

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Sales of gasoline, which constitutes approximately 22% of the refining segment's operating revenue, went up in 2000 by 76% to approximately RMB 51.0 billion. The increase in sales revenues for gasoline was due to:

- an increase of approximately 39% and 38% in the average realised price for intersegment sales and external sales, respectively, to approximately RMB 2,611 and RMB 2,237 per tonne; and
- an increase of approximately 25% in the combined sales volume for external and intersegment sales to approximately 20 million tonnes.

All intersegment sales of gasoline and diesel from the refining segment to the marketing and distribution segment are made at the ex-factory prices which are set with reference to FOB Singapore prices and certain other factors. The ex-factory prices have been set on a monthly basis to more closely reflect the prevailing FOB Singapore prices of gasoline and diesel.

Sales of chemical feedstock, which constitutes approximately 19% of the refining segment's operating revenue, went up in 2000 by 87% to approximately RMB 43.6 billion. The increase in sales revenues for chemical feedstock was due to significant increases in both the volume and the average realised prices in 2000 compared with 1999.

Intersegment sales accounted for approximately 70% of the refining segment's operating revenue in 2000, compared with approximately 63% in 1999. Among the intersegment sales, sales of gasoline and diesel to the marketing and distribution segment accounted for approximately 55% of the refining segment's operating revenue.

To operate more efficiently as an integrated company with distinct refining and marketing and distribution segments, the Company intends to gradually redirect substantially all the refining segment's sales of gasoline and diesel to the marketing and distribution segment. In 2000, the Company has significantly redirected most of the gasoline and diesel sales, other than to certain special customers and exports, to the marketing and distribution segment. External sales volumes of gasoline in 2000, other than export sales, were down approximately 38% from 1999 to approximately 1.36 million tonnes, while

intersegment sales volumes were up by approximately 34% to approximately 16.4 million tonnes in 2000. External sales volume of diesel in 2000, other than export sales, was down by approximately 54% to approximately 2.4 million tonnes while intersegment sales volumes increased by approximately 40% to approximately 34.9 million tonnes.

Operating expenses increased by RMB 99.2 billion, or 74.9%, to RMB 231.7 billion in 2000 from 1999. The increase was principally due to an increase in the purchased crude oil expenses, which accounted for approximately 81% of the total operating expenses for the refining segment in 2000. The average realised price which the Company paid for crude oil in 2000 increased significantly compared to 1999 reflecting the higher international crude oil prices prevailing in 2000 and the new transfer pricing policy between the exploration and production segment and the refining segment. Crude oil transfer pricing policy, effective 1 January 2000, provides that all sales of similar grades of crude oil are to be made at substantially the same prices as those for external sales of the same products. As a result of this new policy, substantially all of the external and intersegment purchases of crude oil of the refining segment are now made at substantially market prices. As a consequence, the crude oil expenses for the refining segment increased in 2000 because this new pricing policy had the effect of increasing the cost of intersegment sales of crude oil to the refining segment. The purchased crude oil expenses also increased because the Company purchased and expensed approximately 16.8 million tonnes more crude oil in 2000 than 1999, primarily sourced from the international crude oil market. In 2000, the Company significantly improved its crude oil distillation capacity utilisation rate and distilled a record amount of crude oil.

Gross refining margin (defined as the difference between sales revenues and crude oil expenses, divided by the volume of crude oil distilled) declined in 2000 compared with 1999. This decline was largely due to increases in the crude oil expenses partially offset by increases in the Company's average realised sales prices of gasoline and diesel. Cash operating cost (defined as the segment's operating expense less the sum of purchased crude oil expenses, depreciation and

amortisation, taxes other than income tax, other operating expenses and adjustments, and divided by the volume of crude oil distilled) was RMB 129.4 per tonne of crude oil distilled in 2000, compared to RMB 173.5 per tonne in 1999.

Operating profit was down by 77% to RMB 1.4 billion in 2000. This decline was largely due to the faster growth rate in the segment's costs of crude oil than in the segment's product prices for its major products such as gasoline, diesel and jet fuel, especially in the first four months in 2000. The price of crude oil in China has been reflecting movements of prices in the international market since June 1998. These prices have generally been rising since late 1999. However, gasoline and diesel prices were infrequently adjusted prior to 1 June 2000, and thus did not fully and timely reflect the increased crude cost. Beginning June 2000, gasoline and diesel prices have been adjusted monthly with reference to FOB Singapore prices. As a result, the segment's operating profit improved significantly in the second half of 2000 compared with the first half of 2000.

### Marketing and Distribution Segment

Marketing and distribution segment consists of the operations related to purchasing refined products from the refining segment and third parties, and marketing, selling and distributing refined products, wholesale to large bulk customers and retail through the Company's retail distribution network.

Operating revenues of the marketing and distribution segment increased by approximately 45.4% to RMB 175.7 billion in 2000 from 1999. More than 90% of such operating revenues were from sales of gasoline and diesel in 2000 and substantially all of the operating revenues were from external sales. The increase in operating revenues was principally due to increased sales revenues from sales of diesel and, to a lesser extent, gasoline and fuel oil.

