

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

certain chemical products including chemical fertilisers.

Corporate and Others

Corporate and others segment principally involves trading activities of the import and export subsidiaries and the Company's research and development activities.

Operating revenues from the corporate and others segment increased significantly from RMB 1.1 billion in 1999 to RMB 26.0 billion in 2000. Operating expenses also increased significantly from RMB 1.9 billion in 1999 to RMB 26.1 billion in 2000. The significant increases in both operating revenues and operating expense primarily resulted from the increased sales and the associated increases in purchased crude oil, products and operating supplies and expenses of the Company's trading subsidiaries including Sinopec Hong Kong Co. and Unipet. The Company increased its equity interest in Unipet to 70% at the end of 1999 which resulted in the Company's accounting for it as a consolidated subsidiary for a full year in 2000.

The Company reduced the operating loss of RMB 0.8 billion in 1999 to an operating loss of RMB 0.1 billion in 2000.

LIQUIDITY AND CAPITAL RESOURCES

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

As at 31 December 2000, the short-term debts (including short-term loans from Sinopec Group Company and fellow subsidiaries) of the Company amounted to RMB 58.7 billion (including the current portion of long-term debts, which was RMB 8.0 billion) and accounted for 46.1% of the total short-term and long-term debts (which long-term debts include interest free subordinated loan from Sinopec Group Company due in 2020) of the Company.

Interest coverage ratio of the Company, calculated by dividing operating profit before depreciation, depletion and amortisation by interest expense, was 8.4 times for the year ended 31 December 2000. The Company has reduced through a variety of methods its short-term debts as a percentage of its outstanding debts as well as its overall debt levels in 2000, including:

- On 31 December 1999, RMB 13.1 billion of the bank loans of the Company were assumed by Sinopec Group Company and are included in the net contributions from Sinopec Group Company in the consolidated statements of shareholders' equity of the Company.
- As at 30 April 2000, the Company had further reduced its total outstanding short- and long-

term debts through a combination of using cash and cash equivalents and transferring receivables and equivalent amounts of outstanding debts to Sinopec Group Company. Approximately RMB 5.8 billion of the short- and long-term debts owed by the Company to non-affiliated third parties were assumed by Sinopec Group Company in April 2000 in consideration

The following table sets forth a condensed summary of the statements of cash flows for the years indicated.

	Year Ended 31 December 2000 RMB	1999 RMB
(in billions)		
Net cash generated from operating activities:		
Net cash provided by operations ⁽¹⁾	57.3	36.7
Net cash used in working capital and other assets and liabilities ⁽²⁾	(15.7)	(1.1)
Net interest and tax paid ⁽³⁾	(13.7)	(10.3)
Total	27.9	25.3
Cash flows from investing activities:		
Capital expenditure	(43.5)	(33.1)
Purchase of investments net of proceeds from disposal of investments	(1.4)	(1.3)
Net increase in time deposits	(17.3)	—
Net changes in other activities ⁽⁴⁾	0.3	0.2
Total	(61.9)	(34.2)
Cash flows from financing activities:		
Proceeds from initial public offering, net of issuing expenses	24.3	—
Cash provided by bank and other loans, net of repayments	9.6	11.9
Cash provided by issuance of shares of subsidiaries, net of distributions to minority interests	(0.6)	1.2
Cash from issuance of convertible bonds and debentures, net of maturities	(0.7)	1.5
Cash contributions from/(distributions to) Sinopec Group Company	(0.6)	0.5
Cash and cash equivalents distributed to Sinopec Group Company in connection with reorganisation	—	(11.8)
Total	32.0	3.3
Net decrease in cash and cash equivalents	(2.0)	(5.6)
Selected consolidated balance sheet items (as of year-end)		
Cash and cash equivalents	19.3	21.3
Time Deposits with financial institutions	21.8	4.5

- (1) Represents profit from ordinary activities before taxation as adjusted for depreciation, depletion and amortisation, dry hole cost, provision for doubtful accounts, income from associates and jointly controlled entities, investment income, interest income, interest expense, unrealised foreign exchange (gains)/losses, loss on allocation of staff quarters, loss on disposal of property, plant and equipment, impairment losses on long-lived assets, reversal of impairment losses on long-lived assets net of depreciation effect and gains from issuance of shares by subsidiaries.
- (2) Represents decreases/(increases) in current assets, increases/(decreases) in current liabilities and increases in other assets, net of other liabilities.
- (3) Represents interest received, interest paid, investment income received, income tax paid, and tax refunds received.
- (4) Represents proceeds from disposal of staff quarters and property, plant and equipment, repayments from associates and jointly controlled entities, net of advances to associates and jointly controlled entities.

of the Company transferring an equivalent amount of receivables to Sinopec Group Company.

