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CHINA PETROLEUM & CHEMICAL CORP

Form 20-F

April 13, 2007

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

FORM 20-F

(Mark One)

[] REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE
SECURITIES EXCHANGE ACT OF 1934

OR

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES
EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

OR

[] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES
EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM _____ TO _____

OR

[] SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

DATE OF EVENT REQUIRING THIS SHELL COMPANY REPORT

FOR THE TRANSACTION PERIOD FORM _____ TO _____

COMMISSION FILE NUMBER 1-15138

[CHINESE CHARACTERS OMITTED]

CHINA PETROLEUM & CHEMICAL CORPORATION

(Exact name of Registrant as specified in its charter)

The People's Republic of China

(Jurisdiction of incorporation or organization)

A6, Huixingdong Street

Chaoyang District, Beijing, 100029

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.

Table with 2 columns: Title of Each Class, Name of Each Exchange On Which Registered. Rows include American Depositary Shares and H Shares.

* Not for trading, but only in connection with the registration of

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American Depository Shares. 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.

| | |
|---|----------------|
| Tradable shares with selling restriction, | |
| par value RMB 1.00 per share..... | 66,337,951,000 |
| H Shares, par value RMB 1.00 per share..... | 16,780,488,000 |
| A Shares, par value RMB 1.00 per share..... | 3,584,000,000 |

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__

If this report 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 X

Note - Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

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 X 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 X Accelerated filer __ Non-accelerated filer __

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

Item 17 __ 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 __ No X

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CERTAIN TERMS AND CONVENTIONS

Definitions

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

- o "Sinopec Corp.", "we", "our" and "us" are to China Petroleum & Chemical Corporation, a PRC joint stock limited company, and its subsidiaries;
- o "Sinopec Group Company" are to our controlling shareholder, China Petrochemical Corporation, a PRC limited liability company;
- o "Sinopec Group" are to the Sinopec Group Company and its subsidiaries other than Sinopec Corp. and its subsidiaries;
- o "China" or the "PRC" are to the People's Republic of China, excluding for purposes of this annual report Hong Kong, Macau and Taiwan;
- o "provinces" are to provinces and to provincial-level autonomous regions and municipalities in China which are directly under the supervision of the central PRC government;
- o "RMB" are to Renminbi, the currency of the PRC;
- o "HK\$" are to Hong Kong dollar, the currency of the Hong Kong Special Administrative Region of the PRC; and
- o "US\$" are to US dollars, the currency of the United States of America.

Conversion Conventions

Conversions of crude oil from tonnes to barrels are made at a rate of one tonne to 7.35 barrels for crude oil we purchase from external sources and one tonne to 7.1 barrels for crude oil we produce, representing the typical gravity of the respective source of crude oil. Conversions of natural gas from cubic meters to cubic feet are made at a rate of one cubic meter to 35.31 cubic feet.

Glossary of Technical Terms

Unless otherwise indicated in the context, references to:

- o "BOE" are to barrels-of-oil equivalent; natural gas is converted at a ratio of 6,000 cubic feet of natural gas to one BOE.

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- o "primary distillation capacity" are to the crude oil throughput capacity of a refinery's crude oil distillation units, calculated by estimating the number of days in a year that such crude oil distillation units are expected to operate, excluding downtime for regular maintenance, and multiplying that number by the amount equal to the units' optimal daily crude oil throughput.
- o "rated capacity" are to the output capacity of a given production unit or, where appropriate, the throughput capacity, calculated by estimating the number of days in a year that such production unit is expected to operate, excluding downtime for regular maintenance, and multiplying that number by an amount equal to the unit's optimal daily output or throughput, as the case may be.

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CURRENCIES AND EXCHANGE RATES

We publish our financial statements in Renminbi. Unless otherwise indicated, all translations from Renminbi to US dollars have been made at a rate of RMB 7.8041 to US\$ 1.00, the noon buying rate as certified for customs purposes by the Federal Reserve Bank of New York on December 29, 2006. We do not represent that Renminbi or US dollar amounts could be converted into US dollars or Renminbi, as the case may be, at any particular rate, the rates below or at all.

The following table sets forth noon buying rate for US dollars in New York City for cable transfers in Renminbi as certified for customs purposes by the Federal Reserve Bank of New York for the periods indicated:

| Period | Noon Buying Rate | | | |
|----------------------------------|--------------------|-------------|--------|--------|
| | End | Average (1) | High | Low |
| | (RMB per US\$1.00) | | | |
| 2002..... | 8.2800 | 8.2772 | 8.2800 | 8.2759 |
| 2003..... | 8.2767 | 8.2772 | 8.2800 | 8.2769 |
| 2004..... | 8.2765 | 8.2767 | 8.2774 | 8.2764 |
| 2005..... | 8.0702 | 8.1826 | 8.2765 | 8.0702 |
| 2006 | 7.8041 | 7.9723 | 8.0702 | 7.9723 |
| October 2006 | 7.8785 | - | 7.9168 | 7.8728 |
| November 2006 | 7.8340 | - | 7.8750 | 7.8303 |
| December 2006 | 7.8041 | - | 7.8350 | 7.8041 |
| January 2007 | 7.7714 | - | 7.8127 | 7.7705 |
| February 2007 | 7.7410 | - | 7.7632 | 7.7410 |
| March 2007 | 7.7232 | - | 7.7454 | 7.7232 |
| April 2007 (up to April 6, 2007) | 7.7248 | - | 7.7345 | 7.7248 |

(1) Determined by averaging the rates on the last business day of each month during the relevant period.

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FORWARD-LOOKING STATEMENTS

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This annual report includes "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical facts, included in this annual report that address activities, events or developments which we expect or anticipate will or may occur in the future are hereby identified as forward-looking statements for the purpose of the safe harbor provided by Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The words such as believe, intend, expect, anticipate, project, estimate, predict, plan and similar expressions are also intended to identify forward-looking statements. These forward-looking statements address, among others, such issues as:

- o amount and nature of future exploration and development,
- o future prices of and demand for our products,
- o future earnings and cash flow,
- o development projects and drilling prospects,
- o future plans and capital expenditures,
- o estimates of proved oil and gas reserves,
- o exploration prospects and reserves potential,
- o expansion and other development trends of the petroleum and petrochemical industry,
- o production forecasts of oil and gas,
- o expected production or processing capacities, including expected rated capacities and primary distillation capacities, of units or facilities not yet in operation,
- o expansion and growth of our business and operations, and
- o our prospective operational and financial information.

These statements are based on assumptions and analyses made by us in light of our experience and our perception of historical trends, current conditions and expected future developments, as well as other factors we believe are appropriate in particular circumstances. However, whether actual results and developments will meet our expectations and predictions depends on a number of risks and uncertainties which could cause actual results to differ materially from our expectations, including the risks set forth in "Item 3. Key Information -- Risk Factors" and the following:

- o fluctuations in crude oil prices,
- o fluctuations in prices of our products,
- o failures or delays in achieving production from development projects,
- o potential acquisitions and other business opportunities,
- o general economic, market and business conditions, and
- o other risks and factors beyond our control.

Consequently, all of the forward-looking statements made in this annual report are qualified by these cautionary statements and readers are cautioned not to place undue reliance on these forward-looking statements. These forward-looking statements should be considered in light of the various important factors set forth above and elsewhere in this Form 20-F. In addition, we cannot assure you that the actual results or developments anticipated by us will be realized or, even if substantially realized, that they will have the expected effect on us or our business or operations.

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PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

Not applicable.

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ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. SELECTED FINANCIAL DATA

The selected income statement data and cash flow data for the years ended December 31, 2004, 2005 and 2006, and the selected balance sheet data as of December 31, 2005 and 2006, presented in International Financial Reporting Standards (IFRS) section, have been derived from, and should be read in conjunction with, the audited consolidated financial statements included elsewhere in this annual report. The selected income statement data and cash flow data for the years ended December 31, 2002 and 2003 and the selected balance sheet data as of December 31, 2002, 2003 and 2004, presented in IFRS section, are derived from our audited consolidated financial statements which are not included elsewhere in this annual report and financial statements of the acquired businesses described below.

We acquired from Sinopec Group Company the operations of Sinopec Group Maoming Petrochemical Company (Sinopec Maoming), Xi'an Petrochemical Main Factory (Xi'an Petrochemical) and Tahe Oilfield Petrochemical Factory (Tahe Petrochemical) in 2003, the operations of Sinopec Group Tianjin Petrochemical Company, Sinopec Group Luoyang Petrochemical General Plant, Zhongyuan Petrochemical Company Limited, Sinopec Group Guangzhou Petrochemical General Plant and certain catalyst plants (collectively, Petrochemical and Catalyst Assets) in 2004, and the equity interest in Sinopec Hainan Refining and Chemical Company Limited (Sinopec Hainan) and certain oil and gas production companies (Oil Production Plants) in 2006. As we and these companies are under the common control of Sinopec Group Company, our acquisitions are considered as "combination of entities under common control" which are accounted for in a manner similar to a pooling-of-interests. Accordingly, the acquired assets and related liabilities have been accounted for at historical cost and our consolidated financial statements for periods prior to the combinations have been restated to include the financial condition and the results of operation of these companies on a combined basis.

Moreover, the selected financial data should be read in conjunction with our consolidated financial statements together with accompanying notes and "Item 5. Operating and Financial Review and Prospects" included elsewhere in this annual report. Unless otherwise indicated, our consolidated financial statements are prepared and presented in accordance with International Financial Reporting Standards, or IFRS. IFRS vary in certain significant respects from accounting principles generally accepted in the United States of America, or US GAAP. Information relating to the nature and effect of such differences is presented in Note 37 to the consolidated financial statements.

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| Years Ended December 31, | | | |
|---|------|------|------|
| 2002 | 2003 | 2004 | 2005 |
| RMB | RMB | RMB | RMB |
| (in millions, except per share and per AD | | | |

Income Statement Data(1):
IFRS

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| | | | | |
|--|-----------|-----------|-----------|---------|
| Consolidated results | | | | |
| Operating revenues..... | 350,213 | 449,168 | 619,915 | 823,2 |
| Other income..... | - | - | - | 9,4 |
| Purchased crude oil, products and operating supplies and expenses..... | (238,603) | (312,616) | (442,503) | (651,20 |
| Selling, general and administrative expenses..... | (22,455) | (27,319) | (32,969) | (33,88 |
| Depreciation, depletion and amortization.. | (26,618) | (28,113) | (32,493) | (31,61 |
| Exploration expenses, including dry holes. | (4,420) | (6,174) | (6,396) | (6,41 |
| Personnel expenses..... | (15,080) | (17,040) | (18,719) | (18,64 |
| Employee reduction expenses..... | (244) | (1,040) | (919) | (36 |
| Taxes other than income tax..... | (12,028) | (13,599) | (16,347) | (17,18 |
| Other operating expenses, net..... | (1,191) | (3,981) | (6,678) | (5,12 |
| Operating income..... | 29,574 | 39,286 | 62,891 | 68,2 |
| Interest expense, net of interest income and net foreign exchange gains (losses). | (4,947) | (4,462) | (4,367) | (4,62 |
| Gains from issuance of shares by a subsidiary..... | - | 136 | - | |
| Other income | 569 | 506 | 918 | 1,0 |
| Income before income tax..... | 25,196 | 35,466 | 59,442 | 64,6 |
| Income tax..... | (7,583) | (10,789) | (18,091) | (19,88 |
| Net income..... | 17,613 | 24,677 | 41,351 | 44,7 |
| Attributable to: | | | | |
| Equity shareholders of the Company..... | 16,397 | 22,558 | 35,335 | 41,4 |
| Minority interests..... | 1,216 | 2,119 | 6,016 | 3,3 |
| Net income..... | 17,613 | 24,677 | 41,351 | 44,7 |
| Basic earnings per share(2)..... | 0.19 | 0.26 | 0.41 | 0. |
| Basic earnings per ADS(2)..... | 18.91 | 26.02 | 40.75 | 47. |
| Cash dividends declared per share..... | 0.10 | 0.09 | 0.10 | 0. |
| Segment results | | | | |
| Exploration and production..... | 15,060 | 19,565 | 26,397 | 48,3 |
| Refining..... | 6,024 | 6,071 | 4,982 | (3,53 |
| Marketing and distribution..... | 8,401 | 11,943 | 14,716 | 10,3 |
| Chemicals..... | 1,088 | 3,543 | 18,721 | 14,2 |
| Corporate and others..... | (999) | (1,836) | (1,925) | (1,19 |
| Operating income..... | 29,574 | 39,286 | 62,891 | 68,2 |
| US GAAP | | | | |
| Depreciation, depletion and amortization.. | (21,172) | (22,747) | (27,149) | (25,30 |
| Income tax..... | (8,917) | (12,287) | (19,890) | (21,46 |
| Net income..... | 19,832 | 26,542 | 39,291 | 45,1 |
| Basic earnings per share (2)..... | 0.23 | 0.31 | 0.45 | 0. |
| Basic earnings per ADS(2)..... | 22.87 | 30.61 | 45.31 | 52. |
| Cash dividends declared per share..... | 0.10 | 0.09 | 0.10 | 0. |

As of December 31,

2002 2003 2004 2005

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| | RMB | RMB | RMB (in millions) | RMB |
|---|---------|---------|----------------------|---------|
| Balance Sheet Data(1): | | | | |
| IFRS | | | | |
| Cash and cash equivalents..... | 19,374 | 16,478 | 18,251 | 14,069 |
| Total current assets..... | 107,850 | 103,670 | 122,685 | 147,057 |
| Total non-current assets(3)..... | 302,771 | 319,413 | 358,152 | 401,983 |
| Total assets(3)..... | 410,621 | 423,083 | 480,837 | 549,040 |
| Short-term debts and loans from Sinopec Group Company and its affiliates (including current portion of long-term debts)..... | 39,710 | 34,046 | 42,994 | 43,216 |
| Long-term debts and loans from Sinopec Group Company and its affiliates (excluding current portion of long-term debts)..... | 86,884 | 87,296 | 99,387 | 112,292 |
| Equity attributable to equity shareholders of the Company(3)..... | 167,585 | 172,499 | 193,340 | 224,301 |
| Capital employed(4)..... | 299,647 | 304,079 | 349,425 | 396,419 |
| US GAAP | | | | |
| Total non-current assets..... | 280,709 | 299,576 | 341,613 | 385,848 |
| Total assets..... | 383,390 | 398,260 | 457,214 | 523,883 |
| Long-term debts and loans from Sinopec Group Company and its affiliates (excluding current portion of long-term debts)..... | 86,569 | 85,496 | 94,684 | 101,949 |
| Shareholders' equity..... | 153,929 | 162,816 | 188,150 | 222,803 |

| | Years Ended December 31 | | | |
|--|-------------------------|------|------|------|
| | 2002 | 2003 | 2004 | 2005 |
| | RMB | RMB | RMB | RMB |

| | (in millions) | | | |
|--|---------------|----------|----------|----------|
| Other Financial Data(1): | | | | |
| IFRS | | | | |
| Net cash from operating activities..... | 56,350 | 63,409 | 68,941 | 78,214 |
| Net cash (used in)/generated from financing activities..... | (16,160) | (14,328) | 8,650 | (4,851) |
| Net cash used in investing activities... | (43,290) | (51,982) | (75,819) | (77,523) |
| Capital expenditure | | | | |
| Exploration and production..... | 20,228 | 20,628 | 21,234 | 23,095 |
| Refining..... | 6,698 | 9,791 | 15,319 | 19,100 |
| Marketing and distribution..... | 6,982 | 6,826 | 16,678 | 10,954 |
| Chemicals..... | 7,769 | 7,680 | 11,025 | 9,386 |
| Corporate and others..... | 816 | 518 | 1,550 | 1,164 |
| Total..... | 42,493 | 45,443 | 65,806 | 63,699 |
| Capital expenditure of Oil Production Plants | | | | |
| Exploration and production..... | 120 | 410 | 642 | 1,612 |
| Capital expenditure of jointly controlled entities | | | | |
| Exploration and production..... | - | 1,200 | 1,323 | 772 |
| Chemicals..... | - | 2,993 | 5,178 | 1,830 |

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| | | | | |
|------------|---|-------|-------|-------|
| Total..... | - | 4,193 | 6,501 | 2,602 |
|------------|---|-------|-------|-------|

-
- (1) The acquisition of Sinopec Maoming, Xi'an Petrochemical and Tahe Petrochemical in 2003, the acquisitions of Petrochemical and Catalyst Assets in 2004, and the acquisitions of equity interest in Sinopec Hainan and Oil Production Plants in 2006 from Sinopec Group Company are considered as "combination of entities under common control" which are accounted in a manner similar to a pooling-of-interests (as-if pooling-of-interests accounting). Accordingly, the acquired assets and liabilities have been accounted for at historical cost and the consolidated financial statements for periods prior to the combinations have been restated to include the financial condition and results of operation of these acquired companies on a combined basis. The considerations for these acquisitions were treated as equity transactions.
 - (2) Basic earnings per share and per ADS have been computed by dividing net income attributable to equity shareholders of the Company by the weighted average number of shares in issue.
 - (3) Includes the effect of the revaluation of property, plant and equipment as of September 30, 1999. In addition, property, plant and equipment of Sinopec Maoming, Xi'an Petrochemical, Tahe Petrochemical, Petrochemical and Catalyst Assets and Oil Production Plants were revalued as of June 30, 2003, October 31, 2003, October 31, 2003, June 30, 2004 and June 30, 2006, respectively, in connection with the acquisitions by Sinopec Corp.
 - (4) Equals the sum of short-term debts, long-term debts, loans from Sinopec Group Company and its affiliates and total equity less cash and cash equivalents.

B. CAPITALIZATION AND INDEBTEDNESS

Not applicable.

C. REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

D. RISK FACTORS

Risks Relating to Sinopec Corp.

We rely heavily on outside suppliers for crude oil and other raw materials, and we may not be able to pass on all increases in our crude oil costs and may even experience disruption of our ability to obtain crude oil and other raw materials.

We currently consume large amount of crude oil and other raw materials to manufacture our refined products and petrochemical products. In 2006, approximately 80% of the crude oil required for our refinery business was sourced from outside suppliers. In addition, our development will leave us no choice but to source an increasing amount of crude oil from outside suppliers. While we try to match price increases in products produced by us with corresponding crude oil price increases, our ability to pass on cost increases to our customers is dependent on international and domestic market conditions as well as the PRC government price control over refined petroleum products. For example, crude oil price fluctuated at a historically high level in the past

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three years, but we were not able to fully pass the increased material cost to our customers, in part due to the government's price control over certain refined petroleum products including gasoline, diesel and jet fuel. Crude oil price began to decline since the later part of 2006 and may fluctuate in 2007 and the years beyond. Although it was reported that new petroleum products price-setting mechanism had been formulated by the relevant government authority, we cannot predict when the revised price-setting mechanism will be fully implemented, and if implemented, to what extent the new price-setting mechanism will allow us to pass our increased crude oil costs to our refined petroleum products customers.

Since we purchase a significant portion of our crude oil and other feedstock requirements from outside suppliers located in different countries and areas in the world, we are subject to the political, geographical and economic risks associated with these countries and areas. If one or more of our supply contracts were terminated or disrupted due to any natural disasters or political events, it is possible that we would be unable to find sufficient alternative sources of supply in a timely manner or on commercially reasonable terms. As a result, our business and financial condition could be materially and adversely affected.

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Our continued business success depends in part on our ability to replace reserves and develop newly discovered reserves.

Our ability to achieve our growth objectives is dependent in part on our level of success in discovering or acquiring additional oil and natural gas reserves and further exploring our current reserve base. Our exploration and development activities for additional reserves expose us to inherent risks associated with drilling, including the risk that no economically productive oil or natural gas reservoirs will be encountered. Without reserve additions through further exploration and development or acquisition activities, our reserves and production will decline over time as our reserves will eventually become depleted. Exploring for, developing and acquiring reserves is highly risky and capital intensive. If these activities are unsuccessful and we do not acquire properties containing proved reserves, our total proved reserves will decline, which may materially and adversely affect our results of operations and financial condition.

We face strong competition from domestic and foreign competitors.

Among our competitors, some are major integrated petroleum and petrochemical companies within and outside the PRC, which have recently become more significant participants in the petroleum and petrochemical industry in China. On December 4, 2006, Ministry of Commerce of the PRC promulgated the "Administrative Rules for Crude Oil Market" and "Administrative Rules for Refined Petroleum Products Market" to open the wholesale market of crude oil and refined petroleum products to new market entrants. As a result, we expect to face more competition in both crude oil and refined petroleum products. We believe such trend will continue. Increased competition may have a material adverse effect on our financial condition and results of operations.

The oil and natural gas reserves data in this annual report are only estimates, and our actual production, revenues and expenditures with respect to our reserves may differ materially from these estimates.

There are numerous uncertainties inherent in estimating quantities of proved oil and natural gas reserves, and in the timing of development expenditures and the projection of future rates of production. The reserve data set forth in this annual report represent estimates only. Adverse changes in

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economic conditions may render it uneconomical to develop certain reserves. Our actual production, revenues, taxes and fees payable and development and operating expenditures with respect to our reserves may likely vary from these estimates.

The reliability of reserves estimates depends on:

- o the quality and quantity of technical and economic data;
- o the prevailing oil and gas prices applicable to our production;
- o the production performance of the reservoirs;
- o extensive engineering judgments; and
- o consistency in the PRC government's oil policies.

In addition, new drilling, testing and production following the estimates may cause substantial upward or downward revisions in the estimates. Furthermore, the discounted future cash flow calculated by applying the 10% discount rate, which was included in "Consolidated Financial Statements-Supplemental Information on Oil and Gas Producing Activities (Unaudited)" following Item 19, may not represent the actual net present value of the relevant cash flow.

Related party transactions; non-competition; conflicts of interest.

We have engaged from time to time and will continue to engage in a variety of transactions with Sinopec Group Company, which provides to us a number of services, including, but not limited to, ancillary supply, engineering, maintenance, transport, educational and community services. The nature of our transactions with Sinopec Group Company is governed by a number of service and other contracts between Sinopec Group Company and us. In addition, Sinopec Group Company has interests in businesses which compete or are likely

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to compete, either directly or indirectly, with our businesses. We and Sinopec Group Company have entered into a non-competition agreement whereby Sinopec Group Company has agreed to refrain from operating businesses which compete or could compete with us in any of our domestic or international markets; grant us an option to purchase Sinopec Group Company's operations that compete or could compete with our businesses; operate its sales enterprises and service stations in a manner uniform to our sales and service operations; and appoint us as sales agent for certain of its products which compete or could compete with our products. Notwithstanding the foregoing contractual arrangements, because Sinopec Group Company is our dominant shareholder and the interests of the Sinopec Group Company may conflict with our own interests, Sinopec Group Company or any of its members may take actions that favor its interests or other subsidiaries' interests over ours.

In addition, while we and Sinopec Group Company have entered into agreements which generally provide that these services provided by Sinopec Group Company will be priced on terms at least as favorable to us as ordinary commercial terms, we have limited or no practical alternative source of supply for some of these services, utilities, materials and equipment at reasonable cost. Moreover, the current terms in the agreements with respect to these services, utilities, materials and equipment may be subject to change when we renew these agreements with Sinopec Group Company.

Our financing costs are subject to change in interest rates

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Changes in interest rates have affected and will continue to affect our financing costs and, ultimately, our results of operations. The People's Bank of China (PBOC) raised the benchmark one-year lending rates from 5.31% to 5.58% in October 2004 and had further raised the benchmark one-year lending rate three times since October 2004 to 6.39%, each time by 27 basis points. The increased lending rate drives up the cost of bank borrowings. Interest expenses (excluding capitalized interest) in 2004, 2005 and 2006 were RMB 4,583 million, RMB 5,926 million and RMB 7,437 million, respectively. We cannot assure you that we will be able to obtain bank loans or renew existing credit facilities in the future on reasonable terms or at all, nor can we assure that the PBOC will not further raise the lending rates, or that our business, financial condition and results of operations will not be adversely affected as a result.

Risks Relating to the Petroleum and Petrochemical Industry

Our business operations may be adversely affected by present or future environmental regulations.

As an integrated petroleum and petrochemical company, we are subject to extensive environmental protection laws and regulations in China. These laws and regulations permit:

- o the imposition of fees for the discharge of waste substances;
- o the levy of fines and payments for damages for serious environmental offenses; and
- o the government, at its discretion, to close any facility which fails to comply with orders and require it to correct or stop operations causing environmental damage.

Our production operations produce substantial amounts of waste water, gas and solid waste materials. In addition, our production facilities require operating permits that are subject to renewal, modification and revocation. We have established a system to treat waste materials to prevent and reduce pollution and believe that our operations substantially comply with all applicable PRC environmental laws and regulations as they have been previously interpreted and enforced.

The PRC government has moved, and may move further, toward more rigorous enforcement of applicable laws, and toward the adoption of more stringent environmental standards, which, in turn, would require us to incur additional expenditures on environmental matters.

Our operations may be adversely affected by the cyclical nature of the market.

Most of our revenues are attributable to sales of refined petroleum products and petrochemical products, and certain businesses and related products have historically been cyclical and sensitive to the availability and prices of feedstock and general economic conditions, such as changes in industry capacity and output levels, cyclical changes in regional and global economic conditions,

prices and availability of substitute products and changes in consumer demand. With the further reduction of tariffs and other import restrictions in the PRC, many of our products have become increasingly subject to the cyclicity of global markets. While we are a company integrated with upstream, midstream

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and downstream operations, it can help us reduce the effects of industry cycles only to a limited extent.

Our business faces operation risks and natural disasters that may cause significant property damages, personal injuries and interruption of operations, and we may not have sufficient insurance coverage for all the financial losses incurred by us.

Exploring for, producing and transporting crude oil and natural gas and producing and transporting refined and petrochemical products involve a number of operating hazards. For example, we handle many highly flammable, explosive, poisonous and harmful materials and operate many facilities under high pressure and high temperatures. As with many other companies in the world which conduct similar businesses, we have experienced accidents that have caused property damages and personal injuries and we cannot assure you that these industry-related accidents will not occur in the future. In addition, significant operating hazards and natural disasters may cause interruption to our operations as well as property or environmental damages, and each of these incidents could have a material adverse effect on our financial condition and results of operations.

Our insurance coverage may not be sufficient to cover all the financial losses caused by the operation risks and natural disasters. We maintain insurance coverage with Sinopec Group Company on our property, plant, equipment and inventory. The amount of coverage is determined on the basis of the historical value of the covered fixed assets and, with respect to inventory, twice each year on the basis of the average month-end inventory value of the most recent six months. The amount of our insurance coverage may be less than the replacement cost of the covered properties and may not be sufficient to cover all our financial losses. Furthermore, we do not carry any business interruption insurance or third party liability insurance to cover claims in respect of personal injuries, property or environmental damages arising from accidents on our properties or relating to our operations other than third party liability insurance with respect to certain transportation vehicles. Losses incurred or payments required to be made by us, which are not fully insured, may have a material adverse effect on our financial condition and results of operations.

Risks Relating to the PRC

Government regulations may limit our activities and affect our business operations.

The PRC government, though gradually liberalizing its regulation of petroleum and petrochemical industry, continues to exercise a certain degree of control over the petroleum and petrochemical industry in China by, among other measures:

- o licensing the right to explore and produce crude oil and natural gas;
- o publishing from time to time guidance prices for natural gas and refined petroleum products such as gasoline, diesel and jet fuel;
- o assessing taxes and fees payable, such as the recently imposed special levy on revenues generated from sales of domestically produced crude oil when the realized price exceeds US\$40 per barrel as well as the expansion of the scope of consumption tax for petroleum products;
- o setting import and export quotas and procedures for crude oil and refined petroleum products; and

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- o setting safety, environmental and quality standards.

As a result, we may face constraints on our flexibility and ability to expand our business operations or to maximize our profitability.

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Some of our development plans require compliance with state policies and regulatory confirmation and registration.

We are currently engaged in a number of construction, renovation and expansion projects. Some of our large construction, renovation and expansion projects are subject to governmental confirmation and registration. The timing and cost of completion of these projects will depend on numerous factors, including when we received the required confirmation and registration from relevant PRC government authorities and the general economic conditions in China. If any of our important projects required for our future growth are not confirmed or registered, or not confirmed or registered in a timely manner, our results of operations and financial condition could be adversely impacted.

Government control of currency conversion and exchange rate fluctuation may adversely affect our operations and financial results.

We receive substantially all of our revenues in Renminbi. A portion of such revenues will need to be converted into other currencies to meet our foreign currency needs, which include, among other things:

- o import of crude oil and other materials;
- o debt service on foreign currency-denominated debt;
- o purchases of imported equipment; and
- o payment of any cash dividends declared in respect of the H shares (including ADS) .

The existing foreign exchange regulations have significantly reduced government foreign exchange controls for transactions under the current account, including trade and service related foreign exchange transactions and payment of dividends. Foreign exchange transactions under the capital account, including principal payments in respect of foreign currency-denominated obligations, continue to be subject to significant foreign exchange controls and require the approval of the State Administration of Foreign Exchange. These limitations could affect our ability to obtain foreign exchange through debt or equity financing, or to obtain foreign exchange for capital expenditures. The PRC government has stated publicly that it intends to make the Renminbi freely convertible in the future. However, we cannot predict whether the PRC government will continue its existing foreign exchange policy and when the PRC government will allow free conversion of Renminbi.

The value of the Renminbi against the US dollar and other currencies may fluctuate and is affected by, among other things, changes in China's political and economic conditions. The conversion of Renminbi into foreign currencies, including US dollars, has historically been set by the PBOC. On July 21, 2005, the PRC government changed its policy of pegging the value of the Renminbi to the US dollar. Under the new policy, the Renminbi is permitted to fluctuate within a band against a basket of certain foreign currencies. This change in policy resulted initially in an approximately 2.0% appreciation in the value of the Renminbi against the US dollar. Since the adoption of this new policy, the value of Renminbi against the US dollar has fluctuated on a daily

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basis within narrow ranges, but overall has further strengthened against the US dollar. There remains significant international pressure on the PRC government to further liberalize its currency policy, which could result in a further and more significant appreciation in the value of the Renminbi against the US dollar. As we outsource a significant portion of our crude oil requirement which are benchmarked to US dollar-denominated international prices, fluctuations in the value of the Renminbi against the US dollars and certain other foreign currencies may affect our crude oil costs.

Enforcement of shareholder rights; mandatory arbitration.

Currently, the primary sources of shareholder rights are our articles of association, the PRC Company Law and the Listing Rules of the Hong Kong Stock Exchange, which, among other things, impose certain standards of conduct, fairness and disclosure on us, our directors and our controlling shareholder. In general, their provisions for protection of shareholder's rights and access to information are different from those applicable to companies incorporated in the United States, the United Kingdom and other Western countries. In addition, the mechanism for enforcement of rights under the corporate framework to which we are subject may also be relatively undeveloped and untested. To our knowledge, there has not been any published report of judicial enforcement in the PRC by

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H share shareholders of their rights under constituent documents of joint stock limited companies or the PRC Company Law or in the application or interpretation of the PRC or Hong Kong regulatory provisions applicable to PRC joint stock limited companies. We cannot assure you that our shareholders will enjoy protections that they may be entitled in other jurisdictions.

China does not have treaties providing for the reciprocal recognition and enforcement of judgments of courts with the United States, the United Kingdom or most other Western countries, and therefore recognition and enforcement in China of judgments of a court in any of these jurisdictions in relation to any matter not subject to a binding arbitration provision may not be assured. Our articles of association as well as the Listing Rules of the Hong Kong Stock Exchange provide that most disputes between holders of H shares and us, our directors, supervisors, officers or holders of domestic shares, arising out of the articles of association or the PRC Company Law concerning the affairs of our company or with respect to the transfer of our shares, are to be resolved through arbitration by arbitration organizations in Hong Kong or China, rather than through a court of law. On June 18, 1999, an arrangement was made between Hong Kong and the PRC for the mutual enforcement of arbitral awards. This new arrangement was approved by the Supreme People's Court of the PRC and the Hong Kong Legislative Council, and became effective on February 1, 2000. So far as we are aware, no action has been brought in China by any shareholder to enforce an arbitral award, and we are uncertain as to the outcome of any action brought in China to enforce an arbitral award granted to shareholders.

ITEM 4. INFORMATION ON THE COMPANY

A. HISTORY AND DEVELOPMENT OF THE COMPANY

Our legal and commercial name is China Petroleum & Chemical Corporation. Our head office is located at A6, Huixindong Street, Chaoyang District, Beijing 100029, the People's Republic of China, our telephone number is (8610) 6499-0060, and our fax number is (8610) 6499-0022. We have appointed SINOPEC USA Inc., 150 E. 52nd St., 28th Fl., New York, NY 10022, USA (telephone number: (212) 759-5085; fax number: (212) 759-6882) as our agent for service of processes for actions brought under the U.S. securities laws.

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We were established as a joint stock limited company on February 25, 2000 under the Company Law of the PRC with Sinopec Group Company as the sole shareholder. Our principal businesses consist of petroleum and petrochemical businesses transferred to us by Sinopec Group Company pursuant to a reorganization agreement. Such businesses include:

- o exploration for, development, production and marketing of crude oil and natural gas;
- o refining of crude oil and marketing and distribution of refined petroleum products, including transportation, storage, trading, import and export of petroleum products; and
- o production and sales of petrochemical products.

Sinopec Group Company's continuing activities consist, among other things, of:

- o operating certain petrochemical facilities, small capacity refineries and retail service stations retained by Sinopec Group Company;
- o providing physical geography exploration, and well drilling, survey, logging and downhole operational services;
- o manufacturing production equipment and providing equipment maintenance services;
- o providing construction services;
- o providing utilities, such as electricity and water; and
- o providing other operational services including transportation services.

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Sinopec Group Company transferred the businesses to us either by transferring its equity holdings in subsidiaries or by transferring their assets and liabilities. Sinopec Group Company also transferred to us its shareholdings in 13 then listed companies. Sinopec Group Company also agreed in the reorganization agreement to transfer to us its exploration and production licenses and all rights and obligations under the agreements in connection with its core businesses transferred to us. The employees relating to these assets were also transferred to us.

In order to expand our core businesses, prevent competition among members of the same group and reduce related party transactions, between 2001 and 2004 we have acquired from Sinopec Group Company Sinopec National Star, Sinopec Maoming, Tahe Petrochemical and Xi'an Petrochemical, Petrochemical and Catalyst Assets, certain refining facilities and service stations. We have also sold and disposed of certain auxiliary assets to third parties.

On January 1, 2006, we reorganized Sinopec Shengli Oil Field Co., Ltd., one of our wholly-owned subsidiaries into Sinopec Shengli Branch Company, a branch company of Sinopec Corp.

We privatized Sinopec Zhenhai Refinery and Chemicals Co., Ltd., or ZRCC, by way of merger by absorption and purchased the publicly held H shares of ZRCC from its shareholders at HK\$ 10.60 per share in cash, the total

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consideration being HK\$ 7.672 billion. ZRCC was delisted from the Hong Kong Stock Exchange on March 24, 2006.

On February 25, 2006, we announced voluntary all-cash tender offers to acquire all the publicly-held shares of Sinopec Qilu Petrochemical Co., Ltd. at a price of RMB 10.18 per share, all the publicly-held shares of Sinopec Yangzi Petrochemical Co., at a price of RMB 13.95 per share, all the publicly-held shares of Sinopec Zhongyuan Petroleum Co., Ltd. at a price of RMB 12.12 per share, all the publicly-held shares of Shengli Oil Field Dynamic Co., Ltd. at a price of RMB 10.30 per share and all the non-tradable shares of Shengli Oil Field Dynamic Co., Ltd. held by other investors at a price of RMB 5.60 per share. Our tender offers became effective on April 6, 2006. Consequently, Sinopec Yangzi Petrochemical Co., Sinopec Zhongyuan Petroleum Co., Ltd. and Shengli Oil Field Dynamic Co., Ltd. have been delisted from Shenzhen stock exchange as of April 21, 2006, and Sinopec Qilu Petrochemical Co., Ltd. has been delisted from Shanghai Stock Exchange as of April 24, 2006. We paid an aggregate amount of approximately RMB 14.3 billion to the holders of the above shares.

On September 25, 2006, our reform plan to convert all non-tradable domestic shares into tradable domestic shares was approved by our shareholder's meeting. According to the plan, our shareholders of tradable A-shares shall receive 2.8 shares of us at no additional cost from our shareholders of non-tradable shares for every 10 tradable A-shares held by them; and all of our shareholders of the non-tradable shares shall have the rights to list their shares for trading on Shanghai Stock Exchange with certain selling restriction. On October 10, 2006, our shareholders of non-tradable shares transferred a total of 784 million consideration shares to our shareholders of tradable A-shares.

On October 11, 2006, Shengjun International Investment Co., Ltd. (Shengjun International), an overseas wholly-owned subsidiary of Sinopec Group Company, and us signed a joint venture contract. Shengjun International and us agreed to increase the registered capital of Sinopec Hainan by way of capital injection, of which, Sinopec Corp. shall inject RMB 2,989.5 million and Shengjun International shall inject RMB 996.5 million of foreign currency equivalents. After completion of the capital injection, Sinopec Corp. and Shengjun International held 75% and 25% of equity interest in Sinopec Hainan, respectively. Sinopec Hainan was put into commercial operation at the end of 2006 with an installed refining capacity of 8 million tonnes of crude oil per annum.

On December 6, 2006, our board of directors approved our plan to acquire the oil production assets of Shengli Petroleum Administration Bureau from Sinopec Group Company. In accordance with the acquisition plan, we acquired from Sinopec Group Company 64.73% equity interest in Shengli Oil Field Dongsheng Jinggong Petroleum Development Co., Ltd., 100% equity interest in Petroleum Development Center of Shengli Petroleum Administration Bureau, 52% equity interest in Shengli Oil Field Zhongsheng Petroleum Development Co., Ltd, and oil wells and relevant oil production assets of the former Shengda Group Oil & Gas Company in Shengli Oil Field for an aggregate consideration of RMB 3.5 billion.

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B. BUSINESS OVERVIEW

Exploration and Production

Overview

We currently explore for, develop and produce crude oil and natural gas in a number of areas across China. As of December 31, 2006, we held 207 production licenses with terms ranging from 7 to 55 years. Our production

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licenses are renewable upon our application 30 days prior to expiration. During the term of our production license, we pay an annual production license fee of RMB 1,000 per square kilometer. Shengli oilfield is the second largest oilfield in China and accounted for more than 68.2% of our total crude oil production in 2006.

As of December 31, 2006, we held 357 exploration licenses for various blocks in which we engaged in exploration activities. The maximum term of our exploration licenses is 7 years. Our exploration licenses may be renewed upon our application 30 days prior to expiration of the original term with each renewal for a two-year term. We are obligated to make an annual minimum exploration investment relating to the exploration blocks in respect of which the exploration licenses are issued. In addition, we are also obligated to pay an annual exploration license fee starting from RMB 100 per square kilometer up to RMB 500 per square kilometer. We are entitled under state laws and regulations to apply for reduction and exemption of exploration license fee for exploration in the western region, ocean and northeast region of the PRC.

Properties

We currently operate 16 oil and gas producing fields, each of which consists of many oil and gas producing blocks and all of which are located in China.

Shengli oilfield is our most important producing oil field and the second largest producing oil field in China. It consists of 69 producing blocks of various sizes extending over an area of 61,000 square kilometers in northern Shandong province. Most of the blocks are located in the Jiyang trough with various oil producing levels. In 2006, Shengli field produced 195 million barrels of crude oil and 28.28 billion cubic feet of natural gas, with an average daily production of 546 thousand barrels-of-oil equivalent, accounting for approximately 60.8% of our total crude oil and natural gas production for the year.

Oil and Natural Gas Reserves

Our estimated proved reserves of crude oil and natural gas as of December 31, 2006 were 3,771 million barrels-of-oil equivalent (including 3,293 million barrels of crude oil and 2,856 billion cubic feet of natural gas), representing a slight decrease of 0.4% from December 31, 2005. Our estimated proved reserves do not include additional quantities recoverable beyond the term of the relevant production licenses, or that may result from extensions of currently proved areas, or from application of improved recovery processes not yet tested and determined to be economical.

The following tables set forth our proved oil and gas reserves and related data as of and for the years ended December 31, 2004, 2005 and 2006.

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| | As of and for the Years Ended D | |
|---|---------------------------------|----------------------|
| | 2004 | 2005 |
| Proved developed and undeveloped reserves (crude oil) | | (in million barrels) |
| Beginning of year..... | 3,257 | 3,26 |
| Revisions of previous estimates..... | 23 | 2 |
| Improved recovery..... | 127 | 14 |

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| | | |
|--|-------------------------|-------|
| Extensions and discoveries..... | 134 | 13 |
| Production..... | (274) | (279) |
| End of year..... | 3,267 | 3,29 |
| Proved developed reserves (crude oil) | (in million barrels) | |
| Beginning of year..... | 2,786 | 2,80 |
| End of year..... | 2,808 | 2,87 |
| Proved developed and undeveloped reserves (natural gas) | (in billion cubic feet) | |
| Beginning of year..... | 2,888 | 3,03 |
| Revisions of previous estimates..... | (95) | (42) |
| Extensions and discoveries..... | 447 | 18 |
| Production..... | (207) | (222) |
| End of year..... | 3,033 | 2,95 |
| Proved developed reserves (natural gas) | (in billion cubic feet) | |
| Beginning of year..... | 1,249 | 1,39 |
| End of year..... | 1,398 | 1,55 |

The following tables set forth proved developed and undeveloped crude oil and natural gas reserves of our major oil and gas producing fields as of December 31, 2004, 2005 and 2006.

| | As of December | |
|---|----------------------|-------|
| | 2004 | 2005 |
| | (in million barrels) | |
| Proved developed and undeveloped crude oil reserves | | |
| Shengli..... | 2,307 | 2,362 |
| Zhongyuan..... | 346 | 314 |
| Xibei..... | 218 | 238 |
| Henan..... | 173 | 154 |
| Jiangsu..... | 112 | 112 |
| Others..... | 111 | 114 |
| Total..... | 3,267 | 3,294 |

| | As of December | |
|---|-------------------------|------|
| | 2004 | 2005 |
| | (in billion cubic feet) | |
| Proved developed and undeveloped natural gas reserves | | |
| Shengli..... | 357 | 322 |
| Zhongyuan..... | 512 | 383 |
| Xibei..... | 67 | 95 |
| Jiangsu..... | 9 | 9 |

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| | | |
|-------------|-------|-------|
| Xinan..... | 801 | 781 |
| Huabei..... | 862 | 908 |
| Others..... | 425 | 454 |
| Total..... | 3,033 | 2,952 |

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Oil and Natural Gas Production

In 2006, we produced an average of 898 thousand barrels-of-oil equivalent per day, of which approximately 87.0% was crude oil and 13.0% was natural gas.

The following tables set forth the average daily production of crude oil and natural gas for the years ended December 31, 2004, 2005 and 2006. The production of crude oil includes condensed oil.

| | For the Years Ended De | |
|------------------------------------|------------------------|------|
| | 2004 | 2005 |
| | (in thousand barr | |
| Average daily crude oil production | | |
| Shengli..... | 519 | 524 |
| Zhongyuan..... | 65 | 62 |
| Xibei..... | 69 | 82 |
| Henan..... | 37 | 36 |
| Jiangsu..... | 31 | 32 |
| Others..... | 28 | 28 |
| Total Production..... | 749 | 764 |

| | For the Years Ended De | |
|--------------------------------------|------------------------|------|
| | 2004 | 2005 |
| | (in million cubic | |
| Average daily natural gas production | | |
| Shengli..... | 87 | 85 |
| Zhongyuan..... | 169 | 161 |
| Xibei..... | 47 | 50 |
| Henan..... | 11 | 10 |
| Jiangsu..... | 5 | 6 |
| Xinan..... | 185 | 203 |
| Huabei..... | 9 | 39 |
| Others..... | 54 | 54 |
| Total Production..... | 567 | 608 |

Lifting Cost & Realized Prices

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The following table sets forth our average lifting costs per barrel-of-oil equivalent of crude oil and natural gas produced, average sales prices per barrel of crude oil and average sales prices per thousand cubic meters of natural gas for the years ended December 31, 2004, 2005 and 2006.

| | Total | Shengli |
|---|--------|---------|
| | (RMB) | (RMB) |
| For the year ended December 31, 2006 | | |
| Average petroleum lifting cost per BOE..... | 73.31 | 77.16 |
| Average realized sales price..... | | |
| Per barrel of crude oil..... | 449.93 | 443.66 |
| Per thousand cubic meters of natural gas..... | 794.28 | 899.76 |
| For the year ended December 31, 2005 | | |
| Average petroleum lifting cost per BOE..... | 68.78 | 70.11 |
| Average realized sales price..... | | |
| Per barrel of crude oil..... | 375.30 | 379.01 |
| Per thousand cubic meters of natural gas..... | 673.01 | 880.91 |
| For the year ended December 31, 2004 | | |
| Average petroleum lifting cost per BOE..... | 57.05 | 57.35 |
| Average realized sales price..... | | |
| Per barrel of crude oil..... | 275.56 | 279.37 |
| Per thousand cubic meters of natural gas..... | 615.53 | 718.21 |

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Exploration and Development Activities

The following table sets forth the numbers of our exploration and development wells, including a breakdown of successful or productive wells and dry holes we drilled during the years ended December 31, 2004, 2005 and 2006.

| | Total | Shengli | Xibei |
|--------------------------------------|-------|---------|-------|
| For the year ended December 31, 2006 | | | |
| Exploration | | | |
| -- Successful..... | 226 | 118 | |
| -- Dry holes..... | 269 | 57 | |
| Development | | | |
| -- Productive..... | 2,620 | 1,125 | |
| -- Dry holes..... | 29 | 4 | |
| For the year ended December 31, 2005 | | | |
| Exploration | | | |
| -- Successful..... | 256 | 109 | |
| -- Dry holes..... | 289 | 91 | |
| Development | | | |
| -- Productive..... | 2,327 | 970 | |
| -- Dry holes..... | 21 | 1 | |
| For the year ended December 31, 2004 | | | |
| Exploration | | | |
| -- Successful..... | 300 | 149 | |
| -- Dry holes..... | 290 | 51 | |
| Development | | | |

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| | | |
|--------------------|-------|-----|
| -- Productive..... | 2,365 | 999 |
| -- Dry holes..... | 17 | - |

The following table sets forth the numbers of our development crude oil and natural gas wells as of December 31, 2006.

| | As of December 31, 2006 | | |
|-------------------------------|-------------------------|---------|--------|
| | Total | Shengli | Others |
| Crude oil development wells | | | |
| -- Total..... | 32,238 | 21,741 | 10,497 |
| -- Productive..... | 25,925 | 16,921 | 9,004 |
| Natural gas development wells | | | |
| -- Total..... | 2,362 | 350 | 2,012 |
| -- Productive..... | 1,851 | 88 | 1,763 |

Refining

Overview

We processed approximately 146.3 million tonnes of crude oil in 2006, representing approximately 50.7% of China's total crude oil throughput. We produce a full range of refined petroleum products. The following table sets forth our production of our principal refined petroleum products for the years ended December 31, 2004, 2005 and 2006.

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| | For the Years Ended December 31, | |
|----------------------------------|----------------------------------|------|
| | 2004 | 2005 |
| | (in million tonnes) | |
| Gasoline..... | 23.6 | 23.0 |
| Diesel..... | 50.9 | 54.9 |
| Kerosene including jet fuel..... | 6.4 | 6.6 |
| Light chemical feedstock..... | 17.7 | 21.1 |
| Lubricant..... | 1.3 | 1.3 |
| Liquefied petroleum gas..... | 7.1 | 7.4 |
| Fuel oil..... | 7.8 | 6.9 |

Gasoline and diesel are our largest revenue producing products, and are sold mostly through our marketing and distribution segment through both retail and wholesale channels. We use most of our production of chemical feedstock as feedstock for our own chemical operations. Most of our other refined petroleum products are sold domestically to a wide variety of industrial and agricultural customers, and a small amount are exported.

Refining Facilities

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We operate 27 refineries in China. As of December 31, 2006, our consolidated primary distillation capacity was 176.1 million tonnes per annum.

The following table sets forth our total primary distillation capacity per annum and refinery throughputs as of and for the years ended December 31, 2004, 2005 and 2006.

| | As of and for the Years Ended | |
|---|-------------------------------|-------|
| | 2004 | 2005 |
| Primary distillation capacity (million tonnes per annum)..... | 155.2 | 160.1 |
| Refinery throughputs (million tonnes)..... | 132.9 | 139.9 |

In 2006, measured by the total output from our refineries, our overall gasoline yield was 15.7%, overall diesel yield was 39.5%, overall kerosene yield was 4.3% and overall light chemical feedstock yield was 15.6%. Our products include lubricant, liquefied petroleum gas, solvent, asphalt, petroleum coke, paraffin and fuel oil. For the years ended December 31, 2004, 2005 and 2006, our overall yield for all refined petroleum products at our refineries was 93.1%, 93.2% and 93.5%, respectively.

The following table sets forth the primary distillation capacity per annum as of and refinery throughput for the years ended, December 31, 2004, 2005 and 2006 of each of our refineries with the primary distillation capacity of 8 million or more per annum throughout 2006.

| Refinery | As of and for the Years Ended December 31, | | | | |
|----------------|--|------------------------|-------------------------------------|------------------------|-------------------------------------|
| | 2004 | | 2005 | | 2006 |
| | Primary Distillation Capacity | Refinery Throughput | Primary Distillation Capacity | Refinery Throughput | Primary Distillation Capacity |
| | (in million tonnes) | | | | |
| Zhenhai..... | 20.0 | 16.0 | 20.0 | 17.1 | 20.0 |
| Shanghai..... | 8.8 | 9.1 | 14.0 | 9.5 | 14.0 |
| Maoming..... | 13.5 | 13.2 | 13.5 | 12.7 | 13.5 |
| Guangzhou..... | 7.7 | 7.4 | 7.7 | 6.7 | 13.2 |
| Jinling..... | 13.0 | 8.2 | 13.0 | 10.7 | 13.0 |
| Gaoqiao..... | 11.0 | 9.1 | 11.0 | 10.1 | 11.0 |
| Qilu..... | 10.5 | 8.8 | 10.5 | 10.0 | 10.5 |
| Yanshan..... | 8.0 | 7.8 | 8.0 | 8.0 | 8.0 |
| Yangzi..... | 8.0 | 6.4 | 8.0 | 7.8 | 8.0 |

In 2006, we newly added 18.5 million tonnes per annum in our primary distillation capacity in 2006, representing a net increase of 16 million tonnes per annum compared with December 31, 2005, of which the newly added distillation capacity of sour crude oil was 11.2 million tonnes per annum. Our hydro-refining

capacity and coking capacity increased by 16.5 million tonnes per annum and 2.6 million tonnes per annum, respectively. The revamping projects for a number of refining facilities aimed to improve capacities for refined petroleum product quality have progressed smoothly.

Sources of Crude Oil

Our most important raw material is crude oil. The following table sets forth the sources of our crude oil supply for the years ended December 31, 2004, 2005 and 2006.

| | For the Years ended December 31, | | |
|-----------------------------|----------------------------------|-------|-------|
| | 2004 | 2005 | 2006 |
| Source of Supply | (in million tonnes) | | |
| Self-supply..... | 28.1 | 28.6 | 29.6 |
| PetroChina Company Ltd..... | 10.3 | 8.8 | 8.8 |
| CNOOC Ltd..... | 6.7 | 5.1 | 4.9 |
| Import..... | 89.0 | 99.1 | 101.5 |
| Total..... | 134.1 | 141.6 | 144.8 |

Marketing and Sales of Refined Petroleum Products

Overview

We operate the largest sales and distribution network for refined petroleum products in China. In 2006, we distributed and sold in China approximately 111.7 million tonnes of gasoline, diesel and kerosene including jet fuel, representing a market share of approximately 64.0% in China.

Most of the refined petroleum products sold by us are produced internally. In 2006, approximately 72.5% of our gasoline sales volume and approximately 82.8% of our diesel sales volumes were produced internally.

The table below sets forth a summary of key data in the marketing and sales of refined petroleum products for the year ended December 31, 2004, 2005 and 2006.

| | For the Years Ended December 31, | |
|--|----------------------------------|-------|
| | 2004 | 2005 |
| Sales volume of refined petroleum products (in million tonnes) | 94.6 | 104.6 |
| Of which: Retail..... | 53.3 | 63.5 |
| Direct Sales..... | 19.7 | 20.4 |
| Wholesale | 21.7 | 20.7 |
| Average annual throughput of service stations (tonnes per station)..... | 2,003 | 2,321 |

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| | | |
|---|--------|--------|
| Total number of service stations under Sinopec brand..... | 30,063 | 29,647 |
| Of which: Self-operated service stations..... | 26,581 | 27,367 |
| Franchised service stations.. | 3,482 | 2,280 |
| Percentage of retail volume in total sales (%)..... | 56.3 | 60.7 |

Retail

All of our retail sales are made through a network of service stations and petroleum shops operated under the Sinopec brand. Through this unified network we are more able to implement consistent pricing policies, maintain both product and service quality standards and more efficiently deploy our retail network.

In 2006, we sold approximately 72.2 million tonnes of refined petroleum products through our retail network, representing approximately 64.6% of our total refined petroleum products sales volume. Our retail market share in 2006

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was approximately 79.3% in our principal market. As of December 31, 2006, our retail network mainly consists of 28,001 service stations that are wholly-owned and operated by us or jointly-owned and operated or leased by us and 800 franchised service stations that are owned and operated by third parties.

