQUIRED BY SECTION 906</u>	

Table of Contents

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.

Table of Contents

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

Table of Contents

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.

Table of Contents

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 the 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 would 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;

6

Table of Contents

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, including changes in applicable tax rates;

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.

Table of Contents**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 7.7039 on May 7, 2007. 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\$)	
November 2006	7.8750	7.8303
December 2006	7.8350	7.8041
January 2007	7.8127	7.7705
February 2007	7.7632	7.7410
March 2007	7.7454	7.7232
April 2007	7.7345	7.7090
May 2007 (through May 7)	7.7065	7.7035

The following table sets forth the average noon buying rates between Renminbi and U.S. dollars for each of 2002, 2003, 2004, 2005 and 2006, 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\$)
2002	8.2772
2003	8.2772
2004	8.2768
2005	8.1826
2006	7.9725

Table of Contents

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. The selected historical income statement and cashflow data for the years ended December 31, 2004, 2005 and 2006 and the selected historical balance sheet data as of December 31, 2005 and 2006 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, 2002 and 2003 and the selected historical balance sheet data as of December 31, 2002, 2003 and 2004 set forth below are derived from our audited 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.

Table of Contents

	Year ended December 31,				
	2002⁽¹⁾	2003⁽¹⁾	2004⁽¹⁾	2005	2006
	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	249,386	310,431	397,354	552,229	688,978
Operating expenses					
Purchases, services and other	(71,383)	(89,741)	(114,249)	(200,321)	(271,123)
Employee compensation costs	(16,665)	(20,044)	(22,934)	(29,675)	(39,161)
Exploration expenses, including exploratory dry holes	(8,203)	(10,624)	(12,090)	(15,566)	(18,822)
Depreciation, depletion and amortization	(37,680)	(42,163)	(48,362)	(51,305)	(61,388)
Selling, general and administrative expenses	(23,930)	(25,982)	(28,302)	(36,538)	(43,235)
Employee separation costs and shutting down of manufacturing assets	(2,121)	(2,355)	(220)		
Taxes other than income taxes	(15,366)	(16,821)	(19,943)	(23,616)	(56,666)
Revaluation loss of property, plant and equipment		(391)			
Other expenses, net	(59)	(598)	(116)	(3,037)	(607)
Total operating expenses	(175,407)	(208,719)	(246,216)	(360,058)	(491,002)
Income from operations	73,979	101,712	151,138	192,171	197,976
Income from equity affiliates and jointly controlled entities					
Exchange gain (loss), net	(430)	(36)	8	88	74
Interest income	663	973	1,373	1,924	2,066
Interest expense	(4,068)	(2,889)	(2,896)	(2,762)	(3,220)
Income before taxes	70,313	100,693	151,244	193,822	199,173
Income taxes	(22,939)	(28,796)	(43,598)	(54,180)	(49,776)

Income for this year	47,374	71,897	107,646	139,642	149,397
Attributable to:					
Shareholders	46,766	69,835	103,843	133,362	142,224
Minority shareholders	608	2,062	3,803	6,280	7,173
	47,374	71,897	107,646	139,642	149,397
Basic and diluted net income per share					
Attributable to shareholders for this year ⁽²⁾	0.27	0.40	0.59	0.75	0.79
Basic and diluted net income per ADS ⁽³⁾	26.60	39.72	59.06	75.44	79.45
US GAAP					
Net income	49,693	75,640	109,051	137,866	146,087
Basic and diluted net income per share ⁽²⁾	0.28	0.43	0.62	0.78	0.82
Basic and diluted net income per ADS ⁽³⁾	28.26	43.02	62.02	77.99	81.60

Table of Contents

	As of December 31,				
	2002⁽¹⁾	2003⁽¹⁾	2004⁽¹⁾	2005	2006
	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	19,532	11,613	11,688	80,905	48,559
Time deposits with maturities after three months but within 12 months	2,621	2,648	1,425	1,691	3,012
Investments in collateralized loans	420	24,224	33,217	235	
Accounts receivable	6,544	4,115	3,842	4,630	8,488
Inventories, at net book value	29,352	30,064	47,377	62,733	76,038
Prepaid expenses and other current assets	19,618	18,845	24,704	25,701	26,125
Total current assets	78,087	91,509	122,253	175,895	162,222
Non-current assets					
Property, plant and equipment, less accumulated depreciation, depletion and amortization	404,135	442,311	485,612	563,890	645,337
Long-term investments, at net book value	6,055	9,405	11,504	13,608	35,010
Prepaid operating lease rentals	6,267	7,286	12,307	16,235	20,468
Intangible and other assets	2,769	3,027	3,020	5,011	6,627
Time deposits mature after one year	3,498	3,485	3,751	3,428	2,499
Total non-current assets	422,724	465,514	516,194	602,172	709,941
Total assets	500,811	557,023	638,447	778,067	872,163
Liabilities and shareholders equity					
Current liabilities					
Short-term debt	23,185	34,328	34,937	28,689	35,763
Accounts payable and accrued liabilities	59,950	66,700	73,072	99,758	120,182
Income tax payable	5,581	12,068	17,484	20,567	17,744
Other taxes payable	5,767	9,251	5,032	4,824	6,190