- In April 2000, RMB 35.6 billion of the short- and long-term debts of the Company were exchanged for an interest-free 20-year subordinated loan from Sinopec Group Company. This loan cannot be repaid prior to 31 December 2006. After 31 December 2006 and prior to its maturity date, this loan can only be repaid with the approval of the Company's independent shareholders. Upon maturity of the loan in 2020, the Company may choose to repay by one repayment in 2020 or two equal installments in 2020 and 2021.

Net Cash Generated from Operating Activities

Primarily as a result of increases in average realised sales prices of refined products, petrochemical products and crude oil, net cash provided by operations increased from 1999 to 2000. The net cash provided by operations increased significantly from RMB 36.7 billion in 1999 to RMB 57.3 billion in 2000 and was partially offset by cash used for working capital and other assets of RMB 15.7 billion and net interest and tax paid of RMB 13.7 billion. The increase in cash used in working capital and other assets and liabilities in 2000 is primarily due to increase in inventory of crude and refined products, to support higher level of sales and throughout in 2000. Net interest and tax paid for the year 2000, consisted primarily of interest payment of RMB 8.1 billion and RMB 6.8 billion of income tax paid, offset by RMB 1.1 billion of cash interest received.

Cash Flows from Investing Activities

Cash outflows of the Company for capital expenditure projects amounted to RMB 33.1

billion and RMB 43.5 billion in 1999 and 2000, respectively.

The Company made investments of RMB 1.5 billion each in 1999 and 2000, respectively, in a variety of joint ventures, including service stations. The Company also realised RMB 0.4 billion and RMB 0.2 billion in 1999 and 2000, respectively, from the disposal of investments and staff quarters, property, plant and equipment.

Cash flow from investing activities also includes a RMB 17.3 billion net increase in time deposits in 2000 of the net proceeds from the Company's initial public offering in October 2000.

Cash Flows from Financing Activities

Cash flows from financing activities increased significantly from RMB 3.3 billion in 1999 to RMB 32.0 billion in 2000 largely due to the net proceeds the Company received from its initial public offering in October 2000. Proceeds from bank and other loans were the largest source of financing, which were offset by debt repayments and maturity of debentures of four subsidiaries totalling RMB 683 million as well as RMB 642 million of dividends paid by the Company's listed subsidiaries to their minority shareholders and RMB 579 million of dividend paid by the Company in February 2000.

Cash and cash equivalents as at 31 December 2000 was RMB 19.3 billion as compared to RMB 21.3 billion as at 31 December 1999. Time deposits with financial institutions as at 31 December 2000 increased to RMB 21.8 billion as compared to RMB 4.5 billion as at 31 December 1999.

The aggregate maturities of long-term bank and other loans, and loans from Sinopec Group Company as at 31 December 2000 were as follows:

Maturity date	Principal as at 31 December 2000 RMB (in billions)
2001	8.0
2002	9.6
2003-2005	15.0
Thereafter ⁽¹⁾	44.1
	76.7

(1) Includes an interest free loan from Sinopec Group Company of RMB 35.6 billion due 2020.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Net borrowings by the Company for the years ended 31 December 1999 and 2000 were as follows:

	Year Ended 31 December 2000 RMB (in billions)	1999 RMB (in billions)
Proceeds from bank and other loans	130.0	98.6
Repayments of bank and other loans	(120.4)	(86.7) ⁽¹⁾
Net borrowings	9.6	11.9

(1) In connection with the reorganisation, RMB 46.0 billion of short- and long-term debt was retained by Sinopec Group Company and RMB 13.1 billion of bank loans was assumed by Sinopec Group Company and reflected as an equity contribution from Sinopec Group Company on 31 December 1999.

Total short- and long-term debts and loans from Sinopec Group Company and fellow subsidiaries outstanding and cash and cash equivalents as well as time deposits with financial institutions as at 31 December 1999 and 2000 were as follows:

	As of 31 December 2000 RMB (in billions)	1999 RMB (in billions)
Short-term debts	50.4	74.4
Long-term debts	31.9	39.9
Loans from Sinopec Group Company and fellow subsidiaries	45.0	10.3
Total debts	127.3	124.6
Cash and cash equivalents	19.3	21.3
Time-deposits with financial institutions	21.8	4.5
Total debts less cash and cash equivalents and time deposits with financial institutions	86.2	98.8

In addition, the Company had, as at 31 December 2000, lease commitments of RMB 99.9 billion, contracted capital commitments of RMB 15.5 billion and contingent liabilities of RMB 0.9 billion, of which RMB 55 million were guarantees on bank loans to Sinopec Group Company and fellow subsidiaries.