Direct Sales

In 2006, we sold approximately 19.0 million tonnes of refined petroleum products, including 2.9 million tonnes of gasoline, 15.9 million tonnes of diesel and 0.2 million tonnes of kerosene, through direct sales to those commercial customers such as industrial enterprises, hotels, restaurants and agricultural producers, representing approximately 17.0% of our total sales volume of refined petroleum products.

Wholesale

In 2006, we sold approximately 20.6 million tonnes of refined petroleum products through wholesale channels, representing approximately 18.4% of our total sales volume of refined petroleum products. Our wholesale sales include sales to large commercial or industrial customers and independent distributors as well as sales to certain long-term customers such as railway, airlines, shipping and public utilities.

Through our wholesale centers, we operate 454 storage facilities with a total capacity of approximately 12.6 million cubic meters, substantially all of which are wholly-owned by us. Our wholesale centers are connected to our refineries by railway, waterway and, in some cases, by pipelines. We also own some dedicated railways, oil wharfs, oil barges, rail tankers and oil trucks.

In 2006, we further improved our refined petroleum products retail networks through acquisition, construction and renovation of service stations, and added a net of 634 self-operated service stations. We believe we have further strengthened our leading position in principal market, and further improved our brand awareness and customer loyalty.

Chemicals

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Overview

We are the largest petrochemical producer in China. We produce a full range of petrochemical products including intermediate petrochemicals, synthetic resins, synthetic fiber monomers and polymers, synthetic fibers, synthetic rubber and chemical fertilizers. Synthetic resins, synthetic fibers, synthetic rubber, chemical fertilizers and some intermediate petrochemicals comprise a significant majority of our external sales. Synthetic fiber monomers and polymers and intermediate petrochemicals, on the other hand, are mostly internally consumed as feedstock for the production of other chemical products. Our chemical operations are integrated with our refining businesses, which supply a significant portion of our chemical feedstock such as naphtha. Because of strong domestic demand, most of our petrochemical products are sold in China's domestic market.

The following table sets forth our production of major chemical products for the years ended December 31, 2004, 2005 and 2006.

| | For the Years Ended Dec | |
|---|-------------------------|-------|
| | 2004 | 2005 |
| | (in thousand tonn | |
| Ethylene..... | 4,074 | 5,319 |
| Synthetic resins..... | 6,221 | 7,605 |
| Synthetic rubbers..... | 561 | 626 |
| Monomers and polymers for synthetic fibers..... | 6,021 | 6,725 |
| Synthetic fibers..... | 1,654 | 1,570 |
| Urea..... | 2,630 | 1,780 |

Note: The operational data for 2005 and 2006 include 100% production of the two joint venture ethylene facilities that we have joint control of 50% each, Shanghai SECCO and BASF-YPC.

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Products

Intermediate Petrochemicals

We are the largest ethylene producer in China. Our rated ethylene capacity was 6.15 million tonnes per annum, which represented 62% of China's total domestic ethylene capacity, as of December 31, 2006. In 2006, we produced 6.16 million tonnes of ethylene, representing approximately 67.0 % of the total domestic output. Nearly all of our olefins production is used as feedstock for our petrochemical operations.

We produce aromatics mainly in the forms of benzene and para-xylene, which are used primarily as feedstock for purified terephthalic acid, or PTA, the preferred raw material for polyester. We are the largest aromatics producer in China.

Organic chemicals extracted mainly from olefins and aromatics are also intermediate petrochemicals and are essential raw materials for synthetic resins, synthetic rubber and synthetic fibers. We are the largest producer of butanol, styrene, paraxylene, vinyl acetate, phenol and acetone in China.

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The following table sets forth our rated capacity per annum, production volume and major plants of production as of or for the year ended December 31, 2006 for our principal intermediate petrochemical products.

| | Our Rated Capacity | Our Production | Major Plants of Production |
|------------------|---|-------------------------------|--|
| | ----- (thousand tonnes per annum) | ----- (thousand tonnes) | ----- |
| Ethylene..... | 6,145 | 6,163 | Yanshan, Shanghai, Yangzi, Maoming, Guangzhou, Tianjin Zhongyuan, SECCO and BASF-Y |
| Propylene..... | 4,884 | 4,903 | Yanshan, Shanghai, Yangzi, Maoming, Guangzhou, Tianjin Zhongyuan, SECCO, BASF-YPC, Gaoqiao, Anqing, Jinan, Jin and Wuhan |
| Benzene..... | 2,298 | 2,226 | Yanshan, Shanghai, Yangzi, Guangzhou, Zhenhai, Tianjin Luoyang, SECCO and BASF-YPC |
| Styrene..... | 964 | 972 | Yanshan, Qilu, Guangzhou, Maoming and SECCO |
| Para-xylene..... | 2,168 | 2,239 | Shanghai, Yangzi, Qilu, Tian and Luoyang |
| Phenol..... | 350 | 390 | Yanshan and Gaoqiao |

Note: The operational data include 100% production of the two joint ventures that we have joint control of 50% each, SECCO and BASF-YPC.

Synthetic Resins

We are the largest producer of polyethylene, polypropylene and polystyrene in China.

The following table sets forth our rated capacity per annum, production volumes and major plants of production for each of our principal synthetic resins as of or for the year ended December 31, 2006.

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| | Our Rated Capacity | Our Production | Major Plants of Production |
|-------------------|---|-------------------------------|----------------------------|
| | ----- (thousand tonnes per annum) | ----- (thousand tonnes) | ----- |
| Polyethylene..... | 4,073 | 4,090 | Yanshan, Shanghai, Yangzi, |

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| | | | |
|-------------------------|-------|-------|---|
| Polypropylene..... | 3,455 | 3,449 | Maoming, Guangzhou, Tianj Zhongyuan, SECCO and BASF Yanshan, Shanghai, Yangzi, Guangzhou, Miaoming, Tianj Zhongyuan, SECCO, Wuha Fenghuang, Jingmen and Fu |
| Polyvinyl chloride..... | 600 | 575 | Qilu |
| Polystyrene..... | 516 | 357 | Yanshan, Qilu, Maoming Guangzhou and SECCO |

Synthetic Fiber Monomers and Polymers

Our principal synthetic fiber monomers and polymers are purified terephthalic acid, ethylene glycol, acrylonitrile, caprolactam, polyester, polyethylene glycol and polyamide fiber. Based on our 2006 production, we are the largest producer of purified terephthalic acid, ethylene glycol, caprolactam and polyester in China. Most of our production of synthetic fiber monomers and polymers are used as feedstock for synthetic fibers.

The following table sets forth our rated capacity per annum, our production volume and major plants of production as of or for the year ended December 31, 2006 for each type of our principal synthetic fiber monomers and polymers.

| | Our Rated Capacity | Our Production | Major Plants of Production |
|---------------------------------|---|-------------------------------|--|
| | ----- (thousand tonnes per annum) | ----- (thousand tonnes) | ----- |
| Purified terephthalic acid..... | 3,034 | 2,838 | Shanghai, Yangzi, Yizhen Tianjin and Luoyang |
| Ethylene glycol..... | 1,033 | 935 | Yanshan, Shanghai, Yangz Tianjin, Maoming and BASF- |
| Acrylonitrile..... | 510 | 425 | Shanghai, Anqing, Qilu, SE |
| Caprolactam..... | 140 | 180 | Shijiazhuang and Baling |
| Polyester | 2,766 | 2,664 | Shanghai, Yizheng, Tianjing Luoyang |

Synthetic Fibers

We are the largest producer of polyester and acrylic fibers in China. Our principal synthetic fiber products are polyester fiber and acrylic fiber.

The following table sets forth our rated capacity per annum, production volume and major plants of production for each type of our principal synthetic fibers as of and for the year ended December 31, 2006.

| | Our Rated Capacity | Our Production | Major Plants of Production |
|----------------------|---|-------------------------------|----------------------------|
| | ----- (thousand tonnes per annum) | ----- (thousand tonnes) | ----- |
| Polyester fiber..... | 1,416 | 1,128 | Yizheng, Shanghai, Tianjin |

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Acrylic fiber..... 315 369 Luoyang
Shanghai, Anqing and Qi

Synthetic Rubbers

Our principal synthetic rubbers are cis-polybutadiene rubber, styrene butadiene rubber, or SBR, styrene butadiene-styrene thermoplastic elastomer and isobutadiene isoprene rubber, or IIR. Based on our 2006 production, we are the largest producer of SBR and cis-polybutadiene rubber and the only producer of IIR in China.

The following table sets forth our rated capacity per annum, production volume and major plants of production as of or for the year ended December 31, 2006 for each of our principal synthetic rubbers.

| | Our Rated Capacity | Our Production | Major Plants of Production |
|---|---|-------------------------------|----------------------------|
| | ----- (thousand tonnes per annum) | ----- (thousand tonnes) | ----- |
| Cis-polybutadiene rubber..... | 252 | 295 | Yanshan, Qilu, Maoming and |
| Styrene butadiene rubber..... | 295 | 174 | Yanshan, Qilu, Maoming and |
| Styrene-butadiene-styrene thermoplastic elastomers | 100 | 160 | Yanshan and Maoming |
| Isobutylene isoprene rubber..... | 30 | 40 | Yanshan |

Chemical Fertilizers

We produce synthetic ammonia and urea. Our synthetic ammonia is used to manufacture urea, caprolactam and acrylic nitrile.

The following table sets forth our rated capacity per annum, our production volume and major plants of production for ammonia and urea as of or for the year ended December 31, 2006.

| | Our Rated Capacity | Our Production | Major Plants of Production |
|-------------|---|-------------------------------|---|
| | ----- (thousand tonnes per annum) | ----- (thousand tonnes) | ----- |
| Ammonia.... | 2,135 | 957 | Zhenhai, Jinling, Anqing, Jiujiang, Qilu, Hubei and Baling |
| Urea..... | 3,610 | 1,609 | Zhenhai, Jinling, Anqing, Jiujiang, Qilu, Hubei and Baling |

Marketing and Sales of Petrochemicals

Price and volume of petrochemical sales are primarily market driven. The southern and eastern regions in China, where most of our petrochemical

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plants are located, constitute the major petrochemical market in China. Our proximity to the major petrochemical market gives us a competitive geographic advantage over our competitors.

Our principal sales and distribution channels consist of direct sales to end-users, most of which are large and medium size manufacturing enterprises, and sales to distributors in our national sales network. In 2006, we sold approximately 64% of our petrochemical products directly to end-users and 36% to our distributors.

We also provided after-sale services to our customers, including technical support. We continuously enhance technical content and added value of our products to meet the needs of market.

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Competition

Exploration and Production

Because our production of crude oil can only meet approximately 20% of our crude oil requirements, we generally do not compete for crude oil customers. However, we compete with other market participants for the acquisition of desirable crude oil and natural gas prospects.

Refining and Marketing of Refined Petroleum Products

Market participants compete primarily on the basis of quality of products and service, efficiency of operations including proximity to customers, awareness of brand name and price. While we constantly face competition from other market participants, we believe that we have a competitive advantage in our principal market over our competitors in most of these aspects.

Chemicals

We compete with domestic and foreign chemicals producers in the chemicals market. We believe our proximity to customers has given us significant competitive geographical advantages. Most of our petrochemical production facilities are located in the eastern and southern regions in China, an area which has experienced higher economic growth rates in China in the past two decades. Proximity of our production facilities to our markets has given us an advantage over our competitors in terms of easy access to our customers, resulting in lower transportation costs, more reliable delivery of products and better service to customers.

Patents and Trademarks

In 2006, we were granted 703 patents in China and overseas. As of December 31, 2006, we owned a total of 3,285 patents in China. We may also use certain patents of Sinopec Group Company under royalty-free licenses. These patents expire from time to time and cover many products, processes and product uses. We also have royalty-free licenses from Sinopec Group Company to use certain Sinopec Group Company's trademarks and brands, including the "Sinopec" brand, for our products and services. Our trademark licenses from Sinopec Group Company are for a term of ten years commencing on February 25, 2000, and the licenses are renewable at our option.

Regulatory Matters

Overview

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China's petroleum and petrochemical industry has seen significant liberalization in the past ten years. However, the exploration, production, marketing and distribution of crude oil and natural gas, as well as the production, marketing and distribution of certain refined petroleum products are still subject to regulation of many government agencies including:

National Development and Reform Commission ("NDRC")

The NDRC is responsible for formulating and implementing key policies in respect of petroleum and petrochemical industry, including:

- o Formulating guidance plan for annual production, import and export amount of crude oil, natural gas and gasoline nationwide based on its forecast on macro economic conditions in China;
- o Publishing guidance prices for certain refined petroleum products, including gasoline, diesel and jet fuel;
- o Approving domestic and overseas resource investment projects whose capital expenditure is in excess of certain amount; and
- o Approving Sino-foreign cooperation projects that are in excess of certain investment limits.

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The Ministry of Commerce ("MOFCOM")

MOFCOM is responsible for examining and approving production sharing contracts, Sino-foreign equity joint venture contracts and Sino-foreign cooperation joint venture contracts for oil and gas development within PRC. It is also responsible to issue quotas and licenses for import and export of crude oil and refined oil.

Ministry of Land and Resources ("MLR")

The MLR is responsible for issuing the licenses that are required to explore and produce crude oil and natural gas in China.

Regulation of Exploration and Production

Exploration and Production Rights

The PRC Constitution provides that all mineral and oil resources belong to the state. In 1986, the standing committee of the National People's Congress passed the Mineral Resources Law which authorizes the Ministry of Land and Resources, or the MLR, to exercise administrative authority over the exploration and production of the mineral and oil resources within the PRC, including its territorial waters. The Mineral Resources Law and its supplementary regulations provide the basic legal framework under which exploration licenses and production licenses are granted. The MLR has the authority to grant exploration licenses and production licenses on a competitive bidding or other basis it considers appropriate. Applicants for these licenses must be companies approved by the State Council to engage in oil and gas exploration and production activities. Currently, only we, PetroChina, CNOOC and Yanchang Petroleum Group Ltd. have received such approval.

Applicants for exploration licenses must first register with the MLR blocks in which they intend to engage in exploration activities. The holder of an exploration license is obligated to make an annual minimum exploration investment relating to the exploration blocks in respect of which the license is

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issued. Investment ranges from RMB 2,000 per square kilometer for the initial year to RMB 5,000 for the second year and to RMB 10,000 for the third and subsequent years. Additionally, the holder has to pay an annual exploration license fee of 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 7 years. The exploration license may be renewed upon application by the holder 30 days prior to expiration of the original term with each renewal 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 proved. The progressive exploration and 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 undertake production.

The MLR issues full production licenses to applicants on the basis of the reserve reports approved by relevant authorities. The maximum term of a full production license is 30 years unless a special dispensation is given by the State Council. Due to a special dispensation granted to us by the State Council, the maximum term of our full production licenses is 55 years. The full production license is renewable upon application by the holder 30 days prior to expiration. A holder of the full production license has to pay an annual full production right usage fee of RMB 1,000 per square kilometer.

All companies approved by the State Council to engage in oil and gas exploration and production activities may apply for exploration and production licenses for onshore and off-shore oil and natural gas resources without geographical restrictions. We have exploration and production licenses for the exploration and production of both onshore and offshore crude oil and natural gas resources in China.

Exploration and production licenses do not grant the holders the right to enter upon any land for the purpose of exploration and production. Holders of exploration and production licenses must separately obtain the right to use the land covered by the licenses, and current owners of the rights to use such land may transfer or lease the land to the license holder.

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Volume and Price of Natural Gas

The NDRC formulates the annual natural gas supply guidelines which require natural gas producers to distribute specified amount of natural gas to specified fertilizer producers. The actual production level of natural gas (excluding the amount supplied to the fertilizer producers) is determined by the natural gas producers themselves.

The price of natural gas has two components:

- o ex-factory price; and
- o pipeline transportation fee

Prior to December 2005, ex-factory prices vary depending on whether or not the natural gas sold is within the government-formulated natural gas supply guidelines. For natural gas sold within the government-formulated supply guidelines, the NDRC fixes the ex-factory prices according to the nature of the customers. Most of these customers are fertilizer producers. For sales of natural gas which is produced in excess of the government-formulated natural gas

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supply plan, the NDRC publishes the median guidance ex-factory price and allows the producers to set the price within +/-10% of this guidance price.

Since December 2005, the NDRC simplified the ex-factory price-setting mechanism by dividing gas prices into two tiers and publishing a median guidance ex-factory price for each tier. Producers may negotiate with their customers to set the price within +/-10% of the guidance price. In addition, the NDRC would adjust the guidance price once per year by up to 8% annually to reflect the price trends of crude oil and other alternative energies.

Natural gas producers also submit to the NDRC for examination and approval any proposed transportation fee for the natural gas transported by pipelines based on the capital investment made in the pipeline, the depreciation period for the pipeline and the ability of end users to pay.

Regulation of Refining and Marketing of Refined Petroleum Products

Volume and Price Controls on Gasoline, Diesel and Jet Fuel

The PRC government continues to exercise control over gasoline, diesel and jet fuel prices.

Beginning on October 17, 2001, the NDRC has started determining the retail guidance prices of gasoline, diesel and jet fuel based on the FOB prices on the Singapore, Rotterdam and New York markets. Within the limit of the total adjustable amount, the NDRC may adjust these prices according to the market conditions in China. The government has started to implement the policies to adjust the prices of refined petroleum products since March 2003, and imposed certain controls over the range and frequency of such adjustment. In 2006, it was reported the new refined petroleum products price-setting mechanism had been formulated by the relevant government authority. However, the revised price-setting mechanism has not been fully implemented.

We are permitted to set our own retail prices within +/-8% of the published guidance prices. There are no government restrictions on how we set prices for sales among our segments and subsidiaries.

Regulation of Crude Oil and Refined Petroleum Products Market

On December 4, 2006, Ministry of Commerce of the PRC promulgated the "Administrative Rules for Crude Oil Market" and "Administrative Rules for Refined Petroleum Products Market" to open the wholesale market of crude oil and refined petroleum products to new market entrants, respectively. We will face more competition in both crude oil and refined petroleum products markets. Such increased competition may have a material adverse effect on our financial conditions and results of operations.

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Investment

Under the State Council's Decision on Investment System Reform, investments without the use of government funds are only subject to a licensing system or a registration system, as the case may be. Under the current system, only significant projects and the projects of restrictive nature are subject to approval so as to maintain social and public interests, and all other projects of any investment scale are only subject to a registration system.

Overseas investment by any Chinese party that is US\$ 30 million or above and falls within the category of resources development shall be verified and approved by the NDRC. Other projects that involve the use of foreign

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exchange by the Chinese party of US\$ 10 million or above shall be verified and approved by the NDRC. Any overseas investment projects other than the foregoing shall be filed with the NDRC and/or the MOFCOM if the investor is an enterprise managed by the central government, or approved by its local government according to law. Domestic enterprise's establishment of overseas enterprise (with the exception of financial enterprises) shall be approved by the MOFCOM.

Taxation, Fees and Royalty

Companies which operate petroleum and petrochemical businesses in China are subject to a variety of taxes, fees and royalties.

On March 26, 2006, the PRC government imposed a special oil income levy on revenues generated from the sale of domestically produced crude oil when its realized price exceeds US\$ 40 per barrel. The special oil income levy has five levels and is calculated and charged according to the progressive ad valorem rates on the excess amounts. The levy is calculated on a monthly basis and collected on a quarterly basis. The applicable rate of the levy is determined based on the weighted average crude oil sale price of the exploration and production company of a particular month.

In 2006, the PRC government adjusted the scope of taxable items of oil consumption tax, and started to impose consumption tax on naphtha, solvent oil, lubricant, jet fuel and fuel oil.

On March 16, 2007, the PRC government enacted the new Corporate Income Tax Law of the PRC (the "New Corporate Income Tax Law"), which will take effect on January 1, 2008. According to the New Corporate Income Tax Law, the corporate income tax rate for entities other than certain qualified non-resident enterprises, high-tech enterprises and small-scale enterprises, as defined in the New Corporate Income Tax Law, will be 25%. In addition, enterprises that are currently taxed at preferential rates will be subject to a five-year transition period during which the tax rates will gradually be increased to the unified tax rate of 25% from January 1, 2008. Therefore, we, except for our high-tech enterprises and certain of our entities currently taxed at preferential rates, will be subject to the unified tax rate of 25% starting from January 1, 2008.

The table below sets forth the various taxes, fees and royalties generally payable by us or by such companies in China.

| Tax Item ----- | Tax Base ----- | Tax Rate ----- |
|----------------------|-------------------|---|
| Corporate income tax | Taxable income | 33%; 25% starting from January 1, 2008 |
| Value-added tax | Revenue | 13% for liquefied petroleum gas, natural density polyethylene for production of and fertilizers and 17% for other items. We charge value-added tax to our customers settlement on top of the selling price on behalf of the taxation authority. We claim refund from the value-added tax customers of any value-added tax that purchasing materials consumed during the process; (ii) charges paid for drilling engineering services; and (iii) labor the production process. |

| | | |
|--|--|--|
| | Sales volume | 5% for the Sino-foreign oil and gas exploration and development cooperative projects. However, value-added tax cannot be deducted. |
| Business tax | Revenue from pipeline transportation services | 3%. |
| Consumption tax | Aggregate volume sold or self-consumed | RMB 277.6 per tonne for gasoline, RMB 256.4 per tonne for diesel, RMB 277 per tonne for naphtha, RMB 256.4 per tonne for solvent oil, RMB 277 per tonne for lubricant, RMB 101.5 per tonne for fuel oil, RMB 124.6 per tonne for jet fuel, payable at the actual applicable rates for naphtha, solvent oil, lubricant and fuel oil is 30% of their actual rates listed above, and the actual applicable rate for kerosene including jet fuel is zero for |
| Import tariff | CIF China price | 5% for gasoline, 6% for diesel and 5% for jet fuel. The actual applicable tax rate in 2007 for gasoline and jet fuel is 2%. |
| Resource tax | Aggregate volume sold or self-consumed | RMB 14 to RMB 30 per tonne for crude oil and RMB 15 per thousand cubic meters for natural gas. The applicable rate for each oil field may vary according to the volume of the exploration and production activities and costs required for the particular oil field. |
| Compensatory fee for mineral resources | Revenue of crude oil and natural gas | 1% |
| Exploration license fee | Area | RMB 100 to 500 per square kilometer per annum |
| Production license fee | Area | RMB 1,000 per square kilometer per annum |
| Royalty fee(1) | Production volume | Progressive rate of 0-12.5% for crude oil and natural gas. |
| City construction tax | Total amount of value-added tax, consumption tax and business tax | 1% to 7%. |
| Education Surcharge | Total amount of value-added tax, consumption tax and business tax | 3%. |
| Special Oil Income Levy | Any revenue derived from sale of domestically produced crude oil when the realized crude oil price exceeds US\$ 40 per barrel. | Progressive rate of 20% to 40% for revenue from crude oil with realized price in excess of US\$ 40 per barrel, i.e. 20% for the portion in excess of US\$ 40 per barrel (inclusive) up to US\$ 45 per barrel (inclusive); 30% for the portion in excess of US\$ 45 per barrel (inclusive) up to US\$ 50 per barrel (inclusive); 40% for the portion in excess of US\$ 50 per barrel (inclusive) up to US\$ 55 per barrel (inclusive); and 40% for the portion in excess of US\$ 55 per barrel (inclusive) up to US\$ 60 per barrel (inclusive); and 40% for the portion in excess of US\$ 60 per barrel (inclusive). |

-
- (1) Payable only by Sino-foreign oil and gas exploration and development cooperative projects, and the project companies of those cooperative projects are not subject to any other resource taxes or fees.

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C. ORGANIZATIONAL STRUCTURE

For a description of our relationship with Sinopec Group Company, see "Item 4. Information on the Company -- A. History and Development of the Company" and "Item 7. Major Shareholders and Related Party Transactions." For a description of our significant subsidiaries, see Note 33 to our consolidated financial statements.

D. PROPERTY, PLANT AND EQUIPMENT

We own substantially all of our properties, plants and equipment relating to our business activities. We hold production licenses covering all of our interests in our developed and undeveloped crude oil and natural gas fields and productive wells. See "Item 4. Information on the Company -- B. Business Overview" for description of our property, plant and equipment.

Environmental Matters

We are subject to various national environmental laws and regulations and also environmental regulations promulgated by the local governments in whose jurisdictions we have operations. For example, national regulations promulgated by the central government set discharge standards for emissions into air and water. They also set forth schedules of discharge fees for various waste substances. These schedules usually provide for discharge fee increases for each incremental increase of the amount of discharge up to a certain level. Above a certain level, the central regulations permit the local government to order any of our facilities to cure certain behavior causing environmental damage and subject to the central government's approval, the local government may also issue orders to close any of our facilities that fail to comply with the existing regulations.

Each of our production subsidiaries has implemented a system to control its pollutant emissions and to oversee compliance with the PRC environmental regulations. We have a central safety and environmental compliance department to set our internal environmental requirements and procedures, and to manage and supervise the environmental protection programs at the various production facilities. Each production subsidiary has an environmental compliance department which is responsible for supervising environmental matters at the subsidiary and implementing our environmental requirements and procedures. These departments report both to the management of the subsidiary and to the central environmental compliance department.

Our production facilities have their own facilities to treat waste water, solid waste and waste gases on site. Waste water first goes through preliminary treatment at our own waste water treatment facilities. Thereafter, the water is sent to nearby waste water treatment centers operated either by us or by Sinopec Group for further treatment. All solid waste materials generated by our production facilities are buried at disposal sites or burned in furnaces either operated by us or by Sinopec Group. Waste gases are generally treated and burned in furnaces before dissipation and the ash is disposed in accordance with our solid waste disposal procedures.

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Environmental regulations also require companies to file an environmental impact report to the environmental bureau for approval before undertaking any construction of a new production facility or any major expansion or renovation of an existing production facility. Such an undertaking will not be permitted to operate until the environmental bureau has performed an inspection and is satisfied that environmentally sound equipment has been installed for the facility.

We believe our environmental protection systems and facilities are adequate for us to comply with current applicable national and local environmental protection regulations. The PRC government, however, may impose stricter regulations which require additional expenditure on compliance with environmental regulations.

We paid pollutant discharge fees of approximately RMB 248 million in 2004, RMB 493 million in 2005 and RMB 1,637 million in 2006.

Insurance

In respect of our refining, petrochemical production, and marketing and sales operations, we currently maintain with Sinopec Group Company, under the terms of its Safety Production Insurance Fund ("SPI Fund"), approximately RMB 302.3 billion of coverage on our property and plants and approximately RMB 43.2 billion of coverage on our inventory. In 2006, we paid an insurance premium of approximately RMB 1.3 billion to Sinopec Group Company for such coverage. Transportation vehicles and products in transit are not covered by

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Sinopec Group Company and we maintain insurance policies for those assets with insurance companies in the PRC.

The insurance coverage under SPI Fund applies to all enterprises controlled by Sinopec Group Company under regulations published by the Ministry of Finance. We believe that, in the event of a major accident, we will be able to recover most of our losses from insurance proceeds paid under the SPI Fund or by insurance companies.

Pursuant to an approval of the Ministry of Finance, on January 29, 2002 Sinopec Group Company entered into an agreement with China People's Insurance Company to purchase a property and casualty policy which would also cover our assets. The policy provides for an annual maximum cumulative claim amount of RMB 4.0 billion and a maximum of RMB 2.36 billion per occurrence.

Consistent with what we believe to be customary practice among PRC enterprises, we do not currently carry any third party liability insurance to cover claims in respect of personal injury, environmental damage arising from accidents on our property or relating to our operations other than on our transportation vehicles. We have not had a third party liability claim filed against us during the past three years. We also do not carry business interruption insurance, as such coverage is not customary in the PRC.

ITEM 4A. UNRESOLVED STAFF COMMENTS

None

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

A. GENERAL

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The following discussion and analysis should be read in conjunction with our audited consolidated financial statements and the accompanying notes. Certain financial information presented in this section is derived from our audited consolidated financial statements that have been prepared in accordance with IFRS. IFRS vary in certain significant respects from US GAAP. Information relating to the nature and effect of such differences is presented in Note 37 to the consolidated financial statements. Unless otherwise indicated, all financial data presented on a consolidated basis or by segment, are presented net of inter-segment transactions (i.e., inter-segment and other intercompany transactions have been eliminated).

We acquired Sinopec National Star Petroleum Company from Sinopec Group Company in 2001, Sinopec Maoming, Xi'an Petrochemical and Tahe Petrochemical Factory from Sinopec Group Company in 2003, certain Petrochemical and Catalyst Assets from Sinopec Group Company in 2004 and Sinopec Hainan and Oil Production Plants in 2006. As we and these companies are under the common control of Sinopec Group Company, our acquisitions are considered as "combination of entities under common control" which are accounted for in a manner similar to a pooling-of-interests. Accordingly, the acquired assets and related liabilities have been accounted for at historical cost and our consolidated financial statements for periods prior to the combinations have been restated to include the financial condition and the results of operation of these acquired companies on a combined basis.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations contained elsewhere in this annual report are based on our consolidated financial statements which have been prepared in accordance with IFRS. Our reported financial condition and results of operations are sensitive to accounting methods, assumptions and estimates that underlie the preparation of our financial statements. We base our assumptions and estimates on historical experience and on various other assumptions that we believe to be reasonable and which form the basis for making judgments about matters that are not readily apparent from other sources. On an on-going basis, our management evaluates its estimates. Actual results may differ from those estimates as facts, circumstances and conditions change.

The selection of critical accounting policies, the judgments and other uncertainties affecting application of those policies and the sensitivity of reported results to changes in conditions and assumptions are factors to be considered when reviewing our financial statements. Our principal accounting policies are set forth in Note 2 to the consolidated financial statements.

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We believe the following critical accounting policies involve the most significant judgments and estimates used in the preparation of our financial statements.

Oil and gas properties and reserves

The accounting for our upstream oil and gas activities is subject to special accounting rules that are unique to the oil and gas business. There are two methods to account for oil and gas business activities, the successful efforts method and the full cost method. We have elected to use the successful efforts method. A description of our policies for oil and gas properties, impairment, maintenance and repair activities is set forth in Note 2 to our consolidated financial statements.

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The successful efforts method reflects the volatility that is inherent in exploring for mineral resources in that costs of unsuccessful exploratory efforts are charged to expense as they are incurred. These costs primarily include dry hole costs, seismic costs and other exploratory costs. Under the full cost method, these costs are capitalized and written-off (depreciation) over time.

Engineering estimates of our oil and gas reserves are inherently imprecise and represent only approximate amounts because of the subjective judgments involved in developing such information. There are authoritative guidelines regarding the engineering criteria that have to be met before estimated oil and gas reserves can be designated as "proved". Proved and proved developed reserves estimates are updated at least annually and take into account recent production and technical information about each field. In addition, as prices and cost levels change from year to year, the estimate of proved and proved developed reserves also changes. This change is considered a change in estimate for accounting purposes and is reflected on a prospective basis in related depreciation rates.

Despite the inherent imprecision in these engineering estimates, these estimates are used in determining depreciation expense and impairment expense, and in disclosing the supplemental standardized measure of discounted future net cash flows relating to proved oil and gas properties. Depreciation rates are determined based on estimated proved developed reserve quantities (the denominator) and capitalized costs of producing properties (the numerator). Producing properties' capitalized costs are amortized based on the units of oil or gas produced. Therefore, assuming all other variables are held constant, an increase in estimated proved developed reserves decreases our depreciation, depletion and amortization expense. Also, estimated reserves are often used to calculate future cash flows from our oil and gas operations, which serve as an indicator of fair value in determining whether a property is impaired or not. The larger the estimated reserves, the less likely the property is impaired. There have been no significant changes to the original reserve estimates during any of the three years ended December 31, 2004, 2005 and 2006.

Impairment for long-lived assets

If circumstances indicate that the net book value of a long-lived asset, including oil and gas properties, may not be recoverable, this asset may be considered "impaired", and an impairment loss may be recognized in accordance with IAS 36 "Impairment of Assets". The carrying amounts of long-lived assets are reviewed periodically in order to assess whether the recoverable amounts have declined below the carrying amounts. These assets are tested for impairment whenever events or changes in circumstances indicate that their recorded carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to recoverable amount. For goodwill, the recoverable amount is estimated annually. The recoverable amount is the greater of the net selling price and the value in use. It is difficult to precisely estimate selling price because quoted market prices for our assets or cash-generating units are not readily available. In determining the value in use, expected cash flows generated by the asset or the cash-generating unit are discounted to their present value, which requires significant judgment relating to level of sale volume, selling price and amount of operating costs. We use all readily available information in determining an amount that is a reasonable approximation of recoverable amount, including estimates based on reasonable and supportable assumptions and projections of reserve quantities, sales volume, selling price and amount of operating costs.

Impairment losses recognized for each of the three years ended December 31, 2004, 2005 and 2006 in our statement of income and equity are summarized as follows:

| | Years ended De | |
|---|----------------|---------|
| | 2004 | 2005 |
| | RMB | RMB |
| Impairment losses on long-lived assets recognized in statement of income | | (in mil |
| Exploration and production..... | 98 | 60 |
| Refining..... | 14 | -- |
| Marketing and distribution..... | 1,769 | 366 |
| Chemicals..... | 2,038 | 1,425 |
| | 3,919 | 1,851 |
| Impairment losses on revaluated long-lived assets recognized in equity attributable to equity shareholders of the Company | | |
| Chemicals..... | 709 | -- |

Depreciation

Property, plant and equipment (other than oil and gas properties) are depreciated on a straight-line basis over the estimated useful lives of the assets, after taking into account the estimated residual value. We review the estimated useful lives of the assets regularly in order to determine the amount of depreciation expense to be recorded during any reporting period. The useful lives are based on our historical experience with similar assets and taking into account anticipated technological changes. The depreciation expense for future periods is adjusted if there are significant changes from previous estimates. There have been no significant changes to the estimated useful lives and residual values during each of the three years ended December 31, 2004, 2005 and 2006.

Revaluation

As required by the relevant PRC rules and regulations, our property, plant and equipment were revalued in connection with our reorganization, and the property, plant and equipment of the companies that we acquired in 2001, 2003, 2004 and 2006 were also revalued in connection with these acquisitions. These revaluations were carried out for each asset class by independent valuers on a depreciated replacement cost basis. Subsequent to these revaluations, property, plant and equipment are carried at the revalued amount, being the fair value as at the date of the revaluation, less subsequent accumulated depreciation and impairment losses. Revaluations are performed with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date. We revalued our property, plant and equipment based on a depreciated replacement cost basis in accordance with our IFRS accounting policies as of December 31, 2004. The results of subsequent revaluations may have an impact on our future results to the extent the fair values of our property, plant and equipment change significantly.

Impairment of accounts receivable for bad and doubtful debts

We estimate impairment of accounts receivable for bad and doubtful

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debts resulting from the inability of our customers to make the required payments. We base our estimates on the aging of our accounts receivable balance, customer credit-worthiness, and historical write-off experience. If the financial condition of our customers were to deteriorate, actual write-offs would be higher than estimated. The changes in the impairment losses for bad and doubtful accounts are as follows:

| | Years ended December 31, | | |
|--|--------------------------|----------------------|-------|
| | 2004 | 2005 | 2006 |
| | RMB | RMB (in millions) | |
| At beginning of year..... | 3,350 | 3,671 | 3,671 |
| Impairment losses recognized for the year..... | 935 | 328 | |
| Written-off/reversal of impairment losses..... | (454) | (859) | |
| Less: Amount distributed to Sinopec Group Company..... | (160) | -- | |
| | ----- | ----- | ----- |
| At end of year..... | 3,671 | 3,140 | 3,140 |
| | ===== | ===== | ===== |

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Recently Pronounced International Financial Reporting Standards

Information relating to the recently pronounced IFRS is presented in Note 36 to the consolidated financial statements.

Overview of Our Operations

We are the largest integrated petroleum and petrochemical company in China and one of the largest in Asia in terms of operating revenues. We engage in exploring for, developing and producing crude oil and natural gas, operating refineries and petrochemical facilities and marketing crude oil, natural gas, refined petroleum products and petrochemicals. We have reported our consolidated financial results according to the following four principal business segments and the corporate and others segment.

- o Exploration and Production Segment, which consists of our activities related to exploring for and developing, producing and selling crude oil and natural gas;
- o Refining Segment, which consists of purchasing crude oil from our exploration and production segment and from third parties, processing of crude oil into refined petroleum products, selling refined petroleum products principally to our marketing and distribution segment;
- o Marketing and Distribution Segment, which consists of purchasing refined petroleum products from our refining segment and third parties, and marketing, selling and distributing refined petroleum products by wholesale to large customers and independent distributors and retail through our retail network;
- o Chemicals Segment, which consists of purchasing chemical feedstock principally from the refining segment and producing, marketing, selling and distributing chemical products; and

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- o Corporate and Others Segment, which consists principally of trading activities of the import and export subsidiaries and our research and development activities.

B. CONSOLIDATED RESULTS OF OPERATIONS

The following table sets forth certain income and expense items from our consolidated statements of income for the periods indicated.

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| | Year Ended December 31, | |
|---|-------------------------|----------------------|
| | 2004 | 2005 |
| | RMB | RMB (in billions) |
| Operating revenues | | |
| Sales of goods..... | 597.3 | 799.3 |
| Other operating revenues..... | 22.6 | 24.0 |
| Total operating revenues..... | 619.9 | 823.3 |
| Other income..... | -- | 9.4 |
| Operating expenses | | |
| Purchased crude oil, products and operating supplies and expenses..... | (442.5) | (651.2) |
| Selling, general and administrative expenses..... | (33.0) | (33.9) |
| Depreciation, depletion and amortization..... | (32.5) | (31.6) |
| Exploration expenses, including dry holes..... | (6.4) | (6.4) |
| Personnel expenses..... | (18.7) | (18.6) |
| Employee reduction expenses..... | (0.9) | (0.4) |
| Taxes other than income tax..... | (16.3) | (17.2) |
| Other operating expenses, net..... | (6.7) | (5.1) |
| Total operating expenses..... | (557.0) | (764.4) |
| Operating income..... | 62.9 | 68.3 |
| Net finance costs..... | (4.4) | (4.6) |
| Other income and gains..... | 0.9 | 1.0 |
| Income before income tax..... | 59.4 | 64.7 |
| Income tax..... | (18.1) | (19.9) |
| Net income..... | 41.3 | 44.8 |
| Attributable to: | | |
| Equity shareholders of the Company..... | 35.3 | 41.5 |
| Minority interests..... | 6.0 | 3.3 |
| | 41.3 | 44.8 |

Year Ended December 31, 2006 Compared with Year Ended December 31, 2005

In 2006, our sales of goods and other operating revenues were RMB 1,044.6 billion and RMB 26.8 billion, respectively, representing an increase of 30.7% and 11.7%, respectively, from those in the previous year. Our operating

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income in 2006 was RMB 83.8 billion, representing an increase of 22.8% from 2005. These results were largely attributable to the following factors: by seizing the opportunities presented by the high market prices of petroleum and chemical products and strong growth of the Chinese economy, we actively implemented our strategy on expanding resources and increased our market share on a number of products. In addition, we sought to optimize our production of refined petroleum and chemical products through improved production safety, reduced energy and utilities, consumption and cost savings. All the above factors contributed to the comparatively good operating results.

Operating Revenues

In 2006, our sales of goods and other operating revenues were RMB 1,071.4 billion, representing an increase of 30.1% compared with 2005. Our sales of goods were RMB 1,044.6 billion, representing an increase of 30.7% compared with 2005. These results were largely attributable to our efforts in expanding resources and markets as well as further optimizing our sales and marketing structure in order to take advantage of the high prevailing market prices of crude oil, petroleum and chemical product. Our other operating revenues increased to RMB 26.8 billion in 2006, representing an increase of 11.7% compared with 2005. Other operating revenues primarily consist of revenues generated from our contractor services as well as our sale of raw and auxiliary materials and utilities such as water, electricity and gas.

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The following table sets forth the average external sales prices and sales volumes by selected products, as well as the respective percentage changes from 2005 to 2006.

| | Average External Sales Price | | Rate of Change from 2005 to 2006 | Sales Volume | |
|-----------------------------|------------------------------|------------|--|--------------|-----------|
| | 2005 | 2006 | | 2005 | 2006 |
| | (RMB) | (RMB) | (%) | | |
| Crude Oil..... | 2,680 (1) | 3,218 (1) | 20.1 | 5.29 (2) | 5.08 (2) |
| Natural Gas..... | 673 (3) | 789 (3) | 17.2 | 4.36 (4) | 5.37 (4) |
| Gasoline | 4,432 (1) | 5,225 (1) | 17.9 | 30.19 (2) | 32.59 (2) |
| Diesel | 3,772 (1) | 4,469 (1) | 18.5 | 67.25 (2) | 72.93 (2) |
| Kerosene | 3,710 (1) | 4,524 (1) | 21.9 | 6.00 (2) | 5.43 (2) |
| Selected Chemical Products: | | | | | |
| Basic chemical | | | | | |
| ----- | | | | | |
| feedstock..... | 4,846 (1) | 5,762 (1) | 18.9 | 8.66 (2) | 10.86 (2) |
| Synthetic Resin | 9,005 (1) | 9,921 (1) | 10.2 | 6.34 (2) | 7.78 (2) |
| Synthetic Fiber..... | 11,123 (1) | 11,389 (1) | 2.4 | 1.59 (2) | 1.61 (2) |
| Synthetic Rubber..... | 13,040 (1) | 13,928 (1) | 6.8 | 0.68 (2) | 0.80 (2) |
| Synthetic Fiber Monomer | | | | | |
| and Polymer..... | 8,879 (1) | 8,846 (1) | (0.4) | 2.99 (2) | 3.78 (2) |
| Chemical fertilizer | 1,539 (1) | 1,650 (1) | 7.2 | 1.82 (2) | 1.65 (2) |

(1) per tonne (2) million tonnes

(3) per thousand cubic meters (4) billion cubic meters

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Sales of crude oil and natural gas

Most of crude oil and a small portion of natural gas produced by us were internally used by our refining and chemical production. The remaining was sold to the refineries controlled by our controlling shareholder, Sinopec Group and third party customers.

In 2006, external sales revenues from crude oil and natural gas amounted to RMB 23.4 billion, or 2.2% of our sales of goods and other operating revenues, representing an increase of 16.7% from 2005. Such increase was primarily attributable to the increase in crude oil prices and our expansion of natural gas business. The average external sales price of crude oil increased to RMB 3,218 per tonne from RMB 2,680 per tonne in 2005, representing an increase of 20.1%. The effect of increased price was partially offset by the decrease in the quantity of external sales from 5.29 million tonnes in 2005 to 5.08 million tonnes in 2006, representing a decrease of 4.0%. The external sales price of natural gas rose from RMB 673 per thousand cubic meters in 2005 to RMB 789 per thousand cubic meters in 2006, representing an increase of 17.2%, and the external sales volume increased from 4.36 billion cubic meters in 2005 to 5.37 billion cubic meters in 2006, representing an increase by 23.2%.

Sales of refined petroleum products

Both the refining and the marketing and distribution segments make sales of refined petroleum products, which consist of gasoline, diesel, kerosene (including jet fuel) and other refined petroleum products, to third parties.

In 2006, the external sales revenue of refined petroleum products recorded by these two segments amounted to RMB 687.5 billion, or 63.9% of our sales of goods and other operating revenues, representing an increase of 26.8% from 2005. The increase was mainly due to our proactive efforts in taking advantage of the high market prices of refined petroleum products through increasing sales volume, further optimizing sales and marketing structure and

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expanding the market of other refined petroleum products. The sales revenue of gasoline, diesel and kerosene was RMB 520.8 billion, comprising 75.8% of the total sales revenue of our refined petroleum products, representing an increase of 27.1% from 2005.

The sales revenues of other refined petroleum products were RMB 166.7 billion, representing an increase of 25.9% over 2005, accounting for 24.2% of the total sales revenues of refined petroleum products.

Sales of chemical products

Our external sales revenues of chemical products were RMB 209.1 billion, representing an increase of 30.1% over 2005, accounting for 19.4% of our sales of goods and other operating revenues. The increase was mainly due to our efforts to capture the opportunity presented by the high market prices of chemical products by increasing our sales volume.

Other income

In 2006, we received a cash grant of RMB 5.0 billion, representing a decrease of 46.9% compared with 2005, from the central government as a compensation of loss incurred due to the distortion of the correlation of domestic refined petroleum products prices and the crude oil prices. There are no unfilled conditions and other contingencies attached to the receipt of this government grant. There is no assurance that we will continue to receive such

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grant in the future.

Operating expenses

In 2006, our operating expenses amounted to RMB 992.6 billion, representing an increase of 29.8% compared with 2005. The operating expenses mainly consisted of the following:

Purchased crude oil, products, and operating supplies and expenses

In 2006, our purchased crude oil, products and operating supplies and expenses were RMB 861.5 billion, representing an increase of 32.3% over 2005, accounting for 86.8% of the total operating expenses, of which:

- o purchased crude oil expenses were RMB 428.8 billion, representing an increase of 26.8% compared with 2005, accounting for 43.1% of the total operating expenses. In 2006, our throughput of crude oil purchased externally was 114.3 million tonnes (excluding amounts processed for third parties), representing an increase of 5.9% compared with 2005. Our average cost for crude oil purchased externally in 2006 was RMB 3,750 per tonne, representing an increase of 19.7% compared with 2005.
- o In 2006, our other purchase expenses were RMB 432.7 billion, representing an increase of 38.2% compared with 2005, accounting for 43.6% of the total operating expenses. The increase was mainly due to the increased costs of refined petroleum products and chemical feedstock purchased externally.

Selling, general and administrative expenses

In 2006, our selling, general and administrative expenses totaled RMB 37.8 billion, representing an increase of 11.4% compared with 2005. The increase was largely due to: an increase of RMB 1.3 billion in repair and maintenance expenses as a result of our renovation of gas stations, an increase of RMB 0.6 billion in lease expenses as a result of increased rents on leased land, an increase of RMB 0.7 billion in general and administrative expenses due to increased number of service outlets and increased expenses from support functions, and an increase of RMB 0.4 billion in mining resource compensation charge as a result of increased sales revenue of crude oil and natural gas.

Depreciation, depletion and amortization

In 2006, our depreciation, depletion and amortization amounted to RMB 34.2 billion, representing an increase of 8.3% compared with 2005. The increase was mainly due to the increased property, plant and equipment in recent years.

Exploration expenses

In 2006, our exploration expenses were RMB 8.0 billion, representing an increase of 24.5% compared with 2005. The increase was largely due to our enhanced exploration efforts made to the Southern marine bed and the new areas in West China.

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Personnel expenses

In 2006, our personnel expenses were RMB 19.9 billion, up by 6.5% compared with 2005.

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Employee reduction expenses

In 2006, in accordance with our voluntary employee reduction plan, we recorded employee reduction expenses of approximately RMB 236 million for approximately 4,000 employees, representing a decrease of RMB 133 million compared with that in 2005.

Taxes other than income tax

In 2006, the Company's taxes other than income tax were RMB 28.6 billion, representing an increase of 66.7% compared with 2005. The increase was largely due to a new special oil income levy in the amount of RMB 8.8 billion that we have been subject to from March 26, 2006, and an increase of RMB 1.7 billion in consumption tax as a result of our increased sales volume of gasoline and diesel and the enlarged tax scope of the consumption tax by the government.

Other operating expenses, net

In 2006, our other operating expenses, net, were RMB 2.4 billion, representing a decrease of 52.5% compared with 2005. The decrease was mainly due to a decrease of RMB 0.5 billion in loss on disposal of property, plant and equipment, a decrease of RMB 1.0 billion in impairment loss on long-lived assets and a debt-extinguishment income of RMB 0.5 billion from one of our subsidiaries.

Operating income

In 2006, our operating income was RMB 83.8 billion, representing an increase of 22.8 % compared with 2005.

Net finance costs

In 2006, our net finance costs were RMB 6.1 billion, representing an increase of 31.9% over 2005. The increase was mainly due to an increase of RMB 1.5 billion in net interest expense as a result of the increase in our outstanding loans and the increase in interest rates associated with these loans.

Income before income tax

In 2006, our income before income tax was RMB 78.9 billion, representing an increase of 22.1% compared with 2005.

Income tax

In 2006, our income tax was RMB 23.5 billion, representing an increase of 18.3% compared with 2005. In 2006, our effective tax rate was 29.8%, representing a decrease of 0.9 percentage point compared with 2005.

Net income attributable to minority interests

In 2006, our net income attributable to minority interests was RMB 1.5 billion, representing a decrease of 55.0% compared with 2005. The decrease was largely because we privatized a number of listed subsidiaries and thereby reduced minority interests in our subsidiaries.

Net income attributable to equity shareholders of the Company

In 2006, our net income attributable to equity shareholders of the

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Company was RMB 53.9 billion, up by 30.0% over 2005.

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

In 2005, our sales of goods and other operating revenues were RMB 799.3 billion and RMB 24.0 billion, respectively, representing an increase of 33.8% and 6.3%, respectively, from those in the previous year. These results were largely attributable to the following factors: international crude oil prices continued to be volatile and remained at a high level; chemical products prices remained at a high level; the effect of the government's tight price control over refined petroleum products which was offset by our effort in proactively developing the market, increasing crude oil and natural gas production, adjusting crude oil processing and output structure, and increasing chemicals production and sales of refined petroleum products. In addition, we received a cash government grant of RMB 9.4 billion from the central government to compensate our inability to fully pass the increased crude oil costs to the refined petroleum products customers due to the tight government control over prices of domestic refined petroleum products, which to some extent relieved the pressure imposed by the increased crude oil costs. All the above factors contributed to the comparatively good operating results.

Operating Revenues

Overview

In 2005, our sales of goods and other operating revenues were RMB 823.3 billion, representing an increase of 32.8% compared with 2004. Our sales of goods were RMB 799.3 billion, representing an increase of 33.8% compared with 2004. These results were largely attributable to the increase in international prices of crude oil and chemical products, and our efforts in expanding the sales volume of our petroleum and chemical products and further optimizing our sales and marketing structure. Our other operating revenues increased to RMB 24.0 billion in 2005, representing an increase of 6% compared with 2004. Other operating revenues primarily consist of revenues generated from our sale of raw and auxiliary materials to Sinopec Group as well as third parties.

The following table sets forth the average external sales prices and sales volumes by selected products, as well as the respective percentage changes from 2004 to 2005.

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| | Average External Sales Price | | Rate of Change from 2004 to 2005 | Sales Volume | |
|-----------------------------|---------------------------------|-----------|-------------------------------------|--------------|------|
| | 2004 | 2005 | | 2004 | 2005 |
| | (RMB) | (RMB) | (%) | | |
| Crude Oil..... | 1,872 (1) | 2,680 (1) | 43.2 | 6.01 (2) | 5.0 |
| Natural Gas..... | 609 (3) | 673 (3) | 10.5 | 3.78 (4) | 4.0 |
| Gasoline | 3,765 (1) | 4,432 (1) | 17.7 | 27.35 (2) | 30.0 |
| Diesel | 3,221 (1) | 3,772 (1) | 17.1 | 60.42 (2) | 67.0 |
| Kerosene | 2,923 (1) | 3,710 (1) | 26.9 | 5.68 (2) | 6.0 |
| Selected Chemical Products: | | | | | |
| Basic chemical | | | | | |
| feedstock..... | 4,429 (1) | 4,846 (1) | 9.4 | 6.66 (2) | 8.0 |

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| | | | | | |
|---|-----------|-----------|------|---------|----|
| Synthetic Resin | 7,986(1) | 9,005(1) | 12.8 | 5.40(2) | 6. |
| Synthetic Fiber..... | 10,818(1) | 11,123(1) | 2.8 | 1.74(2) | 1. |
| Synthetic Rubber..... | 10,238(1) | 13,040(1) | 27.4 | 0.56(2) | 0. |
| Synthetic Fiber Monomer and Polymer..... | 8,022(1) | 8,879(1) | 10.7 | 2.70(2) | 2. |
| Chemical fertilizer | 1,355(1) | 1,539(1) | 13.6 | 2.62(2) | 1. |

(1) per tonne (2) million tonnes

(3) per thousand cubic meters (4) billion cubic meters

Sales of crude oil and natural gas

Most of crude oil and a small portion of natural gas produced by us were internally used by our refining and chemical production. The remaining was sold to the refineries controlled by our controlling shareholder, Sinopec Group and third party customers.

In 2005, external sales revenues from crude oil and natural gas amounted to RMB 20.0 billion, or 2.4% of our sales of goods and other income, representing an increase of 24.3% compared with RMB 16.0 billion in 2004. Such increase was primarily attributable to the increase in crude oil and natural gas prices as well as our expansion of natural gas business. The average external sales price of crude oil increased to RMB 2,680 per tonne from RMB 1,872 per tonne in 2004, representing an increase of 43.2%. The effect of increased price was partially offset by the decrease in the quantity of external sales from 6.01 million tonnes in 2004 to 5.29 million tonnes in 2005, representing a decrease of 12.0%. The external sales price of natural gas rose from RMB 609 per thousand cubic meters in 2004 to RMB 673 per thousand cubic meters in 2005, representing an increase of 10.5%, and the external sales volume increased from 3.78 billion cubic meters in 2004 to 4.36 billion cubic meters in 2005, representing an increase by 15.4%.

Sales of refined petroleum products

Both the refining and the marketing and distribution segments make sales of refined petroleum products, which consist of gasoline, diesel, kerosene (including jet fuel) and other refined petroleum products, to third parties.