Sales revenue for diesel increased by approximately 55% to approximately RMB 103.9 billion in 2000, due to:

- an increase of approximately 35% in the average realised wholesale prices, including prices for direct sales made to special customers, to approximately RMB 2,587 per tonne;
- an increase of approximately 32% in the average realised retail price to approximately RMB 2,830 per tonne; and
- an increase of approximately 109% in retail sales volume to approximately 11.5 million tonnes.

Sales revenue for gasoline increased by approximately 39% to approximately RMB 57.8 billion in 2000, due to:

- an increase of approximately 43% in the average realised wholesale prices, including prices for direct sales made to special customers, to approximately RMB 2,867 per tonne;
- an increase of approximately 28% in the average realised retail prices to approximately RMB 3,073 per tonne; and
- an increase of approximately 41% in retail sales volume to approximately 7.9 million tonnes.

Sales revenue for fuel oil increased by approximately 239% to approximately RMB 2.1 billion in 2000, due to:

- an increase of approximately 144% in total sales volume to approximately 1.4 million tonnes;
- an increase of approximately 39% in the average realised prices to approximately RMB 1,559 per tonne.

Compared to 1999, wholesale sales volume of gasoline and diesel, including direct sales made to special customers, declined by approximately 17% and 5%, respectively, to approximately 11.7 million tonnes and approximately 27.5 million tonnes, respectively, in 2000. Wholesale sales of gasoline and diesel accounted for approximately 59% of the operating revenues of the marketing and distribution segment in 2000, compared to 69% for 1999. Retail sales of gasoline and diesel accounted for approximately 32% of operating revenues of the marketing and distribution segment in 2000, compared to 21% in 1999. Retail sales volume and revenues as a percentage of total sales volume and revenues of gasoline

and diesel increased primarily as a result of the addition to the distribution network of over 8,800 service stations in 2000.

Average realised sales prices of gasoline and diesel increased with the rising international gasoline and diesel prices in 2000 compared with 1999, primarily as a result of the overall upward movement of the retail guidance prices which were published by the State Development Planning Commission in November 1999, February and each month after May 2000 with reference to the Singapore market prices.

Operating expenses of the marketing and distribution segment increased by approximately 43.2% to RMB 169.3 billion, in 2000 from 1999. Purchased gasoline and diesel expenses constituted approximately 85% of the marketing and distribution segment's operating expenses in 2000. The average realised prices expensed by the Company for gasoline and diesel in 2000 increased by 42% and 38%, respectively, to approximately RMB 2,600 per tonne and approximately RMB 2,396 per tonne, respectively, compared with 1999.

Gross marketing margin (defined as the difference between sales revenues and total gasoline and diesel expenses for the marketing and distribution segment divided by the volume of gasoline and diesel sold by the marketing and distribution segment) increased in 2000 compared with 1999. This increase was largely due to the fact that increases in the average realised sales prices for gasoline and diesel outpaced the increases in gasoline and diesel expenses, partly attributable to the increased proportion of the refined products sold through retail sales channels.

Operating profit for the marketing and distribution segment increased by RMB 3.8 billion to RMB 6.4 billion in 2000 from 1999, reflecting the foregoing factors.

Cash operating cost (defined as the segment's operating expenses less the sum of the purchased gasoline, diesel, jet fuel and kerosene expense, taxes other than income tax and depreciation and amortisation, and divided by the sales volume of gasoline, diesel, jet fuel and kerosene) was RMB 181 per tonne of gasoline, diesel, jet fuel and kerosene in 2000, compared with RMB 177 in 1999, primarily due to the increased transportation expenses associated with the Company's expanded retail distribution network.

### Chemicals Segment

Chemicals segment consists of producing, marketing, selling and distributing petrochemical and inorganic chemical products.

Operating revenues decreased in 2000 by RMB 1.8 billion, or 3%, to RMB 60.9 billion from 1999. The decline was a result of lower sales volumes of some of principal chemical products in 2000 compared to 1999, partially offset by higher realised sales prices for most of the chemical products other than chemical fertilisers. The decline in sales volumes was primarily due to the segregation and distribution of certain petrochemical operations, which were retained by Sinopec Group Company in the reorganisation but were included in the historical financial statements of the Company prior to 31 December 1999, to Sinopec Group Company on 31 December 1999. If these operations were excluded as at 1 January 1999, the segment's operating revenues would have increased by 25% in 2000 as compared to 1999, due to:

- an increase in external sales volumes for most of the principal petrochemical products other than synthetic rubber and chemical fertilisers; and
- an increase in average realised prices for most of the principal petrochemical products other than chemical fertilisers.

Operating expenses slightly decreased by RMB 0.5 billion to RMB 58.5 billion in 2000 from 1999. Purchased petrochemical feedstock expenses including naphtha expenses accounted for RMB 33.2 billion, or 57%, of the operating expenses. If those operations retained by Sinopec Group Company were excluded as at 1 January 1999, the segment's operating expenses would have gone up by 36% primarily due to the increased purchased petrochemical feedstock expenses and increased selling, general and administrative expenses. Despite that the Company improved its ethylene yield by 0.19 percentage point.

Operating profit decreased by RMB 1.3 billion to RMB 2.4 billion in 2000 from 1999 as the decline in operating revenues outpaced the decline in operating expenses. Operating profit decreased significantly in the last six months in 2000 compared with the first six months in 2000, primarily because the Company was unable to pass on all the increases in its petrochemical feedstock costs to the realised sales prices of