Historical and Planned Capital Expenditures

The following table sets forth the capital expenditures of the Company by segment for 1999 and 2000 and the capital expenditures in each segment as a percentage of the Company total capital expenditures for such year.

	2000		1999	
	RMB	Percent	RMB	Percent
Exploration and production	14.5	34	9.8	29
Refining	5.5	13	6.9	20
Marketing and distribution	16.1	38	3.2	10
Chemicals	6.2	15	12.9	38
Corporate and others	0.3	—	1.1	3
Total	42.6	100	33.9	100

In 2000, the Company spent:

- RMB 14.5 billion on the exploration and production segment. The Company added 367 million BOE, including 318 million BOE of crude oil and 49 million BOE of natural gas, to the proved reserves in 2000, and to take advantage of the high crude oil price prevailing in 2000, the Company also increased crude oil production by two million barrels from 1999;
- RMB 5.5 billion on the refining segment. The Company upgraded two major refining facilities and increased its rated capability to process imported crude oil with higher sulphur contents by 6 million tonnes per annum. The Company put 20 facilities into production in 2000, including hydro-cracking and coking facilities with rated capacity of 2.8 million tonnes per annum for severe process, reforming facilities with rated capacity of 600,000 tonnes per annum and diesel hydro refining facility with rated capacity of 3.7 million tonnes per annum to improve diesel quality, and to meet market demand for high-class highway asphalt, asphalt facilities with rated capacity of 300,000 tonnes per annum.
- RMB 16.1 billion on the marketing and distribution segment. The Company acquired and built over 8,800 service stations in 2000, and its retail market share for gasoline and diesel is estimated to have increased to 40% nationally and 61% in the Company's principal market at the end of 2000.
- RMB 6.2 billion on the chemical segment. The Company increased its chemical and fiber production capacity to produce more higher value added products, among which, the Company increased its polyester capacity by 100,000 tonnes per annum, PVC capacity by 44,000 tonnes per annum, and caprolactam capacity by 20,000 tonnes per annum.
- RMB 0.3 billion on the corporate and others segment to build an ERP system and other miscellaneous projects including petrochemical e-commerce platforms, refined products sales information system and financial and accounting information system.

In 2001, the Company plans to spend:

- RMB 12.5 billion on crude oil and natural gas exploration and development to discover new reserves and to keep its crude oil and natural gas production relatively stable. The Company

will continue to conduct exploration and production activities in oil fields in eastern China, and will begin to explore and develop the newly registered exploration areas in Tarim Basin, Sungar Basin and Hexi Zhoulang area in western China.

- RMB 6.8 billion on the refining segment to renovate its coastal refineries, particularly to increase their processing capacity of crude oil with higher sulphur content. In addition, the Company plans to construct more crude oil pipelines to reduce crude oil transportation cost.
- RMB 10.6 billion on the marketing and distribution segment to acquire, construct and renovate more service stations and oil storage facilities to further expand its market share of refined products.
- RMB 10.5 billion on the chemical segment to expand and renovate a few major ethylene facilities to increase ethylene production capacity and to produce more higher value-added products. The Company also plans to implement energy saving and other cost reduction measures in such expansion or renovation projects.
- RMB 360 million on the corporate and others segment to continue construction of the ERP system and to implement or upgrade other miscellaneous projects.

The Company plans to fund the capital and related expenditures principally through cash provided by operating activities, short- and long-term debts, cash and cash equivalents and a portion of the net proceeds received from the the Company's initial public offering in October 2000.

The Company is in negotiation with Sinopec Group Company regarding a possible acquisition of its wholly-owned subsidiary Sinopec National Star. Sinopec National Star engages in both onshore and offshore exploration and production of crude oil and natural gas. In conjunction with these negotiations, the Company is also in the process of preparing an offering of its domestic shares, the proceeds of which will be primarily used for the purpose of financing the acquisition of Sinopec National Star, if the Company and Sinopec Group Company successfully conclude the negotiations, and construction of a crude oil pipeline from Ningbo via Shanghai to Nanjing and a refined product pipeline from Maoming via Guizhou to Kunming.