In 2005, the external sales revenue of refined petroleum products recorded by these two segments amounted to RMB 542.1 billion, or 65.8% of our sales of goods and other operating revenues and other income, representing an increase of 33.5% from RMB 406.2 billion in 2004. The increase was mainly due to the rise of refined petroleum products price and our proactive efforts in increasing sales volume, further optimizing sales and marketing structure and expanding the market of other refined petroleum products. The sales revenue of gasoline, diesel and kerosene was RMB 409.70 billion, comprising 75.6% of the total sales revenue of our refined petroleum products, representing an increase of 30.4% from 2004.

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The sales revenues of other refined petroleum products were RMB 132.4 billion, representing an increase of 43.9% over 2004, accounting for 24.4% of the total sales revenues of refined petroleum products.

Sales of chemical products

Our external sales revenues of chemical products were RMB 160.8 billion, representing an increase of 27.6% over 2004, accounting for 19.5% of

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our sales of goods and other operating revenues. The increase was mainly due to the fact that we captured the opportunity of the high level price of chemical products and increased its sales volume accordingly.

Other income

In 2005, we received a cash government grant of RMB 9.4 billion, as a compensation of loss incurred due to the distortion of the correlation of domestic refined petroleum products prices and the crude oil prices. There are no unfilled conditions and other contingencies attached to the receipt of this government grant. There is no assurance that we will continue to receive such grant in the future.

Operating expenses

In 2005, our operating expenses amounted to RMB 764.4 billion, representing an increase of 37.2% compared with 2004. The operating expenses mainly consisted of the following:

Purchased crude oil, products, and operating supplies and expenses

In 2005, our purchased crude oil, products and operating supplies and expenses were RMB 651.2 billion, representing an increase of 47.2% over 2004, accounting for 85.2% of the total operating expenses, of which:

- o purchased crude oil expenses were RMB 338.2 billion, representing an increase of 45.4% compared with 2004, accounting for 44.2% of the total operating expenses, up by 2.4 percentage points over 2004. To meet the increasing market demands in the fast growing Chinese economy, we increased our throughput of crude oil purchased from third parties. In 2005, our throughput of crude oil purchased externally was 107.95 million tonnes (excluding amounts processed for third parties), representing an increase of 7.3% compared with 2004. Our average cost for crude oil purchased externally in 2005 was RMB 3,133 per tonne, representing an increase of 35.5% compared with 2004.
- o In 2005, our other purchase expenses were RMB 313.0 billion, representing an increase of 49.1% compared with 2004, accounting for 41.1% of the total operating expenses. The increase was mainly due to the increased costs of refined petroleum products and chemical feedstock purchased externally.

Selling, general and administrative expenses

In 2005, our selling, general and administrative expenses totaled RMB 33.9 billion, representing an increase of 2.8% compared with 2004. The increase was largely due to:

- o An increase of RMB 1.5 billion in the selling expenses, such as transportation costs, compared with 2004, resulted from the increase in the total sales volume of refined petroleum products and chemical products, and increased sales volume through retail and direct distribution; and
- o An increase of RMB 1.2 billion in operating lease expenses compared with 2004 mainly due to the increased lease of operating facilities to increase sales volume.

It was partially offset by a decrease in repairing and maintenance expenses by RMB 800 million, mainly as a result of the increased maintenance carried out in 2004 for petrol stations.

Depreciation, depletion and amortization

In 2005, our depreciation, depletion and amortization amounted to RMB 31.6 billion, down by 2.7% compared with 2004. The decrease was mainly due to disposal of, and impairment loss on less efficient assets in the previous years.

Exploration expenses

In 2005, our exploration expenses were RMB 6.4 billion, remaining at the same level as in 2004 since our level of exploration activities for unsuccessful wells in 2005 remained at the similar level as in 2004.

Personnel expenses

In 2005, our personnel expenses were RMB 18.6 billion, down by 0.4% compared with 2004. The decrease was mainly due to the reduction of operating personnel resulting from the disposal of downhole operation assets in 2004.

Employee reduction expenses

In 2005, in accordance with our voluntary employee reduction plan, we recorded employee reduction expenses of approximately RMB 369 million for approximately 7,000 employees, representing a decrease of RMB 550 million compared with that in 2004.

Taxes other than income tax

In 2005, the Company's taxes other than income tax were RMB 17.2 billion, representing an increase of 5.1% compared with 2004. The increase was largely due to the increased consumption tax and associated surcharges as a result of the increase in the sales volume of gasoline and diesel.

Other operating expenses, net

In 2005, our other operating expenses, net were RMB 5.1 billion, representing a decrease of 23.1% compared with 2004. In 2005 and 2004, in order to allocate our internal resources more efficiently, we revised the production plans in these years, and accordingly made a provision for impairment loss of RMB 1.9 billion in 2005 on certain less efficient chemical facilities, petrol stations and depots on the difference between the estimated recoverable value and the net book value of these assets, representing a decrease of RMB 2.1 billion compared with 2004. Meanwhile, our net losses on disposals of assets in 2005 were RMB 2.1 billion, representing an increase of RMB 0.4 billion compared with 2004.

Operating income

In 2005, our operating income was RMB 68.3 billion, representing an increase of 8.5 % compared with 2004.

Net finance costs

In 2005, our net finance costs were RMB 4.6 billion, representing an increase of 5.7% over 2004. The increase was mainly due to an increase of RMB 1.3 billion in net interest expense as a result of the increase in long term loans borrowed in accordance with our investment plans, and the increase in short term debts attributable to the increased working capital requirement, as a result of the increased crude oil price and the expansion of production and

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operation. It was partially offset by an increase of RMB 1.1 billion in net foreign exchange gains due to fluctuation of the foreign exchange rate.

Income before income tax

In 2005, our income before income tax was RMB 64.7 billion, representing an increase of 8.8% compared with 2004.

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Income tax

In 2005, our income tax was RMB 19.9 billion, representing an increase of 9.9 % compared with 2004. The increase was primarily due to the increase in operating income. In 2005, our effective tax rate was 30.7%, representing an increase of 0.3 percentage point compared with 2004. The increase was primarily due to the decrease in operating income in certain of our subsidiaries which were taxed at a lower tax rate.

Net income attributable to minority interests

In 2005, our net income attributable to minority interests was RMB 3.3 billion, representing a decrease of 44.8% compared with 2004. The decrease was largely due to the decreased profit in certain subsidiaries and our privatization of Beijing Yanhua.

Net income attributable to equity shareholders of the Company

In 2005, our net income attributable to equity shareholders of the Company was RMB 41.5 billion, up by 17.3% over 2004.

C. DISCUSSIONS ON RESULTS OF SEGMENT OPERATIONS

We divide our operations into four business segments (exploration and production segment, refining segment, marketing and distribution segment and chemicals segment) and corporate and others. Unless otherwise specified, the inter-segment transactions have not been eliminated in the financial data discussed in this section. In addition, the operating revenue data of each segment have included the "other operating revenues" and "other income" of the segment.

The following table sets forth the operating revenues by each segment, the contribution of external sales and inter-segment sales as a percentage of operating revenues before elimination of inter-segment sales, and the contribution of external sales as a percentage of consolidated operating revenues (i.e. after elimination of inter-segment sales) for the periods indicated.

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| Years Ended December 31, | As a Percentage of Consolidated Operating Revenues Before Elimination of Inter-segment Sales | As a Per Conso Operatin After Eli Inter-seg |
|--------------------------|--|---|
| ----- | ----- | ----- |

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| | 2004 | 2005 | 2006 | 2005 | 2006 | 2005 |
|--|---------------|---------|---------|-------|-------|-------|
| | RMB | RMB | RMB | (%) | (%) | (%) |
| | (in billions) | | | | | |
| Exploration and Production | | | | | | |
| External sales(1)..... | 25.4 | 30.8 | 37.5 | 2.3 | 2.1 | 3.7 |
| Inter-segment sales..... | 60.0 | 84.4 | 105.7 | 6.2 | 5.8 | |
| Total operating revenue. | 85.4 | 115.2 | 143.2 | 8.5 | 7.9 | |
| Refining | | | | | | |
| External sales(1)..... | 68.5 | 88.2 | 103.8 | 6.5 | 5.7 | 10.6 |
| Other income..... | - | 9.4 | 5.0 | 0.7 | 0.3 | 1.1 |
| Inter-segment sales..... | 289.8 | 386.5 | 471.6 | 28.3 | 26.1 | |
| Total operating revenue. | 358.3 | 484.1 | 580.4 | 35.5 | 32.1 | |
| Marketing and distribution | | | | | | |
| External sales(1)..... | 343.6 | 460.7 | 589.0 | 33.8 | 32.6 | 55.3 |
| Inter-segment sales..... | 2.8 | 3.1 | 4.6 | 0.2 | 0.3 | |
| Total operating revenue. | 346.4 | 463.8 | 593.6 | 34.0 | 32.9 | |
| Chemicals | | | | | | |
| External sales(1)..... | 132.2 | 166.6 | 215.8 | 12.2 | 11.9 | 20.0 |
| Inter-segment sales..... | 12.5 | 12.2 | 12.3 | 0.9 | 0.7 | |
| Total operating revenue. | 144.7 | 178.8 | 228.1 | 13.1 | 12.6 | |
| Corporate and others | | | | | | |
| External sales(1)..... | 50.2 | 77.0 | 125.3 | 5.6 | 6.9 | 9.3 |
| Inter-segment sales..... | 32.0 | 44.9 | 136.7 | 3.3 | 7.6 | |
| Total operating revenue. | 82.2 | 121.9 | 262.0 | 8.9 | 14.5 | |
| Total operating revenue before inter-segment eliminations..... | 1,017.0 | 1,363.8 | 1,807.3 | 100.0 | 100.0 | |
| Elimination of inter-segment sales..... | (397.1) | (531.1) | (730.9) | | | |
| Consolidated operating revenues..... | 619.9 | 832.7 | 1,076.4 | | | 100.0 |

(1) include other operating revenues. See Note 32 to the consolidated financial statements for other operating revenues of each of our operating segments.

The following table sets forth the operating revenues, other income, operating expenses and operating income by each segment before elimination of the inter-segment transactions for the periods indicated, and the rate of changes from 2005 to 2006.

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| | Years Ended December 31, | | | Rate of Change from 2005 to 2006 (%) |
|------------------------------------|--------------------------|---------|---------|--------------------------------------|
| | 2004 | 2005 | 2006 | |
| | (RMB in billions) | | | |
| Exploration and Production | | | | |
| Total operating revenues..... | 85.4 | 115.2 | 143.2 | 24.3 |
| Total operating expenses..... | (59.0) | (66.9) | (80.0) | 19.6 |
| Total operating income..... | 26.4 | 48.3 | 63.2 | 30.7 |
| Refining | | | | |
| Total operating revenues..... | 358.3 | 474.7 | 575.4 | 21.2 |
| Other income..... | - | 9.4 | 5.0 | (46.8) |
| Total operating expenses..... | (353.3) | (487.6) | (605.7) | 24.2 |
| Total operating income/(loss)..... | 5.0 | (3.5) | (25.3) | 622.9 |
| Marketing and distribution | | | | |
| Total operating revenues..... | 346.4 | 463.8 | 593.6 | 28.0 |
| Total operating expenses..... | (331.7) | (453.4) | (563.4) | 24.2 |
| Total operating income..... | 14.7 | 10.4 | 30.2 | 190.4 |
| Chemicals | | | | |
| Total operating revenues..... | 144.7 | 178.8 | 228.1 | 27.6 |
| Total operating expenses..... | (126.0) | (164.5) | (210.9) | 28.2 |
| Total operating income..... | 18.7 | 14.3 | 17.2 | 20.3 |
| Corporate and others | | | | |
| Total operating revenues..... | 82.2 | 121.9 | 262.0 | 115.0 |
| Total operating expenses..... | (84.1) | (123.1) | (263.5) | 114.2 |
| Total operating loss..... | (1.9) | (1.2) | (1.5) | 25.0 |

Exploration and Production Segment

The business activities of the exploration and production segment consist of exploration, development, production, and sale of crude oil and natural gas. Most of the crude oil and a small portion of the natural gas produced by the exploration and production segment were used for our refining and chemicals production. Most of the natural gas and a small portion of crude oil produced were sold to refineries owned by Sinopec Group Company and other customers.

Year Ended December 31, 2006 Compared with Year Ended December 31, 2005

In 2006, the operating revenues of this segment were RMB 143.2 billion, representing an increase of 24.3% over 2005, largely due to the increase in the sales volume and sales price of crude oil and natural gas compared with those in 2005.

In 2006, this segment sold 37.94 million tonnes of crude oil and 5.7 billion cubic meters of natural gas, representing an increase of 2.9% and 28.9%, respectively, compared with those in 2005. The average realized price of crude oil was RMB 3,195 per tonne, representing an increase of 19.9% over 2005. The

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average realized price of natural gas was RMB 794 per thousand cubic meters, representing an increase of 18.0% compared with 2005.

In 2006, the operating expenses of this segment were RMB 80.0 billion, representing an increase of 19.6% compared with 2005. The increase was mainly due to:

- o An increase of RMB 9.4 billion in taxes other than income tax, which mainly consist of the special oil income levy and the mining resource compensation charge;

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- o An increase of RMB 1.6 billion in exploration expenses (including day hole costs) as a result of our enhanced exploration efforts in the Southern marine bed and the new areas in Western China; and
- o An increase of RMB 1.8 billion in depreciation, depletion and amortization as a result of our continuous investments in property, plant and equipment.

In 2006, this segment's operating income was RMB 63.2 billion, representing an increase of 30.7% compared with 2005.

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

In 2005, the operating revenues of this segment were RMB 115.2 billion, representing an increase of 34.8% over 2004, largely due to the increase in the sales price and sales volume of crude oil and natural gas compared with those in 2004.

In 2005, this segment sold 36.86 million tonnes of crude oil and 4.44 billion cubic meters of natural gas, representing an increase of 1.7% and 14.7% respectively compared with those in 2004. The average realized price of crude oil was RMB 2,665 per tonne, representing an increase of 36.2% over 2004. The average realized price of natural gas was RMB 673 per thousand cubic meters, representing an increase of 9.3% compared with 2004.

In 2005, the operating expenses of this segment were RMB 66.9 billion, representing an increase of 13.2% compared with 2004. The increase was mainly due to:

- o The rise of raw materials and utilities costs accounting for the increase of approximately RMB 2.2 billion in operating expenses compared with 2004;
- o The increase of approximately RMB 1.6 billion in other operating expenses including expenses related to the sales of materials compared with 2004;
- o The increase of RMB 1.5 billion resulted from the increased production activities in this segment to take advantage of the high crude oil price environment;
- o The increase of approximately RMB 700 million in resources tax due to the change of tax rate, and the increased construction tax, education surcharges as well as mineral resources compensation fees associated with the increased sales revenues of crude oil.

In 2005, this segment's operating income was RMB 48.3 billion, representing an increase of 83.1% compared with 2004.

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Refining Segment

The business activities of the refining segment consist of purchasing crude oil from the exploration and production segment and third parties, processing crude oil into refined petroleum products, selling gasoline, diesel and kerosene to marketing and distribution segment, selling a portion of chemical feedstock to chemicals segment and selling other refined petroleum products to domestic and foreign customers.

Year Ended December 31, 2006 Compared with Year Ended December 31, 2005

In 2006, this segment's operating revenues were approximately RMB 580.4 billion, representing an increase of 19.9% compared with 2005. The increase was mainly due to the increased sales prices and sales volume of various refined petroleum products.

The following table sets forth sales revenue and the percentage of total operating revenue for the segment by product category for 2005 and 2006, as well as the percentage changes in sales revenue from 2005 to 2006.

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| | Year Ended December 31, | | Rate of | As a |
|---------------------------------------|-------------------------|--------------|--------------|--------------|
| | 2005 | 2006 | Change from | Total Op |
| | (RMB) | (RMB) | 2005 to 2006 | 2005 |
| | (in billions) | | (%) | (%) |
| Refining Segments, operating revenues | | | | |
| Gasoline..... | 81.0 | 98.2 | 21.2 | 16.7 |
| Diesel | 187.4 | 222.2 | 18.6 | 38.7 |
| Light chemical feedstock | 98.8 | 120.1 | 21.6 | 20.4 |
| Other refined petroleum products..... | 102.1 | 125.9 | 27.6 | 21.1 |
| Other operating revenues..... | 5.4 | 4.6 | (14.8) | 1.1 |
| Other income..... | 9.4 | 5.0 | (46.8) | 2.0 |
| Total..... | 484.1 | 580.4 | | 100.0 |

In 2006, the sales revenues of gasoline by the segment were RMB 98.2 billion, representing an increase of 21.2% compared with 2005, accounting for 16.9% of this segment's operating revenues. In 2006, the sales revenues of diesel by the segment were RMB 222.2 billion, representing an increase of 18.6% compared with 2005, accounting for 38.3% of this segment's operating revenues. In 2006, the sales revenues of light chemical feedstock by the segment were RMB 120.1 billion, representing an increase of 21.6% compared with 2005, accounting for 20.7% of this segment's operating revenues. In 2006, the sales revenues of refined petroleum products other than gasoline, diesel and light chemical feedstock were RMB 125.9 billion, representing an increase of 27.6% compared with 2005, accounting for 22.5% of this segment's operating revenues.

The table below sets forth sales volume and average realized prices by product for 2005 and 2006, as well as the percentage changes in sales volume and

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average realized prices for the periods shown.

| | Sales volume | | Rate of change from | Average realized price | |
|---------------------------------------|------------------|-------|---------------------------|------------------------|-------|
| | 2005 | 2006 | 2005 to 2006 | 2005 | 2006 |
| | ----- | ----- | ----- | ----- | ----- |
| | (million tonnes) | | (%) | (RMB per tonne) | |
| Gasoline..... | 21.52 | 21.86 | 1.6 | 3,763 | 4,492 |
| Diesel..... | 54.13 | 57.58 | 6.4 | 3,462 | 3,859 |
| Light Chemical feedstock | 26.45 | 26.55 | 0.4 | 3,734 | 4,523 |
| Other refined petroleum products..... | 32.72 | 37.02 | 13.1 | 3,121 | 3,521 |

In 2006, the operating expenses of the segment were RMB 605.7 billion, representing an increase of 24.2% compared with 2005. The increase was primarily due to the increase in crude oil price and throughput. In 2006, the average crude oil cost was RMB 3,674 per tonne, representing an increase of 19.9% compared with 2005. Refining throughput was 143.6 million tonnes (excluding amounts processed for third parties) in 2006, representing an increase of 5.5% compared with 2005. The total crude oil costs in 2006 were RMB 527.4 billion, representing an increase of 26.5% compared with 2005, accounting for 87.1% of the total operating expenses of the segment, up by 1.6 percentage points over 2005.

In 2006, although crude oil prices remained at a high level, the Chinese government continued to tightly control domestic prices of refined petroleum products. As a result, while we sought to lower our crude oil cost through processing more higher-sulphur and higher acid crude oil as well as expanding our sales of other refined petroleum products than gasoline and diesel, particularly those higher value-added products, our refining segment incurred significant loss. In 2006, the operating losses of the segment, after the receipt of the one-time cash government grant of RMB 5.0 billion, were

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RMB 25.3 billion, representing an increase in operating loss of RMB 21.8 billion compared with 2005.

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

In 2005, this segment's operating revenues were approximately RMB 484.1 billion, representing an increase of 35.1% compared with 2004. The increase was mainly due to the increased sales prices and sales volume of various refined petroleum products.

The following table sets forth sales revenue and the percentage of total operating revenue for the segment by product category for 2004 and 2005, as well as the percentage changes in sales revenue from 2004 to 2005.

| Year Ended December 31, | | Rate of Change from | As a Refin Total Op |
|-------------------------|-------|------------------------|---------------------------|
| 2004 | 2005 | 2004 to 2005 | 2004 |
| ----- | ----- | ----- | ----- |
| | | | |

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| | (RMB) (in billions) | (RMB) | (%) | (%) |
|---------------------------------------|------------------------|-------|------|-------|
| Refining Segments, operating revenues | | | | |
| Gasoline..... | 63.8 | 81.0 | 27.0 | 17.8 |
| Diesel | 145.3 | 187.4 | 29.0 | 40.5 |
| Light Chemical feedstock | 62.1 | 98.8 | 59.1 | 17.3 |
| Other refined petroleum products..... | 81.9 | 102.1 | 24.7 | 22.8 |
| Other operating revenues..... | 5.2 | 5.4 | 3.8 | 1.6 |
| Other income..... | - | 9.4 | - | - |
| Total..... | 358.3 | 484.1 | 35.1 | 100.0 |

In 2005, the sales revenues of gasoline by the segment were RMB 81 billion, representing an increase of 27.0% compared with 2004, accounting for 16.7% of this segment's operating revenues.

In 2005, the sales revenues of diesel by the segment were RMB 187.4 billion, representing an increase of 29.0% compared with 2004, accounting for 38.7% of this segment's operating revenues.

In 2005, the sales revenues of chemical feedstock by the segment were RMB 98.8 billion, representing an increase of 59.1% compared with 2004, accounting for 20.4% of this segment's operating revenues. The increase in the sales revenues of light chemical feedstock was more than that in the sales revenues of gasoline and diesel, which was primarily due to the smaller increase in gasoline and diesel prices as compared with chemical feedstock prices as a result of tight government control over domestic gasoline and diesel prices. In addition, the segment also increased the sales volume of chemical feedstock.

In 2005, the sales revenues of refined petroleum products other than gasoline, diesel and chemical feedstock were RMB 102.1 billion, representing an increase of 24.7% compared with 2004, accounting for 21.1% of this segment's operating revenues.

In 2005, we received a cash government grant of RMB 9.4 billion, as a compensation of loss incurred due to the distortion of the correlation of domestic refined petroleum products prices and the crude oil prices.

The table below sets forth sales volume and average realized prices by product for 2004 and 2005, as well as the percentage changes in sales volume and average realized prices for the periods shown.

| | Sales volume | | Rate of change | Average realized price | |
|--------------------------------|------------------|-------|-------------------|------------------------|-------|
| | 2004 | 2005 | from 2004 to 2005 | 2004 | 2005 |
| | ---- | ---- | ----- | ---- | ---- |
| | (million tonnes) | | (%) | (RMB per tonne) | |
| Gasoline..... | 21.42 | 21.52 | 0.5 | 2,977 | 3,763 |
| Diesel..... | 50.27 | 54.13 | 7.7 | 2,890 | 3,462 |
| Light Chemical feedstock | 23.17 | 26.45 | 14.2 | 2,682 | 3,734 |

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| | | | | | |
|---------------------------------------|-------|-------|-----|-------|-------|
| Other refined petroleum products..... | 31.71 | 32.72 | 3.2 | 2,583 | 3,121 |
|---------------------------------------|-------|-------|-----|-------|-------|

In 2005, the operating expenses of the segment were RMB 487.6 billion, representing an increase of 38.0% compared with 2004. The increase was primarily due to the increase in crude oil price and throughput.

In 2005, the average crude oil cost was RMB 3,064 per tonne, representing an increase of 35.5% compared with 2004. Refining throughput was 136.08 million tonnes (excluding amounts processed for third parties) in 2005, representing an increase of 5.6% compared with 2004. The total crude oil costs in 2005 were RMB 416.9 billion, representing an increase of 43.1% compared with 2004, accounting for 85.5% of the total operating expenses of the segment, up by 2.8 percentage points over 2004.

In 2005, although crude oil prices remained at a high level; the Chinese government implemented tight control over domestic prices of refined petroleum products, as a result, our refining segment incurred significant loss. To ensure our refining segment's normal operation, we strived to lower our production cost and adjusted the internal transfer prices between the different segments.

In 2005, the operating losses of the segment, after the receipt of the one-time cash government grant of RMB 9.4 billion, were RMB 3.5 billion, representing a decrease in operating income of RMB 8.5 billion compared with 2004.

Marketing and Distribution Segment

The business activities of marketing and distribution segment include purchasing refined petroleum products from the refining segment and third parties, and wholesale selling of refined petroleum products to domestic customers, directly selling and retail distributing the refined petroleum products through the retail network owned by this segment and provision of related services.

Year Ended December 31, 2006 Compared with Year Ended December 31, 2005

In 2006, the operating revenues of this segment were RMB 593.6 billion, representing an increase of 28.0% compared with 2005. The increase was primarily due to the increases in sales volume and prices of gasoline, diesel and kerosene including jet fuel and the further optimization of marketing structure with increased percentage of retail sales in the total sales volume of gasoline and diesel.

In 2006, the operating revenues from sales of gasoline and diesel were RMB 500.1 billion, accounting for 84.3% of the operating revenues of this segment. The percentage of retail sales in the total sales volume of gasoline and diesel increased from 59.6% in 2005 to 63.4% in 2006, up by 3.8 percentage points. The percentage of sales of gasoline and diesel by direct sales in the total sales volume decreased from 19.1% in 2005 to 17.0% in 2006, down by 2.1 percentage points. The percentage of wholesale sales in the total sales volume of gasoline and diesel decreased from 21.3% in 2005 to 19.6% in 2006, down by 1.7 percentage points.

The following table sets forth the sales volumes, average realized prices and the respective rate of changes of the four major product categories in 2005 and 2006 in different forms of sales channels for gasoline and diesel.

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| | Sales Volume | | Rate of Change from 2005 to 2006 ----- (%) | Average Realized Prices | | Ra |
|----------------------------------|-----------------------------------|-----------------------------------|--|----------------------------------|----------------------------------|----|
| | 2005 ----- (million tonnes) | 2006 ----- (million tonnes) | | 2005 ----- (RMB per tonne) | 2006 ----- (RMB per tonne) | |
| Gasoline..... | 30.32 | 32.72 | 7.9 | 4,430 | 5,224 | |
| Retail sale..... | 21.63 | 23.89 | 10.4 | 4,562 | 5,350 | |
| Direct sale..... | 2.84 | 2.81 | (1.0) | 4,206 | 4,922 | |
| Wholesale..... | 5.85 | 6.02 | 2.9 | 4,050 | 4,867 | |
| Diesel | 67.93 | 73.69 | 8.5 | 3,767 | 4,466 | |
| Retail sale..... | 36.90 | 43.53 | 18.0 | 3,885 | 4,527 | |
| Direct sale..... | 15.91 | 15.31 | (3.8) | 3,786 | 4,599 | |
| Wholesale..... | 15.12 | 14.86 | (1.7) | 3,458 | 4,152 | |
| Kerosene including jet fuel..... | 5.96 | 5.40 | (9.4) | 3,710 | 4,524 | |
| Fuel Oil..... | 13.33 | 15.07 | 13.0 | 2,374 | 2,989 | |

In 2006, the segment's operating expenses were RMB 563.4 billion, representing an increase of 24.2% compared with 2005. The increase was mainly due to the increase in purchase expenses, of which, purchase expenses for gasoline and diesel were RMB 443.8 billion, up by 24.8% over 2005, accounting for 78.8% of the segment's operating expenses. In 2006, average purchase prices of gasoline and diesel increased by 19.0% and 13.5%, respectively, to RMB 4,573 per tonne and RMB 3,992 per tonne compared with 2005. The purchase volume of gasoline and diesel increased by 7.9% and 8.5%, respectively, compared with 2005 to 32.7 million tonnes and 73.7 million tonnes.

In 2006 the segment's operating profit was RMB 30.2 billion, representing an increase of RMB 19.8 billion compared with 2005.

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

In 2005, the operating revenues of this segment were RMB 463.8 billion, representing an increase of 33.9% compared with 2004. The increase was primarily due to the increases in sales volume and prices of gasoline, diesel and kerosene including jet fuel, the continuous optimization of marketing structure to further increase the percentage of retail sales in the total sales volume of gasoline and diesel.

In 2005, the operating revenues from sales of gasoline and diesel were RMB 390.2 billion, accounting for 84.1% of the operating revenues of this segment. The percentage of retail sales in the total sales volume of gasoline and diesel increased from 54.6% in 2004 to 59.6% in 2005, up by 5.0 percentage points. The percentage of sales of gasoline and diesel by direct sales in the total sales volume decreased from 20.3% in 2004 to 19.1% in 2005, down by 1.2 percentage points. The percentage of wholesale sales in the total sales volume of gasoline and diesel decreased from 25.1% in 2004 to 21.3% in 2005, down by 3.8 percentage points.

The following table sets forth the sales volumes, average realized prices and the respective rate of changes of the four major product categories in 2004 and 2005 in different forms of sales channels for gasoline and diesel.

| | Rate of Change | Average Realized Prices | Ra |
|--|----------------|----------------------------|----|
|--|----------------|----------------------------|----|

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| | Sales Volume | | from | ----- | |
|----------------------------------|------------------|-------|--------------|-----------------|-------|
| | 2004 | 2005 | 2004 to 2005 | 2004 | 2005 |
| | ---- | ---- | ----- | ---- | ---- |
| | (million tonnes) | | (%) | (RMB per tonne) | |
| Gasoline..... | 27.51 | 30.32 | 10.2 | 3,762 | 4,430 |
| Retail sale..... | 18.42 | 21.63 | 17.4 | 3,911 | 4,562 |
| Direct sale..... | 2.89 | 2.84 | (1.8) | 3,536 | 4,206 |
| Wholesale..... | 6.20 | 5.85 | (5.7) | 3,426 | 4,050 |
| Diesel | 61.10 | 67.93 | 11.2 | 3,215 | 3,767 |
| Retail sale..... | 30.00 | 36.90 | 23.0 | 3,351 | 3,885 |
| Direct sale..... | 15.12 | 15.91 | 5.2 | 3,211 | 3,786 |
| Wholesale..... | 15.98 | 15.12 | (5.4) | 2,963 | 3,458 |
| Kerosene including jet fuel..... | 5.62 | 5.96 | 5.9 | 2,923 | 3,710 |
| Fuel Oil..... | 9.69 | 13.33 | 37.7 | 1,793 | 2,374 |

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In 2005, the segment's operating expenses were RMB 453.4 billion, representing an increase of 36.7% compared with 2004. The increase was mainly due to the increase in purchase expenses, of which, purchase expenses for gasoline and diesel were RMB 355.5 billion, up by 36.3% over 2004, accounting for 78.4% of the segment's operating expenses. In 2005, average purchase prices of gasoline and diesel increased by 27.3% and 20.9%, respectively, to RMB 3,844 per tonne and RMB 3,518 per tonne compared with 2004. The purchase volume of gasoline and diesel increased by 10.2% and 11.2%, respectively, compared with 2004 to 30.32 million tonnes and 67.93 million tonnes.

In 2005, the segment's operating profit was RMB 10.4 billion, representing a decrease of 29.7% compared with 2004.

Chemicals Segment

Our chemicals segment consists of operations related to purchasing chemical feedstock from our refining segment, producing, marketing and distribution of petrochemical products.

Year Ended December 31, 2006 Compared with Year Ended December 31, 2005

In 2006, the segment's operating revenues were RMB 228.1 billion, representing an increase of 27.6% compared with 2005, which was primarily due to the increases in prices and sales volume of major chemical products.

In 2006, the sales revenues of the Company's six major categories of chemical products (namely, basic organic chemicals, monomers and polymers for synthetic fiber, synthetic resin, synthetic fiber, synthetic rubber and chemical fertilizer) totaled approximately RMB 215.7 billion, representing an increase of 35.3% compared with 2005, accounting for 94.6% of the total operating revenues of this segment.

The following table sets forth the sales volume, average realized price and the respective rate of changes for each of these six categories of chemical products of this segment from 2005 to 2006.

| Sales Volumes | Rate of Change | Average Realized Prices | Rate of |
|---------------|----------------|-------------------------|---------|
| ----- | | ----- | of |

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| | 2005 | 2006 | from 2005 to 2006 | 2005 | 2006 | from 2005 to 2006 |
|---|------------------|-------|-------------------|-----------------|--------|-------------------|
| | ---- | ---- | ----- | ---- | ---- | ----- |
| | (million tonnes) | | (%) | (RMB per tonne) | | |
| Basic organic chemicals..... | 9.51 | 12.75 | 34.1 | 4,828 | 5,609 | |
| Synthetic resins..... | 6.37 | 7.89 | 24.0 | 9,007 | 9,870 | |
| Synthetic rubber..... | 0.70 | 0.83 | 18.4 | 13,000 | 13,885 | |
| Synthetic fiber..... | 1.59 | 1.61 | 1.8 | 11,123 | 11,390 | |
| Synthetic fiber monomers and polymers..... | 3.00 | 3.80 | 26.6 | 8,872 | 8,839 | |
| Chemical fertilizer..... | 1.82 | 1.65 | (9.3) | 1,539 | 1,660 | |

In 2006, the operating expenses of the segment were RMB 210.9 billion, representing an increase of 28.2% compared with 2005. The increase was primarily due to the price increases of various raw materials, the increased consumption of various raw materials and auxiliary materials, the increased utilities expenses and other variable expenses and fixed costs, all associated with the increased production of the chemical products. In particular, the costs for raw materials increased by RMB 44.9 billion compared with 2005 as a result of increased consumption of raw materials and their average emit price, and the costs for fuel and other utilities increased by RMB 1.7 billion compared with 2005 as a result of increased production of chemical products.

In 2006, the segment's operating profit was RMB 17.2 billion, representing an increase by 20.3% compared with 2005.

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

In 2005, the segment's operating revenues were RMB 178.8 billion, representing an increase of 23.6% compared with 2004, which was primarily due to the increases in prices and sales volume of major chemical products.

In 2005, the sales revenues of the Company's six major categories of chemical products (i.e. basic organic chemicals, monomers and polymers for synthetic fiber, synthetic resin, synthetic fiber, synthetic rubber and chemical

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fertilizer) totaled approximately RMB 159.5 billion, representing an increase of 27.9% compared with 2004, accounting for 89.2% of the total operating revenues of this segment.

The following table sets forth the sales volume, average realized price and the respective rate of changes for each of these six categories of chemical products of this segment from 2004 to 2005.

| | Sales Volumes | | Rate of Change from 2004 to 2005 | Average Realized Prices | | Rate of Change from 2004 to 2005 |
|------------------------------|------------------|------|-------------------------------------|----------------------------|--------|--|
| | 2004 | 2005 | | 2004 | 2005 | |
| | ---- | ---- | ----- | ---- | ---- | ----- |
| | (million tonnes) | | (%) | (RMB per tonne) | | |
| Basic organic chemicals..... | 7.38 | 9.51 | 28.8 | 4,292 | 4,828 | |
| Synthetic resins..... | 5.40 | 6.37 | 18.0 | 7,986 | 9,007 | |
| Synthetic rubber..... | 0.56 | 0.70 | 24.9 | 10,247 | 13,000 | |
| Synthetic fiber..... | 1.74 | 1.59 | (8.6) | 10,818 | 11,123 | |

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| | | | | | |
|---|------|------|--------|-------|-------|
| Synthetic fiber monomers and polymers..... | 2.70 | 3.00 | 11.1 | 8,022 | 8,872 |
| Chemical fertilizer..... | 2.66 | 1.82 | (31.4) | 1,355 | 1,539 |

In 2005, the operating expenses of the segment were RMB 164.5 billion, representing an increase of 30.6% compared with 2004. The increase was primarily due to the price increases of various raw materials, the increased consumption of various raw materials and auxiliary materials, the increased utilities expenses and other variable expenses and fixed costs, all associated with the increased production of the chemical products.

Among others:

- o Affected by the increase in the consumption of raw materials and their unit prices, the costs for raw materials increased by RMB 37.6 billion compared with 2004. Consumption of naphata and other cracking materials increased by 2.43 million tones over 2004, and unit price of raw materials was RMB 3,704 per tonne, up by RMB 1,160 per tonne over 2004.
- o Due to increased sales volume of chemical products, selling expenses, such as transportation costs, increased by RMB 700 million compared with 2004.

In 2005, the segment's operating profit was RMB 14.3 billion, representing a decrease of RMB 4.4 billion compared with 2004.

Corporate and others

The business activities of corporate and others mainly consist of the import and export businesses of the subsidiaries, research and development activities of us and managerial activities of our headquarters.

Year Ended December 31, 2006 Compared with Year Ended December 31, 2005

In 2006, the operating revenues of corporate and others derived from international trade were RMB 260.4 billion, and the associated operating expenses were RMB 259.4 billion, resulting an operating income of RMB 1.0 billion for our international trade activities. In 2006, operating expenses related to our research institutes and headquarter administration were RMB 2.5 billion.

The segment's operating losses were RMB 1.5 billion, representing an increase of RMB 300 million in operating losses compared with 2005.

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

In 2005, the operating revenues of corporate and others were RMB 121.9 billion, representing an increase of 48.3% compared with 2004. The increase was due to the fact that China Petrochemical International Co., Ltd. and its subsidiaries increased their trading volume in importing and exporting crude oil and petrochemical products and other business transactions.

In 2005, the segment's operating expenses were RMB 123.1 billion, representing an increase of 46.3% compared with 2004. The increase was primarily due to the increased purchase expenses of China Petrochemical International Co., Ltd. and its subsidiaries associated with the increase in their revenues.

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The segment's operating losses were RMB 1.2 billion, representing a decrease of RMB 0.7 billion in operating losses as compared with 2004.

D. LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of funding have been cash provided by operating activities and short-term and long-term borrowings and our primary uses of funds have been for working capital, capital expenditures and repayment of short-term and long-term borrowings.

As of December 31, 2006, our short-term debts (including short-term loans from Sinopec Group Company and its affiliates) were RMB 58.8 billion and accounted for 35.0% of our total short-term and long-term debts (long-term debts include interest free subordinated loan from Sinopec Group Company in the amount of RMB 35.6 billion due in 2020). As of December 31, 2006, cash and cash equivalents were RMB 8.1 billion as compared to RMB 14.1 billion as of December 31, 2005.

Our future debt level is dependent primarily on results of operations, the capital expenditure plan and cash that may be generated from assets disposals. We believe that we have substantial borrowing capacity to meet unanticipated cash requirements.

The following table sets forth a condensed summary of the statements of cash flows for the periods indicated and selected balance sheet items at the end of the periods indicated.

| | For the Years Ended Dec | |
|--|-------------------------|---------------------|
| | 2004 | 2005 |
| | RMB | RMB (in billion) |
| Net cash from operating activities: | | |
| Net cash provided by operations(1)..... | 104.0 | 106.9 |
| Changes in working capital and other assets and liabilities(2)..... | (13.0) | (1.2) |
| Net interest and tax paid(3)..... | (22.1) | (27.5) |
| Total..... | 68.9 | 78.2 |
| Cash flows from investing activities: | | |
| Capital expenditure including capital expenditure of jointly controlled entities and exploratory wells expenditure..... | (75.3) | (72.3) |
| Purchase of investments net of proceeds from disposal of investments..... | (1.1) | (2.4) |
| Net redemption of in time deposits less maturity of time deposits..... | 0.3 | 0.9 |
| Acquisition of minority interests in subsidiaries..... | - | (4.3) |
| Proceeds from disposal of property, plant and equipment | 0.3 | 0.6 |
| Total..... | (75.8) | (77.5) |
| Cash flows from financing activities: | | |
| Proceeds from bank and other loans including those of jointly controlled entities, net of repayments..... | 17.4 | 0.4 |
| Proceeds from issuance of corporate bonds, net of repayment..... | 3.5 | 9.9 |
| Contribution from minority interest, net of distributions to minority interests..... | 0.2 | (1.6) |

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| | | |
|---|-------|--------|
| Dividend paid..... | (8.7) | (10.4) |
| Distributions to Sinopec Group Company..... | (3.7) | (3.2) |
| | 8.7 | (4.9) |
| Net increase/(decrease) in cash and cash equivalents..... | 1.8 | (4.2) |
| Cash and cash equivalents at beginning of year..... | 16.5 | 18.3 |
| | 18.3 | 14.1 |
| | | |

- (1) Represents income before income tax as adjusted for depreciation, depletion and amortization, dry hole cost, income from associates, investment income, interest income, interest expense, unrealized foreign exchange (gains)/losses, loss on disposal of property, plant and equipment, net, and impairment losses on long-lived assets.
- (2) Represents decreases/(increases) in current assets, increases/(decreases) in current liabilities and increases in other assets, net of other liabilities.

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- (3) Represents interest received, interest paid, investment income received, and income tax paid.

Net Cash from Operating Activities

Net cash provided by operations increased from RMB 106.9 billion in 2005 to RMB 124.6 billion in 2006. The increase was primarily due to the increased income before income tax reflecting our better operating results in 2006.

Cash Flows from Investing Activities

Our cash outflows for capital expenditure projects, including expenditure on exploratory wells, amounted to RMB 69.3 billion, RMB 69.8 billion and RMB 78.6 billion in 2004, 2005 and 2006, respectively. In addition, we had RMB 6.0 billion, RMB 2.5 billion and RMB 0.4 billion in 2004, 2005 and 2006, respectively, of capital expenditure in our jointly controlled entities. In addition, we paid RMB 22.0 billion for acquisition of minority interests in a number of listed subsidiaries, including Qilu Petrochemical Co., Ltd., Yangtze Petrochemical Co., Ltd., Zhongyuan Petroleum Co., Ltd., Shengli Oil Field Dynamic Co., Ltd., and Zhenhai Refining and Petrochemical Co., Ltd. in 2006.

Cash Flows from Financing Activities

Net cash from financing activities was RMB 1.2 billion in 2006. We received net proceeds of RMB 22.7 billion from issuance of corporate bonds including a six-month corporate bond in the principal amount of RMB 10.0 billion issued in May 2006 and another six-month corporate bond in the principal amount of RMB 10.0 billion issued in November 2006, and repaid RMB 21.0 billion of corporate bonds in 2006. In 2006, we had a net drawdown of RMB 10.6 billion in bank loans and we paid a dividend of RMB 11.3 billion to our Shareholders.

Contractual Obligations and Commercial Commitments

The following table sets forth our obligations and commitments to make future payments under contracts and under contingent commitments as of December

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31, 2006.

| | As of December 31, 2006 | | | |
|--|-------------------------|---------------------|-----------|-----------|
| | Payment due by period | | | |
| | Total | less than 1 year | 1-3 years | 4-5 years |
| | (RMB millions) | | | |
| Contractual obligations(1) | | | | |
| Short-term debts..... | 44,173 | 44,173 | - | - |
| Long-term debts..... | 139,263 | 21,109 | 52,921 | 18,382 |
| Total contractual obligations..... | 183,436 | 65,282 | 52,921 | 18,382 |
| Other commercial commitments(2) | | | | |
| Operating lease commitment..... | 145,171 | 4,711 | 9,099 | 8,955 |
| Capital commitment..... | 115,070 | 110,044 | 5,026 | - |
| Exploration and production licenses..... | 663 | 156 | 214 | 67 |
| Guarantees (3)..... | 160 | 160 | - | - |
| Total commercial commitments..... | 261,064 | 115,071 | 14,339 | 9,022 |

-
- (1) Contractual obligations include the contractual obligations relating to interest payments. See Note 31 to our audited consolidated financial statements for the contractual obligations relating to post employment benefit plans.
 - (2) Other commercial commitments represent off-balance sheet contingent liabilities, and other potential cash outflows (as of the balance sheet date) which may result from contingent events.
 - (3) Guarantee is not limited by time, therefore specific payment due period is not applicable. As of December 31, 2006, we have not entered into any off-balance sheet arrangements other than guarantees given to banks in respect of banking facilities granted to certain parties. As of December 31, 2006,

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the maximum amount of potential future payments under the guarantees was RMB 160 million. We monitor the conditions that are subject to the guarantees to identify whether a loss is probable, and will recognize any such loss under guarantees when those losses are estimable. As of December 31, 2006, it was not probable that we would be required to make payments under these guarantees. See Note 28 to the consolidated financial statements for further information of the guarantees.

Historical and Planned Capital Expenditure

The following table sets forth our capital expenditure by segment for each of the years ended December 31, 2004, 2005 and 2006 and the capital

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expenditure in each segment as a percentage of our total capital expenditure for such year.

| | 2004 | | 2005 | | 2006 | | RMB |
|------------------------------|---------------------------------------|---------|------|---------|------|---------|-----|
| | RMB | Percent | RMB | Percent | RMB | Percent | |
| | (in billions, except percentage data) | | | | | | |
| Exploration and production . | 21.2 | 32 | 23.0 | 36 | 31.7 | 40 | 75 |
| Refining..... | 15.3 | 23 | 19.1 | 30 | 22.0 | 27 | 56 |
| Marketing and distribution. | 16.7 | 26 | 11.0 | 17 | 11.3 | 14 | 39 |
| Chemicals..... | 11.0 | 17 | 9.4 | 15 | 12.6 | 16 | 33 |
| Corporate..... | 1.6 | 2 | 1.2 | 2 | 2.2 | 3 | 5 |
| Total..... | 65.8 | 100 | 63.7 | 100 | 79.8 | 100 | 209 |

In 2006, our total capital expenditure was RMB 79.8 billion.

- o The capital expenditure for our exploration and production segment was RMB 31.7 billion. The oil and gas exploration in Northeast Sichuan and the preparations for "Sichuan-to-East China Gas Project" were fully commenced, and the construction of new oil and gas production capacity in Tahe Oil Field in the west, Shengli Chengbei Offshore Oil Field in the east and Daniudi Gas Field progressed smoothly. The newly built crude oil and natural gas production capacity were 6.5 million tonnes per annum and 1.9 billion cubic meters per annum, respectively.
- o The capital expenditure for our refining segment was RMB 22.0 billion. The newly added comprehensive crude oil processing capacity was 14.7 million tonnes per annum. The newly built and revamped projects such as Hainan Refinery and Guangzhou Refinery have been completed and put into operations. Yanshan Refinery Upgrading Project has also been completed, and Cezi Island Wharf and Yizhang-Changling Crude Oil Pipeline projects have been put into operation. Construction of Qingdao Refinery is going smoothly.
- o The capital expenditure for our marketing and distribution segment was RMB 11.3 billion. We have further improved our refined petroleum products sales network through construction, acquisition and renovation of service stations. In 2006, we had all self-operated service stations newly added to our network.
- o The capital expenditure for our chemicals segment was RMB 12.6 billion. The newly added production capacity of ethylene, PTA and styrene-butadiene rubber was 0.7 million tonnes, 0.45 million tonnes and 0.1 million tonnes per annum, respectively. Maoming ethylene revamping project has been completed and put into operation, and the chemical fertilizer revamping projects in Anqing, Hubei, and Baling were completed and successfully commissioned. The Fujian Integration Project, Tianjin Ethylene and Zhenhai Ethylene are progressing on schedule.
- o The capital expenditure for corporate and others was RMB 2.2 billion and used for the upgrading of IT system and construction of R&D infrastructures.

In addition, in 2006, the three oil production plants we acquired at

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the end of 2006 incurred the capital expenditure of RMB 3.4 billion and our jointly controlled entities incurred the capital expenditure of RMB 260 million.

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In 2007, our planned capital expenditure is RMB 110.1 billion. The projected capital expenditure for our exploration and production segment is RMB 53.1 billion which is planned to speed up the construction process of "Sichuan-to-East China Gas Project" and strengthen the oil and gas exploration and production in Northeast Sichuan, Ordos and Taihe Oil Field and South Tianshan Mountain. The projected expenditure for our refining segment is RMB 22.7 billion which is primarily planned for Qingdao Oil Refinery Project, Bohai Bay crude oil terminal, expansion and revamping of Gaoqiao, Yanshan Refining Project. The projected capital expenditure for our chemicals segment is RMB 19.5 billion which is planned for Fujian, Tianjin and Zhenhai's ethylene projects and to promote the expansion, revamping and auxiliary facilities construction for synthetic fiber monomers and organic materials in Yangzi, Shanghai and Jingling Petrochemical. The projected capital expenditure for our marketing and distribution segment is RMB 12 billion which is planned to optimize and improve the marketing and distribution network of refined petroleum products and accelerate the construction of the pipelines and oil storage for the refined petroleum products. The projected expenditure for corporate and others is RMB 2.8 billion.

We plan to fund our capital expenditures and working capital requirements principally through cash provided by operating activities and short- and long-term debts from domestic as well as overseas sources. We believe our working capital is sufficient for our present requirements. Our capital expenditure plans are subject to a number of risks and uncertainties, and our actual capital expenditures may vary significantly from these planned amounts due to various factors.

Consumer Price Index

According to the data provided by the National Bureau of Statistics, the consumer price index in the PRC increased by 1.5% in 2006, compared with 1.8% in 2005 and 3.9% in 2004. Inflation in the PRC has not had a significant impact on our results of operations in recent years.

US GAAP Reconciliation

Our consolidated financial statements are prepared in accordance with IFRS which differs in certain material respects from US GAAP. These differences, as they apply to our consolidated financial statements, relate primarily to:

- o the US GAAP requirement that investments accounted for by the equity method while the investee has activities in progress necessary to commence its planned operations are considered as qualifying assets for which interest is capitalized, whereas under IFRS, such investments are not considered as qualifying assets for which interest is capitalized;
- o the US GAAP requirement that foreign exchange differences on funds borrowed for property, plant and equipment be expensed, rather than capitalized as is allowed under IFRS;
- o the US GAAP requirement that property, plant and equipment be carried at historical costs less accumulated depreciation (depreciation expense is based on the historical costs), whereas under IFRS revalued property, plant and equipment can be carried in the consolidated financial statements at the revalued amount less

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accumulated depreciation (depreciation expense is based on the revalued amount); and

- o the US GAAP requirement that an impairment loss be recognized on an asset when the sum of the expected undiscounted future cash flows resulting from the use of the asset and its eventual disposition is less than the carrying amount of the asset and the requirement that such impairment loss cannot be reversed, rather than the IFRS standard which involves the asset's discounted future expected cash flows and which permits, in some circumstances, the reversal of amounts previously written down.
- o the US GAAP requirement that minority interests at the balance sheet date be presented in the consolidated balance sheet either as liabilities or separately from liabilities and equity, whereas under IFRS, minority interest at the balance sheet date be presented in the consolidated balance sheet within equity, separately from the equity attributable to the equity shareholders of the Company.

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- o the US GAAP requirement that minority interests in the results of the Group for the period be separately presented in the consolidated statement of income as deduction before arriving at the net income, whereas under IFRS, minority interests in the results of the Group for the period be presented on the face of the consolidated statement of income as an allocation of the total net income for the period between the minority interests and the equity shareholders of the Company.

See Note 37 to the consolidated financial statements for further information.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

A. DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

Directors

The table and discussion below set forth certain information concerning our directors. The current term for our directors is three years, which will expire in May 2009.

| Name | Age | Positions with Sinopec Corp. |
|---------------|-----|--|
| ---- | --- | ----- |
| Chen Tonghai | 58 | Chairman of the Board of Directors |
| Zhou Yuan | 59 | Vice Chairman of the Board of Directors |
| Wang Tianpu | 44 | Director, President |
| Zhang Jianhua | 42 | Director, Senior Vice President |
| Wang Zhigang | 49 | Director, Senior Vice President |
| Dai Houliang | 43 | Director, Senior Vice President, Chief Financial Officer |
| Liu Zhongli | 72 | Independent Non-executive Director |
| Shi Wanpeng | 69 | Independent Non-executive Director |
| Li Deshui | 62 | Independent Non-executive Director |
| Yao Zhongmin | 54 | Director |
| Fan Yifei | 43 | Director |

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Chen Tonghai, 58, Chairman of the Board of Directors of Sinopec Corp. and President of Sinopec Group Company. Mr. Chen graduated from Northeast Petroleum Institute in September 1976 specializing in petroleum production engineering. Mr. Chen is a professor level senior economist. He has extensive experience in petrochemical industry administration and macro-economic management. From July 1983 to December 1986, Mr. Chen was Vice Party Secretary and the Party Secretary of Zhenhai Petroleum and Petrochemical Plant under the former Sinopec Group Company. From December 1986 to July 1989, Mr. Chen served as Managing Deputy Mayor of Ningbo City, Zhejiang Province. From July 1989 to June 1991, Mr. Chen served as Managing Deputy Director of the Planning and Economic Committee of Zhejiang Province. From June 1991 to February 1992, Mr. Chen served as Acting Mayor of Ningbo City. From February 1992 to January 1994, Mr. Chen served as Mayor of Ningbo City. From January 1994 to April 1998, Mr. Chen served as Vice Minister of the State Planning Commission. Mr. Chen served as Vice President of Sinopec Group Company from April 1998 to March 2003. Mr. Chen has been President of Sinopec Group Company since March 2003. Mr. Chen served as Director and Vice Chairman of the First Session of the Board of Directors of Sinopec Corp. from February 2000 to April 2003. Mr. Chen served as Director and Chairman of the Second Session of the Board of Directors of Sinopec Corp. from April 2003 to May 2006; he was elected as Director and Chairman of the Third Session of the Board of Directors of Sinopec Corp. in May 2006.