Edgar Filing: PETROCHINA CO LTD - Form 20-F

Total current liabilities	94,483	122,347	130,525	153,838	179,879
Non-current liabilities					
Long-term debt	68,894	51,601	44,648	44,570	35,634
Other long-term obligations	1,707	2,010	2,481	1,046	995
Assets disposal obligations	585	735	919	14,187	18,481
Deferred taxes	10,832	13,436	16,902	20,759	19,583
Total non-current liabilities	82,018	67,782	64,950	80,562	74,693
Total liabilities	176,501	190,129	195,475	234,400	254,572
Equity					
Shareholder s equity					
Share capital	175,824	175,824	175,824	179,021	179,021
Retained income	57,358	88,152	143,115	203,812	264,092
Reserves	84,456	93,952	108,834	132,556	143,564
	317,638	357,928	427,773	515,389	586,677
Minority interest	6,672	8,966	15,199	28,278	30,914
Total equity	324,310	366,894	442,972	543,667	617,591
Total liabilities and equity	500,811	557,023	638,447	778,067	872,163
Share capital, issued and outstanding, RMB 1.00 par value					
State-owned shares	158,242	158,242	158,242	157,922	157,922
H shares and ADSs	17,582	17,582	17,582	21,099	21,099
US GAAP					
Property, plant and equipment, less accumulated depreciation, depletion and amortization	353,932	413,383	452,017	537,106	622,668
Total assets	457,065	528,685	605,018	774,740	858,400
Shareholders equity	284,426	330,520	405,573	510,141	574,470

Table of Contents**As of December 31,**

	2002⁽¹⁾	2003⁽¹⁾	2004⁽¹⁾	2005	2006
	RMB	RMB	RMB	RMB	RMB
			(in millions)		
Other Financial Data					
Dividend per share	0.12	0.18	0.26	0.34	0.36
Dividend per ADS	12.00	17.82	26.34	33.80	35.75
Capital expenditures	(75,496)	(86,373)	(98,946)	(124,801)	(148,746)
Cash Flow Data					
IFRS					
Net cash provided by operating activities	98,989	139,570	141,691	203,885	198,102
Net cash used for investing activities	(73,732)	(102,549)	(102,276)	(91,576)	(158,451)
Net cash used for financing activities	(26,488)	(35,593)	(39,586)	(42,634)	(71,739)

Notes:

- (1) 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. 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, or Dayuan, Qingyang Refinery and Petrochemical Company Limited, or Qingyang, both of which we acquired from CNPC, and the operations of CNPC Exploration and Development Company Limited, or CNPC E&D, of which we acquired a 50% interest from China National Oil and Gas Exploration and Development Corporation, or CNODC, a wholly-owned subsidiary of CNPC, had always been combined since inception.
- (2) The basic and diluted income per share for the years ended December 31, 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 corresponding years. The basic and diluted income per share for the year ended December 31, 2005 was calculated by dividing the net profit by the weighted average number of 176,770 million shares issued and outstanding for the year presented. The basic and diluted income per share for the year ended December 31, 2006 was calculated by dividing the net profit by the number of 179,021 million shares issued and outstanding for the year presented.
- (3) The basic and diluted income per ADS for the years ended December 31, 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 corresponding years, each ADS representing 100 H shares. The basic and diluted 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 year presented, each ADS representing 100 H shares. The basic and diluted income per ADS for the year ended December 31, 2006 has been calculated by dividing the net profit by the number of 179,021 million shares issued and outstanding for the year presented, each ADS representing 100 H shares.

Table of Contents

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. In 2006, the PRC government, under its macro economic controls, introduced a new mechanism for determining the prices of refined products. 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, 2005 and 2006 compared to prior years, 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, in 2005 and 2006, 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, or the SEC, 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 control over financial reporting in its annual report, which contains management's assessment of the effectiveness of the company's internal control 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 control over financial reporting. Although our management concluded that our internal control over our financial reporting for the fiscal year ended December 31, 2006 was effective, we may discover other deficiencies in the course of our future evaluation of our internal control over our financial reporting and

Table of Contents

may be unable to remediate such deficiencies in a timely manner. Moreover, in future years, even if our management concludes that our internal control over financial reporting is 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 control over financial reporting is not effective. If we fail to maintain the adequacy of our internal control over financial reporting, we may not be able to conclude that we have effective internal control over financial reporting on an ongoing basis, in accordance with the Sarbanes-Oxley Act. Moreover, effective internal control is necessary for us to produce reliable financial reports and is important to prevent fraud. As a result, our failure to achieve and maintain effective internal control 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 one of our branch companies in Jilin Province. The incident caused serious personal injuries and deaths, loss of property and water pollution of the Songhuajing River. The Chinese government completed its investigation of this accident in December 2006. As a result, our company paid a fine of RMB 1 million in settlement of all liabilities arising from the accident.

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

Table of Contents

otherwise determine the outcome of most corporate actions and, subject to the requirements of the Listing Rules of the Hong