Zhou Yuan, 59, Vice Chairman of the Board of Directors of Sinopec Corp. and Vice President of the Sinopec Group Company. Mr. Zhou graduated from East China Petroleum Institute specializing in petroleum geology in September 1975. He is a senior Economist. He has extensive experience in the management of petroleum and petrochemical and government entities. From April 1986 to March 1989, he was the Deputy Secretary of the Party Committee of Xinjiang Petroleum Administration Bureau (Kelamayi City) as well as the Secretary of the Party Committee of South Xinjiang Petroleum Exploration Company. From March 1989 to August 1990, he was the Vice Commander, Deputy Secretary of the Party Committee and Secretary of the Disciplinary Committee of Talimu Exploration and Development Headquarter. From August 1990 to January 1992, he was the Deputy Secretary of the Party Committee of Xinjiang Petroleum Administration Bureau

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(Kelamayi City) and the Secretary of Politics & Law Committee. From January 1992 to December 1993, he served as Vice Minister of Organization Department of the Party Committee of Xinjiang Autonomous Region. From December 1993 to January 1998, he served as a member of the Standing Committee of Discipline Committee and the Deputy Minister of the Party Committee of the Organisation Department of Xinjiang Autonomous Region. From January 1998 to August 1999, he was a member of the Standing Committee of the Disciplinary Committee of the Xinjiang Autonomous Region and the Secretary of the Party Committee of Yili Autonomous District. From August 1999 to November 1999, he was a member of the Standing Committee of the Party Committee of the Xinjiang Autonomous Region and the Secretary of the Party Committee of Yili Autonomous District. From November 1999 to July 2004, he was a member of Standing Committee of the Party Committee of Xinjiang Autonomous Region and Minister of the Organization Department of the Party Committee of Xinjiang Autonomous Region. Since July 2004, he has been the Vice President of Sinopec Group Company; Mr. Zhou was elected as Director and Vice Chairman of the Third Session of the Board of Directors of Sinopec Corp. in May 2006.

Wang Tianpu, 44, Director of the Board of Directors and President of Sinopec Corp.. Mr. Wang graduated from Qingdao Chemical Institute in July 1985 majoring in basic organic chemistry. He obtained his MBA degree in Dalian University of Science & Technology in July 1996 and Ph.D. degree in Zhejiang University in August 2003 majoring in chemical engineering. He is a professor level senior engineer and well-experienced in the production and management in

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petrochemical industry. From March 1999 to February 2000, Mr. Wang was Vice President of Qilu Petrochemical Company of Sinopec Group. From February 2000 to September 2000, he was Vice President of Sinopec Corp. Qilu Company. From September 2000 to August 2001, he was President of Sinopec Corp. Qilu Company. Mr. Wang was Vice President of Sinopec Corp. from August 2001 to April 2003 and was Senior Vice President of Sinopec Corp. from April 2003 to March 2005. Mr. Wang has been President of Sinopec Corp. since March 2005; Mr. Wang was elected as Director of the Third Session of the Board of Directors of Sinopec Corp. in May 2006 and he is President of Sinopec Corp..

Zhang Jianhua, 42, Director of the Board of Directors and Senior Vice President of Sinopec Corp.. Mr. Zhang graduated from East China Chemical Institute in July 1986 majoring in petroleum refining, and obtained a master's degree from East China University of Science and Technology in December 2000 majoring in chemical engineering. He is a professor level senior engineer. From April 1999 to February 2000, Mr. Zhang was Vice President of Shanghai Gaoqiao Petrochemical Company of Sinopec Group. From February 2000 to September 2000, he was Vice President of Sinopec Corp. Shanghai Gaoqiao Company. He was President of Sinopec Corp. Shanghai Gaoqiao Company from September 2000 to June 2003. Mr. Zhang served as Vice President of Sinopec Corp. from April 2003 to March 2005. He was also the Director General of Sinopec Production & Operation Management Dept. from November 2003 to November 2005. He has been Senior Vice President of Sinopec Corp. since March 2005; Mr. Zhang was elected as Director of the Third Session of the Board of Directors of Sinopec Corp. in May 2006 and has been Senior Vice President of Sinopec Corp..

Wang Zhigang, 49, Director of the Board of Directors of Sinopec Corp. and Senior Vice President of Sinopec Corp.. Mr. Wang graduated from East China Petroleum Institute in January 1982, majoring in oil production, and then obtained a master's degree from University of Petroleum in June 2000, majoring in oil and gas development engineering. He obtained a Ph.D. degree from Geology and Geo-physics Research Institute of the China Academy of Sciences in September 2003 majoring in geology. He is a professor level senior engineer. From February 2000 to June 2000, he was Vice President of Sinopec Shengli Oilfield Company Limited. From June 2000 to December 2001, Mr. Wang served as Director and President of Sinopec Shengli Oilfield Company Limited. He was appointed as honorary Deputy Director-General of the Economic and Trade Committee of Ningxia Hui Autonomous Region from November 2001 to May 2003. He was Vice President of Sinopec Corp. from April 2003 to March 2005. He was also the Director General of Sinopec Exploration and Production Dept. since June 2003 to November 2005. He has been Senior Vice President of Sinopec Corp. since March 2005; Mr. Wang was elected as Director of the Third Session of the Board of Directors of Sinopec Corp. in May 2006 and has been Senior Vice President of Sinopec Corp..

Dai Houliang, 43, Director of the Board of Directors of Sinopec Corp., Senior Vice President and Chief Finance Officer of Sinopec Corp.. Mr. Dai graduated from Jiangsu Chemical Institute in July 1985, specializing in organic chemical engineering. From September 1997 to July 1999, he participated in the MBA training program in Nanjing University. He is a professor level senior engineer. He was Deputy Manager of Sinopec Yangzi Petrochemical Company from December 1997 to April 1998. He served as Director and Deputy General Manager of Sinopec Yangzi Petrochemical Co., Ltd. from April 1998 to July 2002. He was Vice Chairman and General Manager of Sinopec Yangzi Petrochemical Co., Ltd. and Director of Sinopec Yangzi Petrochemical Company from July 2002 to December 2003. He was Chairman and President of Sinopec Yangzi Petrochemical

Co., Ltd. and Chairman of Sinopec Yangzi Petrochemical Company from December 2003 to September 2005. He also served as Chairman of BASF-YPC Company Limited from December 2004 to October 2006. He has been the Deputy CFO of Sinopec Corp.

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from September 2005 to May 2006. Mr. Dai has been Vice President of Sinopec Corp. from November 2005 to May 2006. In May 2006, he was elected as Director of the Third Session of the Board of Directors, Senior Vice President and CFO of Sinopec Corp..

Liu Zhongli, 72, Independent Non-Executive Director of Sinopec Corp.. He graduated from the training course of the Training Department of Central Communist Party School (undergraduate course) in July 1982. He is a senior economist engaging in treasury finance administration and government work for a long time, and has extensive experience in macro-economics, financial and treasury administration. He was working in Commerce Bureau of Heilongjiang Province in 1952 and in Planning Commission of Heilongjiang Provincial Government in 1963. He had served as Deputy Division Director of the General Affairs Office of Planning Commission of Heilongjiang Provincial Government and Deputy Secretary General of Planning Commission of Heilongjiang Provincial Government since September 1973. He was Deputy Director General of Planning Commission of Heilongjiang Provincial Government and a member of Party Committee of Planning Commission of Heilongjiang Provincial Government from July 1982 to May 1983. From May 1983 to May 1985, he was Director General of Planning Commission (Planning & Economics Department) of Heilongjiang Provincial Government and Secretary of Party Committee of Planning Commission (Planning & Economics Department) of Heilongjiang Provincial Government. He served as Deputy Governor of Heilongjiang Province from May 1985 to January 1988. He was Vice Minister of the Ministry of Finance and Deputy Secretary of Party Committee of the Ministry of Finance from February 1988 to July 1990. He served as Deputy Secretary General of the State Council and Deputy Secretary of Party Committee of the State Council from July 1990 to September 1992. From September 1992 to March 1998, he was Minister of the Ministry of Finance and Secretary of Party Committee of the Ministry of Finance and, from February 1994, concurrently Director-General of State Administration of Taxation. From March 1998 to November 2000, he was Head of Economic System Reform Office of the State Council and Secretary of Party Committee of the Economic System Reform Office of the State Council. From August 2000 to March 2003, he was Chairman of National Council for Social Security Fund and Secretary of Party Committee of the National Council for Social Security Fund. He has been a member of the Standing Committee of the Tenth Session of the Chinese People's Political Consultative Conference (CPPCC) and Director-General of the Economics Committee of CPPCC since March 2003. Since October 2004, he has concurrently been Chairman of the Chinese Institute of Certified Public Accountants. Mr. Liu was elected as Independent Non-Executive Director of the Third Session of the Board of Directors of Sinopec Corp. in May 2006.

Shi Wanpeng, 69, Independent Non-Executive Director of Sinopec Corp., a member of the Standing Committee of the National Committee of the Tenth session of the Chinese People's Political Consultative Conference and Deputy Director of its Economic Committee. Mr. Shi graduated from Northern Jiaotong University in August 1960 specializing in railway transportation administration. He is a professor level senior engineer. He has long been engaged in economic management work, and has extensive experience in macro-economic management. From January 1983 to January 1987, he served as Deputy Director of the Transport Bureau of the State Economic Commission. From January 1987 to May 1988, he was the Director of the Economic and Technical Co-operation Bureau of the State Economic Commission. From May 1988 to July 1991, he was Director of the Production and Dispatch Bureau of the State Planning Commission. From July 1991 to July 1992, he served as Deputy Secretary General of the Production Office of the State Council. From July 1992 to April 1993, he served as Deputy Director of the Economic and Trade Office of the State Council. From April 1993 to July 1997, he was Vice Minister of the State Economic and Trade Commission. From July 1997 to March 1998, he was Chairman (minister level) of the China Textiles Association. From March 1998 to February 2002, he served as Vice Minister of the State Economic and Trade Commission. Since January 2003, he has been Chairman of China Packaging Federation. He has been a member of the Standing Committee of the

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National Committee of the Tenth session of the Chinese People's Political Consultative Conference and Deputy Director of its Economic Committee since March 2003. Mr. Shi was elected as Independent Non-executive Director of the Second Session of the Board of Directors of Sinopec Corp. from April 2003 to May 2006; he was elected as Independent Non-Executive Director of the Third Session of the Board of Directors of Sinopec Corp. in May 2006.

Li Deshui, 62, Independent Non-Executive Director of Sinopec Corp.. Mr. Li graduated from university in 1967. He is a senior engineer, researcher, part-time professor of the Economics School of Peking University and the Economics School of Renmin University of China. After graduating from university, he was assigned to work at Maanshan Steel Company and has acted as Workshop Section Head and Dispatch Head. In 1977 he worked at the Planning Institute of the Metallurgy Department. In 1984 he worked at the Raw Materials Bureau

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of the State Planning Commission. In 1988 he acted as Deputy Division Director of the First Industrial Planning Division of the Long-term Planning Department of the State Planning Commission. In 1989 he was Division Director of the First Industrial Planning Division of the Long-term Planning Department and Division Director of the First Industrial Planning Division of the Long-term Planning and Industrial Policy Department. In 1992 he acted as Deputy Director of the National Economy Comprehensive Department of the State Planning Commission. In May 1996 he was Director of the National Economy Comprehensive Department of the State Planning Commission. In November 1996, he acted as Vice Mayor of Chongqing in Sichuan Province. In March 1997 he acted as Vice Mayor of Chongqing Municipality. In November 1999 he worked as Deputy Director of the Research Office of the State Council and a member of the Party Committee. In April 2002, he served as Secretary of the Party Committee and Deputy General Manager of China International Engineering Consultancy Company. In March 2003 he served as Secretary of the Party Committee and Head of the State Statistics Bureau, a member of the Monetary Policy Committee of the People's Bank of China and Chairman of China Statistics Institute. In March 2005, he was elected as Vice Chairman of the Thirty-sixth Statistics Commission of the United Nations. In March 2005 he served as a member of the Tenth Session of the Chinese People's Political Consultative Conference. In April 2006 he acted as a member of the Economic Commission. In March 2006, he was the consultant of the State Statistics Bureau. Mr. Li was elected as Independent Non-Executive Director of the Third Session of the Board of Directors of Sinopec Corp. in May 2006.

Yao Zhongmin, 54, Director of Sinopec Corp.. Mr. Yao graduated from Dongbei University of Finance & Economics in September 1977 specializing in Infrastructure Finance & Credit and graduated as postgraduate from Zhongnan University of Finance & Economics in December 1996 specializing in Investment Economics with a master's degree. He is a senior Economist. Mr. Yao has worked for a long time in financial investment management related work and has extensive experience in finance investment management. From May 1985 to June 1989, he was a member of the Party Committee of China Construction Bank Henan Branch and its Vice-Chairman. From June 1989 to June 1992, he was leading the work of China Construction Bank Henan Branch, and was Deputy Secretary of the Party Committee and Vice Chairman of the bank. From June 1992 to April 1993, he served as Secretary of the Party Committee and Chairman of China Construction Bank Henan Branch. He served as Vice Governor of Henan Province from April 1993 to January 1994. From January 1994 to March 1998, he was a member of the Party Committee of China Development Bank and its Vice Chairman and Chairman of the Disciplinary Supervision Committee. From March 1998 to June 1998, he was Deputy Secretary of the Party Committee of China Development Bank and its Vice Chairman and Chairman of the Disciplinary and Investigation Committee. From June 1998, he was the Deputy Secretary of the Party Committee of China Development Bank and

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its Vice-Chairman. Mr. Yao was elected as Director of the Third Session of the Board of Directors of Sinopec Corp. in May 2006.

Fan Yifei, 43, Director of Sinopec Corp.. Mr. Fan graduated from the treasury and finance department of Renmin University of China in July 1993 and obtained a doctoral degree in economics; He obtained a master's degree in international economics from Columbia University in 2002. He is a senior accountant. From June 1993 to September 1994, he was the Assistant to the General Manager and Manager of the Planning and Finance Department of the Trust Investment Company of China Construction Bank successively. From September 1994 to July 1996, he served as Vice General Manager of the Capital Planning Department of China Construction Bank. He was the General Manager of the Finance and Accounting Department of China Construction Bank from July 1996 to January 1998. He was the General Manager of the Planning and Finance Department of China Construction Bank from January 1998 to February 2000. Mr. Fan served as the Assistant to the Governor of China Construction Bank from February 2000 to June 2005, during which he enriched his experience by participating in the Three Gorges project, and also acted as the Assistant to the General Manager of China Changjiang Power Co., Ltd. In June 2005, Mr. Fan was appointed as Deputy Governor of China Construction Bank. Mr. Fan acted as Director of the Second Session of the Board of Directors of Sinopec Corp. from April 2003 to May 2006; he was elected as Director of the Third Session of the Board of Directors of Sinopec Corp. in May 2006.

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Supervisors

The table and discussion below set forth certain information concerning our supervisors. The current term of our supervisors is three years, which will expire in May 2009.

| Name | Age | Position with the Company |
|----------------|-----|---------------------------------------|
| ---- | --- | ----- |
| Wang Zuoran | 56 | Chairman of the Board of Supervisors |
| Zhang Youcai | 65 | Vice Chairman, Independent Supervisor |
| Kang Xianzhang | 58 | Supervisor |
| Zou Huiping | 46 | Supervisor |
| Li Yonggui | 66 | Independent Supervisor |
| Su Wensheng | 50 | Employee Representative Supervisor |
| Zhang Jitian | 59 | Employee Representative Supervisor |
| Cui Guoqi | 53 | Employee Representative Supervisor |
| Li Zhonghua | 55 | Employee Representative Supervisor |

Wang Zuoran, 56, Chairman of the Supervisory Board of Sinopec Corp.. Mr. Wang graduated from Shandong Economic Administration Institute in September 1994 specializing in economic administration. Mr. Wang is a professor level senior economist and has extensive experience in the management of petroleum industry. From October 1994 to February 2000, Mr. Wang served as Deputy Director and Party Secretary of Shengli Petroleum Administration Bureau. From February 2000 to July 2001, Mr. Wang was the Assistant to the President of Sinopec Group Company. Mr. Wang has been Director of Disciplinary Supervision Committee of Sinopec Group Company since July 2001. Mr. Wang served as Supervisor of the First Session of the Supervisory Board of Sinopec Corp. from February 2000 to April 2003. From April 2003 to May 2006, Mr. Wang served as Supervisor and Chairman of the Second Session of the Supervisory Board of Sinopec Corp.; he was elected as Supervisor and Chairman of the Third Session of the Supervisory Board of Sinopec Corp. in May 2006.

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Zhang Youcai, 65, Independent Supervisor and Vice Chairman of the Supervisory Board of Sinopec Corp.. Mr. Zhang graduated from Nanjing Industrial University in August 1965 majoring in inorganic chemistry. He is a professor and has long been engaged in business administration, financial management and government affairs, and has extensive experience in industrial, economic, financial and accounting management. From January 1968 to August 1980, he served as a technician, Vice-President, Deputy Secretary of the Party Committee and President of Nantong Chemical Fertilizer Plant. From August 1980 to January 1982, he was Deputy Director-General and member of the Party Committee of the Industrial Bureau of Nantong Region. From January 1982 to February 1983, he served as Deputy Director - General of Planning Commission of Nantong Region. From February 1983 to November 1989, he served as Deputy Mayor, Deputy Secretary of the Party Committee and Mayor of Nantong City. He was Vice Minister and member of the Party Committee of Ministry of Finance from December 1989 to July 2002 (from May 1994 to March 1998, he served concurrently as Director-General of State-owned Assets Administration Bureau). He has been Chairman of the Chinese Institute of Chief Accountants since November 2002. He has been a member of the Standing Committee of the Tenth National People's Congress (NPC) and Deputy Director of its Financial and Economic Committee of NPC from March 2003. Mr. Zhang served as an Independent Non-Executive Director of the Second Session of Board of Directors of Sinopec Corp. from April 2003 to May 2006; he was elected as Independent Supervisor and Vice Chairman of the Third Session of the Supervisory Board of Sinopec Corp. in May 2006.

Kang Xianzhang, 58, Supervisor of Sinopec Corp.. Mr. Kang graduated from the Correspondence Teaching Department of the Party School of the Beijing Municipal Party Committee in March 1988 specializing in ideology politics (undergraduate course). He also graduated from the Correspondence Teaching College of the Party School of the Central Committee of the Communist Party of China in December 1992 specializing in party and political affairs management (bachelor course). He is a senior political engineer. From June 1995 to August 1996, he was the Deputy Director of the Organization Department of the Communist Party Committee of the Tibet Autonomous Region. From August 1996 to May 1997, he was a senior researcher of the deputy director level in the Cadre Allocation Bureau of the Organization Department of the Central Committee of the Communist Party of China. He acted as the Deputy Secretary of the Communist Party Committee of the Coal Scientific Research Institute of the Ministry of Coal Industry from May 1997 to October 1998. From October 1998 to May 1999, he was Supervisor of the deputy director level in the Discipline Inspection Group and the Supervisory Bureau of Sinopec Group Company, and acted as a Deputy Director of the Supervisory Bureau of the same company from May 1999 to March 2001. He

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was the Deputy Director of the Supervisory Department of Sinopec Corp. from February 2000 to March 2001. He has been a Deputy Head of the Discipline Inspection Group of the Leading Party Group and Director of the Supervisory Bureau of Sinopec Group Company, as well as Director of the Supervisory Department of Sinopec Corp. since March 2001. Mr. Kang served as Supervisor of the Second Session of the Supervisory Board of Sinopec Corp. from April 2003 to May 2006; he was elected as Supervisor of the Third Session of the Supervisory Board of Sinopec Corp. in May 2006.

Zou Huiping, 46, Supervisor of Sinopec Corp.. Mr. Zou graduated from Jiangxi Institute of Finance and Economics in July 1986 specializing in trade economics. He is a professor level senior accountant. From November 1998 to February 2000, he served as Chief Accountant of Sinopec Group Guangzhou Petrochemical Company. From February 2000 to December 2001, he was Deputy Director General of Financial Assets Department of Sinopec Group Company. From December 2001 to March 2006, he was Deputy Director General of Finance Planning Department of Sinopec Group Company. In March 2006, he was Director General of

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Financial Assets Department of Sinopec Assets Management Co.,Ltd.. Since March 2006, he has been Director General of Audit Department of Sinopec Corp.. Mr. Zou was elected as Supervisor of the Third Session of the Supervisory Board of Sinopec Corp. in May 2006.

Li Yonggui, 66, Independent Supervisor of Sinopec Corp.. Mr. Li graduated from Shandong Institute of Finance and Economics in July 1965, majoring in treasury finance. He is a senior economist and CPA, and has long been engaged in tax management with extensive management experience in taxation. From February 1985 to December 1988, he was Deputy Director-General of Taxation Bureau of Ministry of Finance. He served as Chief Economist of State Administration of Taxation from December 1988 to April 1991. From April 1991 to February 1995, he served as Deputy Director-General of State Administration of Taxation. He was Chief Economist of State Administration of Taxation from February 1995 to September 2001. Mr. Li has been Chairman of Chinese Association of Certified Public Taxation Experts since April 2000. Mr. Li served as Independent Supervisor of the Second Session of Supervisory Board of Sinopec Corp. from April 2003 to May 2006; he was elected as Independent Supervisor of the Third Session of Supervisory Board of Sinopec Corp. in May 2006.

Su Wensheng, 50, Employee Representative Supervisor of Sinopec Corp.. Mr. Su graduated from the General Section of Tsinghua University in December 1980 majoring in environmental engineering. He obtained a master's degree in management science and engineering from Petroleum University (Beijing) in June 2000. He is a senior engineer. From September 1986 to November 1996, he was Deputy Secretary of Party Committee and Secretary of Disciplinary Committee of Beijing Designing Institute of the former Sinopec Group Company. From November 1996 to December 1998, he was Secretary of Party Committee of Beijing Designing Institute. Mr. Su has been Director-General of Ideology & Politics Department and Deputy Secretary of the Affiliated Party Committee of Sinopec Group Company since December 1998. He has been Managing Deputy Secretary of the Party Working Committee of the Western New Region Exploration Headquarter of Sinopec Group since December 2001. Mr. Su served as an Employee Representative Supervisor of the Second Session of Supervisory Board of Sinopec Corp. from April 2003 to May 2006; he was elected as Employee Representative Supervisor of the Third Session of Supervisory Board of Sinopec Corp. in May 2006.

Zhang Jitian, 59, Employee Representative Supervisor of Sinopec Corp.. Mr. Zhang graduated from Hohhot Transportation Institute in July 1968 specializing in road and bridge construction, and he also graduated from Sinopec Management Institute in July 1986 specializing in enterprise management (undergraduate course). He is a senior political engineer. From August 1996 to December 1998, he was Deputy Director of Personnel and Educational Department of the former Sinopec Group Company; from December 1998 to September 2005, he was Deputy Director of Personnel and Educational Department of Sinopec Group Company; he has been Deputy Director (remunerate as Director) of Personnel Department of Sinopec Corp. since September 2005. Mr. Zhang was elected as Employee Representative Supervisor of the Third Session of Supervisory Board of Sinopec Corp. in May 2006.

Cui Guoqi, 53, Employee Representative Supervisor of Sinopec Corp.. Mr. Cui graduated from the Correspondence Teaching College of Renmin University of China in December 1985 majoring in industrial business management. In January 1997, he obtained a MBA degree from the Business Management School of Renmin University of China. He is a professor level senior political engineer. Mr. Cui has served as Director and Trade Union Chairman of Sinopec Yanshan Petrochemical Company since February 2000. He served as a member of the Executive Committee of All China Federation of Trade Unions in December 2000, and a member of the Standing Committee of the National Committee of the Union of Chinese Energy and Chemical Industries since December 2001. He was Deputy Secretary of Party Committee of Sinopec Yanshan Petrochemical Company from August 2005 to

November 2006. Mr. Cui has been the Deputy Secretary (remunerate as Secretary) of Party Committee of Sinopec Yanshan Petrochemical Company since November 2006. Mr. Cui served as Employee Representative Supervisor of the Second Session of Supervisory Board of Sinopec Corp. from April 2003 to May 2006; he was elected as Employee Representative Supervisor of the Third Session of Supervisory Board of Sinopec Corp. in May 2006.

Li Zhonghua, 55, Employee Representative Supervisor of Sinopec Corp.. Mr. Li graduated from the Correspondence Teaching Department of the Party School of Shengli Oilfield in June 1996 specializing in party and political affairs management (undergraduate course). He also graduated from the Correspondence Teaching College of the Party School of Shandong Provincial Party Committee in December 1998 specializing in economic management. He is a professor level senior political engineer. From March 1995 to January 2004, he had been Secretary of Party Committee and Vice General Manager of No. 2 Drilling Company of Shengli Petroleum Administration Bureau; Secretary of Party Committee, General Manager of Offshore Drilling Company of Shengli Petroleum Administration Bureau; and Deputy Party Secretary, General Manager of the Yellow River Drilling Company of Shengli Petroleum Administration Bureau successively. From January 2004 to November 2004, he was Deputy Chief Engineer, Deputy Secretary of Party Committee and General Manager of the Yellow River Drilling Company of Shengli Petroleum Administration Bureau; he has been member of the Standing Committee of Party Committee and Chairman of the Trade Union of Shengli Petroleum Administration Bureau since November 2004. He was Deputy Secretary of Party Committee of Shengli Petroleum Administration Bureau since April 2006. Mr. Li was elected as Employee Representative Supervisor of the Third Session of Supervisory Board of Sinopec Corp. in May 2006.

Other Executive Officers

| Name | Age | Positions with Sinopec Corp. |
|----------------|-----|-------------------------------------|
| ---- | --- | ----- |
| Cai Xiyou | 45 | Senior Vice President |
| Zhang Kehua | 53 | Vice President |
| Zhang Haichao | 49 | Vice President |
| Jiao Fangzheng | 44 | Vice President |
| Chen Ge | 44 | Secretary of the Board of Directors |

Cai Xiyou, 45, Senior Vice President of Sinopec Corp.. Mr. Cai graduated from Fushun Petroleum Institute in August 1982 majoring in petroleum refining automation, and obtained a MBA degree from China Industry and Science Dalian Training Center in October 1990. He is a senior economist. From June 1995 to May 1996, he was Deputy General Manager of Jinzhou Petrochemical Company of the former Sinopec Group Company. From May 1996 to December 1998, he was Deputy General Manager of Dalian Western Pacific Petrochemical Co., Ltd (WEPEC). From December 1998 to June 2001, he was Deputy General Manager of Sinopec Sales Company, and from June 2001 to December 2001, he was Executive Deputy Manager of Sinopec Sales Company. He has been Director and General Manager of China International United Petrochemical Company Limited (UNIPEC) from December 2001 to December 2005. He was Vice President of Sinopec Corp. from April 2003 to November 2005. Mr. Cai has been Senior Vice President of Sinopec Corp. since November 2005.

Zhang Kehua, 53, Vice President of Sinopec Corp. Mr. Zhang graduated from Shanghai Chemical Engineering University in January 1980 majoring in chemical and mechanical engineering. He is a senior engineer and had his

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master's degree from University of Petroleum majoring in management science and engineering in December 2000. He was Deputy Manager of No. 3 Construction Company of the former Sinopec Group Company from February 1994 to April 1996. From April 1996 to December 1998, he was Deputy Director General (Deputy Manager of Sinopec Engineering Incorporation) of the Engineering Department of the former Sinopec Group Company. He was Deputy Director General of the former Engineering Department of Sinopec Group Company from December 1998 to December 2001 and was Deputy Director General of Engineering Department of Sinopec Group Company from December 2001 to September 2002. Mr. Zhang was Director General of Engineering Department of Sinopec Group Company from September 2002 to October 2004. Mr. Zhang has served as the Assistant to the President of Sinopec Group Company and Director General of Engineering Department since October 2004. Mr. Zhang has been Vice President of Sinopec Corp. since May 2006.

Zhang Haichao, 49, Vice President of Sinopec Corp.. Mr. Zhang graduated from Zhoushan Commercial and Technical School in December 1979, specializing

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in oil storage and transportation. He also graduated from Jilin Petrochemical Institute in July 1985 specializing in recycling of lubricating oil. From January 2001 to June 2002, he participated in the business administration program at Macau Science & Technology University. He is an economist. He served as Deputy General Manager of Zhejiang Petroleum Company from March 1998 to September 1999. He served as General Manager of Zhejiang Petroleum Company from September 1999 to February 2000, and has served as Manager of Sinopec Zhejiang Petroleum Company from February 2000 to September 2005. He has been Chairman of Sinopec-BP Zhejiang Petroleum Sales Co., Ltd. since April 2004. He was Secretary of the Party Committee, Vice Chairman and Deputy General Manager of Sinopec Sales Co., Ltd. from October 2004 to November 2005. He was Secretary of Party Committee, Chairman and General Manager of Sinopec Sales Co., Ltd. from November 2005 to June 2006. He has been Chairman and General Manager of Sinopec Sales Co., Ltd. since June 2006. He served as Employee Representative Supervisor of the Second Session of the Supervisory Board of Sinopec Corp. from April 2003 to November 2005. Mr. Zhang has been Vice President of Sinopec Corp. since November 2005.

Jiao Fangzheng, 44, Vice President of Sinopec Corp.. Mr. Jiao won his bachelor's degree in petroleum exploration and won his doctoral degree in natural gas engineering from Southwest Petroleum Institute respectively in July 1983 and November 2000. Mr. Jiao is a professor level senior engineer. From January 1999 to February 2000, he was Chief Geologist of Zhongyuan Petroleum Exploration Bureau of Sinopec Group Company. He then served as Deputy Manager and Chief Geologist of Zhongyuan Oilfield Company of Sinopec Group Company from February 2000 to February 2001. He was Vice President of Sinopec Exploration and Production Research Institute from July 2000 to March 2001. He then served as Deputy Director General of Sinopec Oilfield E & P Department from March 2001 to June 2004. Since June 2004, he served as Manager of the Northwest Company of Sinopec Group Company. Mr. Jiao has served as Vice President of Sinopec Corp. since October 2006.

Chen Ge, 44, Secretary to the Board of Directors of Sinopec Corp.. Mr. Chen graduated from Daqing Petroleum Institute in July 1983 majoring in petroleum refining, and then obtained his MBA degree from Dalian University of Science and Technology in July 1996. He is a senior economist. From July 1983 to February 2000, he worked in Beijing Yanshan Petrochemical Company. From February 2000 to December 2001, he was Deputy Director General of the Board Secretariat of Sinopec Corp.. Mr. Chen has been Director General of the Board Secretariat since December 2001. Mr. Chen has been the Secretary to the Board of Directors of Sinopec Corp. since April 2003.

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B. COMPENSATION

Salaries of Directors, Supervisors and Members of the Senior Management

Our directors and supervisors who hold working posts with us and other senior management members receive their remuneration in the form of basic salary and performance rewards.

The following table sets forth the compensation on individual basis for our directors, supervisors and executive officers who receive compensation from us in 2006.

| Name | Position with the Company | Remuneration paid by the Company in 2006 |
|---------------------|---|---|
| | | (RMB thousand) |
| Directors | | |
| ----- | | |
| Chen Tonghai | Chairman | 0 |
| Zhou Yuan | Vice Chairman | 0 |
| Wang Tianpu | Director, President | 616 |
| Zhang Jianhua | Director, Senior Vice President | 576 |
| Wang Zhigang | Director, Senior Vice President | 576 |
| Dai Houliang | Director, Senior Vice President, CFO | 446 |
| Liu Zhongli | Independent Non-executive Director | 109 |
| Shi Wanpeng | Independent Non-executive Director | 121 |
| 63 | | |
| Li Deshui | Independent Non-executive Director | 109 |
| Yao Zhongmin | Director | 35 |
| Fan Yifei | Director | 35 |
| Wang Jiming | Vice Chairman (till May 2006) | 149 |
| Mou Shuling | Director (till May 2006) | 115 |
| Zhang Jiaren | Director, CFO (till May 2006) | 122 |
| Cao Xianghong | Director (till May 2006) | 144 |
| Liu Genyuan | Director (till May 2006) | 0 |
| Gao Jian | Director (till May 2006) | 0 |
| Chen Qingtai | Independent Non-executive Director (till May 2006) | 12 |
| Ho Tsu Kwok Charles | Independent Non-executive Director (till May 2006) | 9 |
| Zhang Youcai | Independent Non-executive Director (till May 2006) | 9 |
| Cao Yaofeng | Employee Representative Director (till May 2006) | 113 |
| Supervisors | | |
| ----- | | |
| Wang Zuoran | Chairman of Supervisory Committee | 0 |
| Zhang Youcai | Vice Chairman, Independent Supervisor | 109 |

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| | | |
|-----------------------------------|---|-----|
| Kang Xianzhang | Supervisor | 0 |
| Zou Huiping | Supervisor | 102 |
| Li Yonggui | Independent Supervisor | 121 |
| Su Wensheng | Employee Representative Supervisor | 354 |
| Zhang Jitian | Employee Representative Supervisor | 102 |
| Cui Guoqi | Employee Representative Supervisor | 329 |
| Li Zhonghua | Employee Representative Supervisor | 94 |
| Zhang Chongqing | Supervisor (till May 2006) | 0 |
| Wang Peijun | Supervisor (till May 2006) | 0 |
| Wang Xianwen | Supervisor (till May 2006) | 0 |
| Zhang Baojian | Supervisor (till May 2006) | 0 |
| Cui Jianmin | Independent Supervisor (till May 2006) | 9 |
| Zhang Xianglin | Employee Representative Supervisor (till May 2006) | 239 |
| Other Executive officers ----- | | |
| Cao Xiyou | Senior Vice President | 518 |
| Zhang Kehua | Vice President | 123 |
| Zhang Haichao | Vice President | 415 |
| Jiao Fangzheng | Vice President | 35 |

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| | | |
|---------|--|-----|
| Chen Ge | Secretary to the Board of Directors | 355 |
|---------|--|-----|

C. BOARD PRACTICE

We have three special board committees, namely, an audit committee, a strategy committee and a remuneration and evaluation committee. The majority of the members of the strategy committee and the remuneration and evaluation committee, and all members of the audit committee, are independent directors. In addition, the audit committee shall have at least one independent director who is a financial expert.

The main responsibilities of the audit committee include:

- o to propose the appointment or replacement of the external auditor;
- o to oversee the internal auditing system and its implementation;
- o to coordinate the communication between the internal auditing department and the external auditor;
- o to examine and approve financial information and its disclosure; and
- o to examine the internal control system.

The main responsibilities of the strategy committee are to conduct research and put forward proposals on the long-term development strategy and significant investments.

The main responsibilities of the remuneration and evaluation committee include:

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- o to research on evaluation criteria for directors and the president, to conduct their evaluations and make necessary suggestions; and
- o to research on and review the policies and proposals in respect of the remuneration of directors, supervisors, president, vice-president, Chief Financial Officer and secretary of the board of directors.

The members of audit committee are Liu Zhongli, Shi Wanpeng and Li Deshui. The members of strategy committee are Wang Tianpu, Zhang Jianhua, Wang Zhigang, Li Deshui, Yao Zhongmin and Fan Yifei. The members of remuneration and evaluation committee are Liu Zhongli, Shi Wanpeng, Li Deshui and Dai Houliang.

D. EMPLOYEES

As of December 31, 2004, 2005 and 2006, we had approximately 389,451, 364,528 and 340,886 employees. The following table sets forth the number of our employees by our business segments, their scope of work and their education as of December 31, 2006.

| By Segment | Number of Employees ----- | Percentage of Total Employees ----- |
|----------------------------------|------------------------------|---|
| Exploration and Production | 112,702 | 33.1 |
| Refining | 81,352 | 23.8 |
| Marketing and Distribution | 61,269 | 18.0 |
| Chemicals | 77,185 | 22.6 |
| Corporate and Others | 8,378 | 2.5 |
| Total..... | 340,886 | 100.0 |

| By Employee's Scope of Work | Number of Employees ----- | Percentage of Total Employees ----- |
|-----------------------------|------------------------------|---|
| Production..... | 173,415 | 50.9 |
| Sales..... | 60,479 | 17.7 |

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| | | |
|---------------------|---------|-------|
| Technical..... | 44,525 | 13.1 |
| Finance..... | 8,991 | 2.6 |
| Administration..... | 27,270 | 8.0 |
| Others..... | 26,206 | 7.7 |
| Total..... | 340,886 | 100.0 |

| By Education | Number of Employees ----- | Percentage of Total Employees ----- |
|--------------------------------|------------------------------|---|
| Master's degree and above..... | 4,392 | 1.3 |

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| | | |
|---|---------|-------|
| University | 54,764 | 16.1 |
| Tertiary education..... | 72,728 | 21.3 |
| Technical/polytechnic school..... | 34,416 | 10.1 |
| Secondary, technical/polytechnic school or below..... | 174,586 | 51.2 |
| Total..... | 340,886 | 100.0 |

We have trade unions that protect employee rights, organize educational programs, assist in the fulfillment of economic objectives, encourage employee participation in management decisions, and assist in mediating disputes between us and individual employees. We have not been subject to any strikes or other labor disturbances that have interfered with our operation, and we believe that our relations with our employees are good.

The total remuneration of our employees includes salary, performance bonuses and allowances. Employees also receive certain subsidies in housing, health services, education and other miscellaneous items.

We have implemented an employee reduction plan since 2001 by means of retirement, voluntary resignation and/or redundancy to enhance our efficiency and operating profit. In 2006, we recorded employee reduction expenses of approximately RMB 236 million relating to the reduction of 4,000 employees.

E. SHARE OWNERSHIP

Our directors, supervisors and senior officers do not have share ownership in us.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. MAJOR SHAREHOLDERS

The following table sets forth information regarding our major shareholders as of April 6, 2007.

| Shareholder | Number of Shares Owned (in millions) | Percentage of Ownership (%) |
|----------------------------|--|--------------------------------|
| ----- | ----- | ----- |
| Sinopec Group Company..... | 65,758.04 | 75.84 |

As of January 1, 2004, Sinopec Group Company held 55.06% of our total outstanding shares. In 2004 and 2005, China Development Bank ("CDB") and China Cinda Asset Management Corporation ("Cinda") transferred a total of approximately 8.1 billion and 5.9 billion state-owned shares of us to Sinopec Group Company, respectively. In 2006, China Orient Asset Management Corporation, Cinda and CBD transferred a total of approximately 4.8 billion state-owned shares of us to Sinopec Group Company. On September 25, 2006, pursuant to our reform plan to convert all non-tradable domestic shares into tradable domestic shares, our shareholders of non-tradable shares, including Sinopec Group Company, transferred a total of 784 million shares to our shareholders of tradable A-shares at no additional cost, and obtained the rights to list their shares for trading on Shanghai Stock Exchange with certain selling restrictions. As a result of the above share transfers and the reform, Sinopec Group Company held 75.84% of our total outstanding shares as of April 6, 2007.

As of March 30, 2007, we had 66,337,951,000 tradable shares with selling restrictions, 16,780,488,000 H shares and 3,584,000,000 A shares outstanding. As of March 30, 2007, 1,327,715,600 H shares were registered in the name of a nominee of Citibank, N.A., the depositary under our ADS deposit

agreement.

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Citibank, N.A. has advised us that, as of March 30, 2007, 13,277,156 ADSs, representing 1,327,715,600 H shares, were held of record by Cede & Co. and 62 other registered shareholders domiciled in and outside of the United States. We have no further information as to common shares held, or beneficially owned, by U.S. persons.

B. RELATED PARTY TRANSACTIONS

Sinopec Group Company owns 75.84% of our outstanding equity as of April 6, 2007. Sinopec Group Company will be able to exercise all the rights of a controlling shareholder, including the election of directors and voting in respect of amendments to our articles of association. Sinopec Group Company, as our controlling shareholder, will be subject to certain minority shareholder protection provisions under our articles of association.

We have engaged from time to time and will continue to engage in a variety of transactions with Sinopec Group Company, which provide a number of services to us, including ancillary supply, transport, educational and community services. The nature of our transactions with Sinopec Group Company is governed by a number of service and other contracts between Sinopec Group Company and us. A discussion of these agreements and arrangements is set forth under the heading "Item 7 - Major Shareholders and Related Party Transactions-Related Party Transactions" in our annual report on Form 20-F filed with the Securities and Exchange Commission on April 17, 2001.

On March 31, 2006, we entered into a supplemental agreement to amend the terms of the various related party transactions with Sinopec Group Company. The supplemental agreement is filed as an exhibit to this annual report on Form 20-F, and brief summary of major changes of the supplemental agreement is set forth below:

- o the Product Agency Agreement shall be terminated immediately as of the date of the Supplemental Agreement;
- o the term of the Agreement for Provision of Culture, Education, Hygiene and Community Services shall be extended to December 31, 2009 starting from January 1, 2007; and
- o the term of the Agreement for Mutual Provision of Products and Ancillary Services shall be extended to December 31, 2009 starting from January 1, 2007.

In addition, we have amended the Land Use Rights Leasing Contract and Property Leasing Contract several times since 2000 to reflect the changes in rental areas due to our acquisitions of various assets from Sinopec Group Company as well as rent adjustments. On March 31, 2006, we entered into a memorandum on adjustment of the rent of land use rights with Sinopec Group Company. Pursuant to the memorandum, the parties confirmed that the aggregate areas of the Land Use Rights Leasing Contract were 426 million square meters, and agreed that the total annual rents shall be RMB 3.1 billion.

Our aggregate amount of connected transactions actually occurred during 2006 was RMB 228.8 billion, of which, incoming trade amounted to RMB 99.5 billion, and outgoing trade amounted to RMB 129.3 billion (including, RMB 129.2 billion of sales of products and services, RMB 52 million of interest earned, RMB 60 million of income from agency fee). All of these transactions satisfied the conditions of waiver granted by the Hong Kong Stock Exchange. In 2006, the

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products and services provided by Sinopec Group Company (procurement, storage, transportation, exploration and production services, production-related services) to us were RMB 87.8 billion, representing 8.9% of our operating expenses for year 2006, a decrease of 0.7 percentage points compared with those in 2005, which were within the cap of 18% for waiver. The auxiliary and community services provided by Sinopec Group Company to us were RMB 1.7 billion, representing 0.17% of the operating expenses, with a slight decrease compared with 0.23% in the preceding year, which were within the cap of 2% for waiver. In 2006, the product sales from us to Sinopec Group Company amounted to RMB 76.8 billion, representing 7.16% of our operating revenue, which were within the cap of 14% for waiver. With regard to the Leasing Agreement for Land Use Rights, the amount of rent paid by us as of December 31, 2006 was approximately RMB 3.2 billion. In 2006, we paid an insurance premium of approximately RMB 1.3 billion to Sinopec Group Company under the terms of its SPI Fund.

Please also see Note 30 to our consolidated financial statements included elsewhere in this annual report.

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C. INTERESTS OF EXPERTS AND COUNSEL

Not applicable.

ITEM 8. FINANCIAL INFORMATION

A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION

See F-pages following Item 19.

Legal Proceedings

We are involved in certain judicial and arbitral proceedings before Chinese courts or arbitral bodies concerning matters arising in connection with the conduct of our businesses. We believe, based on currently available information, that the results of such proceedings, in the aggregate, will not have a material adverse effect on our financial condition or results of operations.

Dividend Distribution Policy

Our board of directors will determine the payment of dividends, if any, with respect to our shares on a per share basis. Any final dividend for a financial year shall be subject to shareholders' approval. The board may declare interim and special dividends at any time under general authorization by a shareholders' ordinary resolution. A decision to declare or to pay any dividends in the future, and the amount of any dividends, will depend on our results of operations, cash flows, financial condition, the payment by our subsidiaries of cash dividends to us, future prospects and other factors which our directors may determine are important.

For holders of our H shares, cash dividend payments, if any, shall be declared by our board of directors in Renminbi and paid in HK dollars. The depositary will convert the HK dollar dividend payments and distribute them to holders of ADSs in US dollars, less expenses of conversion.

In addition to cash, dividends may be distributed in the form of shares. Any distribution of shares, however, must be approved by special resolution of the shareholders. Dividends in the form of shares will be distributed to the depositary and, except as otherwise described in the Deposit Agreement, will be distributed by the depositary in the form of additional ADSs,

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to holders of ADSs.

Dividends may be paid only out of our distributable profits (less allocations to the statutory surplus reserve funds which are 10% of our net income determined in accordance with the PRC Accounting Rules and Regulations) and may be subject to PRC withholding tax. Our articles of association limit our distributable profits to the lower of the amount determined in accordance with the PRC Accounting Rules and Regulations and IFRS. Subject to the above, we currently expect that we will distribute as dividends up to 40% of our distributable profits.

In accordance with the board resolution adopted on April 6, 2007, our board has proposed a final dividend of RMB 0.15 per ordinary share for the year ended December 31, 2006, which is equivalent to RMB 15.0 per ADS. After deducting the interim dividends distribution of RMB 0.04 per ordinary share, the year end dividend is RMB 0.11 per ordinary share, which is equivalent to RMB 11 per ADS. The total dividend to be paid amounted to approximately RMB 9,537 million. The resolution is subject to the approval by the general shareholders' meeting.

B. SIGNIFICANT CHANGES

None

ITEM 9. THE OFFER AND LISTING

A. OFFER AND LISTING DETAILS

Not applicable, except for Item 9A (4) and Item 9C.

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Our H Shares have been listed on the Hong Kong Stock Exchange (Code: 0386), and our ADSs, each representing 100 H Shares, have been listed on the New York Stock Exchange and the London Stock Exchange under the symbol "SNP", since we completed our initial public offering on October 19, 2000. Prior to that time, there was no public market for our H Shares. The Hong Kong Stock Exchange is the principal non-U.S. trading market for our H Shares. Our publicly traded domestic shares, or A shares, are listed on the Stock Exchange of Shanghai since August 8, 2001 (Code: 600028).

The following table sets forth, for the periods indicated, the high and low closing prices per H Share, as reported on the Stock Exchange of Hong Kong, per ADS, as reported on the New York Stock Exchange and per A share, as reported on the Stock Exchange of Shanghai.

| Period | | The Stock Exchange of Hong Kong ----- | | The New York Stock Exchange ----- | | The Shanghai Excha ----- |
|--------|--------------------------|---|------|---|-------|--------------------------------|
| | | High | Low | High | Low | High |
| | Past 6 months | (HK dollar per H share) | | (US dollar per ADS) | | (RMB per A |
| 2007 | April (up to April 4) | 6.90 | 6.63 | 87.76 | 85.78 | 10.34 |
| | March | 6.65 | 6.57 | 86.22 | 72.92 | 9.97 |
| | February | 6.78 | 6.25 | 86.27 | 79.25 | 9.89 |
| | January | 7.32 | 6.30 | 92.23 | 80.92 | 11.20 |
| | December | 7.20 | 6.23 | 92.64 | 80.58 | 9.15 |
| | November | 6.32 | 5.39 | 80.89 | 69.05 | 8.20 |

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| | | | | | | |
|----------------|----------------|-------|-------|-------|-------|------|
| 2006 | October | 5.40 | 4.67 | 69.37 | 60.64 | 6.43 |
| Quarterly Data | | | | | | |
| 2007 | First Quarter | | | | | |
| 2006 | Fourth Quarter | 7.20 | 4.67 | 92.64 | 60.64 | 9.15 |
| | Third Quarter | 4.92 | 4.15 | 63.12 | 53.17 | 6.80 |
| | Second Quarter | 5.50 | 3.775 | 71.94 | 47.40 | 7.24 |
| | First Quarter | 5.00 | 3.875 | 63.73 | 50.29 | 5.39 |
| 2005 | Fourth Quarter | 3.90 | 3.075 | 50.58 | 39.80 | 4.66 |
| | Third Quarter | 3.75 | 3.00 | 47.48 | 38.47 | 4.62 |
| | Second Quarter | 3.225 | 2.75 | 41.08 | 35.55 | 4.38 |
| | First Quarter | 3.575 | 2.950 | 45.42 | 38.26 | 4.52 |
| Annual Data | | | | | | |
| 2006 | | 7.20 | 3.775 | 92.64 | 47.40 | 9.15 |
| 2005 | | 3.90 | 2.75 | 50.58 | 35.55 | 4.66 |
| 2004 | | 3.85 | 2.475 | 49.90 | 32.08 | 5.77 |
| 2003 | | 3.475 | 1.24 | 44.41 | 17.30 | 5.06 |
| 2002 | | 1.44 | 1.05 | 18.33 | 13.50 | 3.90 |

Source: Bloomberg

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ITEM 10. ADDITIONAL INFORMATION

A. SHARE CAPITAL

Not applicable.

B. MEMORANDUM AND ARTICLES OF ASSOCIATION

The following is a summary of certain provisions of our articles of association, as amended, the Company Law of the PRC (2006) and certain other applicable laws and regulations of the PRC. You and your advisors should refer to the text of our articles of association, as amended, and to the texts of applicable laws and regulations for further information.

Objects and Purposes

We are a joint stock limited company established in accordance with the Company Law and certain other laws and regulations of the PRC. We are registered with the PRC State Administration of Industry and Commerce with business license number 1000001003298. Article 12 of our articles of association provides that our scope of businesses includes, among other things, exploration, development and sales of petroleum and natural gas; pipeline transportation of petroleum and natural gas; petroleum refining; production, sales and storage of refined petroleum products, petrochemical products, chemical fiber products and other chemical products; wholesale, retailing and storage of refined petroleum products and other petroleum products; operation of convenience stores; power generation; manufacturing and installation of machinery; purchase and sales of raw materials, charcoal, equipment and its components; research, development, application of technology and information; import and export; and provision of technology services and labor services.

Directors

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Our directors shall be elected at our shareholders' general meeting. Cumulative voting shall be adopted for the election of directors if a controlling shareholder controls 30% or more of our shares. Details of the cumulative voting mechanism are set forth in Article 57 of the Rules and Procedures for the Shareholders' General Meetings that is an appendix to, and forms an integral part of, our articles of association. Our directors shall be elected for a term of three years and may serve consecutive terms upon re-election, except that independent directors may only serve a maximum of two terms. Our directors are not required to hold any shares in us, and there is no age limit requirement for the retirement or non-retirement of our directors.

Where a director is materially interested, directly or indirectly, in a contract, transaction or arrangement (including any proposed contract, transaction or arrangement) with us, he or she shall declare the nature and extent of his or her interests to the board of directors at the earliest opportunity, whether or not such contract, transaction or arrangement is otherwise subject to the approval of the board. A director shall not vote, and shall not be counted in the quorum of the meeting, on any resolution concerning any contract, transaction or arrangement where the director owns material rights or interests therein. A director is deemed to be interested in a contract, transaction or arrangement in which his associate (as defined by the Listing Rule of the Hong Kong Stock Exchange) is interested.

Unless the interested director discloses his interests to the board and the contract, transaction or arrangement in which the director is materially interested is approved by the board at a meeting in which the director neither votes nor is not counted in the quorum, such contract, transaction or arrangement shall be voidable by us except with respect to a bona fide party thereto who does not have notice of the director's interests.

We are prohibited from making loans or providing guarantees to our directors and their associates except where such loan or guarantee is to meet expenditure requirement incurred or to be incurred by the director for the purposes of the company or for the purpose of enabling the director to perform his or her duties properly.

The board of directors shall examine and approve the amount of the long-term loans for the current year in accordance with the annual investment plan as approved by the shareholders' general meeting. The chairman of the board may make adjustments of not more than 10% of the total amount of the long-term loans for the current year as approved by the board of directors. The board of directors shall also approve the total amount of the working capital loans for

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the current year. Within the total amount of the long-term or working capital loans as approved by the board of directors, the chairman of the board is authorized to approve and sign on behalf of the company any such loan contract with loan amount over RMB 1.0 billion, and the president of the company is authorized to approve and sign on behalf of the company any such loan contract with loan amount not exceeding RMB 1.0 billion.

Matters relating to the remuneration and liability insurance of our directors shall be determined by the shareholders' general meeting.

Dividends

A distribution of final dividends for any financial year is subject to shareholders' approval. Except otherwise decided by Shareholders' meeting, the board of directors may make decision on the distribution of interim dividends. Except otherwise provided by law and regulation, the sum of interim dividends

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shall not exceed 50 percents of the distributive profit as set out in the table for semi-year profit. Dividends may be distributed in the form of cash or shares. A distribution of shares, however, must be approved by special resolution of the shareholders.

Dividends may only be distributed after allowance has been made for:

- o recovery of losses, if any;
- o allocations to the statutory surplus reserve fund; and
- o allocations to a discretionary surplus reserve fund if approved by the shareholders.

The allocations to the statutory surplus reserve fund shall be 10% of our net income determined in accordance with PRC accounting rules and regulations.

The articles of association require us to appoint on behalf of the holders of H shares a receiving agent which is registered as a trust corporation under the Trustee Ordinance of Hong Kong to receive dividends declared by us in respect of the H shares on behalf of such shareholders. The articles of association require that cash dividends in respect of H shares be declared in Renminbi and paid by us in HK dollars. The depositary of our ADSs will convert such proceeds into U.S. dollars and will remit such converted proceeds to our holders of ADSs. If we record no profit for the year, we may not normally distribute dividends for the year.

Dividend payments may be subject to PRC withholding tax.

Voting Rights and Shareholders' Meetings

Our board of directors shall convene a shareholders' annual general meeting once every year and within six months from the end of the preceding financial year. Our board shall convene an extraordinary general meeting within two months of the occurrence of any one of the following events:

- o where the number of directors is less than the number stipulated in the PRC Company Law or two-thirds of the number specified in our articles of association;
- o where our unrecovered losses reach one-third of the total amount of our share capital;
- o where shareholder(s) holding 10% or more of our issued and outstanding voting shares request(s) in writing the convening of an extraordinary general meeting;
- o whenever our board deems necessary or our board of supervisors so requests; or
- o circumstances provided in the articles of association.

Meetings of a special class of shareholders must be called in certain enumerated situations when the rights of the holders of such class of shares may be modified or adversely affected as discussed below. Resolutions proposed by the board of supervisors or shareholder(s) holding 5% or more of the total number of voting shares shall be included in the agenda for the relevant annual general meeting if they are matters which fall within the scope of the functions and powers of shareholders in general meeting.

All shareholders' meetings must be convened by our board by written notice given to shareholders not less than 45 days before the meeting. Based on the written replies received by us 20 days before a shareholders' meeting, we shall calculate the number of voting shares represented by shareholders who have indicated that they intend to attend the meeting. Where the number of voting

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shares represented by those shareholders amount to more than one-half of our total voting shares, we may convene the shareholders' general meeting (regardless of the number of shareholders who actually attend). Otherwise, we shall, within five days, inform the shareholders again of the motions to be considered and the date and venue of the meeting by way of public announcement. After the announcement is made, the shareholders' meeting may be convened. The accidental omission by us to give notice of a meeting to, or the non-receipt of notice of a meeting by, a shareholder will not invalidate the proceedings at that shareholders' meeting.

Shareholders at meetings have the power, among other things, to approve or reject our profit distribution plans, annual budget, financial statements, increase or decrease in share capital, issuance of debentures, merger or liquidation and any amendment to our articles of association. In addition, the rights of a class of shareholders may not be modified or abrogated, unless approved by a special resolution of all shareholders at a general shareholders' meeting and by a special resolution of shareholders of that class of shares at a separate meeting. Our articles of association enumerate, without limitation, certain amendments which would be deemed to be a modification or abrogation of the rights of a class of shareholders, including increasing or decreasing the number of shares of a class disproportionate to increases or decreases of other classes of shares, removing or reducing rights to receive dividends in a particular currency or creating shares with voting or equity rights superior to shares of such class.

Cumulative voting is adopted for the election of directors. For all other matters, each share is entitled to one vote on all such matters submitted to a vote of our shareholders at all shareholders' meetings, except for meetings of a special class of shareholders where only holders of shares of the affected class are entitled to vote on the basis of one vote per share of the affected class.

Shareholders are entitled to attend and vote at meetings either in person or by proxy. Proxies must be in writing and deposited at our legal address, or such other place as is specified in the meeting notice, not less than 24 hours before the time for holding the meeting at which the proxy proposes to vote or the time appointed for the passing of the relevant resolution(s). When the instrument appointing a proxy is executed by the shareholder's attorney-in-fact, such proxy when deposited must be accompanied by a notary certified copy of the relevant power of attorney or other authority under which the proxy was executed.

Except for those actions discussed below which require supermajority votes ("special resolutions"), resolutions of the shareholders are passed by a simple majority of the voting shares held by shareholders who are present in person or by proxy. Special resolutions must be passed by or more than two-thirds of the voting rights represented held by shareholders who are present in person or by proxy.

The following decisions must be adopted by special resolution:

- o an increase or reduction of our share capital or the issue of shares, including stock distributions, of any class, warrants and other similar securities;
- o issuance of debentures;
- o our division, merger, dissolution and liquidation; (Shareholders who object to a proposed division or merger are entitled to demand that either we or the shareholders who approved the merger purchase their shares at a fair price.)
- o repurchase of shares;
- o amendments to our articles of association; and

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- o any other matters considered by the shareholders in a general meeting and which they have resolved by way of an ordinary resolution to be of a nature which may have a material impact on us and should be adopted by special resolution.

All other actions taken by the shareholders, including the appointment and removal of our directors and supervisors and the declaration of cash dividend payments, will be decided by an ordinary resolution of the shareholders. The listing agreement between us and the Hong Kong Stock Exchange (the "Listing Agreement") provided that we may not permit amendments to certain sections of the articles of association which have been mandated by the Hong Kong Stock Exchange. These sections include provisions relating to:

- o varying the rights of existing classes of shares;
- o voting rights;
- o our power to purchase our own shares;

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- o rights of minority shareholders; and
- o procedure on liquidation.

In addition, certain amendments to the articles of association require the approval and consent of the relevant PRC authorities.

Any shareholder resolution which is in violation of any laws or regulations of the PRC or the articles of association will be null and void.

Liquidation Rights

In the event of our liquidation, the H shares will rank pari passu with the domestic ordinary shares, and payment of debts out of our remaining assets shall be made in the order of priority prescribed by applicable laws and regulations or, if no such standards exist, in accordance with such procedure as the liquidation committee which has been appointed either by us or the People's Court of the PRC may consider to be fair and reasonable. After payment of debts, we shall distribute the remaining property to shareholders according to the class and proportion of their shareholders.

Further Capital Call

Shareholders are not liable to make any further contribution to the share capital other than according to the terms, which were agreed by the subscriber of the relevant shares at the time of subscription.

Increases in Share Capital and Preemptive Rights

The articles of association require the approval by a special resolution of the shareholders and by special resolution of holders of domestic ordinary shares and H shares at separate shareholder class meetings be obtained prior to authorizing, allotting, issuing or granting shares, securities convertible into shares or options, warrants or similar rights to subscribe for any shares or such convertible securities. No such approval is required if, but only to the extent that:

- o we issue domestic ordinary shares and/or H shares, either separately or concurrently, in numbers not exceeding 20% of the number of domestic ordinary shares and H shares then in issue, respectively, in any 12-month period, as approved by a special resolution of the shareholders; or

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- o if our plans for issuing domestic ordinary shares and H shares upon its establishment are implemented within fifteen months of the date of approval by the China Securities Regulatory Commission.

New issues of shares must also be approved by the relevant PRC authorities.

Reduction of Share Capital and Purchase by Us of Our Shares and General Mandate to Repurchase Shares

We may reduce our registered share capital only upon obtaining the approval of the shareholders by a special resolution and, in certain circumstances, of relevant PRC authorities. The number of H shares, which may be purchased is subject to the Hong Kong Takeovers and Share Repurchase Codes.

Restrictions on Large or Controlling Shareholders

Our articles of association provide that, in addition to any obligation imposed by laws and administration regulations or required by the listing rules of the stock exchanges on which our H shares are listed, a controlling shareholder shall not exercise his voting rights in a manner prejudicial to the interests of the shareholders generally or of some part of the shareholders:

- o to relieve a director or supervisor from his or her duty to act honestly in our best interests;
- o to approve the expropriation by a director or supervisor (for his or her own benefit or for the benefit of another person) of our assets in any way, including, without limitation, opportunities which may benefit us; or

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- o to approve the expropriation by a director or supervisor (for his or her own benefit or for the benefit of another person) of the individual rights of other shareholders, including, without limitation, rights to distributions and voting rights (save according to a restructuring of our company which has been submitted for approval by the shareholders in a general meeting in accordance with our articles of association).

A controlling shareholder, however, will not be precluded by our articles of association or any laws and administrative regulations or the listing rules of the stock exchanges on which our H shares are listed from voting on these matters.

When a controlling shareholder intends to put forward a new motion on profit distribution at an annual general meeting, the controlling shareholder shall, at not less than ten days before the date of the annual general meeting, submit the motion to the board of directors to enable it to make an announcement, failing which the shareholder is not entitled to put forward the motion at the annual general meeting.

A controlling shareholder is defined by our articles of association as any person who acting alone or in concert with others:

- o is in a position to elect more than one-half of the board of directors;
- o has the power to exercise, or to control the exercise of, 30% or more of our voting rights;
- o holds 30% or more of our issued and outstanding shares; or

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- o has de facto control of us in any other way.

As of the date of this annual report, Sinopec Group Company is and will be our only controlling shareholder.

Disclosure

The Listing Agreement imposes a requirement on us to keep the Hong Kong Stock Exchange, our shareholders and other holders of our listed securities informed as soon as reasonably practicable of any information relating to us and our subsidiaries, including information on any major new developments which are not public knowledge, which:

- o is necessary to enable them and the public to appraise the position of us and our subsidiaries;
- o is necessary to avoid the establishment of a false market in its securities; and
- o might be reasonably expected materially to affect market activity in and the price of its securities.

There are also requirements under the Listing Rules for us to obtain prior shareholders' approval and/or to disclose to shareholders details of certain acquisitions or disposals of assets and other transactions (including transactions with controlling shareholders).

Sources of Shareholders' Rights

The PRC's legal system is based on written statutes and is a system in which decided legal cases have little precedent value. The PRC's legal system is similar to civil law systems in this regard. In 1979, the PRC began the process of developing its legal system by undertaking to promulgate a comprehensive system of laws. In December 1993, the Standing Committee of the 8th National People's Congress adopted the PRC Company Law. On October 27, 2005, the PRC Company law was amended by the Standing Committee of the 10th National People's Congress, and came into force on January 1, 2006. The amended PRC Company Law enhanced the protection of shareholders' rights primarily in the following regards:

- o Shareholders holding 10 percent or more of the shares of the company are entitled to petition the court to dissolve the company if (i) the company is in serious operational difficulties; (ii) its continuing existence will seriously prejudice the interests of the shareholders; and (iii) such difficulties cannot be resolved through any other means;
- o Shareholders holding 1 percent or more of the shares of the company for more than 180 consecutive days are entitled to request the board of supervisors (in terms of directors and senior management) or the board of directors (in terms of supervisors) to bring legal proceedings, or bring legal proceedings in their own name on behalf of the company where it is in emergency and the company will be

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subject to irreparable loss if not to do so, against directors, supervisors or senior management who fail to comply with the laws and regulations or the company's articles of association in the course of performing their duties and cause loss to the company;

- o Shareholders who oppose the company's decision on merger or separation are entitled to request the company to repurchase their shares; and

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- o Shareholders holding 10 percent or more of the voting rights of the company are entitled to convene a shareholders' meeting.

Currently, the primary sources of shareholder rights are our articles of association, as amended, the PRC Company Law and the Listing Rules of the Hong Kong Stock Exchange, which, among other things, impose certain standards of conduct, fairness and disclosure on us, our directors and our controlling shareholder, i.e., Sinopec Group Company. To facilitate the offering and listing of shares of PRC companies overseas, and to regulate the behavior of companies whose shares are listed overseas, the State Council Securities Committee and the State Commission for Restructuring the Economic System issued on August 27, 1994 the Mandatory Provisions for articles of association of Company Listing Overseas (the "Mandatory Provisions"). These Mandatory Provisions become entrenched in that, once they are incorporated into the articles of association of a PRC company, any amendment to those provisions will only become effective after approval by the State-owned Assets Supervision and Administration Commission of the State Council. The Listing Rules require a number of additional provisions to the Mandatory Provisions to be included in the articles of association of PRC companies listing H shares on the Hong Kong Stock Exchange (the "Additional Provisions"). The Mandatory Provisions and the Additional Provisions have been incorporated into our articles of association.

In addition, upon the listing of and for so long as the H shares are listed on the Hong Kong Stock Exchange, we will be subject to those relevant ordinances, rules and regulations applicable to companies listed on the Hong Kong Stock Exchange, including the Listing Rules of the Hong Kong Stock Exchange, the Securities (Disclosure of Interests) Ordinance (the "SDI Ordinance"), the Securities (Insider Dealing) Ordinance and the Hong Kong Codes on Takeovers and Mergers and Share Repurchases (the "Hong Kong Takeovers and Repurchase Codes").

Unless otherwise specified, all rights, obligations and protections discussed below derive from our articles of association and/or the PRC Company Law.

Enforceability of Shareholders' Rights

There has not been any public disclosure in relation to the enforcement by holders of H shares of their rights under constitutive documents of joint stock limited companies or the PRC Company Law or in the application or interpretation of the PRC or Hong Kong regulatory provisions applicable to PRC joint stock limited companies.

In most states of the United States, shareholders may sue a corporation "derivatively". A derivative suit involves the commencement by a shareholder of a corporate cause of action against persons (including corporate officers, directors or controlling shareholders) who have allegedly wronged the corporation, where the corporation itself has failed to enforce such claim against such persons directly. Such action is brought based upon a primary right of the corporation, but is asserted by a shareholder on behalf of the corporation. The PRC company law as amended in October 2005 and effective in January 2006 has also granted shareholders with the rights to bring such derivative suits.

Our articles of association provide that all differences or claims:

- o between a holder of H shares and us;
- o between a holder of H shares and any of our directors, supervisors, general managers, deputy general managers or other senior officers;
- or

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- o between a holder of H shares and a holder of domestic ordinary shares, arising from any provision of our articles of association, any right or obligation conferred or imposed by the PRC Company Law or any other relevant law or administrative regulation which concerns our affairs

must, with certain exceptions, be referred to arbitration at either the China International Economic and Trade Arbitration Commission in the PRC or the Hong Kong International Arbitration Center. Our articles of association provide that such arbitration will be final and conclusive. In June 1999, an arrangement was made between the People's Courts of the PRC and the courts of Hong Kong to mutually enforce arbitration awards rendered in the PRC and Hong Kong according

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to their respective laws. This new arrangement was approved by the Supreme Court of the PRC and the Hong Kong Legislative Council and became effective on February 1, 2000. We have provided an undertaking to the United States Securities and Exchange Commission that, at such time, if any, as all applicable laws and regulations of the PRC and (unless our H shares are no longer listed on the Hong Kong Stock Exchange) all applicable regulations of the Stock Exchange of Hong Kong Ltd. shall not prohibit, and to the extent Section 14 under the United States Securities Act of 1933, as amended, so requires, our board of directors shall propose an amendment to the articles of association which would permit shareholders to adjudicate disputes arising between our shareholders and us, our directors, supervisors or officers by means of judicial proceedings.

The holders of H shares will not be able to bring actions on the basis of violations of the Listing Rules and must rely on the Hong Kong Stock Exchange to enforce its rules. The SDI Ordinance establishes certain obligations in relation to disclosure of shareholder interests in Hong Kong listed companies, the violation of which is subject to prosecution by the Securities and Futures Commission of Hong Kong. The Hong Kong Takeovers and Repurchase Codes do not have the force of law and are only standards of commercial conduct considered acceptable for takeover and merger transactions and share repurchases in Hong Kong as established by the Securities and Futures Commission and the securities and futures industry in Hong Kong.

We have appointed our subsidiary in the U.S., SINOPEC-USA Co., Ltd., 150 E. 52nd Street, 28th Floor, New York, NY 10022, USA, as our agent to receive service of process with respect to any action brought against us in certain courts in New York under the United States federal and New York State's securities laws. However, as the PRC does not have treaties providing for the reciprocal recognition and enforcement of judgments of courts within the United States, the United Kingdom, Japan or most other the Organization for Economic Cooperation and Development countries, administrative actions brought by regulatory authorities, such as the Commission, and other actions which result in foreign court judgments, could (assuming such actions are not required by PRC law and the articles of association to be arbitrated) only be enforced in the PRC on a reciprocal basis or according to relevant international treaty to which China is a party if such judgments or rulings do not violate the basic principles of the law of the PRC or the sovereignty, security and public interest of the society of the PRC, as determined by a People's Court of the PRC which has the jurisdiction for recognition and enforcement of judgments. We have been advised by our PRC counsel, Haiwen & Partners, that there is certain doubt as to the enforceability in the PRC of actions to enforce judgments of United States courts arising out of or based on the ownership of H shares or ADSs, including judgments arising out of or based on the civil liability provisions of United States federal or state securities laws.

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Restrictions on Transferability and the Share Register

According to PRC Company Law, our domestic ordinary shares held by Sinopec Group Company may not be transferred within three years of our establishment on February 25, 2000, except as permitted under the March 23, 2000 debt to equity swap agreement executed on March 23, 2000 between Sinopec Group Company and our other shareholders, whereby Sinopec Group Company may transfer our domestic ordinary shares to such other shareholders. H shares may be traded only among investors who are not PRC persons, and may not be sold to PRC investors. There are no restrictions on the ability of investors who are not PRC residents to hold H shares.

As provided in the articles of associations we may refuse to register a transfer of H shares unless:

- o any relevant transfer fee is paid;
- o the instrument of transfer is only related to H shares listed in Hong Kong;
- o the instrument of transfer is accompanied by the share certificates to which it relates, or such other evidence is given as may be reasonably necessary to show the right of the transferor to make the transfer;
- o the stamp duty which is chargeable on the instrument of transfer has already been paid;
- o if it is intended that the shares be transferred to joint owners, the maximum number of joint owners shall not be more than four (4); and
- o the Company does not have any lien on the relevant shares.

We are required to keep a register of our shareholders which shall be comprised of various parts, including one part which is to be maintained in Hong Kong in relation to H shares to be listed on the Hong Kong Stock Exchange. Shareholders have the right to inspect and, for a nominal charge, to copy the share register. No transfers of ordinary shares shall be recorded in our share register within 30 days prior to the date of a shareholders' general meeting or

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within 5 days prior to the record date established for the purpose of distributing a dividend.

We have appointed HKSCC Registrars Limited to act as the registrar of our H shares. This registrar maintains our register of holders of H shares at our offices in Hong Kong and enters transfers of shares in such register upon the presentation of the documents described above.

C. MATERIAL CONTRACTS

We have not entered into any material contracts other than in the ordinary course of business and other than those described in Item 4. Information on the Company, Item 7. Major Shareholders and Related Party Transactions - Related Party Transactions or elsewhere in this Form 20-F.

D. EXCHANGE CONTROLS

The existing foreign exchange regulations have significantly reduced government foreign exchange controls for transactions under the current account, including trade and service related foreign exchange transactions and payment of dividends. We may undertake current account foreign exchange transactions without prior approval from the State Administration of Foreign Exchange by producing commercial documents evidencing such transactions, provided that they

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are processed through Chinese banks licensed to engage in foreign exchange transactions. The PRC government has stated publicly that it intends to make the Renminbi freely convertible in the future. However, we cannot predict whether the PRC government will continue its existing foreign exchange policy and when the PRC government will allow free conversion of Renminbi to foreign currency.

Foreign exchange transactions under the capital account, including principal payments in respect of foreign currency-denominated obligations, continue to be subject to significant foreign exchange controls and require the approval of the State Administration of Foreign Exchange. These limitations could affect our ability to obtain foreign exchange through debt or equity financing, or to obtain foreign exchange for capital expenditures.

The value of the Renminbi against the U.S. dollar and other currencies may fluctuate and is affected by, among other things, changes in China's political and economic conditions. The conversion of Renminbi into foreign currencies, including U.S. dollars, has historically been set by the People's Bank of China. On July 21, 2005, the PRC government changed its policy of pegging the value of the Renminbi to the U.S. dollar. Under the new policy, the Renminbi is permitted to fluctuate within a band against a basket of certain foreign currencies. This change in policy resulted initially in an approximately 2.0% appreciation in the value of the Renminbi against the U.S. dollar. Since the adoption of this new policy, the value of Renminbi against the U.S. dollar has fluctuated on a daily basis within narrow ranges, but overall has further strengthened against the U.S. dollar. There remains significant international pressure on the PRC government to further liberalize its currency policy, which could result in a further and more significant appreciation in the value of the Renminbi against the U.S. dollar. As we import a significant portion of our crude oil requirement from the international market, fluctuations in the value of the Renminbi against the U.S. dollars and certain other foreign currencies may increase our crude oil costs. In addition, any significant revaluation of the Renminbi may have a material adverse effect on our revenues and financial condition, and the value of, and any dividends payable on, our ADSs in foreign currency terms.

E. TAXATION

PRC Taxation

The following discussion addresses the principal PRC tax consequences of investing in the H shares or ADSs.

Taxation of Dividends

Individual Investors

According to the current PRC tax regulations, dividends paid by PRC companies are ordinarily subject to a PRC withholding tax levied at a flat rate of 20%. However, such withholding tax is not applicable with respect to those

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PRC companies which have their shares listed on an overseas stock exchange, such as H shares and ADSs, because of an exemption issued first in 1993 and then confirmed in 1994. The relevant tax authority has not collected withholding tax on dividend payments on H shares or ADSs.

In the event that the exemption is no longer available or is withdrawn, a 20% tax may be withheld on dividends in accordance with the PRC individual income tax law. Such withholding tax may be reduced under an applicable treaty

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on the avoidance of double taxation.

Foreign Enterprises

According to the current PRC tax regulations, dividends paid by PRC companies to foreign enterprises are ordinarily subject to a PRC withholding tax levied at a flat rate of 20%. However, foreign enterprises with no permanent establishment in China receiving dividends paid with respect to a PRC company's H shares or ADSs have been temporarily exempted from the 20% withholding tax.

In accordance with the New Corporate Income Tax Law that will become effective on January 1, 2008, dividends paid by PRC companies to foreign enterprises with no permanent establishment in China are generally subject to a PRC withholding tax levied at a flat rate of 20%. However, such withholding tax may be exempted or reduced by the State Council. As the State Council has not yet promulgated any regulations on exemption or reduction of the withholding tax as of the date of this annual report, it may become applicable to holders of H shares and ADSs as of January 1, 2008, unless exempted or reduced pursuant to an applicable double-taxation treaty or other exemptions.

Tax Treaties

Holders resident in countries which have entered into avoidance of double taxation treaties with the PRC may be entitled to a reduction of the withholding tax imposed on the payment of dividends. The PRC currently has avoidance of double taxation treaties with a number of other countries, which include Australia, Canada, France, Germany, Japan, Malaysia, the Netherlands, Singapore, the United Kingdom and the United States.

Under a tax treaty between United States and China, China may tax dividends paid by Sinopec Corp. to eligible US Holders up to a maximum of 10% of the gross amount of such dividend. Under the tax treaty, an eligible US Holder is a person who, by reason of domicile, residence, place of head office, place of incorporation or any other criterion of similar nature is liable to tax in the United States, subject to a detailed "treaty shopping" provision.

Taxation of Capital Gains

A PRC tax regulation provides that gains realized upon the sale of overseas shares by foreign enterprises and individuals are not subject to tax on capital gains. However, the Provision for Implementing of the Individual Income Tax Law of the PRC (the "Detailed Implementing Rules"), promulgated on January 28, 1994, imposes income tax of 20% on gains derived from the sale of equity shares by an individual. A notice issued in 1998 by the Ministry of Finance and State Administration of Tax states that no capital gains tax will be imposed on gains from the sale of shares by individuals from 1997. If such tax exemption relief is no longer available, individual holders of H shares or ADSs may be subject to a 20% capital gains tax unless such tax is reduced or eliminated by an applicable double taxation treaty. As the Amendments and the Detailed Implementing Rules only relate to individual income tax, the tax exemption for foreign enterprises under the PRC tax regulation should still be valid.

In accordance with the New Corporate Income Tax Law, capital gains realized by foreign enterprises with no permanent establishment in China upon the sale of overseas shares are generally subject to a PRC withholding tax levied at a flat rate of 20%. However, such withholding tax may be exempted or reduced by the State Council under the New Corporate Income Tax Law. As the State Council has not yet promulgated any regulations on exemption or reduction of the withholding tax as of the date of this annual report, it may become applicable to holders of H shares and ADSs as of January 1, 2008, unless exempted or reduced pursuant to an applicable double-taxation treaty or other exemptions.

PRC Stamp Tax Considerations

Under the current PRC tax regulation, the PRC stamp tax is not imposed on the transfer of H shares and ADSs of PRC companies publicly listed outside China.

United States Federal Income Tax Considerations

The following is a summary of United States federal income tax considerations that are anticipated to be material for US Holders (as defined below) who hold H shares or ADSs. This summary is based upon existing United States federal income tax law, which is subject to change, possibly with retroactive effect. This summary does not discuss all aspects of United States federal income taxation which may be important to particular investors in light of their individual investment circumstances, such as investors subject to special tax rules including: financial institutions, insurance companies, broker-dealers, tax-exempt organizations, non-US Holders, investors who own (directly, indirectly, or constructively) 10% or more of our voting stock, investors that will hold H shares or ADSs as part of a straddle, hedge, conversion, constructive sale, or other integrated transaction for United States federal income tax purposes, or US Holders that have a functional currency other than the United States dollar, all of whom may be subject to tax rules that differ significantly from those summarized below. In addition, this summary does not discuss any foreign, state, local or alternative minimum tax considerations. This summary only addresses investors that will hold their H shares or ADSs as "capital assets" (generally, property held for investment) under the United States Internal Revenue Code (the "Code"). Each holder is urged to consult its tax advisor regarding the United States federal, state, local, and foreign income and other tax considerations of the purchase, ownership, and disposition of H shares or ADSs.

For purposes of this summary, a US Holder is a beneficial owner of H shares or ADSs that is for United States federal income tax purposes:

- o an individual who is a citizen or resident of the United States;
- o a corporation created in or organized under the laws of, the United States or any State or political subdivision thereof;
- o an estate the income of which is includible in gross income for United States federal income tax purposes regardless of its source;
- o a trust the administration of which is subject to the primary supervision of a United States court and which has one or more United States persons who have the authority to control all substantial decisions of the trust; or
- o a trust that has elected to be treated as a United States person under the Code.

If a partnership (including any entity treated as a partnership for United States federal income tax purposes) holds H shares or ADSs, the tax treatment of a partner in such partnership will depend upon the status of the partner and the activities of the partnership. Partners in a partnership holding our H shares or ADSs are urged to consult their tax advisors as to the particular United States federal income tax consequences applicable to them.

A foreign corporation will be treated as a "passive foreign investment company" (a "PFIC"), for United States federal income tax purposes, if 75% or

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more of its gross income consists of certain types of "passive" income or 50% or more of its assets are passive. Sinopec Corp. presently does not believe that it is a PFIC and does not anticipate becoming a PFIC. This is, however, a factual determination made on an annual basis and is subject to change. The following discussion is based on the belief that Sinopec Corp. will not be classified as a PFIC for United States federal income tax purposes. See the discussion below under the heading "PFIC Considerations" for a brief summary of the PFIC rules.

General

For United States federal income tax purposes, a US Holder of an ADS will be treated as the owner of the proportionate interest of the H shares held by the depositary that is represented by an ADS and evidenced by such ADS. Accordingly, no gain or loss will be recognized upon the exchange of an ADS for the holder's proportionate interest in the H shares. A US Holder's tax basis in the withdrawn H shares will be the same as the tax basis in the ADS surrendered

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therefor, and the holding period in the withdrawn H shares will include the period during which the holder held the surrendered ADS.

Dividends

Any cash distributions paid by Sinopec Corp. out of earnings and profits, as determined under United States federal income tax principles, will be subject to tax as dividend income and will be includible in the gross income of a US Holder upon receipt. A non-corporate recipient of dividend income will generally be subject to tax on dividend income from a "qualified foreign corporation" at a maximum U.S. federal tax rate of 15% rather than the marginal tax rates generally applicable to ordinary income so long as certain holding period requirements are met. A non-U.S. corporation (other than a passive foreign investment company) generally will be considered to be a qualified foreign corporation (i) if it is eligible for the benefits of a comprehensive tax treaty with the United States which the Secretary of Treasury of the United States determines is satisfactory for purposes of this provision and which includes an exchange of information program or (ii) with respect to any dividend it pays on stock which is readily tradable on an established securities market in the United States. There is currently a tax treaty in effect between the United States and the People's Republic of China which the Secretary of Treasury of the United States determined is satisfactory for these purposes and Sinopec Group, presently believes that it is eligible for the benefits of such treaty. Additionally, our ADSs trade on the New York Stock Exchange, an established securities market in the United States. Cash distributions paid by Sinopec Corp. in excess of its earnings and profits will be treated as a tax-free return of capital to the extent of the US Holder's adjusted tax basis in its shares or ADSs, and after that as gain from the sale or exchange of a capital asset. Dividends paid in Hong Kong dollars will be includible in income in a United States dollar amount based on the United States dollar - Hong Kong dollar exchange rate prevailing at the time of receipt of such dividends by the depositary, in the case of ADSs, or by the US Holder, in the case of H shares held directly by such US Holder. Gain or loss, if any, recognized on a subsequent sale, conversion or other disposition of Hong Kong dollars generally will be U.S. source income or loss. Dividends received on H shares or ADSs will not be eligible for the dividends received deduction allowed to corporations.

Dividends received on H shares or ADSs will be treated, for United States federal income tax purposes, as foreign source income. A US Holder may be eligible, subject to a number of complex limitations, to claim a foreign tax credit in respect of any foreign withholding taxes imposed on dividends received on H shares or ADSs. US Holders who do not elect to claim a foreign tax credit

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for foreign income tax withheld may instead claim a deduction, for United States federal income tax purposes, in respect of such withholdings, but only for a year in which the US Holder elects to do so for all creditable foreign income taxes.

A distribution of additional shares of Sinopec Corp.'s stock to US Holders with respect to their H shares or ADSs that is pro rata to all Sinopec Corp.'s shareholders may not be subject to United States federal income tax. The tax basis of such additional shares will be determined by allocating the US Holders' adjusted tax basis in the H shares or ADSs between the H shares or ADSs and the additional shares, based on their relative fair market values on the date of distribution.

Sale or Other Disposition of H shares or ADSs

A US Holder will recognize capital gain or loss upon the sale or other disposition of H shares or ADSs in an amount equal to the difference between the amount realized upon the disposition and the US Holder's adjusted tax basis in such H shares or ADSs, as each is determined in US dollars. Any capital gain or loss will be long-term if the H shares or ADSs have been held for more than one year and may be, under the income tax treaty between the People's Republic of China and the United States, foreign source gain or loss. The claim of a deduction in respect of a capital loss, for United States federal income tax purposes, may be subject to limitations.

PFIC Considerations

If Sinopec Corp. were to be classified as a PFIC in any taxable year, a U.S. Holder would be subject to special rules generally intended to reduce or eliminate any benefits from the deferral of United States federal income tax that a U.S. Holder could derive from investing in a foreign company that does not distribute all of its earnings on a current basis. In such event, a U.S. Holder of the H shares or ADSs may be subject to tax at ordinary income tax rates on (i) any gain recognized on the sale of the H shares or ADSs and (ii) any "excess distribution" paid on the H shares or ADSs (generally, a distribution in excess of 125% of the average annual distributions paid by

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Sinopec Corp. in the three preceding taxable years). In addition, a U.S. Holder may be subject to an interest charge on such gain or excess distribution.

The above results may be eliminated if a "mark-to-market" election is available and a US Holder validly makes such an election. If the election is made, such holder generally will be required to take into account the difference, if any, between the fair market value and its adjusted tax basis in H shares or ADSs at the end of each taxable year as ordinary income or ordinary loss (to the extent of any net mark-to-market gain previously included in income). In addition, any gain from a sale or other disposition of H shares or ADSs will be treated as ordinary income, and any loss will be treated as ordinary loss (to the extent of any net mark-to-market gain previously included in income).

F. DIVIDENDS AND PAYING AGENTS

Not applicable.

G. STATEMENT BY EXPERTS

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Not applicable.

H. DOCUMENTS ON DISPLAY

We filed with the Securities and Exchange Commission in Washington, D.C. a Registration Statement on Form F-1 (Registration No. 333-12502) under the Securities Act in connection with the ADSs offered in the global offering. The Registration Statement contains exhibits and schedules. Any statement in this annual report about any of our contracts or other documents is not necessarily complete. If the contract or document is filed as an exhibit to the Registration Statement, the contract or document is deemed to modify the description contained in this annual report. You must review the exhibits themselves for a complete description of the contract or documents.

You may inspect and copy our registration statements, including their exhibits and schedules, and the reports and other information we file with the Securities and Exchange Commission in accordance with the Exchange Act at the public reference facilities maintained by the Securities and Exchange Commission at Judiciary Plaza, 450 Fifth Street, Room 1024, N.W., Washington, D.C. 20549 and at the regional offices of the Securities and Exchange Commission located at 233 Broadway, New York, NY 10279 and at Citicorp Center, 500 West Madison Street, Suite 1400, Chicago, Illinois 60661. You may also inspect the registration statements, including their exhibits and schedules, at the office of the New York Stock Exchange, Wall Street, New York, New York 10005. Copies of such material may also be obtained from the Public Reference Section of the Securities and Exchange Commission at 450 Fifth Street, N.W., Washington, D.C. 20549, at prescribed rates. You may obtain information regarding the Washington D.C. Public Reference Room by calling the Securities and Exchange Commission at 1-800-SEC-0330 or by contacting the Securities and Exchange Commission over the internet at its website at <http://www.sec.gov>.

I. SUBSIDIARY INFORMATION

Not applicable.

ITEM 11. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

Our primary market risk exposures are to fluctuations in oil and gas prices, exchange rates and interest rates.

Commodity Price Risk

We are exposed to fluctuations in prices of crude oil, refined products and petrochemicals whose prices are volatile. We purchase substantial volumes of crude oil from domestic and international suppliers and sell substantial volumes of refined products and petrochemicals to domestic buyers. Therefore, fluctuations of prices of crude oil, refined products and petrochemicals have a significant effect on our operating expenses and net profits.

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Foreign Exchange Rate Risk

The Renminbi is not a freely convertible currency. With the authorization from the PRC government, the PBOC announced that the PRC government reformed the exchange rate regime by moving into a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies on July 21, 2005. Actions taken by the PRC government could cause future exchange rates to vary significantly from current or historical exchange rates. Fluctuations in exchange rates may adversely affect the value,

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translated or converted into US dollars or Hong Kong dollars, of our net assets, earnings and any declared dividends. We cannot give any assurance that any future movements in the exchange rate of the Renminbi against the US dollar and other foreign currencies will not adversely affect our results of operations and financial condition. However, we believe that significant depreciation in the Renminbi against major foreign currencies may have a material adverse impact on our capital expenditure program.

The following presents various market risk information regarding market-sensitive financial instruments that we held or issued as of December 31, 2006 and 2005. We conduct our business primarily in Renminbi, which is also our functional and reporting currency.

The following tables provide information regarding instruments that are sensitive to foreign exchange rates as of December 31, 2006 and 2005. For debt obligations, the table presents cash flows and related weighted average rates by expected maturity dates.

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As of December 31, 2006:

| | Expected maturity | | | | | |
|---|-------------------|------|------|------|------|------------|
| | 2007 | 2008 | 2009 | 2010 | 2011 | thereafter |
| (RMB equivalent in millions, except interest rates) | | | | | | |
| Assets | | | | | | |
| Cash and cash equivalents | | | | | | |
| In United States dollar | 761 | - | - | - | - | - |
| In Hong Kong dollar | 27 | - | - | - | - | - |
| In Japanese yen | 17 | - | - | - | - | - |
| In Euro | 23 | - | - | - | - | - |
| Liabilities | | | | | | |
| Debts in United States dollar | | | | | | |
| Fixed rate | 4,236 | 220 | 196 | 195 | 113 | 52 |
| Average interest rate | 5.3% | 3.3% | 3.1% | 2.7% | 2.2% | 2.0% |
| Variable rate | 3,902 | 527 | 537 | 546 | 561 | 1,300 |
| Average interest rate (1) | 6.0% | 6.0% | 6.0% | 6.0% | 6.0% | 6.0% |
| Debts in Japanese yen | | | | | | |
| Fixed rate | 165 | 95 | 95 | 95 | 68 | 77 |
| Average interest rate | 2.8% | 2.6% | 2.6% | 2.6% | 2.6% | 2.6% |
| Variable rate | 361 | 260 | 256 | 180 | 180 | 180 |
| Average interest rate (1) | 3.2% | 3.2% | 3.1% | 3.0% | 3.0% | 2.1% |
| Debts in Hong Kong dollar | | | | | | |
| Fixed rate | 50 | - | - | - | - | - |
| Average interest rate | 4.7% | - | - | - | - | - |
| Variable rate | 8,213 | - | - | - | - | - |
| Average interest rate (1) | 4.5% | - | - | - | - | - |

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| | | | | | |
|-----------------------|------|------|------|------|---|
| Debts in Euro | | | | | |
| Fixed rate | 25 | 25 | 25 | 26 | - |
| Average interest rate | 6.7% | 6.7% | 6.7% | 6.7% | - |

(1) The average interest rates for variable rate loans are calculated based on the rates reported as of December 31, 2006.

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As of December 31, 2005:

| | Expected maturity | | | | | |
|-------------------------------|--|-------|------|------|------|------------|
| | 2006 | 2007 | 2008 | 2009 | 2010 | thereafter |
| | (RMB equivalent in millions, except interest rate) | | | | | |
| Assets | | | | | | |
| Cash and cash equivalents | | | | | | |
| In United States dollar | 617 | - | - | - | - | - |
| In Hong Kong dollar | 66 | - | - | - | - | - |
| In Japanese yen | 19 | - | - | - | - | - |
| In Euro | 21 | - | - | - | - | - |
| Liabilities | | | | | | |
| Debts in United States dollar | | | | | | |
| Fixed rate | 2,471 | 304 | 250 | 203 | 192 | 616 |
| Average interest rate | 4.4% | 3.6% | 3.2% | 2.9% | 2.3% | 1.4% |
| Variable rate | 8,506 | 1,521 | 354 | 356 | 356 | 2,930 |
| Average interest rate (1) | 5.2% | 5.2% | 5.2% | 5.2% | 5.2% | 5.2% |
| Debts in Japanese yen | | | | | | |
| Fixed rate | 246 | 172 | 101 | 101 | 94 | 883 |
| Average interest rate | 3.0% | 2.8% | 2.6% | 2.6% | 2.6% | 2.6% |
| Variable rate | 370 | 355 | 262 | 269 | 178 | 363 |
| Average interest rate (1) | 2.6% | 2.6% | 2.8% | 2.8% | 3.0% | 3.0% |
| Debts in Hong Kong dollar | | | | | | |
| Fixed rate | 788 | - | - | - | - | - |
| Average interest rate | 4.1% | - | - | - | - | - |
| Variable rate | 196 | 12 | - | - | - | - |
| Average interest rate (1) | 4.9% | 4.8% | - | - | - | - |
| Debts in Euro | | | | | | |
| Fixed rate | 24 | 23 | 23 | 24 | 23 | - |
| Average interest rate | 6.7% | 6.7% | 6.7% | 6.7% | 6.7% | - |

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(1) The average interest rates for variable rate loans are calculated based on the rates reported

Interest Rate Risk

We are exposed to interest rate risk resulting from fluctuations in interest rates on our short- and long-term debts. Upward fluctuations in interest rates increase the cost of new debt and the interest cost of outstanding floating rate borrowings.

Our debts consist of fixed and variable rate debt obligations with original maturities ranging from 1 to 25 years. Fluctuations in interest rates can lead to significant fluctuations in the fair values of our debt obligations.

The following tables present principal cash flows and related weighted average interest rates by expected maturity dates of our interest rate sensitive financial instruments as of December 31, 2006 and 2005.

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As of December 31, 2006:

| | Expected maturity | | | | | | Total | Fair |
|---|---|--------|--------|-------|-------|------------|---------|------|
| | 2007 | 2008 | 2009 | 2010 | 2011 | thereafter | | |
| | (RMB equivalent in millions, except interest rates) | | | | | | | |
| Assets | | | | | | | | |
| Cash and cash equivalents | | | | | | | | |
| In Renminbi | 7,260 | - | - | - | - | - | 7,260 | 7 |
| In United States dollar | 761 | - | - | - | - | - | 761 | |
| In Hong Kong dollar | 27 | - | - | - | - | - | 27 | |
| In Japanese yen | 17 | - | - | - | - | - | 17 | |
| In Euro | 23 | - | - | - | - | - | 23 | |
| Time deposits with financial institutions | | | | | | | | |
| In Renminbi | 635 | - | - | - | - | - | 635 | |
| Liabilities | | | | | | | | |
| Debts in Renminbi | | | | | | | | |
| Fixed rate | 40,293 | 24,125 | 8,057 | 2,477 | 258 | 41,031 | 116,241 | 115 |
| Average interest rate | 4.7% | 5.2% | 5.0% | 4.8% | 4.7% | 0.6% | | |
| Variable rate | 1,515 | 1,277 | 10,895 | 7,315 | 4,130 | 2,516 | 27,648 | 27 |
| Average interest rate (2) | 5.6% | 5.6% | 5.6% | 5.8% | 5.9% | 6.1% | | |
| Debts in United States dollar | | | | | | | | |
| Fixed rate | 4,236 | 220 | 196 | 195 | 113 | 521 | 5,481 | 5 |
| Average interest rate | 5.3% | 3.3% | 3.1% | 2.7% | 2.2% | 2.0% | | |
| Variable rate | 3,902 | 527 | 537 | 546 | 561 | 1,305 | 7,378 | 7 |
| Average interest rate (2) | 6.0% | 6.0% | 6.0% | 6.0% | 6.0% | 6.0% | | |

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| | | | | | | | |
|---------------------------|-------|------|------|------|------|------|-------|
| Debts in Japanese yen | | | | | | | |
| Fixed rate | 165 | 95 | 95 | 95 | 68 | 775 | 1,293 |
| Average interest rate | 2.8% | 2.6% | 2.6% | 2.6% | 2.6% | 2.6% | |
| Variable rate | 361 | 260 | 256 | 180 | 180 | 183 | 1,420 |
| Average interest rate (2) | 3.2% | 3.2% | 3.1% | 3.0% | 3.0% | 2.1% | |
| Debts in Hong Kong dollar | | | | | | | |
| Fixed rate | 50 | - | - | - | - | - | 50 |
| Average interest rate | 4.7% | - | - | - | - | - | |
| Variable rate | 8,213 | - | - | - | - | - | 8,213 |
| Average interest rate (2) | 4.5% | - | - | - | - | - | |
| Debts in Euro | | | | | | | |
| Fixed rate | 25 | 25 | 25 | 26 | - | - | 101 |
| Average interest rate | 6.7% | 6.7% | 6.7% | 6.7% | - | - | |

(1) Carrying amounts are used for loans from Sinopec Group Company and its affiliates as it is not practicable to estimate their fair values because the cost of obtaining discount and borrowing rates for comparable borrowings would be excessive.

(2) The average interest rates for variable rate loans are calculated based on the rates reported as of December 31, 2006.

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As of December 31, 2005:

| | Expected maturity | | | | | |
|---|--|--------|--------|-------|-------|------|
| | 2006 | 2007 | 2008 | 2009 | 2010 | th |
| | ---- | ---- | ---- | ---- | ---- | ---- |
| | (RMB equivalent in millions, except interest rate) | | | | | |
| Assets | | | | | | |
| Cash and cash equivalents | | | | | | |
| In Renminbi | 13,346 | - | - | - | - | |
| In United States dollar | 617 | - | - | - | - | |
| In Hong Kong dollar | 66 | - | - | - | - | |
| In Japanese yen | 19 | - | - | - | - | |
| In Euro | 21 | - | - | - | - | |
| Time deposits with financial institutions | | | | | | |
| In Renminbi | 1,002 | - | - | - | - | |
| Liabilities | | | | | | |
| Debts in Renminbi | | | | | | |
| Fixed rate | 29,198 | 16,233 | 24,508 | 5,787 | 5,517 | 41 |
| Average interest rate | 4.5% | 5.1% | 5.1% | 5.0% | 5.0% | |
| Variable rate | 1,418 | 1,167 | 420 | 1,158 | 3,265 | 2 |
| Average interest rate (2) | 5.3% | 5.4% | 5.4% | 5.4% | 5.4% | |

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| | | | | | |
|-------------------------------|-------|-------|------|------|------|
| Debts in United States dollar | | | | | |
| Fixed rate | 2,471 | 304 | 250 | 203 | 192 |
| Average interest rate | 4.4% | 3.6% | 3.2% | 2.9% | 2.3% |
| Variable rate | 8,506 | 1,521 | 354 | 356 | 356 |
| Average interest rate (2) | 5.2% | 5.2% | 5.2% | 5.2% | 5.2% |
| Debts in Japanese yen | | | | | |
| Fixed rate | 246 | 172 | 101 | 101 | 94 |
| Average interest rate | 3.0% | 2.8% | 2.6% | 2.6% | 2.6% |
| Variable rate | 370 | 355 | 262 | 269 | 178 |
| Average interest rate (2) | 2.6% | 2.6% | 2.8% | 2.8% | 3.0% |
| Debts in Hong Kong dollar | | | | | |
| Fixed rate | 788 | - | - | - | - |
| Average interest rate | 4.1% | - | - | - | - |
| Variable rate | 196 | 12 | - | - | - |
| Average interest rate (2) | 4.9% | 4.8% | - | - | - |
| Debts in Euro | | | | | |
| Fixed rate | 24 | 23 | 23 | 24 | 23 |
| Average interest rate | 6.7% | 6.7% | 6.7% | 6.7% | 6.7% |

- (1) Carrying amounts are used for loans from Sinopec Group Company and its affiliates as it is not practicable to estimate their fair values because the cost of obtaining discount and borrowing rates for comparable borrowings would be excessive.
- (2) The average interest rates for variable rate loans are calculated based on the rates reported as of December 31, 2005.

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ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not applicable

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

None

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

A. MATERIAL MODIFICATIONS TO THE RIGHTS TO SECURITIES HOLDERS

None

B. USE OF PROCEEDS

Not applicable

ITEM 15. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Our management, with the participation of our Chairman, President and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) of the Securities Exchange Act of 1934) as of the end of the fiscal year covered by this annual report. Based on this evaluation, our Chairman, President and Chief Financial Officer have concluded that, as of the end of the fiscal year covered by this annual report, our disclosure controls and procedures were adequate and effective to ensure that material information relating to our company, including our consolidated subsidiaries, was made known to them by others within our company and our consolidated subsidiaries.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) of the Securities Exchange Act of 1934). The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with International Financial Reporting Standards and generally accepted accounting principles in the United States of America.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of our internal control over financial reporting based upon the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission as of December 31, 2006. Based on that evaluation, our management has concluded that our internal control over financial reporting was effective as of December 31, 2006 based on the these criteria.

KPMG, an independent registered public accounting firm, has audited the consolidated financial statements included in this annual report on Form 20-F and, as part of the audit, has issued a report, included herein, on our

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management's assessment of the effectiveness of our internal control over financial reporting and the effectiveness of our internal control over financial reporting.

Attestation Report of the Registered Public Accounting Firm

The Board of Directors and Shareholders of
China Petroleum & Chemical Corporation:

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that China

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Petroleum & Chemical Corporation and subsidiaries (the "Group") maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control--Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Group's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Group's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that the Group maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in Internal Control--Integrated Framework issued by COSO. Also, in our opinion, the Group maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control--Integrated Framework issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Group as of December 31, 2005 and 2006, and the related consolidated statements of income, cash flows and equity for each of the years in the three-year period ended December 31, 2006, and our report dated April 6, 2007 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG
Hong Kong, China

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April 6, 2007

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Changes in Internal Control over Financial Reporting

During the year ended December 31, 2006, there have been no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 16. RESERVED

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

The board of directors has determined that Mr. Liu Zhongli qualifies as an audit committee financial expert in accordance with the terms of Item 16A of Form 20-F. Mr. Liu was appointed as an independent non-executive director and a member of the audit committee of the third board of our company in May 2006. For Mr. Liu's biographical information, see "Item 6 Directors, Senior Management and Employees - A. Directors, members of the supervisory committee and senior management."

ITEM 16B. CODE OF ETHICS

As of the date of this annual report, we do not have, in form, a code of ethics that applies to our principal executive officer, principal financial officer and principal accounting officer. Our principal executive officers, Mr. Chen Tonghai (Chairman) and Mr. Wang Tianpu (President), and our principal financial officer, Mr. Dai Houliang (CFO), currently also serve as our directors and are thus subject to the director service contracts that they have with us. Under the director service contracts, each of them agrees that he owes a fiduciary and diligence obligation to our company and that he shall not engage in any activities in competition with our business or carry out any activities detrimental to the interests of our company. Each of them also agrees to perform his respective duties as a director and senior officer in accordance with the Company Law of the PRC, relevant rules and regulations promulgated by China Securities Regulatory Commission and the Mandatory Provisions of Articles of Association of Overseas Listed Companies.

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following table sets forth the aggregate audit fees, audit-related fees, tax fees of our principal accountants and all other fees billed for products and services provided by our principal accountants other than the audit fees, audit-related fees and tax fees for each of the fiscal years 2005 and 2006:

| | Audit Fees | Audit-Related Fees | Tax Fees | Other Fees |
|------|----------------|--------------------|----------|------------|
| | ----- | ----- | ----- | ----- |
| 2005 | RMB 72 million | -- | -- | -- |
| 2006 | RMB 81 million | -- | -- | -- |

Before our principal accountants were engaged by our company or our subsidiaries to render audit or non-audit services, the engagement has been approved by our audit committee.

ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

Not applicable.

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ITEM 16E. PURCHASERS OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

None.

PART III

ITEM 17. FINANCIAL STATEMENTS

Not applicable.

ITEM 18. FINANCIAL STATEMENTS

See F-pages following Item 19.

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ITEM 19. EXHIBITS

- 1* Articles of Association of the Registrant, amended and adopted by the shareholders' meeting on May 24, 2006 (English translation).
- 4.1* Forms of Director Service Contracts dated May 24, 2006 (English translation).
- 4.2* Forms of Supervisor Service Contracts dated May 24, 2006 (English translation).
- 4.3** Reorganization Agreement between China Petrochemical Corporation and China Petroleum & Chemical Corporation dated June 3, 2000 (including English translation), incorporated by reference to Exhibit 10.1 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission on October 10, 2000 (File Number: 333-12502).
- 4.4** Agreement for Mutual Provision of Products and Ancillary Services between China Petrochemical Corporation and China Petroleum & Chemical Corporation dated June 3, 2000 (including English translation), incorporated by reference to Exhibit 10.3 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission on October 10, 2000 (File Number: 333-12502).
- 4.5** Agreement for Provision of Cultural, Educational, Hygiene and Community Services between China Petrochemical Corporation and China Petroleum & Chemical Corporation dated June 3, 2000 (including English translation), incorporated by reference to Exhibit 10.4 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission on October 10, 2000 (File Number: 333-12502).
- 4.6** Trademark License Agreement between China Petrochemical Corporation and China Petroleum & Chemical Corporation dated June 3, 2000 (including English translation), incorporated by reference to Exhibit 10.6 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission on October 10, 2000 (File Number: 333-12502).
- 4.7** Patents and Proprietary Technology License Contract between China Petrochemical Corporation and China Petroleum & Chemical Corporation dated June 3, 2000 (including English translation), incorporated by reference to Exhibit 10.7 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission on October 10, 2000

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(File Number: 333-12502).

- 4.8** Computer Software License Contract between China Petrochemical Corporation and China Petroleum & Chemical Corporation dated June 3, 2000 (including English translation), incorporated by reference to Exhibit 10.8 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission on October 10, 2000 (File Number: 333-12502).
 - 4.9** Assets Swap Contract between China Petrochemical Corporation and China Petroleum & Chemical Corporation dated June 3, 2000 (including English translation), incorporated by reference to Exhibit 10.9 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission on October 10, 2000 (File Number: 333-12502).
 - 4.10** Land Use Rights Leasing Contract between China Petrochemical Corporation and China Petroleum & Chemical Corporation dated June 3, 2000 (including English translation), incorporated by reference to Exhibit 10.10 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission on October 10, 2000 (File Number: 333-12502).
 - 4.12** Property Leasing Contract between China Petrochemical Corporation and China Petroleum & Chemical Corporation dated June 3, 2000 (including English translation), incorporated by reference to Exhibit 10.11 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission on October 10, 2000 (File Number: 333-12502).
 - 4.13** Accounts Collectable Contract between China Petrochemical Corporation and China Petroleum & Chemical Corporation dated August 16, 2000 (including English translation), incorporated by reference to Exhibit 10.17 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission on October 10, 2000 (File Number: 333-12502).
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- 4.14** Loan Transfer and Adjustment Contract between China Petrochemical Corporation and China Petroleum & Chemical Corporation dated August 16, 2000 (including English translation), incorporated by reference to Exhibit 10.18 to our Registration Statement on Form F-1 filed with the Securities and Exchange Commission on October 10, 2000 (File Number: 333-12502).
 - 4.15* Agreement on Adjustment to Related Party Transactions between China Petrochemical Corporation and China Petroleum & Chemical Corporation dated June 11, 2001 (English translation).
 - 4.16* Land Use Right Leasing Agreement between China Petrochemical Corporation and China Petroleum & Chemical Corporation dated August 22, 2003 (English translation).
 - 4.17* 2004 Agreement on Adjustment to Related Party Transactions between China Petrochemical Corporation and China Petroleum & Chemical Corporation dated October 31, 2004 (English translation).
 - 4.18* Memorandum on Adjustment of Rent of Land Use Rights between China Petrochemical Corporation and China Petroleum & Chemical Corporation dated March 31, 2006 (English translation).

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- 4.19* Supplemental Agreement on Related Party Transactions between China Petrochemical Corporation and China Petroleum & Chemical Corporation dated March 31, 2006 (English translation).
- 8* A list of the Registrant's subsidiaries.
- 12.1* Certification of Chairman pursuant to Rule 13a-14(a).
- 12.2* Certification of President pursuant to Rule 13a-14(a).
- 12.3* Certification of CFO pursuant to Rule 13a-14(a).
- 13* Certification of CEO and CFO pursuant to 18 U.S.C. ss.1350, and Rule 13a-14(b).

* Filed as part of this annual report

** Incorporated by reference.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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|--|------|
| | ---- |
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders of
China Petroleum & Chemical Corporation:

We have audited the accompanying consolidated balance sheets of China Petroleum & Chemical Corporation and subsidiaries (the "Group") as of December 31, 2005 and 2006, and the related consolidated statements of income, cash flows and equity for each of the years in the three-year period ended December 31, 2006, all expressed in Renminbi. These consolidated financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Group as of December 31, 2005 and 2006, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

International Financial Reporting Standards vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature and effect of such differences is presented in Note 37 to the consolidated financial statements.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Group's internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control--Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated April 6, 2007 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

/s/ KPMG
Hong Kong, China
April 6, 2007

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

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FOR THE YEARS ENDED DECEMBER 31, 2004, 2005 AND 2006
(Amounts in millions, except per share data)

| | | Years ended Decem | |
|---|------|-------------------|---------|
| | Note | 2004 | 2005 |
| | | RMB | RMB |
| Operating revenues | | | |
| Sales of goods..... | | 597,318 | 799,25 |
| Other operating revenues..... | 3 | 22,597 | 24,01 |
| | | ----- | ----- |
| | | 619,915 | 823,27 |
| Other income | 4 | - | 9,41 |
| Operating expenses | | | |
| Purchased crude oil, products and operating supplies and expenses..... | | (442,503) | (651,20 |
| Selling, general and administrative expenses..... | | (32,969) | (33,88 |
| Depreciation, depletion and amortization..... | | (32,493) | (31,61 |
| Exploration expenses, including dry holes..... | | (6,396) | (6,41 |
| Personnel expenses..... | 5 | (18,719) | (18,64 |
| Employee reduction expenses..... | 6 | (919) | (36 |
| Taxes other than income tax..... | 7 | (16,347) | (17,18 |
| Other operating expenses, net..... | 8 | (6,678) | (5,12 |
| | | ----- | ----- |
| Total operating expenses..... | | (557,024) | (764,44 |
| Operating income..... | | 62,891 | 68,24 |
| | | ----- | ----- |
| Finance costs | | | |
| Interest expense..... | 9 | (4,583) | (5,92 |
| Interest income..... | | 378 | 38 |
| Foreign exchange losses..... | | (223) | (7 |
| Foreign exchange gains..... | | 61 | 99 |
| | | ----- | ----- |
| Net finance costs..... | | (4,367) | (4,62 |
| Investment income..... | | 121 | 17 |
| Income from associates..... | | 797 | 85 |
| | | ----- | ----- |
| Income before income tax..... | | 59,442 | 64,65 |
| Income tax..... | 10 | (18,091) | (19,88 |
| | | ----- | ----- |
| Net income | | 41,351 | 44,77 |
| | | ===== | ===== |
| Attributable to: | | | |
| Equity shareholders of the Company..... | | 35,335 | 41,45 |
| Minority interests..... | | 6,016 | 3,32 |
| | | ----- | ----- |
| Net income | | 41,351 | 44,77 |
| | | ===== | ===== |
| Basic and diluted earnings per share..... | 11 | 0.41 | 0.4 |
| | | ===== | ===== |

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Weighted average number of shares..... 11 86,702 86,702
 =====

See accompanying notes to consolidated financial statements.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
 AS OF DECEMBER 31, 2005 AND 2006
 (Amounts in millions)

| | | December 31, | |
|--|------|--------------|---------|
| | Note | 2005 | 2006 |
| | | ----- | ----- |
| | | RMB | RMB |
| ASSETS | | | |
| Current assets | | | |
| Cash and cash equivalents..... | | 14,069 | 8,088 |
| Time deposits with financial institutions..... | | 1,002 | 635 |
| Trade accounts receivable, net..... | 12 | 14,646 | 15,590 |
| Bills receivable..... | | 7,167 | 8,757 |
| Inventories..... | 13 | 89,519 | 93,436 |
| Prepaid expenses and other current assets..... | 14 | 20,654 | 18,961 |
| | | ----- | ----- |
| Total current assets..... | | 147,057 | 145,467 |
| | | ----- | ----- |
| Non-current assets | | | |
| Property, plant and equipment, net..... | 15 | 317,382 | 366,475 |
| Construction in progress..... | 16 | 54,380 | 53,180 |
| Goodwill..... | 17 | 2,203 | 14,325 |
| Investments..... | 18 | 3,151 | 2,582 |
| Interest in associates..... | 19 | 9,267 | 11,617 |
| Deferred tax assets..... | 21 | 6,072 | 7,158 |
| Lease prepayments..... | | 2,407 | 2,937 |
| Long-term prepayments and other assets..... | 22 | 7,121 | 8,049 |
| | | ----- | ----- |
| Total non-current assets..... | | 401,983 | 466,323 |
| | | ----- | ----- |
| Total assets..... | | 549,040 | 611,790 |
| | | ===== | ===== |
| LIABILITIES AND EQUITY | | | |
| Current liabilities | | | |
| Short-term debts..... | 23 | 40,411 | 53,359 |
| Loans from Sinopec Group Company and its affiliates..... | 23 | 2,805 | 5,401 |
| Trade accounts payable..... | 24 | 53,817 | 52,125 |
| Bills payable..... | | 23,243 | 21,685 |
| Accrued expenses and other payables..... | 25 | 49,523 | 69,056 |
| Income tax payable..... | | 5,212 | 9,176 |
| | | ----- | ----- |
| Total current liabilities..... | | 175,011 | 210,802 |
| | | ----- | ----- |
| Non-current liabilities | | | |

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| | | | |
|--|----|---------|---------|
| Long-term debts..... | 23 | 72,359 | 69,970 |
| Loans from Sinopec Group Company and its affiliates..... | 23 | 39,933 | 39,095 |
| Deferred tax liabilities..... | 21 | 5,975 | 6,339 |
| Other liabilities..... | | 782 | 795 |
| | | ----- | ----- |
| Total non-current liabilities..... | | 119,049 | 116,199 |
| | | ----- | ----- |
| Total liabilities..... | | 294,060 | 327,001 |
| | | ----- | ----- |
| Equity | | | |
| Share capital..... | 26 | 86,702 | 86,702 |
| Reserves..... | 27 | 137,599 | 176,143 |
| | | ----- | ----- |
| Total equity attributable to equity shareholders of the Company | | 224,301 | 262,845 |
| Minority interests..... | | 30,679 | 21,944 |
| | | ----- | ----- |
| Total equity..... | | 254,980 | 284,789 |
| | | ----- | ----- |
| Total liabilities and equity..... | | 549,040 | 611,790 |
| | | ===== | ===== |

See accompanying notes to consolidated financial statements.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2004, 2005 AND 2006
(Amounts in millions)

| | Note | Years ended December | |
|---|------|----------------------|----------|
| | | 2004 | 2005 |
| | | ----- | ----- |
| | | RMB | RMB |
| Net cash generated from operating activities..... | (a) | 68,941 | 78,214 |
| | | ----- | ----- |
| Cash flows from investing activities | | | |
| Capital expenditure..... | | (64,313) | (63,993) |
| Exploratory wells expenditure..... | | (4,959) | (5,810) |
| Capital expenditure of jointly controlled entities..... | | (6,035) | (2,474) |
| Purchase of investments, investments in associates and subsidiaries, net of cash acquired..... | | (1,305) | (3,650) |
| Proceeds from disposal of investments and investments in associates..... | | 186 | 1,264 |
| Proceeds from disposal of property, plant and equipment..... | | 322 | 567 |
| Acquisition of minority interests in subsidiaries..... | | -- | (4,324) |
| Purchase of time deposits with financial institutions..... | | (1,932) | (565) |
| Maturity of time deposits with financial institutions..... | | 2,217 | 1,462 |
| | | ----- | ----- |
| Net cash used in investing activities..... | | (75,819) | (77,523) |
| | | ----- | ----- |
| Cash flows from financing activities | | | |
| Proceeds from bank and other loans..... | | 403,201 | 554,187 |

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| | | |
|--|-----------|-----------|
| Proceeds from bank and other loans of jointly controlled entities..... | 3,014 | 3,954 |
| Proceeds from issuance of corporate bonds..... | 3,472 | 9,875 |
| Repayments of bank and other loans..... | (388,811) | (557,692) |
| Repayment of corporate bonds..... | -- | -- |
| Distributions to minority interests..... | (823) | (1,682) |
| Contributions from minority interests..... | 1,008 | 129 |
| Dividend paid..... | (8,670) | (10,404) |
| Distributions to Sinopec Group Company..... | (3,741) | (3,218) |
| | ----- | ----- |
| Net cash generated from/(used in) financing activities | 8,650 | (4,851) |
| | ----- | ----- |
| Net increase/(decrease) in cash and cash equivalents..... | 1,772 | (4,160) |
| Effect of foreign exchange rate changes..... | 1 | (22) |
| Cash and cash equivalents at January 1..... | 16,478 | 18,251 |
| | ----- | ----- |
| Cash and cash equivalents at December 31..... | 18,251 | 14,069 |
| | ===== | ===== |

See accompanying notes to consolidated financial statements.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2004, 2005 AND 2006
(Amounts in millions)

(a) Reconciliation of income before income tax to net cash generated from operating activities

The reconciliation of income before income tax to net cash generated from operating activities is as follows:

| | Years ended December 31, | | |
|---|--------------------------|---------|---------|
| | 2004 | 2005 | 2006 |
| | ----- | ----- | ----- |
| | RMB | RMB | RMB |
| Operating activities | | | |
| Income before income tax..... | 59,442 | 64,656 | 78,920 |
| Adjustment for: | | | |
| Depreciation, depletion and amortization..... | 32,493 | 31,618 | 34,230 |
| Dry hole cost..... | 2,976 | 2,992 | 3,960 |
| Income from associates..... | (797) | (857) | (940) |
| Investment income..... | (121) | (178) | (250) |
| Interest income..... | (378) | (384) | (550) |
| Interest expense..... | 4,583 | 5,926 | 7,430 |
| Unrealized foreign exchange losses/(gains)..... | 150 | (852) | (680) |
| Loss on disposal of property, plant and equipment, net..... | 1,697 | 2,098 | 1,640 |
| Impairment losses on long-lived assets..... | 3,919 | 1,851 | 820 |
| | ----- | ----- | ----- |
| Operating income before changes in working capital..... | 103,964 | 106,870 | 124,570 |

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| | | | |
|---|----------|----------|---------|
| Increase in trade accounts receivable..... | (521) | (4,759) | (73) |
| (Increase)/decrease in bills receivable..... | (1,495) | 652 | (1,57) |
| Increase in inventories..... | (16,526) | (25,037) | (3,11) |
| Decrease in prepaid expenses and other current assets..... | 2,930 | 1,786 | 37 |
| Decrease/(increase) in lease prepayments..... | 187 | (1,071) | (55) |
| Increase in long-term prepayments and other assets..... | (4,321) | (2,222) | (1,12) |
| Increase/(decrease) in trade accounts payable..... | 850 | 29,142 | (1,90) |
| Increase/(decrease) in bills payable..... | 6,521 | (7,554) | (1,61) |
| (Decrease)/increase in accrued expenses and other payables... | (289) | 8,154 | 9,53 |
| (Decrease)/increase in other liabilities..... | (334) | (227) | 1 |
| | ----- | ----- | ----- |
| Cash generated from operations | 90,966 | 105,734 | 123,87 |
| Interest received..... | 378 | 388 | 55 |
| Interest paid..... | (5,450) | (6,967) | (8,86) |
| Investment and dividend income received..... | 330 | 668 | 61 |
| Income tax paid..... | (17,283) | (21,609) | (20,32) |
| | ----- | ----- | ----- |
| Net cash generated from operating activities..... | 68,941 | 78,214 | 95,87 |
| | ===== | ===== | ===== |

See accompanying notes to consolidated financial statements.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EQUITY
(Amounts in millions)

| | Share capital | Capital reserve | Share premium | Revaluation reserve | Other reserves | Retained earnings |
|---|------------------|--------------------|------------------|------------------------|-------------------|----------------------|
| | RMB | RMB | RMB | RMB | RMB | RMB |
| Balance at January 1, 2004, as previously reported..... | 86,702 | (18,960) | 18,072 | 30,341 | 23,528 | 31,832 |
| Adjusted for the acquisition of the Acquired Group..... | -- | -- | -- | -- | 984 | -- |
| | ----- | ----- | ----- | ----- | ----- | ----- |
| Balance at January 1, 2004, as adjusted | 86,702 | (18,960) | 18,072 | 30,341 | 24,512 | 31,832 |
| Net income / (loss) recognized directly in equity: | | | | | | |
| Revaluation surplus of Petrochemical and Catalyst Assets.. | -- | (257) | -- | 257 | 257 | -- |
| Impairment losses on revalued assets (Note 8) | -- | -- | -- | (709) | -- | -- |
| | ----- | ----- | ----- | ----- | ----- | ----- |
| Net income..... | -- | (257) | -- | (452) | 257 | -- |
| | ----- | ----- | ----- | ----- | ----- | ----- |
| Net income..... | -- | -- | -- | -- | -- | 35,335 |
| | ----- | ----- | ----- | ----- | ----- | ----- |
| Total recognized income for the year.... | -- | (257) | -- | (452) | 257 | 35,335 |
| Final dividend for 2004 | -- | -- | -- | -- | -- | (5,202) |

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| | | | | | | |
|---|--------|----------|--------|---------|---------|---------|
| Interim dividend for 2004..... | -- | -- | -- | -- | -- | (3,468) |
| Appropriations (Note 27 (c) and (d)).... | -- | -- | -- | -- | 6,456 | (6,456) |
| Revaluation surplus realized..... | -- | -- | -- | (1,891) | -- | 1,891 |
| Realization of deferred tax on land use rights..... | -- | -- | -- | -- | (5) | 5 |
| Transfer from retained earnings to other reserves..... | -- | -- | -- | -- | 815 | (815) |
| Net assets distributed to Sinopec Group Company (Note 27(g))..... | -- | -- | -- | -- | (2,244) | -- |
| Consideration for Acquisition of Petrochemical and Catalyst Assets (Note 30)..... | -- | -- | -- | -- | (3,128) | -- |
| Distributions to minority interests net of contribution..... | -- | -- | -- | -- | -- | -- |
| Balance at December 31, 2004 | 86,702 | (19,217) | 18,072 | 27,998 | 26,663 | 53,122 |
| Net income / total recognized income for the year..... | -- | -- | -- | -- | -- | 41,455 |
| Final dividend for 2004 | -- | -- | -- | -- | -- | (6,936) |
| Interim dividend for 2005..... | -- | -- | -- | -- | -- | (3,468) |
| Appropriation (Note 27 (c) and (d)).... | -- | -- | -- | -- | 7,912 | (7,912) |
| Revaluation surplus realized..... | -- | -- | -- | (1,656) | -- | 1,656 |
| Realization of deferred tax on land use rights..... | -- | -- | -- | -- | (5) | 5 |
| Transfer from retained earnings to other reserves..... | -- | -- | -- | -- | 535 | (535) |
| Distribution to Sinopec Group Company (Note 27(g))..... | -- | -- | -- | -- | (90) | -- |
| Acquisitions of minority interests in subsidiaries | -- | -- | -- | -- | -- | -- |
| Distributions to minority interests net of contribution..... | -- | -- | -- | -- | -- | -- |
| Balance at December 31, 2005..... | 86,702 | (19,217) | 18,072 | 26,342 | 35,015 | 77,387 |

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EQUITY - (Continued)
(Amounts in millions)

| | Share capital | Capital reserve | Share premium | Revaluation reserve | Other reserves | Retained earnings |
|--|---------------|-----------------|---------------|---------------------|----------------|-------------------|
| | RMB | RMB | RMB | RMB | RMB | RMB |
| Balance at December 31, 2005..... | 86,702 | (19,217) | 18,072 | 26,342 | 35,015 | 77,387 |
| Net income recognized directly in equity: | | | | | | |
| Change in fair value of available-for-sale securities, net of deferred tax | -- | -- | -- | -- | 34 | -- |
| Net income..... | -- | -- | -- | -- | -- | 53,912 |
| Total recognized income for the year | -- | -- | -- | -- | 34 | 53,912 |

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| | | | | | | |
|---|--------|----------|--------|---------|---------|----------|
| Final dividend for 2005..... | -- | -- | -- | -- | -- | (7,803) |
| Interim dividend for 2006..... | -- | -- | -- | -- | -- | (3,468) |
| Appropriation (Note 27(c) and (e))..... | -- | -- | -- | -- | 25,066 | (25,066) |
| Revaluation surplus realized | -- | -- | -- | (1,590) | -- | 1,590 |
| Realization of deferred tax on land use rights..... | -- | -- | -- | -- | (7) | 7 |
| Transfer from retained earnings to other reserves..... | -- | -- | -- | -- | 1,013 | (1,013) |
| Transfer from capital reserve to other reserves..... | -- | (2,373) | -- | -- | 2,373 | -- |
| Distribution to Sinopec Group Company (Note 27(g))..... | -- | -- | -- | -- | (631) | -- |
| Consideration for the Acquisition of Oil Production Plants (Note 1)..... | -- | -- | -- | -- | (3,500) | -- |
| Acquisitions of minority interests in subsidiaries..... | -- | -- | -- | -- | -- | -- |
| Contributions from minority interests net of distributions..... | -- | -- | -- | -- | -- | -- |
| Disposal of a subsidiary (Note 33)..... | -- | -- | -- | -- | -- | -- |
| | ----- | ----- | ----- | ----- | ----- | ----- |
| Balance at December 31, 2006..... | 86,702 | (21,590) | 18,072 | 24,752 | 59,363 | 95,546 |
| | ===== | ===== | ===== | ===== | ===== | ===== |

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in millions, except per share data and except otherwise stated)

1 PRINCIPAL ACTIVITIES, ORGANIZATION AND BASIS OF PRESENTATION

Principal activities

China Petroleum & Chemical Corporation (the "Company") is an energy and chemical company that, through its subsidiaries (hereinafter collectively referred to as the "Group"), engages in fully integrated oil and gas and chemical operations in the People's Republic of China (the "PRC"). Oil and gas operations consist of exploring for, developing and producing crude oil and natural gas; transporting crude oil, natural gas and products by pipelines; refining crude oil into finished petroleum products; and marketing crude oil, natural gas and refined petroleum products. Chemical operations include the manufacture and marketing of a wide range of chemicals for industrial uses.

Organization

The Company was established in the PRC on February 25, 2000 as a joint stock limited company as part of the reorganization (the "Reorganization") of China Petrochemical Corporation ("Sinopec Group Company"), the ultimate holding company of the Group and a ministry-level enterprise under the direct supervision of the State Council of the PRC. Prior to the incorporation of the Company, the oil and gas and chemical operations of the Group were carried on by oil administration bureau, petrochemical and refining production enterprises and sales and marketing companies of Sinopec Group Company.

As part of the Reorganization, certain of Sinopec Group Company's core oil and gas and chemical operations and businesses together with the related assets and liabilities were transferred to the Company. On February 25, 2000, in

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consideration for Sinopec Group Company transferring such oil and gas and chemical operations and businesses and the related assets and liabilities to the Company, the Company issued 68.8 billion domestic state-owned ordinary shares with a par value of RMB 1.00 each to Sinopec Group Company. The shares issued to Sinopec Group Company on February 25, 2000 represented the entire registered and issued share capital of the Company at that date. The oil and gas and chemical operations and businesses transferred to the Company related to (i) the exploration, development and production of crude oil and natural gas, (ii) the refining, transportation, storage and marketing of crude oil and petroleum products, and (iii) the production and sale of chemicals (collectively the "Predecessor Operations").

Basis of presentation

Pursuant to the resolution passed at the Directors' meeting on October 10, 2006, the Group acquired equity interests in Sinopec Hainan Refining and Chemical Company Limited ("Sinopec Hainan") for cash of RMB 2,990 (hereinafter referred to as the "Acquisition of Sinopec Hainan"). Sinopec Hainan was previously wholly owned by Sinopec Group Company.

Pursuant to the resolution passed at the Directors' meeting on December 6, 2006, the Group acquired the equity interests in certain oil and gas production companies ("Oil Production Plants") from Sinopec Group Company, for a total consideration of RMB 3,500 payable in 2007 (hereinafter referred to as the "Acquisition of Oil Production Plants").

As the Group, Sinopec Hainan and Oil Production Plants are under the common control of Sinopec Group Company, the Acquisitions of Sinopec Hainan and Oil Production Plants are considered as "combination of entities under common control" which are accounted in a manner similar to a pooling-of-interests ("as-if pooling-of-interests accounting"). Accordingly, the assets and liabilities acquired from Sinopec Hainan and Oil Production Plants have been accounted for at historical cost. In connection with these acquisitions, certain assets, primarily property, plant and equipment and construction in progress, were retained by Sinopec Group Company. The assets retained by Sinopec Group Company and the considerations paid by the Company for these acquisitions were treated as equity transactions.

The financial condition and results of operation previously reported by the Group as of December 31, 2005 and for the years ended December 31, 2004 and 2005 have been restated to include the financial condition and results of operation of Sinopec Hainan and Oil Production Plants (collectively the "Acquired Group") as set out below.

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| | The Group without the Acquired Group | The Acquired Group |
|---|---|--------------------------|
| | ----- RMB | ----- RMB |
| 2004 | | |
| Results of operation: | | |
| Operating revenue..... | 619,783 | 132 |
| Net income attributable to the equity shareholders of the Company..... | 36,019 | (684) |
| Basic and diluted earnings per share..... | 0.42 | (0.01) |

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2005

| | | |
|---|---------|--------|
| Results of operation: | | |
| Operating revenue..... | 823,117 | 155 |
| Net income attributable to the equity shareholders of the Company..... | 40,920 | 535 |
| Basic and diluted earnings per share..... | 0.47 | 0.01 |
| Financial condition: | | |
| Current assets..... | 145,291 | 1,766 |
| Total assets..... | 537,321 | 11,719 |
| Current liabilities..... | 170,649 | 4,362 |
| Total liabilities..... | 284,325 | 9,735 |
| Total equity attributable to equity shareholders of the Company..... | 223,556 | 745 |

For the years presented, all significant balances and transactions between the Group and the Acquired Group have been eliminated.

The accompanying consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") promulgated by the International Accounting Standards Board ("IASB"). IFRS includes International Accounting Standards ("IAS") and related interpretations. A summary of the principal accounting policies adopted by the Group is set out in Note 2. These accounting policies have been consistently applied by the Group. Information relating to the nature and effect of the significant differences between IFRS and accounting principles generally accepted in the United States of America ("US GAAP") are set forth in Note 37.

The accompanying consolidated financial statements are prepared on the historical cost basis as modified by the revaluation of certain property, plant and equipment (Note 15).

The preparation of the financial statements requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

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Key assumptions and estimation made by management in the application of IFRS that have significant effect on the financial statements and have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities in the following year are disclosed in Note 35.

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2. PRINCIPAL ACCOUNTING POLICIES

(a) Basis of consolidation

The consolidated financial statements comprise the Company and its subsidiaries, and the Group's interest in associates and jointly controlled entities.

(i) Subsidiaries

Subsidiaries are those entities controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The financial statements of subsidiaries are included in the consolidated financial statements from the date that control effectively commences until the date that control effectively ceases.

Minority interests at the balance sheet date, being the portion of the net assets of subsidiaries attributable to equity interests that are not owned by the Company, whether directly or indirectly through subsidiaries, are presented in the consolidated balance sheet and consolidated statements of equity within equity, separately from equity attributable to the equity shareholders of the Company. Minority interests in the results of the Group are presented on the face of the consolidated statements of income as an allocation of the total net income or loss for the year between minority interests and the equity shareholders of the Company.

The particulars of the Group's principal subsidiaries are set out in Note 33.

(ii) Interests in associates

An associate is an entity, not being a subsidiary, in which the Group exercises significant influence over its management. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

Investments in associates are accounted for in the consolidated financial statements using the equity method from the date that significant influence commences until the date that significant influence ceases.

(iii) Jointly controlled entities

A jointly controlled entity is an entity over which the Group can exercise joint control with other venturers. Joint control is the contractually agreed sharing of control over an economic activity.

Investments in jointly controlled entities are accounted for in the consolidated financial statements on a proportionate consolidation basis. Under this method, the Group combines its proportionate share of the jointly

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controlled entity's turnover and expenses with each major turnover and expense caption of the Group's consolidated statements of income and combines its proportionate share of the jointly controlled entity's assets and liabilities with each major asset and liability caption of the Group's consolidated balance sheet, from the date that joint control commences until the date that joint control ceases.

(iv) Transactions eliminated on consolidation

Inter-company balances and transactions and any unrealized gains arising from inter-company transactions are eliminated on consolidation. Unrealized gains arising from transactions with associates and jointly controlled entities are eliminated to the extent of the Group's interest in the entity. Unrealized losses are eliminated in the same way as unrealized gains, but only to the extent that there is no evidence of impairment.

(b) Translation of foreign currencies

The presentation currency of the Group is Renminbi. Foreign currency transactions during the year are translated into Renminbi at the applicable rates of exchange quoted by the People's Bank of China ("PBOC rates") prevailing on the transaction dates. Foreign currency monetary assets and liabilities are translated into Renminbi at the applicable PBOC rates at the balance sheet date.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

Exchange differences, other than those capitalized as construction in progress, are recognized as income or expenses in the consolidated statements of income. There were no exchange differences capitalized for the years ended December 31, 2004, 2005 and 2006.

(c) Cash and cash equivalents

Cash equivalents consist of time deposits with financial institutions with an initial term of less than three months when purchased. Cash equivalents are stated at cost, which approximates fair value.

(d) Trade accounts and other receivables

Trade accounts and other receivables are initially recognized at fair value and thereafter stated at amortized cost less impairment losses for bad and doubtful debts (Note 2(1)).

(e) Inventories

Inventories, other than spare parts and consumables, are stated at the lower of cost and net realizable value. Cost includes the cost of purchase computed using the weighted average method and, in the case of work in progress and finished goods, direct labor and an appropriate proportion of production overheads. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and the estimated costs necessary to make the sale.

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Spare parts and consumables are stated at cost less any provision for obsolescence.

(f) Property, plant and equipment

An item of property, plant and equipment is initially recorded at cost, less accumulated depreciation and impairment losses (Note 2(1)). The cost of an asset comprises its purchase price, any directly attributable costs of bringing the asset to working condition and location for its intended use. Subsequent to the revaluation (Note 15), which was based on depreciated replacement costs, property, plant and equipment are carried at revalued amount, being the fair value at the date of the revaluation less any subsequent accumulated depreciation and impairment losses. Revaluations are performed periodically to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date. The Group recognizes in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Group and the cost of the item can be measured reliably. All other expenditure is recognized as an expense in the consolidated statements of income in the year in which it is incurred.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

Gains or losses arising from the retirement or disposal of an item of property, plant and equipment, other than oil and gas properties, are determined as the difference between the net disposal proceeds and the carrying amount of the item and are recognized as income or expense in the consolidated statements of income on the date of retirement or disposal. On disposal of a revalued asset, the related revaluation surplus is transferred from the revaluation reserve to retained earnings.

Depreciation is provided to write off the cost/revalued amount of items of property, plant and equipment, other than oil and gas properties, over its estimated useful life on a straight-line basis, after taking into account its estimated residual value, as follows:

| | |
|---|----------|
| Buildings | 15 to 45 |
| Plant, machinery, equipment, oil depots, storage tanks and others | 4 to 18 |
| Service stations | 25 |

Where parts of an item of property, plant and equipment have different useful lives, the cost or valuation of the item is allocated on a reasonable basis between the parts and each part is depreciated separately. Both the useful life of an asset and its residual value, if any, are reassessed annually.

(g) Oil and gas properties

The Group uses the successful efforts method of accounting for its oil and gas producing activities. Under this method, costs of development wells and the

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related support equipment are capitalized. The cost of exploratory wells is initially capitalized as construction in progress pending determination of whether the well has found proved reserves. The impairment of exploratory well costs occurs upon the determination that the well has not found proved reserves. Exploratory wells that find oil and gas reserves in any area requiring major capital expenditure are expensed unless the well has found a sufficient quantity of reserves to justify its completion as a producing well if the required capital expenditure is made, and drilling of the additional exploratory wells is under way or firmly planned for the near future. However, in the absence of a determination of the discovery of proved reserves, exploratory well costs are not carried as an asset for more than one year following completion of drilling. If, after one year has passed, a determination of the discovery of proved reserves cannot be made, the exploratory well costs are impaired and charged to expense. All other exploration costs, including geological and geophysical costs, other dry hole costs and annual lease rentals, are expensed as incurred. Capitalized costs relating to proved properties are amortized at the field level on a unit-of-production method. The amortization rates are determined based on oil and gas reserves estimated to be recoverable from existing facilities over the shorter of the economic lives of crude oil and natural gas reservoirs and the terms of the relevant production licenses.

Gains and losses on the disposal of proved oil and gas properties are not recognized unless the disposal encompasses an entire property. The proceeds on such disposals are credited to the carrying amounts of oil and gas properties.

(h) Lease prepayments

Lease prepayments represent land use rights paid to the relevant government authorities. Land use rights are carried at cost less accumulated amortization and impairment losses (Note 2(1)). Amortization is provided to write off the cost of lease prepayments on a straight-line basis over the respective periods of the rights.

(i) Construction in progress

Construction in progress represents buildings, oil and gas properties, various plant and equipment under construction and pending installation, and is stated at cost less impairment losses (Note 2(1)). Cost of an item comprises direct costs of construction as well as interest charges, and foreign exchange differences on related borrowed funds to the extent that they are regarded as an adjustment to interest charges, during the periods of construction.

Construction in progress is transferred to property, plant and equipment when the asset is substantially ready for its intended use.

No depreciation is provided in respect of construction in progress.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

(j) Goodwill

Goodwill represents amounts arising on acquisition of subsidiaries, associates or jointly controlled entities. Goodwill represents the difference between the cost of acquisition and the fair value of the net identifiable assets acquired.

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Goodwill is stated at cost less accumulated impairment losses. Goodwill is allocated to cash-generating units and is tested annually for impairment (Note 2(1)). In respect of associates, the carrying amount of goodwill is included in the carrying amount of the interest in associates.

(k) Investments

Investment in available-for-sale equity securities are carried at fair value with any change in fair value, other than impairment losses (Note 2(1)), recognized directly in equity. When these investments are derecognized or impaired, the cumulative gain or loss previously recognized directly in equity is recognized in the consolidated statements of income. Investments in equity securities, other than investments in associates, that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are recognized in the balance sheet at cost less impairment losses (Note 2(1)).

(l) Impairment of assets

(i) Impairment of trade accounts receivable, other receivables and investment in equity securities other than investments in associates are accounted as follows:

Trade accounts receivable, other receivables and investment in equity securities other than investments in associates are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, an impairment loss is determined and recognized. The impairment loss is measured as the difference between the asset's carrying amount and the estimated future cash flows, discounted at the current market rate of return for a similar financial asset where the effect of discounting is material, and is recognized as an expense in the consolidated statements of income. Impairment losses for trade and other receivables are reversed through the consolidated statements of income if in a subsequent period the amount of the impairment losses decreases. Impairment losses for equity securities are not reversed.

(ii) Impairment of other long-lived assets is accounted for as follows:

The carrying amounts of other long-lived assets, including property, plant and equipment, construction in progress, lease prepayment and investments in associates, are reviewed periodically in order to assess whether the recoverable amounts have declined below the carrying amounts. These assets are tested for impairment whenever events or changes in circumstances indicate that their recorded carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to the recoverable amount. For goodwill, the recoverable amount is estimated at each balance sheet date.

The recoverable amount is the greater of the fair value less costs to sell and the value in use. In determining the value in use, expected future cash flows generated by the asset are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

The amount of the reduction is recognized as an expense in the consolidated statements of income unless the asset is carried at revalued amount for which an impairment loss is recognized directly against any related revaluation reserve to the extent that the impairment loss does not exceed the amount held in the revaluation reserve for that same asset. Impairment losses recognized in respect

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of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit and then, to reduce the carrying amount of the other assets in the unit on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

The Group assesses at each balance sheet date whether there is any indication that an impairment loss recognized for an asset, except in the case of goodwill, in prior years may no longer exist. An impairment loss is reversed if there has been a favorable change in the estimates used to determine the recoverable amount. A

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

subsequent increase in the recoverable amount of an asset, when the circumstances and events that led to the write-down or write-off cease to exist, is recognized as income unless the asset is carried at revalued amount. Reversal of an impairment loss on a revalued asset is credited to the revaluation reserve except for impairment loss which was previously recognized as an expense in the consolidated statements of income; a reversal of such impairment loss is recognized as an income. The reversal is reduced by the amount that would have been recognized as depreciation had the write-down or write-off not occurred. An impairment loss in respect of goodwill is not reversed.

(m) Trade accounts and other payables

Trade accounts and other payables are initially recognized at fair value and thereafter stated at amortized cost unless the effect of discounting would be immaterial, in which case they are stated at cost.

(n) Interest-bearing borrowings

Interest bearing borrowings are recognized initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortized cost with any difference between cost and redemption value being recognized in the consolidated statements of income over the period of borrowings using the effective interest method.

(o) Provisions and contingent liability

A provision is recognized for liability of uncertain timing or amount when the Group has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made.

When it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

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(p) Revenue recognition

Revenues associated with the sale of crude oil, natural gas, petroleum and chemical products and ancillary materials are recorded when the customer accepts the goods and the significant risks and rewards of ownership and title have been transferred to the buyer. Revenue from the rendering of services is recognized in the consolidated statements of income upon performance of the services. No revenue is recognized if there are significant uncertainties regarding recovery of the consideration due, the possible return of goods, or when the amount of revenue and the costs incurred or to be incurred in respect of the transaction cannot be measured reliably.

Interest income is recognized on a time apportioned basis that takes into account the effective yield on the asset.

Government grants relating to the purchase of assets used for technology improvements are initially recorded as long-term liabilities when there is reasonable assurance that they will be received and thereafter offset against the cost of the related assets upon the transfer of these assets to property, plant and equipment. The grants are recognized as income over the useful life of these property, plant and equipment by way of reduced depreciation.

A government grant that becomes receivable as compensation for expenses or losses already incurred with no future related costs is recognized as income in the period in which it becomes receivable.

(q) Borrowing costs

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Borrowing costs are expensed in the consolidated statements of income in the year in which they are incurred, except to the extent that they are capitalized as being attributable to the construction of an asset which necessarily takes a period of time to get ready for its intended use.

(r) Repairs and maintenance expenditure

Repairs and maintenance expenditure is expensed as incurred.

(s) Environmental expenditures

Environmental expenditures that relate to current ongoing operations or to conditions caused by past operations are expensed as incurred.

Liabilities related to future remediation costs are recorded when environmental assessments and/or cleanups are probable and the costs can be reasonably estimated. As facts concerning environmental contingencies become known to the Group, the Group reassesses its position both with respect to accrued liabilities and other potential exposures.

(t) Research and development costs

Research and development costs are recognized as expenses in the year in which they are incurred. Research and development costs amounted to RMB 1,541, RMB 2,244 and RMB 2,902 for the years ended December 31, 2004, 2005 and 2006, respectively.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

(u) Operating leases

Operating lease payments are charged to the consolidated statements of income on a straight-line basis over the period of the respective leases. Operating lease charges amounted to RMB 4,288, RMB 5,516 and RMB 6,128 for the years ended December 31, 2004, 2005 and 2006, respectively.

(v) Retirement benefits

The contributions payable under the Group's retirement plans are recognized as expenses in the consolidated statements of income as incurred and according to the contribution determined by the plans. Further information is set out in Note 31.

(w) Income tax

Income tax comprises current and deferred tax. Current tax is calculated on taxable income by applying the applicable tax rates. Deferred tax is provided using the balance sheet liability method on all temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is calculated on the basis of the enacted tax rates that are expected to apply in the period when the asset is realized or the liability is settled.

The tax value of losses expected to be available for utilization against future taxable income is set off against the deferred tax liability within the same legal tax unit and jurisdiction to the extent appropriate, and is not available for set-off against the taxable profit of another legal tax unit. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

(x) Dividends

Dividends are recognized as a liability in the period in which they are declared.

(y) Segmental reporting

A business segment is a distinguishable component of the Group that is engaged in providing products or services and is subject to risks and rewards that are different from those of other segments.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

3. OTHER OPERATING REVENUES

Other operating revenues represent:

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| | Years ended December 31, | | |
|--|--------------------------|--------|--------|
| | 2004 | 2005 | 2006 |
| | ----- | ----- | ----- |
| | RMB | RMB | RMB |
| Sale of materials, service and others..... | 22,224 | 23,619 | 26,366 |
| Rental income..... | 373 | 394 | 384 |
| | ----- | ----- | ----- |
| | 22,597 | 24,013 | 26,750 |
| | ===== | ===== | ===== |

4. OTHER INCOME

During the years ended December 31, 2005 and 2006, the Group received cash government grants from the Ministry of Finance of the PRC of RMB 9,415 and RMB 5,000, respectively, as a compensation of loss incurred due to the distortion of the correlation of domestic refined petroleum product prices and the crude oil prices. There are no unfilled conditions and other contingencies attached to the receipt of the government grant. There is no assurance that the Group will continue to receive such grant in the future.

5. PERSONNEL EXPENSES

Personnel expenses represent:

| | Years ended December 31, | | |
|--|--------------------------|--------|--------|
| | 2004 | 2005 | 2006 |
| | ----- | ----- | ----- |
| | RMB | RMB | RMB |
| Wages and salaries..... | 13,660 | 13,742 | 14,840 |
| Staff welfare..... | 1,782 | 1,808 | 1,927 |
| Contributions to retirement schemes..... | 2,245 | 2,273 | 2,270 |
| Social security contributions..... | 1,032 | 826 | 820 |
| | ----- | ----- | ----- |
| | 18,719 | 18,649 | 19,857 |
| | ===== | ===== | ===== |

6. EMPLOYEE REDUCTION EXPENSES

During the year ended December 31, 2004, in accordance with the Group's voluntary employee reduction plan, and in connection with the Acquisition of Petrochemical and Catalyst Assets from and Disposal of Downhole Assets to Sinopec Group Company, the Group recorded employee reduction expenses of RMB 919 relating to reduction of approximately 24,000 employees.

During the year ended December 31, 2005, in accordance with the Group's voluntary employee reduction plan, the Group recorded employee reduction expenses of RMB 369 in respect of the voluntary termination of approximately 7,000 employees.

During the year ended December 31, 2006, in accordance with the Group's voluntary employee reduction plan, the Group recorded employee reduction expenses of RMB 236 in respect of the voluntary termination of approximately 4,000 employees.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
 (All amounts in millions, except per share data and except otherwise stated)

7. TAXES OTHER THAN INCOME TAX

Taxes other than income tax represent:

| | Years ended December 31, | | |
|------------------------------|--------------------------|--------|--------|
| | 2004 | 2005 | 2006 |
| | RMB | RMB | RMB |
| Consumption tax..... | 11,920 | 12,430 | 14,121 |
| Special oil income levy..... | - | - | 8,747 |
| City construction tax..... | 2,544 | 2,589 | 3,038 |
| Education surcharge..... | 1,260 | 1,311 | 1,615 |
| Resources tax..... | 458 | 642 | 854 |
| Business tax..... | 165 | 213 | 264 |
| | ----- | ----- | ----- |
| | 16,347 | 17,185 | 28,639 |
| | ===== | ===== | ===== |

Consumption tax is levied on producers of gasoline, diesel, naphtha, fuel oil, jet fuel, lubricant oil and solvent oil based on a tariff rate applied to the volume of sales. Effective March 26, 2006, a special oil income levy has been levied on oil exploration and production entities based on the progressive rates ranging from 20% to 40% on the portion of the monthly weighted average sales price of the crude oil produced in the PRC exceeding USD 40 per barrel. City construction tax is levied on an entity based on its total amount of value-added tax, consumption tax and business tax.

8. OTHER OPERATING EXPENSES, NET

Other operating expenses, net represent:

| | Years ended December 31, | | |
|---|--------------------------|-------|-------|
| | 2004 | 2005 | 2006 |
| | RMB | RMB | RMB |
| Fines, penalties and compensations..... | 277 | 155 | 65 |
| Donations..... | 291 | 203 | 98 |
| Loss on disposal of property, plant and equipment, net... | 1,697 | 2,098 | 1,646 |
| Impairment losses on long-lived assets (i)..... | 3,919 | 1,851 | 825 |
| Gain from debt extinguishment (ii)..... | - | - | (486) |
| Others..... | 494 | 821 | 289 |
| | ----- | ----- | ----- |
| | 6,678 | 5,128 | 2,437 |
| | ===== | ===== | ===== |

(i) Impairment losses recognized on long-lived assets of the refining segment were RMB 14, RMB nil and RMB nil for the years ended December 31, 2004, 2005 and 2006, respectively. Impairment losses recognized on long-lived assets of the chemicals segment were RMB 2,747, RMB 1,425 and RMB 250 for the years ended December 31, 2004, 2005 and 2006, respectively. These impairment losses relate to certain refining and chemical production facilities that are held for use.

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The carrying values of these facilities were written down to their recoverable amount that were based either on the asset held for use model using the present value of estimated future cash flows or on the appraised values of the production facilities. Amounts of RMB 2,052, RMB 1,425 and RMB 250 for the years ended December 31, 2004, 2005 and 2006, respectively, were charged to the consolidated statements of income. An amount of RMB 709 for the year ended December 31, 2004 was charged directly against the related revaluation reserve in respect of those assets that were carried at revalued amount. The primary factor resulting in the impairment losses on long-lived assets of the refining and chemicals segments was due to higher operating and production costs caused by the increase in the prices of raw materials that are not expected to be recovered through an increase in selling price.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

Impairment losses recognized on long-lived assets of the marketing and distribution segment of RMB 1,769, RMB 366 and RMB 23 respectively, for the years ended December 31, 2004, 2005 and 2006 primarily relate to certain service stations that were closed during the year. In measuring the amounts of impairment charges, the carrying amounts of these assets were compared to the present value of the expected future cash flows of the assets, as well as information about sales and purchases of similar properties in the same geographic area.

The factors resulting in the exploration and production ("E&P") segment impairment losses of RMB 98, RMB 60 and RMB 552 for the years ended December 31, 2004, 2005 and 2006, respectively, were unsuccessful development drilling and high operating and development costs for certain small oil fields. The carrying values of these E&P properties were written down to a recoverable amount which was determined based on the present values of the expected future cash flows of the assets. The oil and gas pricing was a factor used in the determination of the present values of the expected future cash flows of the assets and had an impact on the recognition of the asset impairment.

(ii) During the year ended December 31, 2006, a subsidiary of the Group reached an agreement with a bank to waive loan principal balance and related interest payable totaling RMB 486.

9. INTEREST EXPENSE

Interest expense represents:

| | Years ended Dec 31 | |
|--|--------------------|---------|
| | 2004 | 2005 |
| | RMB | RMB |
| Interest expense incurred..... | 5,493 | 7,311 |
| Less: Interest expense capitalized*..... | (910) | (1,385) |
| | 4,583 | 5,926 |

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* Interest rates per annum at which borrowing costs were capitalized for construction in progress..... 3.1% to 6.0% 3.3% to 6.6%
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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

10. INCOME TAX

Income tax in the consolidated statements of income represents:

| | Years ended December 31, | | |
|---------------------------------------|--------------------------|---------|--------|
| | 2004 | 2005 | 2006 |
| | RMB | RMB | RMB |
| Current tax | | | |
| - Provision for the year..... | 18,458 | 20,646 | 23,981 |
| - Under-provision in prior years..... | 340 | 477 | 260 |
| Deferred taxation (Note 21)..... | (707) | (1,243) | (726) |
| | 18,091 | 19,880 | 23,515 |
| | ===== | ===== | ===== |

A reconciliation between actual tax expense and accounting profit at applicable tax rates is as follows:

| | Years ended Decem | |
|---|-------------------|---------|
| | 2004 | 2005 |
| | RMB | RMB |
| Income before income tax..... | 59,453 | 64,656 |
| Expected PRC income tax expense at a statutory tax rate of 33%..... | 19,620 | 21,336 |
| Tax effect of non-deductible expenses..... | 821 | 461 |
| Tax effect of non-taxable income..... | (216) | (567) |
| Tax effect of differential tax rate on subsidiaries' income (Note)..... | (2,091) | (2,010) |
| Tax effect of tax losses not recognized for deferred tax, net..... | 409 | 391 |
| Under-provision in prior years..... | 94 | 477 |
| Tax credit for domestic equipment purchases..... | (546) | (208) |
| Actual tax expense | 18,091 | 19,880 |
| | ===== | ===== |

Substantially all income before income tax and related tax expense is from PRC sources.

Note: The provision for PRC current income tax is based on a statutory rate

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of 33% of the assessable income of the Group as determined in accordance with the relevant income tax rules and regulations of the PRC, except for certain entities of the Group, which are taxed at a preferential rate of 15%.

11. BASIC AND DILUTED EARNINGS PER SHARE

The calculation of basic and diluted earnings per share are based on the net income attributable to the equity shareholders of the Company of RMB 35,335, RMB 41,455 and RMB 53,912 divided by the weighted average number of shares in issue during the year of 86,702,439,000 for each of the years in the three-year period ended December 31, 2006.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

12. TRADE ACCOUNTS RECEIVABLE, NET

Trade accounts receivable are analyzed as follows:

| | December 31, | |
|--|--------------|--------------|
| | 2005 | 2006 |
| | ----- RMB | ----- RMB |
| Amounts due from third parties..... | 13,564 | 14,601 |
| Amounts due from Sinopec Group Company and its affiliates..... | 3,145 | 3,396 |
| Amounts due from associates..... | 572 | 380 |
| Amounts due from jointly controlled entities..... | 505 | 547 |
| | ----- | ----- |
| | 17,786 | 18,924 |
| Less: Impairment losses for bad and doubtful debts..... | (3,140) | (3,334) |
| | ----- | ----- |
| | 14,646 | 15,590 |
| | ===== | ===== |

The impairment losses for bad and doubtful debts are analyzed as follows:

| | Years ended Decemb | |
|--|--------------------|--------------|
| | 2004 | 2005 |
| | ----- RMB | ----- RMB |
| At beginning of year..... | 3,350 | 3,671 |
| Impairment losses recognized for the year..... | 935 | 328 |
| Written-off/reversal of impairment losses..... | (454) | (859) |
| Less: Amount distributed to Sinopec Group Company in connection with | | |

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| | | |
|---|-------|-------|
| the Acquisition of Petrochemical and Catalyst Assets..... | (160) | -- |
| | ----- | ----- |
| At end of year..... | 3,671 | 3,140 |
| | ===== | ===== |

Sales are generally on a cash term. Credit is generally only available for major customers with well-established trading records. Amounts due from Sinopec Group Company and its affiliates are repayable under the same terms.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

13. INVENTORIES

Inventories represent:

| | December 31, | |
|--|--------------|--------|
| | 2005 | 2006 |
| | ----- | ----- |
| | RMB | RMB |
| Crude oil and other raw materials..... | 53,360 | 54,227 |
| Work in progress..... | 9,422 | 9,828 |
| Finished goods..... | 23,173 | 25,762 |
| Spare parts and consumables..... | 4,456 | 4,485 |
| | ----- | ----- |
| | 90,411 | 94,302 |
| Less: Allowance for diminution in value of inventories.... | (892) | (866) |
| | ----- | ----- |
| | 89,519 | 93,436 |
| | ===== | ===== |

The allowance for diminution in value of inventories is analyzed as follows:

| | Years ended Decemb | |
|---|--------------------|-------|
| | 2004 | 2005 |
| | ----- | ----- |
| | RMB | RMB |
| At beginning of year..... | 601 | 906 |
| Provision for the year..... | 648 | 262 |
| Written back on sales..... | (261) | (276) |
| Less: Amount distributed to Sinopec Group Company in connection with the Acquisition of Petrochemical and Catalyst Assets..... | (82) | -- |
| | ----- | ----- |
| At end of year..... | 906 | 892 |
| | ===== | ===== |

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The cost of inventories recognized as an expense in the consolidated statements of income amounted to RMB 474,104, RMB 682,288 and RMB 895,290 for the years ended December 31, 2004, 2005 and 2006, respectively.

14. PREPAID EXPENSES AND OTHER CURRENT ASSETS

Prepaid expenses and other current assets represent:

| | December 31, | |
|---|--------------|--------|
| | 2005 | 2006 |
| | RMB | RMB |
| Advances to third parties..... | 1,776 | 1,732 |
| Amounts due from Sinopec Group Company and its affiliates..... | 2,965 | 2,020 |
| Other receivables..... | 1,977 | 2,298 |
| Purchase deposits..... | 2,496 | 3,106 |
| Prepayments in connection with construction work and equipment purchases... | 6,613 | 4,658 |
| Prepaid value-added tax and customs duty..... | 4,288 | 4,815 |
| Amounts due from associates..... | 539 | 332 |
| | 20,654 | 18,961 |
| | 20,654 | 18,961 |

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

15. PROPERTY, PLANT AND EQUIPMENT, NET

By segment:

| | Exploration and production | Refining | Marketing and distribution | Chemicals |
|--|----------------------------------|----------|----------------------------------|-----------|
| | RMB | RMB | RMB | RMB |
| Cost/valuation: | | | | |
| Balance at January 1, 2005 | 194,466 | 116,923 | 65,345 | 163,222 |
| Additions | 412 | 129 | 382 | 271 |
| Transferred from construction in progress | 23,451 | 8,121 | 14,017 | 18,457 |
| Proportionate share of a jointly controlled entity | -- | -- | -- | 1,028 |
| Reclassification | (157) | (432) | 204 | 289 |
| Disposals | (3,131) | (2,859) | (2,927) | (3,164) |
| | 215,041 | 121,882 | 77,021 | 180,103 |
| Balance at December 31, 2005 | 215,041 | 121,882 | 77,021 | 180,103 |

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| | | | | |
|---|---------|---------|---------|---------|
| Balance at January 1, 2006 | 215,041 | 121,882 | 77,021 | 180,103 |
| Additions | 1,175 | 145 | 1,280 | 280 |
| Transferred from construction in progress | 28,695 | 26,994 | 10,087 | 15,461 |
| Acquisition of a subsidiary | 2,071 | -- | -- | -- |
| Reclassification | (56) | (600) | -- | 725 |
| Disposals | (5,562) | (1,522) | (2,280) | (4,302) |
| | ----- | ----- | ----- | ----- |
| Balance at December 31, 2006 | 241,364 | 146,899 | 86,108 | 192,267 |
| | ----- | ----- | ----- | ----- |
| Accumulated depreciation: | | | | |
| Balance at January 1, 2005 | 94,977 | 56,581 | 13,465 | 92,042 |
| Depreciation charge for the year | 11,090 | 6,974 | 3,013 | 9,392 |
| Impairment losses for the year | 60 | -- | 366 | 1,425 |
| Reclassification | (78) | (214) | 78 | 160 |
| Written back on disposals | (2,706) | (2,206) | (2,110) | (2,719) |
| | ----- | ----- | ----- | ----- |
| Balance at December 31, 2005 | 103,343 | 61,135 | 14,812 | 100,300 |
| | ----- | ----- | ----- | ----- |
| Balance at January 1, 2006 | 103,343 | 61,135 | 14,812 | 100,300 |
| Depreciation charge for the year | 12,839 | 7,671 | 3,422 | 9,391 |
| Acquisition of a subsidiary | 592 | -- | -- | -- |
| Impairment losses for the year | 552 | -- | 23 | 250 |
| Reclassification | (23) | (392) | -- | 420 |
| Written back on disposals | (5,253) | (1,314) | (1,103) | (3,470) |
| | ----- | ----- | ----- | ----- |
| Balance at December 31, 2006 | 112,050 | 67,100 | 17,154 | 106,891 |
| | ----- | ----- | ----- | ----- |
| Net book value: | | | | |
| At January 1, 2005 | 99,489 | 60,342 | 51,880 | 71,180 |
| | ===== | ===== | ===== | ===== |
| At December 31, 2005 | 111,698 | 60,747 | 62,209 | 79,803 |
| | ===== | ===== | ===== | ===== |
| At December 31, 2006 | 129,314 | 79,799 | 68,954 | 85,376 |
| | ===== | ===== | ===== | ===== |

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

By asset class:

| Buildings | Oil and gas properties | Oil depots, storage tanks and service stations | ma e an |
|-----------|---------------------------|--|---------------|
| ----- | ----- | ----- | --- |
| RMB | RMB | RMB | |

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| | | | |
|--|---------|---------|---------|
| Cost/valuation: | | | |
| Balance at January 1, 2005 | 45,119 | 175,522 | 60,533 |
| Additions | 108 | 253 | 228 |
| Transferred from construction in progress | 2,535 | 22,235 | 13,851 |
| Proportionate share of a jointly controlled entity | 182 | -- | -- |
| Reclassification | (406) | (802) | 650 |
| Disposals | (1,034) | (1,928) | (2,145) |
| | ----- | ----- | ----- |
| Balance at December 31, 2005 | 46,504 | 195,280 | 73,117 |
| | ----- | ----- | ----- |
| Balance at January 1, 2006 | 46,504 | 195,280 | 73,117 |
| Additions | 748 | 777 | 1,071 |
| Transferred from construction in progress | 2,777 | 26,579 | 14,549 |
| Acquisition of a subsidiary | 519 | 1,313 | -- |
| Reclassification | (1,569) | 10 | 3,170 |
| Disposals | (749) | (5,266) | (1,658) |
| | ----- | ----- | ----- |
| Balance at December 31, 2006 | 48,230 | 218,693 | 90,249 |
| | ----- | ----- | ----- |
| Accumulated depreciation: | | | |
| Balance at January 1, 2005 | 20,334 | 85,996 | 11,781 |
| Depreciation charge for the year | 1,724 | 10,431 | 2,914 |
| Impairment losses for the year | 79 | 60 | 261 |
| Reclassification | (98) | (430) | 153 |
| Written back on disposals | (598) | (1,683) | (1,379) |
| | ----- | ----- | ----- |
| Balance at December 31, 2005 | 21,441 | 94,374 | 13,730 |
| | ----- | ----- | ----- |
| Balance at January 1, 2006 | 21,441 | 94,374 | 13,730 |
| Depreciation charge for the year | 1,787 | 12,126 | 3,728 |
| Acquisition of a subsidiary | 49 | 468 | -- |
| Impairment losses for the year | 118 | 532 | 23 |
| Reclassification | (352) | (45) | 1,221 |
| Written back on disposals | (437) | (5,073) | (834) |
| | ----- | ----- | ----- |
| Balance at December 31, 2006 | 22,606 | 102,382 | 17,868 |
| | ----- | ----- | ----- |
| Net book value: | | | |
| At January 1, 2005 | 24,785 | 89,526 | 48,752 |
| | ===== | ===== | ===== |
| At December 31, 2005 | 25,063 | 100,906 | 59,387 |
| | ===== | ===== | ===== |
| At December 31, 2006 | 25,624 | 116,311 | 72,381 |
| | ===== | ===== | ===== |

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

As required by the relevant PRC regulations with respect to the Reorganization, the property, plant and equipment of the Group as of September 30, 1999 were valued for each asset class by China United Assets Appraisal Corporation, Beijing Zhong Zheng Appraisal Company, CIECC Assets Appraisal Corporation and Zhong Fa International Properties Valuation Corporation, independent valuers registered in the PRC, on a depreciated replacement cost basis. The value of property, plant and equipment was determined at RMB 159,788.

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The surplus on revaluation of RMB 32,320, net of amounts allocated to minority interests, was incorporated in the financial statements of the Group at December 31, 1999.

In connection with the acquisitions of certain entities and related operations from Sinopec Group Company in prior years, the related property, plant and equipment were revalued by independent valuers in accordance with PRC relevant rules and regulations. The surplus on these revaluations of RMB 1,409, net of amounts allocated to minority interests, was credited to revaluation reserve.

In connection with the Acquisition of Oil Production Plants, the property, plant and equipment of the Oil Production Plants were revalued at June 30, 2006, by a firm of independent valuers in accordance with the PRC relevant rules and regulations. The value of property, plant and equipment of the Oil Production Plants pursuant to the valuation, based on depreciated replacement costs, was determined at RMB 2,303, which approximated the net historical carrying value of the assets.

In accordance with IAS 16, subsequent to these revaluations, which was based on depreciated replacement costs, property, plant and equipment are carried at revalued amount, being the fair value at the date of the revaluation less any subsequent accumulated depreciation and impairment losses. Revaluation is performed periodically to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date. Based on a revaluation performed as of December 31, 2004, which was based on depreciated replacement costs, the carrying value of property, plant and equipment did not differ materially from their fair value.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

16. CONSTRUCTION IN PROGRESS

| | Exploration and production | Refining | Marketing and distribution | Chemicals |
|---|----------------------------------|--------------|----------------------------------|--------------|
| | ----- RMB | ----- RMB | ----- RMB | ----- RMB |
| Balance at January 1, 2005..... | 9,387 | 9,483 | 13,781 | 13,170 |
| Additions..... | 27,245 | 18,971 | 10,572 | 9,115 |
| Additions by jointly controlled entities..... | 814 | -- | -- | 1,830 |
| Proportionate share of a jointly controlled entity..... | -- | -- | -- | 5,461 |
| Dry hole costs written off..... | (2,992) | -- | -- | -- |
| Transferred to property, plant and equipment and other assets..... | (23,451) | (8,121) | (14,017) | (19,014) |
| | ----- | ----- | ----- | ----- |
| Balance at December 31, 2005..... | 11,003 | 20,333 | 10,336 | 10,562 |
| | ===== | ===== | ===== | ===== |
| Balance at January 1, 2006..... | 11,003 | 20,333 | 10,336 | 10,562 |
| Additions..... | 37,892 | 21,824 | 10,039 | 12,361 |

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| | | | | |
|---|----------|----------|----------|----------|
| Additions by jointly controlled entities..... | 91 | -- | -- | 148 |
| Acquisition of a subsidiary..... | 89 | -- | -- | -- |
| Dry hole costs written off..... | (3,960) | -- | -- | -- |
| Transferred to property, plant and equipment... | (28,695) | (26,994) | (10,087) | (15,461) |
| | ----- | ----- | ----- | ----- |
| Balance at December 31, 2006..... | 16,420 | 15,163 | 10,288 | 7,610 |
| | ===== | ===== | ===== | ===== |

The Group's proportionate share of the jointly controlled entities' construction in progress in the E&P and the chemicals segments reflected in the above table were RMB 2,888 and RMB 504, respectively, as of December 31, 2005, and RMB 2,979 and RMB 603, respectively, as of December 31, 2006.

Net changes in capitalized cost of exploratory wells included in the Group's construction in progress in the E&P segment are analyzed as follows:

| | Years ended December | |
|--|----------------------|---------|
| | 2004 | 2005 |
| | ----- | ----- |
| | RMB | RMB |
| At beginning of year..... | 2,438 | 2,898 |
| Additions, net of amount that were capitalized and subsequently expensed in the same year, pending the determination of proved reserves..... | 2,031 | 2,554 |
| Transferred to oil and gas properties based on the determination of proved reserves..... | (382) | (671) |
| Dry hole costs written off..... | (1,189) | (1,208) |
| | ----- | ----- |
| At end of year..... | 2,898 | 3,573 |
| | ===== | ===== |

Aging of capitalized exploratory well costs based on the date the drilling was completed are analyzed as follows:

| | December 31, | |
|-----------------------|--------------|-------|
| | 2004 | 2005 |
| | ----- | ----- |
| | RMB | RMB |
| One year or less..... | 2,711 | 3,277 |
| Over one year..... | 187 | 296 |
| | ----- | ----- |
| | 2,898 | 3,573 |
| | ===== | ===== |

Capitalized exploratory wells costs aged over one year are related to wells for which the drilling results are being further evaluated or the development plans are being formulated.

The geological and geophysical costs paid during the years ended December

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31, 2004, 2005 and 2006 amounted to RMB 3,235, RMB 3,200 and RMB 3,878, respectively.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

17 Goodwill

| | 2005 | 2006 |
|---|-------|--------|
| | ----- | ----- |
| | RMB | RMB |
| Cost: | | |
| Balance at January 1..... | 383 | 2,203 |
| Additions..... | 1,820 | 12,122 |
| | ----- | ----- |
| Balance at December 31..... | 2,203 | 14,325 |
| | ===== | ===== |
| Accumulated impairment losses: | | |
| Balance at January 1 and December 31..... | - | - |
| | ----- | ----- |
| Net book value..... | | |
| Balance at January 1..... | 383 | 2,203 |
| | ===== | ===== |
| Balance at December 31..... | 2,203 | 14,325 |
| | ===== | ===== |

Impairment tests for cash-generating units containing goodwill

Goodwill is allocated to the following Group's cash-generating units:

| | December 31, | |
|--|--------------|--------|
| | ----- | ----- |
| | 2005 | 2006 |
| | ----- | ----- |
| | RMB | RMB |
| Sinopec Beijing Yanshan Branch ("Sinopec Yanshan")..... | 1,157 | 1,157 |
| Sinopec Zhenhai Refining and Chemical Company Limited ("Sinopec Zhenhai")... | - | 3,952 |
| Sinopec Qilu Petrochemical Company Limited ("Sinopec Qilu")..... | - | 2,159 |
| Sinopec Yangzi Petrochemical Company Limited ("Sinopec Yangzi")..... | - | 2,737 |
| Sinopec Zhongyuan Petroleum Company Limited ("Sinopec Zhongyuan")..... | - | 1,391 |
| Shengli Oil Field Dynamic Company Limited ("Dynamic")..... | - | 1,361 |
| Multiple units without significant goodwill..... | 1,046 | 1,568 |
| | ----- | ----- |
| | 2,203 | 14,325 |
| | ===== | ===== |

During the year ended December 31, 2005, the Group acquired the entire 1,012,000,000 H shares, representing approximately 29.99% of the issued share capital of Sinopec Beijing Yanshan Petrochemical Company Limited from minority

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interests shareholders at HK\$ 3.80 per share. The total consideration paid by the Group was approximately RMB 4,088 which was settled in cash. The excess of the cost of purchase over the fair value of the underlying assets and liabilities (on a proportionate share) was RMB 1,157.

During the year ended December 31, 2006, the Group acquired additional equity interests in Sinopec Zhenhai, Sinopec Qilu, Sinopec Yangzi, Sinopec Zhongyuan and Dynamic of 28.7%, 17.7%, 14.8%, 28.5% and 71.4%, respectively. The Company acquired these additional equity interests to reduce management layers and improve the efficiency of the production, management and sales of the Group as a whole. The total consideration paid by the Group was approximately RMB 21,971 which was settled in cash. The excess of the cost of purchase over the fair value of the underlying assets and liabilities (on a proportionate share) in Sinopec Zhenhai, Sinopec Qilu, Sinopec Yangzi, Sinopec Zhongyuan and Dynamic were RMB 3,952, RMB 2,159, RMB 2,737, RMB 1,391 and RMB 1,361, respectively.

Management of the Company considers the acquisitions of additional equity interests in these companies can reduce management layers and improve the efficiency of the production, management and sales of the Group as a whole.

As of December 31, 2006, the goodwill allocated to the E&P, refining, chemicals, and marketing and distribution segments were RMB 2,774, RMB 4,346, RMB, 6,053 and 1,152, respectively. As of December 31, 2005, the goodwill allocated to the refining, chemicals, and marketing and distribution segments were RMB 394, RMB 1,157 and 652, respectively.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

The recoverable amounts of the Sinopec Yanshan, Sinopec Zhenhai, Sinopec Yangzi, Sinopec Qilu, Sinopec Zhongyuan and Dynamic are determined based on value in use calculations. These calculations use cash flow projections based on financial budgets approved by management covering a one-year period and pre-tax discount rates primarily ranging from 14.2% to 17.2%. Cash flows beyond the one-year period are maintained constant. Management believes any reasonably possible change in the key assumptions on which these entities' recoverable amounts are based would not cause these entities' carrying amounts to exceed their recoverable amounts.

Key assumptions used for the value in use calculations for these entities are the gross margin and sales volume. Management determined the budgeted gross margin based on the gross margin achieved in the period immediately before the budget period and its expectation for the development of international crude oil prices. The sales volume was based on the production capacity and the sales volume in the period immediately before the budget period.

18. INVESTMENTS

| | December 31, | |
|--|--------------|-------|
| | 2005 | 2006 |
| | RMB | RMB |
| Available-for-sale securities..... | 119 | 157 |
| Other unlisted investments, at cost..... | 3,359 | 2,741 |
| | ----- | ----- |

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| | | |
|------------------------------|-------|-------|
| | 3,478 | 2,898 |
| Less: Impairment losses..... | (327) | (316) |
| | ----- | ----- |
| | 3,151 | 2,582 |
| | ===== | ===== |

Unlisted investments represent the Group's interests in PRC domiciled enterprises which are mainly engaged in non-oil and gas activities and operations. The Group has no significant investments in marketable securities.

The impairment losses relating to investments for the years ended December 31, 2004, 2005 and 2006 were RMB 96, RMB 77 and RMB 48, respectively.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

19. INTEREST IN ASSOCIATES

| | | |
|--------------------------|--------------|--------|
| | December 31, | |
| | ----- | |
| | 2005 | 2006 |
| | ----- | ----- |
| | RMB | RMB |
| Share of net assets..... | 9,267 | 11,617 |
| | ===== | ===== |

The Group's investments in associates are with companies primarily engaged in the oil and gas and chemical operations in the PRC. These investments are individually and in the aggregate not material to the Group's financial condition or results of operations for all periods presented. The share of associates' taxation amounted to RMB 340, RMB 420 and RMB 439 for the years ended December 31, 2004, 2005 and 2006, respectively. The principal investments in associates, all of which are incorporated in the PRC, are as follows:

| Name of company | Form of business structure | Particulars of issued and paid up capital | Percentage of equities held by the Company | Percentage of equity held by the Company's subsidiaries |
|--|----------------------------|--|--|---|
| ----- | ----- | ----- | % | % |
| Sinopec Shandong Taishan Petroleum Company Limited ("Taishan") | Incorporated | 480,793,320 ordinary shares of RMB 1.00 each | 38.68 | --- |
| Sinopec Finance Company Limited | Incorporated | Registered capital RMB 6,000,000,000 | 49.00 | --- |
| Shanghai Petroleum National Gas Corporation | Incorporated | Registered capital RMB 900,000,000 | 30.00 | --- |
| Shanghai Chemical Industry | Incorporated | Registered capital | --- | 38.26 |

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| | | | | |
|--|--------------|--------------------------------------|---|-------|
| Park Development Company Limited | | RMB 2,372,439,000 | | |
| China Shipping & Sinopec Suppliers Company Limited | Incorporated | Registered capital RMB 876,660,000 | — | 50.00 |
| China Aviation Oil Supply Company Limited | Incorporated | Registered capital RMB 3,800,000,000 | — | 29.00 |

During the year ended December 31, 2006, the Group acquired 71.4% equity interests in Dynamic, which was previously an associate of the Group, and thereafter, Dynamic became a subsidiary of the Company (Note 17 and 33).

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

20. INTEREST IN JOINTLY CONTROLLED ENTITIES

The Group's investments in jointly controlled entities are primarily engaged in the oil and gas and chemical operations in the PRC as follows:

| Name of company ----- | Form of business structure ----- | Particulars of issued and paid up capital ----- | Percentage of equities held by the Company ----- % | Percenta of equit held by Company' subsidi ----- % |
|---|---|---|---|--|
| Shanghai Secco Petrochemical Company Limited | Incorporated | Registered capital USD 901,440,964 | 30.00 | 20.00 |
| BASF-YPC Company Limited | Incorporated | Registered capital RMB 8,793,000,000 | 30.00 | 10.00 |
| Yueyang Sinopec and Shell Coal Gasification Company Limited | Incorporated | Registered capital USD 45,588,700 | 50.00 | -- |
| Block A Oil Field in the Western Area Chengdao in Bohai Bay | Unincorporated | -- | -- | 43.00 |

Included in the consolidated financial statements are the following items that represent the Group's proportionate share of the jointly controlled

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entities' results of operation, financial condition and cash flows.

| | Years ended December 31, | | |
|--------------------------|--------------------------|---------|----------|
| | 2004 | 2005 | 2006 |
| | ----- | ----- | ----- |
| | RMB | RMB | RMB |
| Results of operation: | | | |
| Operating revenue..... | 313 | 10,082 | 17,913 |
| Expenses..... | (450) | (9,773) | (15,180) |
| | ----- | ----- | ----- |
| Net (loss) / income..... | (137) | 309 | 2,733 |
| | ===== | ===== | ===== |

| | Years ended December 31, | |
|--|--------------------------|----------|
| | 2004 | 2005 |
| | ----- | ----- |
| | RMB | RMB |
| Financial condition: | | |
| Current assets..... | | 2,631 |
| Non-current assets, primarily property, plant and equipment and construction in progress with net book value of RMB 14,259 (2005: RMB 15,287) and RMB 3,582 (2005: RMB 3,392), respectively..... | | 19,522 |
| Current liabilities..... | | (2,543) |
| Non-current liabilities, primarily long-term bank loans, excluding current portion, of RMB 8,267 (2005: RMB 10,006) | | (10,177) |
| | | ----- |
| Net assets..... | | 9,433 |
| | | ===== |

| | Years ended December 31, | |
|---|--------------------------|---------|
| | 2004 | 2005 |
| | ----- | ----- |
| | RMB | RMB |
| Cash flows: | | |
| Net cash generated from / (used in) operating activities..... | 233 | (1,434) |
| Net cash used in investing activities..... | (6,035) | (2,474) |
| Net cash generated from / (used in) financing activities..... | 5,909 | 4,011 |

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

21. DEFERRED TAX ASSETS AND LIABILITIES

Deferred tax assets and deferred tax liabilities are attributable to the

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items detailed in the table below:

| | Assets | | Liabilities | | |
|--|--------------|-------|--------------|---------|----|
| | December 31, | | December 31, | | |
| | 2005 | 2006 | 2005 | 2006 | |
| | RMB | RMB | RMB | RMB | |
| Current | | | | | |
| Receivables and inventories..... | 3,448 | 3,531 | -- | -- | 3 |
| Accruals..... | 456 | 865 | -- | -- | |
| Non-current | | | | | |
| Property, plant and equipment..... | 1,642 | 2,295 | (1,619) | (1,678) | |
| Accelerated depreciation..... | -- | -- | (4,290) | (4,657) | (4 |
| Tax value of losses carried forward, net of valuation allowances..... | 128 | 53 | -- | -- | |
| Lease prepayments | 359 | 351 | -- | -- | |
| Others..... | 39 | 63 | (66) | (4) | |
| | ----- | ----- | ----- | ----- | |
| Deferred tax assets/(liabilities) | 6,072 | 7,158 | (5,975) | (6,339) | |
| | ===== | ===== | ===== | ===== | |

As of December 31, 2006, certain subsidiaries of the Company provided valuation allowance against tax value of losses carried forward for PRC income tax purpose of RMB 4,382 which are available to offset their future PRC taxable income, if any. Tax value of losses carried forward of RMB 215, RMB 341, RMB 720 RMB 1,185 and RMB 1,921 will expire in 2007, 2008, 2009, 2010, and 2011, respectively.

A valuation allowance on deferred tax assets is recorded if it is probable that some portion or all of the deferred tax assets will not be realized through the recovery of taxes previously paid and/or future taxable income. The allowance is subject to ongoing adjustments based on changes in circumstances that affect the Group's assessment on the realizability of the deferred tax assets. The Group has reviewed its deferred tax assets as of December 31, 2004, 2005 and 2006. Based on this review, net valuation allowances of RMB 409, RMB 391 and RMB 258 were provided for the years ended December 31, 2004, 2005 and 2006, respectively. The Group determined the valuation allowance based on management's assessment of the probability that taxable profits will be available over the period which the deferred tax assets can be realized or utilized. In assessing the probability, both positive and negative evidence was considered, including whether it is probable that the operations will have future taxable profits over the periods which the deferred tax assets are deductible or utilized and whether the tax losses result from identifiable causes which are unlikely to recur. Based on this assessment, a valuation allowance was provided to reduce the deferred tax asset to the amount that is probable to be realized.

The valuation allowance is analyzed as follows:

| | Years ended December 31, | | |
|-------------------------------------|--------------------------|-------|-------|
| | 2004 | 2005 | 2006 |
| | RMB | RMB | RMB |
| At beginning of year..... | 641 | 1,050 | 1,354 |
| Allowance during the year, net..... | 409 | 391 | 258 |
| Written-off..... | -- | (87) | (166) |

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| | | | |
|----------------------|-------------------------|-------------------------|-------------------------|
| At end of year | ----- 1,050 ===== | ----- 1,354 ===== | ----- 1,446 ===== |
|----------------------|-------------------------|-------------------------|-------------------------|

Movements in temporary differences between calculations of certain items for accounting and for taxation purposes can be specified as follows:

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

| | Balance at January 1, 2004 ---- | Recognized in consolidated statements of income ----- | Recognized other reserve ----- |
|--|--|---|---|
| | RMB | RMB | RMB |
| Current | | | |
| Receivables and inventories..... | 1,446 | 814 | — |
| Accruals..... | 23 | 245 | — |
| Non-current | | | |
| Property, plant and equipment..... | (709) | 571 | — |
| Accelerated depreciation..... | (3,673) | (327) | — |
| Tax value of losses carried forward, net of valuation allowance (Note i)..... | 923 | (591) | (266) |
| Lease prepayments..... | 373 | (7) | — |
| Others..... | 30 | 2 | — |
| | ----- | ----- | ----- |
| Net deferred tax (liabilities)/assets..... | (1,587) | 707 | (266) |
| | ===== | ===== | ===== |

(Note 10)

| | Balance at January 1, 2004 ---- | Recognized in consolidated statements of income ----- | Recognized other reserve ----- |
|---|--|---|---|
| | RMB | RMB | RMB |
| Current | | | |
| Receivables and inventories..... | 2,260 | 1,188 | — |
| Accruals..... | 268 | 188 | — |
| Non-current | | | |
| Property, plant and equipment..... | (138) | 161 | — |
| Accelerated depreciation..... | (4,000) | (290) | — |
| Tax value of losses carried forward, net of valuation allowance..... | 66 | 62 | — |
| Lease prepayments | 366 | (7) | — |
| Others..... | 32 | (59) | — |
| | ----- | ----- | ----- |

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| | | | |
|--|------------|---------------|------------|
| Net deferred tax (liabilities)/assets..... | (1,146) | 1,243 | _____ |
| | ===== | ===== | ===== |
| | | (Note 10) | |
| | Balance at | Recognized in | Recognized |
| | January 1, | consolidated | other |
| | 2004 | statements of | reserve |
| | ---- | ----- | ----- |
| | RMB | RMB | RMB |
| Current | | | |
| Receivables and inventories..... | 3,448 | 83 | _____ |
| Accruals..... | 456 | 409 | _____ |
| Non-current | | | |
| Property, plant and equipment..... | 23 | 594 | _____ |
| Accelerated depreciation..... | (4,290) | (367) | _____ |
| Tax value of losses carried forward, net of valuation allowance..... | 128 | (75) | _____ |
| Lease prepayments..... | 359 | (8) | _____ |
| Others (Note ii)..... | (27) | 90 | (4) |
| | ----- | ----- | ----- |
| Net deferred tax assets..... | 97 | 726 | (4) |
| | ===== | ===== | ===== |
| | | (Note 10) | |

Note:

- (i) As of December 31, 2004, deferred tax assets of RMB 266 were distributed to Sinopec Group Company in connection with the Acquisition of Petrochemical and Catalyst Assets.
- (ii) The amount recognized in equity represents the tax effect of change in fair value of available-for-sale securities, which was recognized directly in equity.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

22. LONG-TERM PREPAYMENTS AND OTHER ASSETS

Long-term prepayments and other assets primarily represent prepaid rental expenses over one year, computer software and catalysts.

23. SHORT-TERM AND LONG-TERM DEBTS AND LOANS FROM SINOPEC GROUP COMPANY AND ITS AFFILIATES

Short-term debt represent:

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| | December ----- 2005 ----- RMB |
|--|---|
| Third parties' debt | |
| Short-term bank loans..... | 15,392 |
| | ----- |
| Current portion of long-term bank loans..... | 14,879 |
| Current portion of long-term other loans..... | 26 |
| Current portion of long-term bank loans of jointly controlled entities | 193 |
| | ----- |
| | 15,098 |
| | ----- |
| Corporate bonds (a)..... | 9,921 |
| | ----- |
| | 40,411 |
| | ----- |
| Loans from Sinopec Group Company and its affiliates | |
| Short-term loans..... | 2,705 |
| Current portion of long-term loans..... | 100 |
| | ----- |
| | 2,805 |
| | ----- |
| | 43,216 |
| | ===== |

The Group's weighted average interest rates on short-term loans were 4.0% and 5.2% as of December 31, 2005 and 2006, respectively.

As of December 31, 2005, the Company had standby credit facilities with several PRC financial institutions which allowed the Company to borrow up to RMB 130,000 on an unsecured basis, at 4.698%. As of December 31, 2005, the Company's outstanding borrowings under these facilities were RMB 2,000 and were included in short-term bank loans. These facilities expire at various dates in 2006 and contain no financial covenants.

As of December 31, 2006, the Company had standby credit facilities with several PRC financial institutions which allowed the Company to borrow up to RMB 130,000 on an unsecured basis, at 5.020%. As of December 31, 2006, the Company's outstanding borrowings under these facilities were RMB 4,420 and were included in short-term bank loans. These facilities expire at various dates in 2007 and contain no financial covenants.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

Long-term debt comprise:

Interest rate and final maturity

De

2005

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| | | |
|---|--|-----------------|
| | | ----- RMB |
| Third parties' debt | | |
| Long-term bank loans | | |
| Renminbi denominated | Interest rates ranging from interest free to 6.9% per annum as of December 31, 2006 with maturities through 2016 | 65,06 |
| Japanese | Yen denominated Interest rates ranging from 2.6% to 5.8% per annum as of December 31, 2006 with maturities through 2024 | 3,39 |
| US | Dollar denominated Interest rates ranging from interest free to 7.4% per annum as of December 31, 2006 with maturities through 2031 | 5,05 |
| Euro denominated | Fixed interest rate at 6.7% per annum as of December 31, 2006 with maturities through 2010 | 11 |
| Hong Kong Dollar denominated | Floating rate at Hong Kong Prime Rate plus 0.8% to 1.1% per annum as of December 31, 2005 with maturities through 2007; Paid off as of December 31, 2006 | 94 |
| | | ----- 73,730 |
| Long-term other loans | | |
| Renminbi denominated | Interest rates ranging from interest free to 5.2% per annum as of December 31, 2006 with maturities through 2009 | 17 |
| US Dollar denominated | Interest rates ranging from interest free to 2.0% per annum as of December 31, 2006 with maturities through 2015 | 5 |
| | | ----- 221 |
| Total long-term banks and other loans carried forward | | ----- 73,951 |

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

Long-term debt comprise:

| | |
|----------------------------------|-------|
| Interest rate and final maturity | De |
| ----- | ----- |
| | 2005 |

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| | | |
|--|---|---------|
| | | RMB |
| Total long-term banks and other loans brought forward | | 73,95 |
| Corporate bonds | | |
| Renminbi denominated | Fixed interest rate at 4.61% per annum as of December 31, 2006 with maturity in February 2014 (b) | 3,50 |
| Long-term bank loans of jointly controlled entities | | |
| Renminbi | denominated Floating rate at 90% of PBOC's base lending rate per annum as of December 31, 2006 with maturities through 2021 | 5,71 |
| US | Dollar denominated Floating rate at London Interbank Offer Rate plus 0.4% to 0.7% per annum as of December 31, 2006 with maturities through 2021 | 4,29 |
| | | 10,00 |
| Total third parties' long-term debts | | 87,45 |
| Less: Current portion | | (15,09) |
| | | 72,35 |
| Long-term loans from Sinopec Group Company and its affiliates | | |
| Renminbi denominated | Interest rates ranging from interest free to 5.7% per annum as of December 31, 2006 with maturities through 2020 | 39,96 |
| Long-term loans of jointly controlled entities from Sinopec Group Company and its affiliates | | |
| Renminbi denominated | Floating rate at 90% of PBOC's base lending rate applicable to three-year tenor loan per annum as of December 31, 2006 with maturities through 2021 | 71 |
| Less: Current portion | | (100) |
| | | 39,933 |
| | | 112,292 |

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

(a) The Company issued six-month corporate bonds of face value at RMB 10,000

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to corporate investors in PRC debenture market on October 24, 2005, at a discounted value of RMB 98.75 per RMB 100 par value, with an effective yield at 2.54% per annum. The Company redeemed the corporate bonds in April 2006.

A subsidiary of the Company issued 270-day corporate bonds of face value at RMB 1,000 to corporate investors in PRC debenture market on February 23, 2006, at a discounted value of RMB 97.78 per RMB 100 par value with an effective yield of 3.07% per annum. The Company redeemed the corporate bonds in November 2006.

The Company issued 183-day corporate bonds of face value at RMB 10,000 to corporate investors in PRC debenture market on May 16, 2006, at a discounted value of RMB 98.68 per RMB 100 par value, with an effective yield of 2.67% per annum. The Company redeemed the corporate bonds in November 2006.

The Company issued 182-day corporate bonds of face value at RMB 10,000 to corporate investors in PRC debenture market on November 13, 2006, at a discounted value of RMB 98.43 per RMB 100 par value, with an effective yield of 3.20% per annum. The bonds mature in May 2007.

A subsidiary of the Company issued 365-day corporate bonds of face value at RMB 2,000 to corporate investors in the PRC debenture market on December 11, 2006 at par value, with an effective yield 3.83% per annum. The bonds mature in December 2007.

- (b) The Company issued ten-year corporate bonds of RMB 3,500 to PRC citizens as well as PRC legal and non-legal persons on February 24, 2004, with a fixed interest rate at 4.61% per annum.

Third parties' loans of RMB 35 and RMB 171 as of December 31, 2005 and 2006, respectively, were secured by certain of the Group's property, plant and equipment. The net book value of property, plant and equipment of the Group pledged as security amounted to RMB 83 and RMB 288 as of December 31, 2005 and 2006, respectively.

The aggregate maturities of long-term debts and loans from Sinopec Group Company and its affiliates subsequent to December 31, 2006 are as follows:

| | RMB |
|-----------------|---------|
| 2007..... | 16,360 |
| 2008..... | 26,529 |
| 2009..... | 20,061 |
| 2010..... | 10,834 |
| 2011..... | 5,310 |
| Thereafter..... | 46,331 |
| | ----- |
| | 125,425 |
| | ===== |

Included in short-term and long-term debts and loans from Sinopec Group Company and its affiliates of the Group are the following amounts denominated in a currency other than the functional currency of the entity to which they relate:

| | December 31, | |
|-------------------|--------------|------------|
| | 2005 | 2006 |
| US Dollars..... | USD 2,158 | USD 985 |
| Japanese Yen..... | JPY 50,507 | JPY 41,350 |

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| | | | | |
|------------------------|-----|-------|-------|-------|
| Euro | EUR | 12 | EUR | 10 |
| Hong Kong Dollars..... | HKD | 128 | HKD | 7,789 |
| | | ===== | ===== | |

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

24. TRADE ACCOUNTS PAYABLE

Trade accounts payable are analyzed as follows:

| | December 31, | |
|--|--------------|--------|
| | 2005 | 2006 |
| | RMB | RMB |
| Amounts due to third parties..... | 50,353 | 49,177 |
| Amounts due to Sinopec Group Company and its affiliates..... | 2,763 | 2,194 |
| Amounts due to jointly controlled entities..... | 650 | 750 |
| Amounts due to associates..... | 51 | 4 |
| | ----- | ----- |
| | 53,817 | 52,125 |
| | ===== | ===== |

Amounts due to Sinopec Group Company and its affiliates are repayable in accordance with normal commercial terms.

25. ACCRUED EXPENSES AND OTHER PAYABLES

Accrued expenses and other payables represent:

| | December 31, | |
|---|--------------|--------|
| | 2005 | 2006 |
| | RMB | RMB |
| Amounts due to Sinopec Group Company and its affiliates.... | 8,133 | 12,670 |
| Accrued expenditures..... | 19,660 | 23,266 |
| Taxes other than income tax..... | 3,092 | 6,313 |
| Receipts in advance..... | 12,375 | 18,513 |
| Advances from third parties..... | 1,226 | 1,356 |
| Others..... | 5,037 | 6,938 |
| | ----- | ----- |
| | 49,523 | 69,056 |
| | ===== | ===== |

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

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(All amounts in millions, except per share data and except otherwise stated)

26. SHARE CAPITAL

| | December 31, | |
|--|--------------|--------|
| | 2005 | 2006 |
| | RMB | RMB |
| Registered, issued and fully paid | | |
| 69,921,951,000 domestic listed A shares of RMB 1.00 each..... | _____ | 69,922 |
| 16,780,488,000 overseas listed H shares of RMB 1.00 each..... | 16,780 | 16,780 |
| 67,121,951,000 domestic state-owned A shares of RMB 1.00 each. | 67,122 | _____ |
| 2,800,000,000 domestic listed A shares of RMB 1.00 each..... | 2,800 | _____ |
| | ----- | ----- |
| | 86,702 | 86,702 |
| | ===== | ===== |

The Company was established on February 25, 2000 with a registered capital of 68.8 billion domestic state-owned shares with a par value of RMB 1.00 each. Such shares were issued to Sinopec Group Company in consideration for the assets and liabilities of the Predecessor Operations transferred to the Company (Note 1).

Pursuant to the resolutions passed at an Extraordinary General Meeting held on July 25, 2000 and approvals from relevant government authorities, the Company is authorized to increase its share capital to a maximum of 88.3 billion shares with a par value of RMB 1.00 each and offer not more than 19.5 billion shares with a par value of RMB 1.00 each to investors outside the PRC. Sinopec Group Company is authorized to offer not more than 3.5 billion shares of its shareholdings in the Company to investors outside the PRC. The shares sold by Sinopec Group Company to investors outside the PRC would be converted into H shares.

In October 2000, the Company issued 15,102,439,000 H shares with a par value of RMB 1.00 each, representing 12,521,864,000 H shares and 25,805,750 American Depositary Shares ("ADSs", each representing 100 H shares), at prices of HK\$ 1.59 per H share and US\$ 20.645 per ADS, respectively, by way of a global initial public offering to Hong Kong and overseas investors. As part of the global initial public offering, 1,678,049,000 domestic state-owned ordinary shares of RMB 1.00 each owned by Sinopec Group Company were converted into H shares and sold to Hong Kong and overseas investors.

In July 2001, the Company issued 2.8 billion domestic listed A shares with a par value of RMB 1.00 each at RMB 4.22 by way of a public offering to natural persons and institutional investors in the PRC.

On September 25, 2006, the shareholders of listed A shares accepted the proposal offered by the shareholders of state-owned A shares whereby the shareholders of state-owned A shares agreed to transfer 2.8 state-owned A shares to shareholders of listed A shares for every 10 listed A shares they held, in exchange for the approval for the listing of all state-owned A shares. In October 2006, the 67,121,951,000 domestic state-owned A shares became listed A shares.

All A shares and H shares rank pari passu in all material aspects.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

27. RESERVES

| | 2005 |
|---|----------|
| | ----- |
| | RMB |
| Capital reserve (Note (a)) | |
| At January 1..... | (19,217) |
| Transfer from capital reserve to other reserves..... | -- |
| | ----- |
| December 31..... | (19,217) |
| | ----- |
| Share premium (Note (b)) | |
| At January 1 and December 31..... | 18,072 |
| | ----- |
| Revaluation reserve | |
| At January 1..... | 27,998 |
| Revaluation surplus realized..... | (1,656) |
| | ----- |
| At December 31..... | 26,342 |
| | ----- |
| Statutory surplus reserve (Note (c)) | |
| At January 1..... | 9,558 |
| Appropriation..... | 3,956 |
| Statutory public welfare fund transferred to statutory surplus reserve..... | -- |
| | ----- |
| At December 31..... | 13,514 |
| | ----- |
| Statutory public welfare fund (Note (d)) | |
| At January 1..... | 9,558 |
| Appropriation..... | 3,956 |
| Statutory public welfare fund transferred to statutory surplus reserve..... | -- |
| | ----- |
| At December 31..... | 13,514 |
| | ----- |
| Discretionary surplus reserve (Note (e)) | |
| At January 1 | 7,000 |
| Appropriation..... | -- |
| | ----- |
| At December 31..... | 7,000 |
| | ----- |
| Other reserves | |
| At January 1, as adjusted..... | 547 |
| Change in fair value of available-for-sale securities, net of deferred tax | -- |
| Realization of deferred tax on land use rights (Note (f))..... | (5) |
| Transfer from retained earnings to other reserves..... | 535 |

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| | |
|--|-------|
| Transfer from capital reserve to other reserves..... | -- |
| Distribution to Sinopec Group Company (Note (g))..... | (90) |
| Consideration for Acquisition of Oil Production Plants (Note 1)..... | -- |
| | ----- |
| At December 31..... | 987 |
| | ----- |

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

| | 2005 |
|--|---------|
| | ----- |
| | RMB |
| Retained earnings (Note (h)) | |
| At January 1..... | 53,122 |
| Net income attributable to equity shareholders of the Company..... | 41,455 |
| Final dividend in respect of the previous financial years, approved and paid during the year (Note (i))..... | (6,936) |
| Interim dividend (Note (j))..... | (3,468) |
| Appropriation..... | (7,912) |
| Revaluation surplus realized..... | 1,656 |
| Realization of deferred tax on land use rights..... | 5 |
| Transfer from retained earnings to other reserves..... | (535) |
| | ----- |
| At December 31..... | 77,387 |
| | ----- |
| | 137,599 |
| | ===== |

Notes:

- (a) The capital reserve represents (i) the difference between the total amount of the par value of shares issued and the amount of the net assets transferred from Sinopec Group Company in connection with the Reorganization and (ii) the difference between the considerations paid over the amount of the net assets of certain entities and related operations acquired from Sinopec Group Company.
- (b) The application of the share premium account is governed by Sections 168 and 169 of the PRC Company Law.
- (c) According to the Company's Articles of Association, the Company is required to transfer 10% of its net income, as determined in accordance with the PRC Accounting Rules and Regulations, to statutory surplus reserve until the reserve balance reaches 50% of the registered capital. The transfer to this reserve must be made before distribution of a dividend to shareholders.

Statutory surplus reserve can be used to make good previous years' losses, if any, and may be converted into share capital by the issue of new shares to shareholders in proportion to their existing shareholdings or by increasing the par value of the shares currently held by them, provided that the balance after such issue is not less than 25% of the registered

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capital. During the years ended December 31, 2005 and 2006, the Company transferred RMB 3,956 and RMB 5,066, respectively, being 10% of the current year's net income determined in accordance with the PRC Accounting Rules and Regulations, to this reserve.

- (d) Before January 1, 2006, according to the Company's Articles of Association, the Company was required to transfer 5% to 10% of its net income, as determined in accordance with the PRC Accounting Rules and Regulations, to the statutory public welfare fund. This fund could only be utilized on capital items for the collective benefits of the Company's employees such as the construction of dormitories, canteen and other staff welfare facilities. The transfer to this fund must be made before distribution of a dividend to shareholders.

Pursuant to the Company's Articles of Associations and a resolution passed at the Directors' meeting on August 26, 2005, the directors authorized to transfer RMB 1,804 for the six-month period ended June 30, 2005, being 10% of the net income for the six-month period ended June 30, 2005 determined in accordance with the PRC Accounting Rules and Regulations, to this fund.

The directors authorized the transfer of RMB 2,152, being 10% of the net income for the six-month period ended December 31, 2005 determined in accordance with the PRC Accounting Rules and Regulations, which was approved by the shareholders at the Annual General Meeting on May 24, 2006, to this fund.

According to the Company Law of the PRC which was revised on October 27, 2005, the Company is no longer required to make appropriation to the statutory public welfare fund commencing from January 1, 2006. Pursuant to the notice "Cai Qi [2006] No. 67" issued by the Ministry of Finance on March 15, 2006, the balance of this fund as of December 31, 2005 was transferred to the statutory surplus reserve.

- (e) The directors authorized the transfer of RMB 20,000 for the year ended December 31, 2006, subject to the shareholders' approval at the Annual General Meeting, to the discretionary surplus reserve. There was no

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

transfer to this fund for the year ended December 31, 2005. The usage of the discretionary surplus reserve is similar to that of statutory surplus reserve.

- (f) Effective January 1, 2002, land use rights which are included in lease prepayments are carried at historical cost. Accordingly, the surplus on the revaluation of land use rights credited to revaluation reserve previously, net of minority interests, was eliminated during the year. The effect of this change did not have a material impact on the Group's financial condition and results of operations in the periods prior to the change. As a result of the tax deductibility of the revaluation surplus, a deferred tax asset, net of minority interests, is created with a corresponding increase in other reserves.
- (g) These represent net assets distributed to Sinopec Group Company for no

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monetary consideration. The net assets distributed to Sinopec Group Company during the year ended December 31, 2004 represent certain net assets retained, including certain property, plant and equipment with net book value of RMB 1,840 and certain construction in progress with net book value of RMB 232, by Sinopec Group Company in connection with the Acquisition of Petrochemical and Catalyst Assets. These transactions were recorded at historical cost and were reflected as changes in other reserves in the year the transaction occurred.

- (h) According to the Company's Articles of Association, the amount of retained earnings available for distribution to equity shareholders of the Company is the lower of the amount determined in accordance with the PRC Accounting Rules and Regulations and the amount determined in accordance with IFRS. As of December 31, 2005 and 2006, the amounts of retained earnings available for distribution were RMB 20,591 and RMB 42,156, respectively, being the amount determined in accordance with IFRS. Pursuant to a resolution passed at the Directors' meeting on April 6, 2007, a final dividend in respect of the year ended December 31, 2006 of RMB 0.11 per share totaling RMB 9,537 was proposed for shareholders' approval at the Annual General Meeting. Final dividend of RMB 9,537 in respect of the year ended December 31, 2006 has not been not recognized as a liability as of the balance sheet date.

Subject to the relevant provisions of the PRC Company Law and the Company's Articles of Association, Sinopec Group Company may seek to influence the Company's determination of dividends with a view to satisfying Sinopec Group Company's cash flow requirements.

- (i) Pursuant to the shareholders' approval at the Annual General Meeting on May 18, 2005, a final dividend of RMB 0.08 per share totaling RMB 6,936 in respect of the year ended December 31, 2004 was declared and paid on June 27, 2005.

Pursuant to the shareholders' approval at the Annual General Meeting on May 24, 2006, a final dividend of RMB 0.09 per share totaling RMB 7,803 in respect of the year ended December 31, 2005 was declared and paid on June 30, 2006.

- (j) Pursuant to the Company's Articles of Association and a resolution passed at the Director's meeting on August 26, 2005, the directors authorized to declare an interim dividend for the year ended December 31, 2005 of RMB 0.04 per share totaling RMB 3,468, which was paid on September 30, 2005.

Pursuant to the Company's Articles of Association and a resolution passed at the Director's meeting on August 25, 2006, the directors authorized to declare an interim dividend for the year ended December 31, 2006 of RMB 0.04 per share totaling RMB 3,468, which was paid on September 28, 2006.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

28. COMMITMENTS AND CONTINGENT LIABILITIES

Operating lease commitments

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The Group leases service stations and other equipment through non-cancellable operating leases. These operating leases do not contain provisions for contingent lease rentals. None of the rental agreements contain escalation provisions that may require higher future rental payments.

As of December 31, 2006, the future minimum lease payments under operating leases are as follows:

| | RMB |
|-----------------------------------|---------|
| 2007..... | 4,711 |
| 2008..... | 4,568 |
| 2009..... | 4,531 |
| 2010..... | 4,505 |
| 2011..... | 4,450 |
| Thereafter..... | 122,406 |
| | ----- |
| Total minimum lease payments..... | 145,171 |
| | ===== |

The Group's leasing arrangement impose no restrictions on dividends, additional debt and/or further leasing.

Capital commitments

As of December 31, 2006, the Group had capital commitments as follows:

| | RMB |
|--|---------|
| The Group | |
| Authorized and contracted for..... | 113,192 |
| Authorized but not contracted for..... | 165,967 |
| | ----- |
| | 279,159 |
| | ===== |
| Jointly controlled entities | |
| Authorized and contracted for..... | 1,878 |
| Authorized but not contracted for..... | 5 |
| | ----- |
| | 1,883 |
| | ===== |

These capital commitments relate to oil and gas exploration and development, refining and petrochemical production capacity expansion projects, the construction of service stations and oil depots, and capital contributions to the Group's investments and interest in associates.

Exploration and production licenses

Exploration licenses for exploration activities are registered with the Ministry of Land and Resources. The maximum term of the Group's exploration licenses is 7 years, and may be renewed twice within 30 days prior to expiration of the original term with each renewal being for a two-year term. The Group is obligated to make progressive annual minimum exploration investment relating to the exploration blocks in respect of which the license is issued. The Ministry of Land and Resources also issues production licenses to the Group on the basis of the reserve reports approved by relevant authorities. The maximum term of a full production license is 30 years unless a special dispensation was given by the State Council. The maximum term of production licenses issued to the Group is 55 years as a special dispensation was given to the Group by the State Council. The Group's production license is renewable upon application by the Group 30 days prior to expiration.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

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The Group is required to make payments of exploration license fees and production right usage fees to the Ministry of Land and Resources annually which are expensed as incurred. Payments incurred were approximately RMB 189, RMB 208 and RMB 236 for the years ended December 31, 2004, 2005 and 2006, respectively.

Estimated future annual payments as of December 31, 2006 are as follows:

| | RMB |
|---------------------|-------|
| 2007..... | 156 |
| 2008..... | 147 |
| 2009..... | 67 |
| 2010..... | 57 |
| 2011..... | 10 |
| Thereafter..... | 226 |
| | ----- |
| Total payments..... | 663 |
| | ===== |

Contingent liabilities

(a) The Company has been advised by its PRC lawyers that, except for liabilities constituting or arising out of or relating to the business assumed by the Company in the Reorganization, no other liabilities were assumed by the Company, and the Company is not jointly and severally liable for other debts and obligations incurred by Sinopec Group Company prior to the Reorganization.

(b) As of December 31, 2006, guarantees given to banks in respect of banking facilities granted to the parties below were as follows:

| | RMB |
|-----------------|-----|
| Associates..... | 160 |
| | === |

The Group monitors the conditions that are subject to the guarantees to identify whether it is probable that a loss has occurred, and recognize any such losses under guarantees when those losses are estimable. As of December 31, 2006, it is not probable that the Group will be required to make payments under the guarantees. Thus no liability has been accrued for a loss related to the Group's obligation under these guarantee arrangements.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

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Environmental contingencies

To date, the Group has not incurred any significant expenditures for environmental remediation, is currently not involved in any environmental

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remediation, and has not accrued any amounts for environmental remediation relating to its operations. Under existing legislation, management believes that there are no probable liabilities that will have a material adverse effect on the financial position or operating results of the Group. The PRC government, however, has moved, and may move further towards more rigorous enforcement of applicable laws, and towards the adoption of more stringent environmental standards. Environmental liabilities are subject to considerable uncertainties which affect the Group's ability to estimate the ultimate cost of remediation efforts. These uncertainties include i) the exact nature and extent of the contamination at various sites including, but not limited to refineries, oil fields, service stations, terminals and land development areas, whether operating, closed or sold, ii) the extent of required cleanup efforts, iii) varying costs of alternative remediation strategies, iv) changes in environmental remediation requirements, and v) the identification of new remediation sites. The amount of such future cost is indeterminable due to such factors as the unknown magnitude of possible contamination and the unknown timing and extent of the corrective actions that may be required. Accordingly, the outcome of environmental liabilities under proposed or future environmental legislation cannot reasonably be estimated at present, and could be material. The Group paid normal routine pollutant discharge fees of approximately RMB 248, RMB 493 and RMB 1,637 for the years ended December 31, 2004, 2005 and 2006, respectively.

Legal contingencies

The Group is a defendant in certain lawsuits as well as the named party in other proceedings arising in the ordinary course of business. While the outcomes of such contingencies, lawsuits or other proceedings cannot be determined at present, management believes that any resulting liabilities will not have a material adverse effect on the financial position or operating results of the Group.

29. CONCENTRATION OF RISKS

Credit risk

The carrying amounts of cash and cash equivalents, time deposits with financial institutions, trade accounts and bills receivables, and other current assets, except for prepayments and deposits, represent the Group's maximum exposure to credit risk in relation to financial assets.

The majority of the Group's trade accounts receivable relate to sales of petroleum and chemical products to related parties and third parties operating in the petroleum and chemical industries. The Group performs ongoing credit evaluations of its customers' financial condition and generally does not require collateral on trade accounts receivable. The Group maintains an impairment loss for bad and doubtful debts and actual losses have been within management's expectations. No single customer accounted for greater than 10% of total revenues during the years ended December 31, 2004, 2005 and 2006.

No other financial assets carry a significant exposure to credit risk.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

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Concentration of economic risk

The Group's operations may be adversely affected by significant political, economic, and social uncertainties in the PRC. In addition, the ability to negotiate and implement specific projects in a timely and favorable manner may be impacted by political considerations unrelated to or beyond the control of the Group. Although the PRC government has been pursuing economic reform policies for the past two decades, no assurance can be given that the PRC government will continue to pursue such policies or that such policies may not be significantly altered. There is also no guarantee that the PRC government's pursuit of economic reforms will be consistent or effective and as a result, changes in the rate or method of taxation, reduction in tariff protection and other import restrictions, and changes in state policies affecting the industries to which the Group sells its products, may have a negative effect on its operating results and financial conditions.

Currency risk

Substantially all of the revenue-generating operations of the Group are transacted in Renminbi, which is not fully convertible into foreign currencies. On January 1, 1994, the PRC government abolished the dual rate system and introduced a single rate of exchange as quoted by the People's Bank of China. However, the unification of the exchange rate does not imply convertibility of Renminbi into United States dollars or other foreign currencies. All foreign exchange transactions continue to take place either through the People's Bank of China or other banks authorized to buy and sell foreign currencies at the exchange rates quoted by the People's Bank of China. Approval of foreign currency payments by the People's Bank of China or other institutions requires submitting a payment application form together with suppliers' invoices, shipping documents and signed contracts.

With the authorization from the PRC government, the People's Bank of China announced that the PRC government reformed the exchange rate regime by moving into a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies on July 21, 2005.

Other than the amounts as disclosed in Note 23, the amounts of other financial assets and liabilities of the Group are substantially denominated in the functional currency of respective entity of the Group.

Business risk

The Group conducts its principal operations in China and accordingly is subject to special considerations and significant risks not typically associated with investments in equity securities of the United States and Western European companies. These include risks associated with, among others, the political, economic and legal environment, influence of the State Council over substantially all aspects of its operations and competition in the oil and gas industry.

Interest rate risk

The interest rates and terms of repayment of short-term and long-term debt of the Group are disclosed in Note 23.

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30. RELATED PARTY TRANSACTIONS

Parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control or jointly control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control or common significant influence. Related parties may be individuals (being members of key management personnel, significant shareholders and/or their close family members) or other entities and include entities which are under the significant influence of related parties of the Group where those parties are individuals, and post-employment benefit plans which are for the benefit of employees of the Group or of any entity that is a related party of the Group.

- (a) Transactions with Sinopec Group Company and its affiliates, associates and jointly controlled entities

The Group is part of a larger group of companies under Sinopec Group Company, which is owned by the PRC government, and has significant transactions and relationships with Sinopec Group Company and its affiliates. Because of these relationships, it is possible that the terms of these transactions are not the same as those that would result from transactions among unrelated parties.

The principal related party transactions with Sinopec Group Company and its affiliates, associates and jointly controlled entities, which were carried out in the ordinary course of business, are as follows:

| | Note | Years ended | |
|---|--------|-------------|---------|
| | | 2004 | 2005 |
| | | RMB | RMB |
| Sales of goods..... | (i) | 63,507 | 95,000 |
| Purchases..... | (ii) | 35,402 | 45,000 |
| Transportation and storage..... | (iii) | 2,003 | 1,000 |
| Exploration and development services..... | (iv) | 14,446 | 17,000 |
| Production related services..... | (v) | 9,036 | 10,000 |
| Ancillary and social services..... | (vi) | 1,740 | 1,000 |
| Operating lease charges..... | (vii) | 3,297 | 3,000 |
| Agency commission income..... | (viii) | 41 | 0 |
| Intellectual property licence fee paid..... | (ix) | 10 | 0 |
| Interest received..... | (x) | 59 | 0 |
| Interest paid..... | (xi) | 623 | 1,000 |
| Net deposits placed with/ (withdrawn from) related parties..... | (xii) | 340 | 0 |
| Net loans obtained from/ (repaid to) related parties..... | (xiii) | 3,548 | (4,000) |

The amounts set out in the table above in respect of each of the years in the three-year period ended December 31, 2006 represent the relevant costs to the Group as determined by the corresponding contracts with the related parties.

There were no guarantees given to banks by the Group in respect of banking facilities to Sinopec Group Company and its affiliates as of December 31, 2005 and 2006. Guarantees given to banks by the Group in respect of banking facilities to associates are disclosed in Note 28.

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The directors of the Company are of the opinion that the above transactions with related parties were conducted in the ordinary course of business and on normal commercial terms or in accordance with the agreements governing such transactions, and this has been confirmed by the independent non-executive directors.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

Notes:

- (i) Sales of goods represent the sale of crude oil, intermediate petrochemical products, petroleum products and ancillary materials.
- (ii) Purchases represent the purchase of materials and utility supplies directly related to the Group's operations such as the procurement of raw and ancillary materials and related services, supply of water, electricity and gas.
- (iii) Transportation and storage represent the cost for the use of railway, road and marine transportation services, pipelines, loading, unloading and storage facilities.
- (iv) Exploration and development services comprise direct costs incurred in the exploration and development such as geophysical, drilling, well testing and well measurement services.
- (v) Production related services represent ancillary services rendered in relation to the Group's operations such as equipment repair and general maintenance, insurance premium, technical research, communications, fire fighting, security, product quality testing and analysis, information technology, design and engineering, construction which includes the construction of oilfield ground facilities, refineries and chemical plants, manufacture of replacement parts and machinery, installation, project management and environmental protection.
- (vi) Ancillary and social services represent expenditures for social welfare and support services such as educational facilities, media communication services, sanitation, accommodation, canteens, property maintenance and management services.
- (vii) Operating lease charges represent the rental paid to Sinopec Group Company for operating leases in respect of land, buildings and equipment.
- (viii) Agency commission income represents commission earned for acting as an agent in respect of sales of products and purchase of materials for certain entities owned by Sinopec Group Company.
- (ix) Intellectual property license fee represents reimbursement paid to Sinopec Group Company for fees required to maintain the validity of certain licenses for trademarks, patents, technology and computer software.
- (x) Interest received represents interest received from deposits placed with Sinopec Finance Company Limited, a finance company controlled by Sinopec

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Group Company. The applicable interest rate is determined in accordance with the prevailing saving deposit rate. The balance of deposits as of December 31, 2005 and 2006 were RMB 4,599 and RMB 689, respectively.

- (xi) Interest paid represents interest charges on the loans and advances obtained from Sinopec Group Company and Sinopec Finance Company Limited.
- (xii) Deposits were placed with / withdrawn from Sinopec Finance Company Limited.
- (xiii) The Group obtained loans from / repaid loans to Sinopec Group Company and Sinopec Finance Company Limited.

In connection with the Reorganization, the Company and Sinopec Group Company entered into a number of agreements under which 1) Sinopec Group Company will provide goods and products and a range of ancillary, social and supporting services to the Group and 2) the Group will sell certain goods to Sinopec Group Company. The terms of these agreements are summarized as follows:

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

- (a) The Company has entered into a non-exclusive Agreement for Mutual Provision of Products and Ancillary Services ("Mutual Provision Agreement") with Sinopec Group Company effective from January 1, 2000 in which Sinopec Group Company has agreed to provide the Group with certain ancillary production services, construction services, information advisory services, supply services and other services and products. While each of Sinopec Group Company and the Company is permitted to terminate the Mutual Provision Agreement upon at least six months notice, Sinopec Group Company has agreed not to terminate the agreement if the Group is unable to obtain comparable services from a third party. The pricing policy for these services and products provided by Sinopec Group Company to the Group is as follows:
 - o the government-prescribed price;
 - o where there is no government-prescribed price, the government-guidance price;
 - o where there is neither a government-prescribed price nor a government-guidance price, the market price; or
 - o where none of the above is applicable, the price to be agreed between the parties, which shall be based on a reasonable cost incurred in providing such services plus a profit margin not exceeding 6%.
- (b) The Company has entered into a non-exclusive Agreement for Provision of Cultural and Educational, Health Care and Community Services with Sinopec Group Company effective from January 1, 2000 in which Sinopec Group Company has agreed to provide the Group with certain cultural, educational, health care and community services on the same pricing terms and termination conditions as agreed to in the above Mutual Provision Agreement.
- (c) The Company has entered into a series of lease agreements with Sinopec

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Group Company to lease certain land and buildings at a rental of approximately RMB 3,241 and RMB 568, respectively, per annum. The Company and Sinopec Group Company can renegotiate the rental amount every three years for land and every year for buildings, however such amount cannot exceed the market price as determined by an independent third party. The Group has the option to terminate these leases upon six months notice to Sinopec Group Company.

- (d) The Company has entered into agreements with Sinopec Group Company effective from January 1, 2000 under which the Group has been granted the right to use certain trademarks, patents, technology and computer software developed by Sinopec Group Company. The Group will reimburse Sinopec Group Company for fees required to maintain the validity of these licenses.
- (e) The Company has entered into a service stations franchise agreement with Sinopec Group Company effective from January 1, 2000 under which its service stations and retail stores would exclusively sell the refined products supplied by the Group.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

During the year ended December 31, 2004, the Group acquired the equity interest of Sinopec Group Tianjin Petrochemical Company, Sinopec Group Luoyang Petrochemical General Plant, Zhongyuan Petrochemical Company Limited, Sinopec Group Guangzhou Petrochemical General Plant and certain catalyst plants from Sinopec Group Company for a total consideration of RMB 3,128 which was fully paid in 2005 (the "Acquisition of Petrochemical and Catalyst Assets"). In addition, the Group acquired certain individual assets and liabilities from Sinopec Group Company, including certain property, plant and equipment with net book value of RMB 1,883, for a total consideration payable of RMB 2,232. In connection with these acquisitions, the Group disposed of certain property, plant and equipment, with net book value of RMB 1,857, and certain other assets and liabilities, related to its oilfield downhole operation (the "Downhole Assets") to Sinopec Group Company for a consideration receivable of RMB 1,712, which approximated the net carrying value of the assets and liabilities, resulting in a net cash consideration of RMB 3,648 payable to Sinopec Group Company. This consideration was fully paid during the year ended December 31, 2005.

As discussed in Note 1, pursuant to the resolution passed at the Directors' meeting on October 10, 2006, the Group acquired equity interests in Sinopec Hainan for cash of RMB 2,990. Sinopec Hainan was previously wholly owned by Sinopec Group Company.

As discussed in Note 1, pursuant to the resolution passed at the Directors' meeting on December 6, 2006, the Group acquired the equity interests in Oil Production Plants from Sinopec Group Company, for a total consideration of RMB 3,500 payable in 2007.

Amounts due from / to Sinopec Group Company and its affiliates, associates and jointly controlled entities included in respective accounts caption are summarized as follows:

| | December |
|--|----------|
| | ----- |
| | 2005 |
| | ----- |
| | RMB |
| Trade accounts receivable..... | 4,222 |
| Prepaid expenses and other current assets..... | 3,504 |
| | ----- |
| Total amounts due from Sinopec Group Company and its affiliates, associates and jointly controlled entities..... | 7,726 |
| | ===== |
| Trade accounts payable..... | 3,464 |
| Accrued expenses and other payables..... | 8,133 |
| Short-term loans and current portion of long-term loans from Sinopec Group Company and its affiliates..... | 2,805 |
| Long-term loans excluding current portion from Sinopec Group Company and its affiliates..... | 39,933 |
| | ----- |
| Total amounts due to Sinopec Group Company and its affiliates, associates and jointly controlled entities..... | 54,335 |
| | ===== |

Amounts due from / to Sinopec Group Company and its affiliates, associates and jointly controlled entities, other than short-term loans and long-term loans, bear no interest, are unsecured and are repayable in accordance with normal commercial terms. The terms and conditions associated with short-term loans and long-term loans payable to Sinopec Group Company and its affiliates are set out in Note 23.

As of and for the year ended December 31, 2006, no impairment losses for bad and doubtful debts were recorded in respect of amounts due from Sinopec Group Company and its affiliates, associates and jointly controlled entities.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

(b) Key management personnel emoluments

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Group, directly or indirectly, including directors and supervisors of the Group. The key management personnel compensations are as follows:

| | Years ended December 31, | | |
|--------------------------------------|--------------------------|---------|---------|
| | 2004 | 2005 | 2006 |
| | ----- | ----- | ----- |
| | RMB'000 | RMB'000 | RMB'000 |
| Short-term employee benefits..... | 3,997 | 2,868 | 4,562 |
| Retirement scheme contributions..... | 202 | 115 | 184 |
| | ----- | ----- | ----- |
| | 4,199 | 2,983 | 4,746 |
| | ===== | ===== | ===== |

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Total emoluments are included in "personnel expenses" as disclosed in Note 5.

(c) Contributions to defined contribution retirement plans

The Group participates in various defined contribution retirement plans organized by municipal and provincial governments for its staff. The details of the Group's employee benefits plan are disclosed in Note 31. As of December 31, 2006, there was no material outstanding contribution to post-employment benefit plans.

(d) Transactions with other state-controlled entities in the PRC

The Group is a state-controlled energy and chemical enterprise and operates in an economic regime currently dominated by entities directly or indirectly controlled by the PRC government through its government authorities, agencies, affiliations and other organizations (collectively referred as "state-controlled entities").

Apart from transactions with Sinopec Group Company and its affiliates, the Group has transactions with other state-controlled entities include but not limited to the following:

- o sales and purchase of goods and ancillary materials;
- o rendering and receiving services;
- o lease of assets;
- o depositing and borrowing money; and
- o use of public utilities.

These transactions are conducted in the ordinary course of the Group's business on terms comparable to those with other entities that are not state-controlled. The Group has established its procurement policies, pricing strategy and approval process for purchases and sales of products and services which do not depend on whether the counterparties are state-controlled entities or not.

Having considered the transactions potentially affected by related party relationships, the entity's pricing strategy, procurement policies and approval processes, and the information that would be necessary for an understanding of the potential effect of the related party relationship on the financial statements, the directors are of the opinion that the following related party transactions require disclosure of numeric details:

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

(i) Transactions with other state-controlled energy and chemical companies

The Group's major domestic suppliers of crude oil and refined petroleum products are China National Petroleum Corporation and its subsidiaries ("CNPC Group") and China National Offshore Oil Corporation and its subsidiaries ("CNOOC Group"), which are state-controlled entities.

During the years ended December 31, 2004, 2005 and 2006, the aggregate

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amount of crude oil purchased by refining segment from CNPC and CNOOC Group and refined petroleum purchased by marketing and distribution segment from CNPC Group was RMB 41,652, RMB 58,957 and RMB 60,863, respectively.

The aggregate amounts due from / to CNPC Group and CNOOC Group are summarized as follows:

| | December 31, | |
|--|--------------|-------|
| | 2005 | 2006 |
| | ----- | ----- |
| | RMB | RMB |
| Trade accounts receivable..... | 213 | 111 |
| Prepaid expenses and other current assets..... | 120 | 115 |
| | ----- | ----- |
| Total amounts due from CNPC Group and CNOOC Group..... | 333 | 226 |
| | ===== | ===== |
| Trade accounts payable..... | 1,237 | 1,231 |
| Accrued expenses and other payables..... | 127 | 7 |
| | ----- | ----- |
| Total amounts due to CNPC Group and CNOOC Group..... | 1,364 | 1,238 |
| | ===== | ===== |

(ii) Transactions with state-controlled banks

The Group deposits its cash with several state-controlled banks in the PRC. The Group also obtains short-term and long-term loans from these banks in the ordinary course of business. The interest rates of the bank deposits and loans are regulated by the PBOC. The Group's interest income from and interest expense to these state-controlled banks in the PRC are as follows:

| | Years ended December 31, | | |
|-----------------------|--------------------------|-------|-------|
| | 2004 | 2005 | 2006 |
| | ----- | ----- | ----- |
| | RMB | RMB | RMB |
| Interest income..... | 315 | 323 | 458 |
| | ===== | ===== | ===== |
| Interest expense..... | 3,786 | 4,878 | 6,163 |
| | ===== | ===== | ===== |

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

The amounts of cash deposited at and loans from state-controlled banks in the PRC are summarized as follows:

| | December 31, | |
|--|--------------|-------|
| | 2005 | 2006 |
| | ----- | ----- |
| | RMB | RMB |

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| | | |
|---|--------|--------|
| Cash and cash equivalents..... | 9,418 | 7,366 |
| Time deposits with financial institutions..... | 964 | 615 |
| | ----- | ----- |
| Total deposits at state-controlled banks in the PRC..... | 10,382 | 7,981 |
| | ===== | ===== |
| Short-term loans and current portion of long-term loans..... | 27,891 | 34,803 |
| Long-term loans excluding current portion of long-term loans..... | 67,641 | 62,346 |
| | ----- | ----- |
| Total loans from state-controlled banks in the PRC..... | 95,532 | 97,149 |
| | ===== | ===== |

31. EMPLOYEE BENEFITS PLAN

As stipulated by the regulations of the PRC, the Group participates in various defined contribution retirement plans organized by municipal and provincial governments for its staff. The Group is required to make contributions to the retirement plans at rates ranging from 17.0% to 30.0% of the salaries, bonuses and certain allowances of its staff. A member of the plan is entitled to a pension equal to a fixed proportion of the salary prevailing at his or her retirement date. The Group has no other material obligation for the payment of pension benefits associated with these plans beyond the annual contributions described above. The Group's contributions for the years ended December 31, 2004, 2005 and 2006 were RMB 2,245, RMB 2,273 and RMB 2,270, respectively.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

32. SEGMENTAL REPORTING

The Group has five operating segments as follows:

- (i) Exploration and production, which explores and develops oil fields, produces crude oil and natural gas and sells such products to the refining segment of the Group and external customers.
- (ii) Refining, which processes and purifies crude oil, that is sourced from the exploration and production segment of the Group and external suppliers, and manufactures and sells petroleum products to the chemicals and marketing and distribution segments of the Group and external customers.
- (iii) Marketing and distribution, which owns and operates oil depots and service stations in the PRC, and distributes and sells refined petroleum products (mainly gasoline and diesel) in the PRC through wholesale and retail sales networks.
- (iv) Chemicals, which manufactures and sells petrochemical products, derivative petrochemical products and other chemical products mainly to external customers.

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- (v) Corporate and others, which largely comprise the trading activities of the import and export companies of the Group and research and development undertaken by other subsidiaries.

The segments were determined primarily because the Group manages its exploration and production; refining; marketing and distribution; chemicals; and corporate and others businesses separately. The reportable segments are each managed separately because they manufacture and/or distribute distinct products with different production processes and due to their distinct operating and gross margin characteristics. In view of the fact that the Company and its subsidiaries operate mainly in the PRC, no geographical segment information is presented.

The Group evaluates the performance and allocates resources to its operating segments on an operating income basis, without considering the effects of finance costs or investment income. The accounting policies of the Group's segments are the same as those described in the principal accounting policies (see Note 2). Corporate administrative costs and assets are not allocated to the operating segments; instead, operating segments are billed for direct corporate services. Inter-segment transfer pricing is based on cost plus an appropriate margin, as specified by the Group's policy.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

Reportable information on the Group's business segments is as follows:

| | Years ended December 31, | | |
|----------------------------|--------------------------|---------|---------|
| | 2004 | 2005 | 2006 |
| | RMB | RMB | RMB |
| Sales of goods | | | |
| Exploration and production | | | |
| External sales..... | 16,091 | 20,006 | 23,355 |
| Inter-segment sales..... | 60,053 | 84,423 | 105,656 |
| | ----- | ----- | ----- |
| | 76,144 | 104,429 | 129,011 |
| Refining | | | |
| External sales..... | 63,388 | 82,810 | 99,201 |
| Inter-segment sales..... | 289,699 | 386,456 | 471,571 |
| | ----- | ----- | ----- |
| | 353,087 | 469,266 | 570,772 |
| Marketing and distribution | | | |
| External sales..... | 342,840 | 459,292 | 588,270 |
| Inter-segment sales..... | 2,831 | 3,172 | 4,601 |
| | ----- | ----- | ----- |
| | 345,671 | 462,464 | 592,871 |
| Chemicals | | | |
| External sales..... | 126,013 | 160,783 | 209,135 |
| Inter-segment sales..... | 12,510 | 12,199 | 12,299 |
| | ----- | ----- | ----- |
| | 138,523 | 172,982 | 221,432 |

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| | | | |
|---|-----------|-----------|-----------|
| Corporate and others | | | |
| External sales..... | 48,986 | 76,368 | 124,693 |
| Inter-segment sales..... | 32,046 | 44,897 | 136,775 |
| | ----- | ----- | ----- |
| | 81,032 | 121,265 | 261,468 |
| Elimination of inter-segment sales..... | (397,139) | (531,147) | (730,902) |
| | ----- | ----- | ----- |
| Total sales of goods..... | 597,318 | 799,259 | 1,044,652 |
| | ----- | ----- | ----- |
| Other operating revenues | | | |
| Exploration and production..... | 9,294 | 10,756 | 14,155 |
| Refining..... | 5,186 | 5,421 | 4,590 |
| Marketing and distribution..... | 755 | 1,358 | 687 |
| Chemicals..... | 6,170 | 5,841 | 6,661 |
| Corporate and others..... | 1,192 | 637 | 657 |
| | ----- | ----- | ----- |
| Total other operating revenues..... | 22,597 | 24,013 | 26,750 |
| | ----- | ----- | ----- |
| Other income | | | |
| Refining..... | -- | 9,415 | 5,000 |
| | ----- | ----- | ----- |
| Total other income..... | -- | 9,415 | 5,000 |
| | ----- | ----- | ----- |
| | 619,915 | 832,687 | 1,076,402 |
| | ===== | ===== | ===== |

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

| | Years ended December 31, | | |
|--|--------------------------|---------|----------|
| | 2004 | 2005 | 2006 |
| | RMB | RMB | RMB |
| Operating income by segment | | | |
| - Exploration and production..... | 26,397 | 48,334 | 63,182 |
| - Refining..... | 4,982 | (3,536) | (25,298) |
| - Marketing and distribution..... | 14,716 | 10,350 | 30,234 |
| - Chemicals..... | 18,721 | 14,296 | 17,234 |
| - Corporate and others..... | (1,925) | (1,198) | (1,532) |
| | ----- | ----- | ----- |
| Total operating income..... | 62,891 | 68,246 | 83,820 |
| | ----- | ----- | ----- |
| Income/(loss) from associates | | | |
| - Exploration and production..... | 447 | 326 | 233 |
| - Refining..... | 58 | 23 | 58 |
| - Marketing and distribution..... | 302 | 241 | 404 |
| - Chemicals..... | (164) | 1 | 20 |
| - Corporate and others..... | 154 | 266 | 232 |
| | ----- | ----- | ----- |
| Aggregate income from associates | 797 | 857 | 947 |
| | ----- | ----- | ----- |

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| | | | |
|-------------------------------|----------|----------|----------|
| Finance costs | | | |
| Interest expense..... | (4,583) | (5,926) | (7,437) |
| Interest income..... | 378 | 384 | 555 |
| Foreign exchange losses..... | (223) | (79) | (153) |
| Foreign exchange gains..... | 61 | 996 | 935 |
| | ----- | ----- | ----- |
| Net finance costs..... | (4,367) | (4,625) | (6,100) |
| Investment income..... | 121 | 178 | 256 |
| | ----- | ----- | ----- |
| Income before income tax..... | 59,442 | 64,656 | 78,923 |
| Income tax..... | (18,091) | (19,880) | (23,515) |
| | ----- | ----- | ----- |
| Net income..... | 41,351 | 44,776 | 55,408 |
| | ===== | ===== | ===== |

Assets and liabilities dedicated to a particular segment's operations are included in that segment's total assets and liabilities. Assets which benefit more than one segment or are considered to be corporate assets are not allocated. "Unallocated assets" consists primarily of cash and cash equivalents, time deposits with financial institutions, investments and deferred tax assets. "Unallocated liabilities" consists primarily of short-term and long-term debts, loans from Sinopec Group Company and its affiliates, income tax payable, deferred tax liabilities and other liabilities.

Interest in and income from associates are included in the segments in which the associates operate. Information on associates is included in Note 19. Additions to long-lived assets by operating segment are included in Notes 15 and 16.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

| | Years ended December 31, | | |
|-----------------------------------|--------------------------|---------|---------|
| | 2004 | 2005 | 2006 |
| | RMB | RMB | RMB |
| Assets | | | |
| Segment assets | | | |
| - Exploration and production..... | 112,720 | 127,471 | 155,043 |
| - Refining..... | 112,963 | 142,776 | 163,898 |
| - Marketing and distribution..... | 93,722 | 102,935 | 108,053 |
| - Chemicals..... | 105,032 | 115,942 | 125,051 |
| - Corporate and others..... | 17,574 | 20,570 | 22,641 |
| | ----- | ----- | ----- |
| Total segment assets..... | 442,011 | 509,694 | 574,686 |
| | ----- | ----- | ----- |
| Interest in associates | | | |
| - Exploration and production..... | 1,396 | 1,494 | 1,063 |
| - Refining..... | 319 | 571 | 1,117 |
| - Marketing and distribution..... | 2,410 | 4,298 | 4,692 |
| - Chemicals..... | 4,315 | 1,092 | 1,245 |
| - Corporate and others..... | 1,787 | 1,812 | 3,500 |
| | ----- | ----- | ----- |

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| | | | |
|---------------------------------------|---------|---------|---------|
| Aggregate interest in associates..... | 10,227 | 9,267 | 11,617 |
| | ----- | ----- | ----- |
| Unallocated assets..... | 28,600 | 30,079 | 25,487 |
| | ----- | ----- | ----- |
| Total assets..... | 480,838 | 549,040 | 611,790 |
| | ===== | ===== | ===== |
| Liabilities | | | |
| Segment liabilities | | | |
| - Exploration and production..... | 17,158 | 20,262 | 30,082 |
| - Refining..... | 28,170 | 27,311 | 30,162 |
| - Marketing and distribution..... | 23,419 | 23,713 | 27,090 |
| - Chemicals..... | 16,528 | 19,442 | 19,619 |
| - Corporate and others..... | 15,547 | 35,855 | 35,913 |
| | ----- | ----- | ----- |
| Total segment liabilities..... | 100,822 | 126,583 | 142,866 |
| | ----- | ----- | ----- |
| Unallocated liabilities..... | 154,721 | 167,477 | 184,135 |
| | ----- | ----- | ----- |
| Total liabilities..... | 255,543 | 294,060 | 327,001 |
| | ===== | ===== | ===== |

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

Segment capital expenditure is the total cost incurred during the year to acquire segment assets that are expected to be used for more than one year.

| | Years ended December | |
|--|----------------------|--------|
| | 2004 | 2005 |
| | ----- | ----- |
| | RMB | RMB |
| Capital expenditure | | |
| Exploration and production..... | 21,234 | 23,095 |
| Refining..... | 15,319 | 19,100 |
| Marketing and distribution..... | 16,678 | 10,954 |
| Chemicals..... | 11,025 | 9,386 |
| Corporate and others..... | 1,550 | 1,164 |
| | ----- | ----- |
| | 65,806 | 63,699 |
| | ===== | ===== |
| Capital expenditure of Oil Production Plants | | |
| Exploration and production..... | 642 | 1,612 |
| | ===== | ===== |
| Capital expenditure of jointly controlled entities | | |
| Exploration and production..... | 1,323 | 772 |
| Chemicals..... | 5,178 | 1,830 |
| | ----- | ----- |
| | 6,501 | 2,602 |
| | ===== | ===== |

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| | | |
|--|--------|--------|
| Depreciation, depletion and amortization | | |
| Exploration and production..... | 12,217 | 11,118 |
| Refining..... | 7,730 | 7,055 |
| Marketing and distribution..... | 2,759 | 3,026 |
| Chemicals..... | 9,325 | 9,697 |
| Corporate and others..... | 462 | 722 |
| | ----- | ----- |
| | 32,493 | 31,618 |
| | ===== | ===== |
| Impairment losses on long-lived assets recognized in consolidated statements of income | | |
| Exploration and production..... | 98 | 60 |
| Refining..... | 14 | --- |
| Marketing and distribution..... | 1,769 | 366 |
| Chemicals..... | 2,038 | 1,425 |
| | ----- | ----- |
| | 3,919 | 1,851 |
| | ===== | ===== |
| Impairment losses on revalued long-lived assets recognized in equity attributable to equity shareholders of the Company | | |
| Chemicals..... | 709 | -- |
| | ===== | ===== |

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

33. PRINCIPAL SUBSIDIARIES

| Name of company ----- | Particulars of issued and paid up capital ----- | Type of Legal Entity ----- | Percentage of equities held by the Company ----- | Per of hel Com sub ----- |
|--|---|----------------------------------|--|---|
| | | | % | |
| China Petrochemical International Company Limited | RMB 1,663 | Limited company | 100.00 | |
| Sinopec Sales Company Limited | RMB 1,700 | Limited company | 100.00 | |
| Sinopec Zhenhai Refining and Chemical Company Limited (Note 17) | RMB 2,524 | Limited company | 100.00 | |
| Sinopec Qilu Petrochemical Company | RMB 1,950 | Limited | 99.76 | |

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| | | | |
|---|-----------|-----------------|-------|
| Sinopec Yangzi Petrochemical Company | RMB 2,330 | Limited | 99.81 |
| Sinopec Zhongyuan Petroleum Company Limited (Note 17) | RMB 875 | Limited company | 99.35 |
| Shengli Oil Field Dynamic Company Limited (Note 17) | RMB 364 | Limited company | 97.71 |
| Sinopec Fujian Petrochemical Company Limited (i) | RMB 2,253 | Limited company | 50.00 |
| Sinopec Shanghai Petrochemical Company Limited | RMB 7,200 | Limited company | 55.56 |
| Sinopec Shijiazhuang Refining-Chemical Company Limited | RMB 1,154 | Limited company | 79.73 |
| Sinopec Kantons Holdings Limited | HK\$ 104 | Limited company | — |
| Sinopec Wuhan Petroleum Group Company Limited (i) | RMB 147 | Limited company | 46.25 |
| Sinopec Yizheng Chemical Fibre Company Limited (i) | RMB 4,000 | Limited company | 42.00 |
| Sinopec Zhongyuan Petrochemical Company Limited | RMB 2,400 | Limited company | 93.51 |
| Sinopec Shell (Jiangsu) Petroleum Marketing Company Limited | RMB 830 | Limited company | 60.00 |
| BP Sinopec (Zhejiang) Petroleum Company Limited | RMB 800 | Limited company | 60.00 |
| Sinopec Qingdao Refining and Chemical Company Limited | RMB 800 | Limited company | 85.00 |
| Sinopec Hainan Refining and Chemical | RMB 3,986 | Limited | 75.00 |

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Company Limited

company

Except for Sinopec Kantons Holdings Limited, which is incorporated in Bermuda, all of the above principal subsidiaries are incorporated in the PRC.

- (i) The Group consolidated the results of the entity because the Group controlled the board of this entity and had the power to govern its financial and operating policies.

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- (ii) During the year ended December 31, 2006, the Company disposed the 211,423,651 A shares, representing approximately 40.72% of the issued share capital, in Sinopec Wuhan Phoenix Company Limited pursuant to an agreement entered into with a third party. No significant disposal gain or loss was recorded from this transaction.

34. FAIR VALUES OF FINANCIAL INSTRUMENTS

Financial assets of the Group include cash and cash equivalents, time deposits with financial institutions, investments, trade accounts receivable, bills receivable, amounts due from Sinopec Group Company and its affiliates, advances to third parties, amounts due from associates, and other receivables. Financial liabilities of the Group include bank and other loans, loans from Sinopec Group Company and its affiliates, trade accounts payable, bills payable, amounts due to Sinopec Group Company and its affiliates, receipts in advance, and advances from third parties. The Group has no derivative instruments that are designated and qualified as hedging instruments as of December 31, 2005 and 2006.

The disclosures of the fair value estimates, methods and assumptions, set forth below for the Group's financial instruments, are made to comply with the requirements of IAS 32 and IAS 39 and should be read in conjunction with the Group's consolidated financial statements and related notes. The estimated fair value amounts have been determined by the Group using market information and valuation methodologies considered appropriate. However, considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Group could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The Group has not developed an internal valuation model necessary to make the estimate of the fair value of loans from Sinopec Group Company and its affiliates as it is not considered practicable to estimate their fair value because the cost of obtaining discount and borrowing rates for comparable borrowings would be excessive based on the Reorganization of the Group, its existing capital structure and the terms of the borrowings.

The following table presents the carrying amount and fair value of the

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Group's long-term indebtedness other than loans from Sinopec Group Company and its affiliates as of December 31, 2005 and 2006:

| | December 31, | |
|----------------------|--------------|--------|
| | 2005 | 2006 |
| | RMB | RMB |
| Carrying amount..... | 87,457 | 85,778 |
| Fair value..... | 87,461 | 85,376 |

The fair value of long-term indebtedness is estimated by discounting future cash flows thereon using current market interest rates offered to the Group for debts with substantially the same characteristics and maturities.

Unquoted equity securities are individually and in the aggregate not material to the Group's financial condition or results of operations for all periods presented. There are no listed market prices for such interests in the PRC and, accordingly, a reasonable estimate of fair value could not be made without incurring excessive costs.

The fair values of all other financial instruments approximate their carrying amounts due to the nature or short-term maturity of these instruments.

35. ACCOUNTING ESTIMATES AND JUDGEMENTS

The Group's financial condition and results of operations are sensitive to accounting methods, assumptions and estimates that underlie the preparation of the financial statements. The Group bases the assumptions and estimates on historical experience and on various other assumptions that the Group believes to be reasonable

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and which form the basis for making judgments about matters that are not readily apparent from other sources. On an on-going basis, management evaluates its estimates. Actual results may differ from those estimates as facts, circumstances and conditions change.

The selection of critical accounting policies, the judgments and other uncertainties affecting application of those policies and the sensitivity of reported results to changes in conditions and assumptions are factors to be considered when reviewing the financial statements. The principal accounting policies are set forth in Note 2. The Group believes the following critical accounting policies involve the most significant judgments and estimates used in the preparation of the financial statements.

Oil and gas properties and reserves

The accounting for the exploration and production's oil and gas activities is subject to accounting rules that are unique to the oil and gas business. There are two methods to account for oil and gas business activities, the successful efforts method and the full cost method. The Group has elected to use

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the successful efforts method. The successful efforts method reflects the volatility that is inherent in exploring for mineral resources in that costs of unsuccessful exploratory efforts are charged to expense as they are incurred. These costs primarily include dry hole costs, seismic costs and other exploratory costs. Under the full cost method, these costs are capitalized and written-off or depreciated over time.

Engineering estimates of the Group's oil and gas reserves are inherently imprecise and represent only approximate amounts because of the subjective judgments involved in developing such information. There are authoritative guidelines regarding the engineering criteria that have to be met before estimated oil and gas reserves can be designated as "proved". Proved and proved developed reserves estimates are updated at least annually and take into account recent production and technical information about each field. In addition, as prices and cost levels change from year to year, the estimate of proved and proved developed reserves also changes. This change is considered a change in estimate for accounting purposes and is reflected on a prospective basis in related depreciation rates.

Despite the inherent imprecision in these engineering estimates, these estimates are used in determining depreciation expense and impairment expense. Depreciation rates are determined based on estimated proved developed reserve quantities (the denominator) and capitalized costs of producing properties (the numerator). Producing properties' capitalized costs are amortized based on the units of oil or gas produced.

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Impairment for long lived assets

If circumstances indicate that the net book value of a long-lived asset may not be recoverable, the asset may be considered "impaired", and an impairment loss may be recognized in accordance with IAS 36 "Impairment of Assets". The carrying amounts of long-lived assets are reviewed periodically in order to assess whether the recoverable amounts have declined below the carrying amounts. These assets are tested for impairment whenever events or changes in circumstances indicate that their recorded carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to recoverable amount. For goodwill, the recoverable amount is estimated annually. The recoverable amount is the greater of the net selling price and the value in use. It is difficult to precisely estimate selling price because quoted market prices for the Group's assets or cash-generating units are not readily available. In determining the value in use, expected cash flows generated by the asset or the cash-generating unit are discounted to their present value, which requires significant judgment relating to level of sale volume, selling price and amount of operating costs. The Group uses all readily available information in determining an amount that is a reasonable approximation of recoverable amount, including estimates based on reasonable and supportable assumptions and projections of sale volume, selling price and amount of operating costs.

Depreciation

Property, plant and equipment, other than oil and gas properties, are depreciated on a straight-line basis over the estimated useful lives of the

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assets, after taking into account the estimated residual value. The Group reviews the estimated useful lives of the assets regularly in order to determine the amount of depreciation expense to be recorded during any reporting period. The useful lives are based on the Group's historical experience with similar assets and taking into account anticipated technological changes. The depreciation expense for future periods is adjusted if there are significant changes from previous estimates.

Impairment for bad and doubtful debts

The Group estimates impairment losses for bad and doubtful debts resulting from the inability of the customers to make the required payments. The Group bases the estimates on the aging of the accounts receivable balance, customer credit-worthiness, and historical write-off experience. If the financial condition of the customers were to deteriorate, actual write-offs would be higher than estimated.

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36. POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE ANNUAL ACCOUNTING PERIOD ENDED DECEMBER 31, 2006

Up to the date of issue of these financial statements, the IASB has issued the following amendments, new standards and interpretations which are not yet effective for the annual accounting period ended December 31, 2006 and which have not been adopted in these financial statements:

| | Effective for accounting period beginning on |
|---|--|
| IFRS 7, Financial instruments: disclosures | January 1, 2007 |
| IFRS 8, Operating Segments | January 1, 2009 |
| IFRIC 7, Applying the restatement approach under IAS 29, Financial reporting in hyperinflationary economies | March 1, 2006 |
| IFRIC 8, Scope of IFRS 2 | May 1, 2006 |
| IFRIC 9, Reassessment of Embedded Derivatives | June 1, 2006 |
| IFRIC 10, Interim financial reporting and impairment | November 1, 2006 |
| IFRIC 11, IFRS 2 - Group and treasury share transaction | March 1, 2007 |
| IFRIC 12, Service concession arrangements | January 1, 2008 |
| Amendment to IAS 1, Presentation of financial statements: capital disclosures | January 1, 2007 |

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The Group is in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application. Up to the date of issuance of these financial statements, the Group believes that the adoption of IFRIC 7, IFRIC 8, IFRIC 9, IFRIC 10, IFRIC 11, IFRIC 12 and the amendment to IAS 1 are not applicable to any of the Group's operations and that the adoption of the remainder of the above new standards and new interpretations is unlikely to have a significant impact on the Group's results of operations and financial position.

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

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37. SIGNIFICANT DIFFERENCES BETWEEN IFRS AND US GAAP

The Group's accounting policies conform with IFRS which differ in certain significant respects from accounting principles generally accepted in the United States of America ("US GAAP"). Information relating to the nature and effect of such differences are set out below.

(a) Foreign exchange gains and losses

In accordance with IFRS, foreign exchange differences on funds borrowed for construction are capitalized as property, plant and equipment to the extent that they are regarded as an adjustment to interest costs during the construction period. Under US GAAP, all foreign exchange gains and losses on foreign currency debt are included in current earnings. For the years presented herein, the US GAAP adjustments represent the amortization effect of such originating adjustments described above. Accordingly, the carrying amount of property, plant and equipment under IFRS was higher than the amount under US GAAP by RMB 241 and RMB 195 as of December 31, 2005 and 2006, respectively.

(b) Capitalization of property, plant and equipment

In the years prior to those presented herein, certain adjustments arose between IFRS and US GAAP with regard to the capitalization of interest and pre-production results under IFRS that were reversed and expensed under US GAAP. For the years presented herein, there were no further additions related to the capitalization of interest and pre-production results under IFRS and the US GAAP adjustments represent the amortization effect of such originating adjustments described above. The amounts were fully amortized as of December 31, 2004. Accordingly, there was no difference in the carrying amount of property, plant and equipment under IFRS and US GAAP as of December 31, 2005 and 2006, respectively.

(c) Revaluation of property, plant and equipment

As required by the relevant PRC regulations with respect to the Reorganization, the property, plant and equipment of the Group were revalued at September 30, 1999. In addition, the property, plant and equipment of Sinopec National Star, Sinopec Maoming, Refining Assets, Petrochemical and Catalyst Assets and Oil Production Plants were revalued at December 31, 2000, June 30, 2003, October 31, 2003, June 30, 2004 and June 30, 2006, respectively, in connection with the acquisitions of Sinopec National Star, Sinopec Maoming,

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Refining Assets, Petrochemical and Catalyst Assets and Oil Production Plants. Under IFRS, such revaluations result in an increase in equity with respect to the increase in carrying amount of certain property, plant and equipment above their historical cost bases and a charge to income with respect to the reduction in carrying amount of certain property, plant and equipment below their historical cost bases.

Under US GAAP, property, plant and equipment are stated at their historical cost less accumulated depreciation. However, as a result of the tax deductibility of the net revaluation surplus, a deferred tax asset related to the reversal of the revaluation surplus is created under US GAAP with a corresponding increase in equity.

In addition, under IFRS, on disposal of a revalued asset, the related revaluation surplus is transferred from the revaluation reserve to retained earnings. Under US GAAP, the gain and loss on disposal of an asset is determined with reference to the asset's historical carrying amount and included in current earnings.

Accordingly, the carrying amount of property, plant and equipment under IFRS was higher than the amount under US GAAP by RMB 1,838 and RMB 86 as of December 31, 2005 and 2006, respectively.

(d) Exchange of assets

During 2002, the Company and Sinopec Group Company entered into an asset swap transaction. Under IFRS, the cost of property, plant and equipment acquired in an exchange for a dissimilar item of property, plant and equipment is measured at fair value. Under US GAAP, as the exchange of assets was between entities under common control, the assets received from Sinopec Group Company are measured at historical cost. The

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difference between the historical cost of the net assets transferred and the net assets received is accounted for as an equity transaction. For the years presented herein, the US GAAP adjustments represent the amortization effect of such originating adjustments described above. Accordingly, the carrying amount of property, plant and equipment under IFRS was higher than the amount under US GAAP by RMB 509 and RMB 486 as of December 31, 2005 and 2006, respectively.

(e) Reversal of impairment of long-lived assets

Under IFRS, impairment charges are recognized when a long-lived asset's carrying amount exceeds the higher of an asset's fair value less costs to sell and value in use, which incorporates discounting the asset's estimated future cash flows.

Under US GAAP, determination of the recoverability of a long-lived asset held for use is based on an estimate of undiscounted future cash flows resulting from the use of the asset and its eventual disposition. If the sum of the expected future cash flows is less than the carrying amount of the asset, an

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impairment loss is recognized. Measurement of an impairment loss for a long-lived asset is based on the difference between the asset's carrying value and the fair value of the asset.

In addition, under IFRS, a subsequent increase in the recoverable amount of an asset is reversed to the consolidated statements of income to the extent that an impairment loss on the same asset was previously recognized as an expense when the circumstances and events that led to the write-down or write-off cease to exist. The reversal is reduced by the amount that would have been recognized as depreciation had the write-off not occurred. Under US GAAP, an impairment loss establishes a new cost basis for the impaired asset and the new cost basis should not be adjusted subsequently other than for further impairment losses.

For the years presented herein, the US GAAP adjustment represents the effect of reversing the recovery of previous impairment charges recorded under IFRS. Accordingly, the carrying amount of property, plant and equipment under IFRS was higher than the amount under US GAAP by RMB 456 and RMB 418 as of December 31, 2005 and 2006, respectively.

(f) Capitalized interest on investment in associates

Under IFRS, an investment accounted for by the equity method is not considered a qualifying asset for which interest is capitalized. Under US GAAP, an investment accounted for by the equity method while the investee has activities in progress necessary to commence its planned principal operations, provided that the investee's activities include the use of funds to acquire qualifying assets for its operations, is a qualifying asset for which interest is initially capitalized and subsequently amortized when the operation of the qualifying assets begin. Accordingly, the carrying amount of the investment in associates under IFRS was lower than the amount under US GAAP by RMB 486 and RMB 446 as of December 31, 2005 and 2006, respectively.

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(g) Goodwill

Under IFRS, with reference to IFRS 3, "Business Combination", goodwill arising from a business combination for which the purchase agreement date is on or after March 31, 2004 is not amortized, or goodwill arising from a business combination for which the purchase agreement date was before March 31, 2004 is no longer amortized from the first annual reporting period beginning on or after March 31, 2004. Instead, goodwill is tested for impairment annually.

Under US GAAP, with reference to Statement of Financial Accounting Standards No.142, "Goodwill and Other Intangible Assets" ("SFAS No.142"), goodwill is no longer amortized beginning January 1, 2002. Instead, goodwill is reviewed for impairment at least annually.

As a result, there is no difference in respect of goodwill amortization effective January 1, 2005. Accordingly, the carrying amount of the goodwill under IFRS was lower than the amount under US GAAP by RMB 43 and RMB 43 as of December 31, 2005 and 2006, respectively, due to the continued amortization of goodwill under IFRS until the end of 2004.

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(h) Presentation of minority interests

Under IFRS, minority interests at the balance sheet date are presented in the consolidated balance sheet within equity, separately from the equity attributable to the equity shareholders of the Company, and minority interests in the results of the Group for the year are presented on the face of the consolidated statements of income as an allocation of the total net income for the year between the minority interests and the equity shareholders of the Company. Under US GAAP, minority interests at the balance sheet date are presented in the consolidated balance sheet either as liabilities or separately from liabilities and equity. Minority interests in the results of the Group for the year are also separately presented in the consolidated statements of income as a component of net income.

(i) Companies included in consolidation

Under IFRS, the Group consolidates less than majority owned entities in which the Group has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities, and proportionately consolidates jointly controlled entities in which the Group has joint control with other venturers. However, US GAAP requires that any entity of which the Group owns 20% to 50% of total outstanding voting stock not be consolidated nor proportionately consolidated, but rather be accounted for under the equity method. Accordingly, certain of the Group's subsidiaries, of which the Group owns between 40.72% to 50% of the outstanding voting stock, and the Group's jointly controlled entities are not consolidated nor proportionately consolidated under US GAAP and instead accounted for under the equity method. This exclusion does not affect the income attributable to equity shareholders of the Company or the total equity attributable to the equity shareholders of the Company reconciliations between IFRS and US GAAP.

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Presented below is summarized financial information prepared in accordance with US GAAP of such subsidiaries and jointly controlled entities.

| | Years ended December 31, | | |
|-------------------------------|--------------------------|-----------------|--------|
| | 2004 | 2005 | 2006 |
| | RMB | RMB | RMB |
| Sales of goods..... | 28,004 | 53,768 | 75,184 |
| Income before income tax..... | 1,373 | 286 | 6,119 |
| Net income / (loss)..... | 969 | (204) | 5,672 |
| | | At December 31, | |
| | | 2005 | 2006 |
| | | RMB | RMB |
| Current assets..... | | 12,101 | 19,417 |
| Total assets..... | | 64,560 | 68,458 |
| Current liabilities..... | | 8,901 | 12,231 |

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| | | |
|------------------------|--------|--------|
| Total liabilities..... | 31,727 | 31,448 |
| Total equity..... | 32,833 | 37,010 |

(j) Recently issued accounting standards

SFAS No. 157

In September 2006, the FASB issued SFAS No. 157 "Fair Value Measurements" which defines fair value, provides a framework for measuring fair value, and expands the disclosures required for fair value measurements. SFAS No. 157 applies to other accounting pronouncements that require fair value measurements and does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. Currently, the Group does not expect the adoption of SFAS No. 157 will have a material impact on its consolidated financial statements.

FIN No. 48

In June 2006, the FASB issued FASB Interpretation No. 48 "Accounting for Uncertainty in Income Taxes - an interpretation of SFAS No. 109" ("FIN48"), which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109. FIN 48 requires that the Group recognizes in the consolidated financial statements the impact of a tax position, if that position is more likely than not of being sustained upon examination, based on the technical merits of the position. FIN 48 will be effective for the first fiscal year beginning after December 15, 2006. Currently, the Group does not expect the adoption of this Interpretation will have a material effect on its consolidated financial statements.

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Reconciliation to US GAAP

The effect on net income attributable to equity shareholders of the Company of significant differences between IFRS and US GAAP is as follows:

| | Reference in note above ----- | Years ended December 2004 ----- RMB | 2005 ----- RMB |
|---|--|--|----------------------|
| Net income attributable to equity shareholders of the Company under IFRS..... | | 35,335 | 41,455 |
| US GAAP adjustments: | | | |
| Foreign exchange gains and losses..... | (a) | 60 | 54 |
| Capitalization of property, plant and equipment..... | (b) | 22 | - |
| Depreciation on revalued property, plant and equipment. | (c) | 4,301 | 4,016 |
| Disposal of property, plant and equipment..... | (c) | 2,099 | 1,838 |
| Exchange of assets..... | (d) | 23 | 23 |
| Depreciation effect of reversal of impairment of long-lived assets..... | (e) | 29 | 76 |

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| | | | |
|--|-----|---------|---------|
| Capitalized interest on investments in associates, net of amortization effect..... | (f) | 205 | (40) |
| Goodwill amortization for the year..... | (g) | 13 | - |
| Deferred tax effect of US GAAP adjustments..... | | (2,277) | (1,786) |
| Minority interests..... | (h) | (519) | (489) |
| | | ----- | ----- |
| Net income attributable to equity shareholders of the Company under US GAAP..... | | 39,291 | 45,147 |
| | | ===== | ===== |
| Basic and diluted earnings per share under US GAAP..... | | 0.45 | 0.52 |
| | | ===== | ===== |
| Basic and diluted earnings per ADS under US GAAP*..... | | 45.31 | 52.07 |
| | | ===== | ===== |

*Basic and diluted earnings per ADS is calculated on the basis that one ADS is equivalent to 100 H shares.

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The effect on the total equity attributable to equity shareholders of the Company of significant differences between IFRS and US GAAP is as follows:

| | Reference in note above ----- | Years ended December 2005 ----- RMB | 2006 ----- RMB |
|--|--|--|----------------------|
| Total equity attributable to equity shareholders of the Company under IFRS..... | | 224,301 | 262,8 |
| US GAAP adjustments: | | | |
| Foreign exchange gains and losses..... | (a) | (241) | (1 |
| Revaluation of property, plant and equipment..... | (c) | (1,838) | (4 |
| Exchange of assets..... | (d) | (509) | (4 |
| Reversal of impairment of long-lived assets..... | (e) | (456) | (4 |
| Capitalized interest on investments in associates..... | (f) | 486 | 4 |
| Goodwill..... | (g) | 43 | |
| Effect of US GAAP adjustments on deferred tax assets.... | | 921 | 4 |
| Effect of US GAAP adjustments on deferred tax liabilities..... | | (134) | (1 |
| Minority interests..... | (h) | 230 | 1 |
| | | ----- | ----- |
| Total equity attributable to equity shareholders of the Company under US GAAP..... | | 222,803 | 262,2 |
| | | ===== | ===== |

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38. SUBSEQUENT EVENT

On December 6, 2006, the Group announced its proposal to issue US\$ 1,500 convertible bonds, which are convertible into H shares of the Company. This proposal was subsequently approved by the shareholders of the Company at the Extraordinary General Meeting held on January 22, 2007.

On March 16, 2007, the Fifth Plenary Session of the Tenth National People's Congress passed the Corporate Income Tax Law of the People's Republic of China ("new tax law"), which will take effect on January 1, 2008. According to the new tax law, the corporate income tax rate for entities other than certain high-tech enterprises and small-scale enterprises, as defined in the new tax law will be revised to 25%. In addition, entities that are currently taxed at preferential rates will be subject to a five-year transition period during which the tax rates will gradually be increased to the unified rate of 25% from January 1, 2008. As a result of the new tax law, it is expected that the income tax rate applicable to the Company and certain of its subsidiaries will be reduced from 33% to 25% from January 1, 2008. However, since the detailed implementation rules as to how the existing preferential rates will gradually be increased to the unified rate of 25% over the five-year transition period have not been formulated and promulgated, management is not yet in a position to estimate the impact of the new tax law on the deferred tax assets and liabilities of certain entities which are being taxed at preferential rates. The financial effect of the new tax law, if any, will be reflected in the Group's 2007 financial statements. The enactment of the new tax law is not expected to have any financial effect on the amounts accrued in the balance sheet in respect of current tax payable.

39. PARENT AND ULTIMATE HOLDING COMPANY

The directors consider the parent and ultimate holding company of the Group as of December 31, 2006 is Sinopec Group Company, a state-owned enterprise established in the PRC. This entity does not produce financial statements available for public use.

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In accordance with the United States Statement of Financial Accounting Standards No. 69, "Disclosures about Oil and Gas Producing Activities" ("SFAS No. 69"), this section provides supplemental information on oil and gas exploration and producing activities of the Group at December 31, 2004, 2005 and 2006, and for each of the years then ended in the following six separate tables. Tables I through III provide historical cost information under US GAAP pertaining to capitalized costs related to oil and gas producing activities; costs incurred in exploration and development; and results of operations related to oil and gas producing activities. Tables IV through VI present information on the Group's estimated net proved reserve quantities; standardized measure of discounted future net cash flows; and changes in the standardized measure of discounted future net cash flows.

Table I: Capitalized costs related to oil and gas producing activities

Years ended Dec

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| | 2004 RMB | 2003 RMB |
|--|-------------|-------------|
| Property cost..... | | |
| Wells and related equipment and facilities..... | 160,380 | 180,138 |
| Supporting equipment and facilities..... | 12,756 | 13,573 |
| Uncompleted wells, equipment and facilities..... | 9,387 | 11,003 |
| Total capitalized costs..... | 182,523 | 204,714 |
| Accumulated depreciation, depletion, amortization and impairment allowances..... | (80,491) | (88,274) |
| Net capitalized costs..... | 102,032 | 116,440 |

Table II: Cost incurred in exploration and development

| | Years ended December 31 | |
|--------------------------|-------------------------|-------------|
| | 2004 RMB | 2003 RMB |
| Exploration..... | 8,481 | 9,086 |
| Development..... | 21,113 | 22,804 |
| Total cost incurred..... | 29,594 | 31,890 |

Table III: Results of operations for oil and gas producing activities

| | Years ended December 31 | |
|---|-------------------------|-------------|
| | 2004 RMB | 2003 RMB |
| Revenues | | |
| Sales..... | 13,380 | 16,796 |
| Transfers..... | 60,053 | 84,423 |
| | 73,433 | 101,219 |
| Production costs excluding taxes..... | (17,606) | (21,722) |
| Exploration expenses..... | (6,396) | (6,411) |
| Depreciation, depletion, amortization and impairment provisions.. | (11,707) | (10,595) |
| Taxes other than income tax..... | (1,167) | (1,687) |
| Income before income tax..... | 36,557 | 60,804 |
| Income tax expense..... | (12,064) | (20,065) |
| Results of operations from producing activities..... | 24,493 | 40,739 |

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

The results of operations for producing activities for the years ended December 31, 2004, 2005 and 2006 are shown above. Revenues include sales to unaffiliated parties and transfers (essentially at third-party sales prices) to other segments of the Group. All revenues reported in this table do not include royalties to others as there were none. In accordance with SFAS No. 69, income taxes are based on statutory tax rates, reflecting allowable deductions and tax credits. General corporate overhead and interest income and expense are excluded from the results of operations.

Table IV: Reserve quantities information

The Group's estimated net proved underground oil and gas reserves and changes thereto for the years ended December 31, 2004, 2005 and 2006 are shown in the following table.

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, 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 on escalations based upon future conditions. Due to the inherent uncertainties and the limited nature of reservoir data, estimates of underground reserves are subject to change as additional information becomes available.

Proved reserves do not include additional quantities recoverable beyond the term of the relevant production licenses, or that may result from extensions of currently proved areas, or from application of improved recovery processes not yet tested and determined to be economical. The Group's estimated proved reserves do not include any quantities that are recoverable through application of tertiary recovery techniques.

Proved developed reserves are the quantities expected to be recovered through existing wells with existing equipment and operating methods.

"Net" reserves exclude royalties and interests owned by others and reflect contractual arrangements in effect at the time of the estimate.

| | Years ended Dec | |
|---|-----------------|-------|
| | 2004 | 2005 |
| Proved developed and undeveloped reserves (oil) (million barrels) | | |
| Beginning of year..... | 3,257 | 3,267 |
| Revisions of previous estimates..... | 23 | 26 |
| Improved recovery..... | 127 | 142 |
| Extensions and discoveries..... | 134 | 138 |
| Production..... | (274) | (279) |
| | 3,267 | 3,294 |
| End of year..... | 3,267 | 3,294 |
| | ===== | ===== |

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| | | |
|--|-------|-------|
| Proved developed reserves | | |
| Beginning of year..... | 2,786 | 2,808 |
| | ===== | ===== |
| End of year..... | 2,808 | 2,870 |
| | ===== | ===== |
| Proved developed and undeveloped reserves (gas) (billion cubic feet) | | |
| Beginning of year..... | 2,888 | 3,033 |
| Revisions of previous estimates..... | | (42) |
| | (95) | |
| Extensions and discoveries..... | 447 | 183 |
| Production..... | (207) | (222) |
| | ----- | ----- |
| End of year..... | 3,033 | 2,952 |
| | ===== | ===== |
| Proved developed reserves | | |
| Beginning of year..... | 1,249 | 1,398 |
| | ===== | ===== |
| End of year..... | 1,398 | 1,557 |
| | ===== | ===== |

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CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(All amounts in millions, except per share data and except otherwise stated)

Table V: Standardized measure of discounted future net cash flows

The standardized measure of discounted future net cash flows, related to the above proved oil and gas reserves, is calculated in accordance with the requirements of SFAS No. 69. Estimated future cash inflows from production are computed by applying year-end prices for oil and gas to year-end quantities of estimated net proved reserves. Future price changes are limited to those provided by contractual arrangements in existence at the end of each reporting year. Future development and production costs are those estimated future expenditures necessary to develop and produce year-end estimated proved reserves based on year-end cost indices, assuming continuation of year-end economic conditions. Estimated future income taxes are calculated by applying appropriate year-end statutory tax rates to estimated future pre-tax net cash flows, less the tax basis of related assets. Discounted future net cash flows are calculated using 10% midperiod discount factors. This discounting requires a year-by-year estimate of when the future expenditure will be incurred and when the reserves will be produced.

The information provided does not represent management's estimate of the Group's expected future cash flows or value of proved oil and gas reserves. Estimates of proved reserve quantities are imprecise and change over time as new information becomes available. Moreover, probable and possible reserves, which may become proved in the future, are excluded from the calculations. The arbitrary valuation prescribed under SFAS No. 69 requires assumptions as to the timing and amount of future development and production costs. The calculations are made for the years ended December 31, 2004, 2005 and 2006 and should not be relied upon as an indication of the Group's future cash flows or value of its oil and gas reserves.

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| | Years ended December 31, | | |
|---|--------------------------|-----------|-----------|
| | 2004 | 2005 | 2006 |
| Future cash flows..... | 1,003,511 | 1,401,283 | 1,235,524 |
| Future production costs..... | (350,012) | (440,743) | (487,895) |
| Future development costs..... | (25,577) | (26,994) | (33,523) |
| Future income tax expenses..... | (174,060) | (270,607) | (189,465) |
| Undiscounted future net cash flows..... | 453,862 | 662,939 | 524,641 |
| 10% annual discount for estimated timing of cash flows..... | (204,183) | (304,893) | (241,180) |
| Standardized measure of discounted future net cash flows..... | 249,679 | 358,046 | 283,461 |

Table VI: Changes in the standardized measure of discounted future net cash flows

| | Years ended December 31, | |
|--|--------------------------|-------------|
| | 2004 RMB | 2005 RMB |
| Sales and transfers of oil and gas produced, net of production costs | (46,145) | (61,346) |
| Net changes in prices and production costs | 69,305 | 130,221 |
| Net change due to extensions, discoveries and improved recoveries | 36,209 | 56,131 |
| Revisions of previous quantity estimates | 2,204 | 3,964 |
| Previously estimated development costs incurred during the year | 7,148 | 8,134 |
| Accretion of discount | 16,176 | 21,352 |
| Net change in income taxes | (22,733) | (50,397) |
| Others | 213 | 308 |
| Net change for the year | 62,377 | 108,367 |

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SIGNATURE

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

China Petroleum & Chemical Corporation

By /s/ Chen Ge

Name: Chen Ge

Title: Secretary to the Board of Directors

Date: April 6, 2007