

MANAGEMENT'S DISCUSSION AND ANALYSIS

THE FOLLOWING DISCUSSION AND ANALYSIS SHOULD BE READ IN CONJUNCTION WITH THE COMPANY'S AUDITED FINANCIAL STATEMENTS AND THE ACCOMPANYING NOTES. PART OF THE FINANCIAL INFORMATION PRESENTED IN THIS SECTION IS DERIVED FROM THE COMPANY'S AUDITED FINANCIAL STATEMENTS THAT HAVE BEEN PREPARED IN ACCORDANCE WITH INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS").

1 CONSOLIDATED RESULTS OF OPERATIONS

In 2003, the Company's turnover and operating profit were RMB 424.3 billion and RMB 37.3 billion, respectively, representing an increase of 28.9% and 30.0%, respectively, over those in the previous year. These changes are largely attributable to a number of factors. First, the Company closely monitored the changes in market demands, and quickly responded to such changes through adjustments of its operating strategy. Second, to take advantage of the favorable opportunity of higher prices of crude oil and chemical products in the global market and the rapid growth of Chinese economy, the Company managed to overcome the negative impact caused by SARS and further expanded its target market. In addition, the Company continued to strive for better operating results through more strengthened management, further corporate reforms, better asset structure and more efficient operation.

The table below sets forth the major items in the consolidated income statement of the Company for the indicated periods.

	Year ended 31 December		Change (%)
	RMB billions		
	2003	2002	
Turnover and other operating revenues	443.1	345.1	28.4
of which: Turnover	424.3	329.1	28.9
Other operating revenues	18.8	16.0	17.5
Operating expenses	(405.8)	(316.4)	28.3
of which:			
Purchased crude oil, products and operating supplies and expenses	(312.5)	(237.6)	31.5
Selling, general and administrative expenses	(25.9)	(21.5)	20.5
Depreciation, depletion and amortization	(26.7)	(25.3)	5.5
Exploration expenses (including dry holes)	(6.1)	(4.4)	38.6
Personnel expenses	(16.2)	(14.4)	12.5
Employee reduction expenses	(1.0)	(0.2)	400.0
Taxes other than income tax	(13.5)	(11.9)	13.4
Other operating expenses, net	(3.9)	(1.1)	254.5
Operating profit	37.3	28.7	30.0
Net finance costs	(3.8)	(4.2)	(9.5)
Investment income, share of profit less losses from associates and gain from issuance of shares by a subsidiary	0.6	0.6	0.0
Profit from ordinary activities before taxation	34.1	25.1	35.9
Taxation	(10.6)	(7.7)	37.7
Profit from ordinary activities after taxation	23.5	17.4	35.1
Minority interests	(1.9)	(1.1)	72.7
Profit attributable to shareholders	21.6	16.3	32.5

(1) Turnover and other operating revenues

In 2003, the Company's turnover and other operating revenues were RMB 443.1 billion, representing an increase of 28.4% compared with 2002. Turnover was RMB 424.3 billion, representing an increase of 28.9% compared with 2002. In 2003, prices of crude oil, petroleum products and chemical products in the global market all went up. To seize the market opportunity, the Company increased its refining throughput and increased the sales volume of its refined products. In addition, the Company's sales volume of major petrochemical products increased significantly. The Company's other operating revenues went up to RMB 18.8 billion in 2003, representing an increase of 17.5% compared with 2002. The "other operating revenues" mainly constituted of sales revenue from its sale of raw and auxiliary materials and other products and services to China Petrochemical Corp. and its subsidiaries and to third parties. The turnover and other operating

revenues principally consisted of the following:

Sale of crude oil and natural gas

Most of crude oil and a small portion of natural gas produced by the Company were internally used by its refining and chemical production. The remaining was sold to the refineries controlled by the Company's controlling shareholder, China Petrochemical Corp. and other customers. In 2003, turnover from crude oil and natural gas that were sold externally amounted to RMB 14.9 billion, accounting for 3.4% of the Company's turnover and other operating revenues, representing an increase of 36.7% compared with that of RMB 10.9 billion in 2002. Such increase was mainly due to the increase in both price and sales volume of crude oil. The external sales price of crude oil increased to RMB 1,493 per tonne from RMB 1,189 per tonne in 2002, representing an increase of 25.6%. The external sales volume went from 6.35 million tonnes in 2002 to 7.22 million tonnes in 2003, representing an increase of 13.7%. The external sales price of natural gas rose from RMB 574 per thousand cubic meters in 2002 to RMB 591 per thousand cubic meters in 2003, and the external sales volume increased from 3.2 billion cubic meters in 2002 to 3.4 billion cubic meters in 2003.

Sale of petroleum products

The Company's Refining Segment and Marketing and Distribution Segment sell petroleum products (mainly consisting of gasoline, diesel, jet fuel, kerosene and other refined petroleum products) to third parties. In 2003, the external sales revenue of petroleum products by these two segments were RMB 295.9 billion, accounting for 66.8% of the Company's turnover and other operating revenues, representing an increase of 28.4% compared with that of RMB 230.5 billion in 2002. The sales revenue of gasoline and diesel was RMB 209.1 billion, accounting for 70.7% of the total sales revenue of petroleum products, representing an increase of 23.5% from

that of RMB 169.3 billion in 2002. Among others, the sales revenue of gasoline in 2003 was RMB 77 billion, representing an increase of 21.6% compared with 2002. The sales revenue of diesel was RMB 132.1 billion, representing an increase of 24.6% compared with 2002. The increase of sales revenue of gasoline and diesel was due to both the rise of gasoline and diesel prices and the increased sales volume as a result of the Company's proactive efforts. In 2003, the average external sales price of gasoline was RMB 3,298 per tonne, representing an increase of 17.5% compared with 2002, and the average external sales price of diesel was RMB 2,794 per tonne, representing an increase of 16% compared with 2002. The external sales volume of gasoline was 23.36 million tonnes, representing an increase of 3.6% compared with 2002, and the external sales volume of diesel was 47.29 million tonnes, representing an increase of 7.4% compared with 2002. The combined sales volume of gasoline and diesel was 6.1% higher than that of 2002.

Sales of chemical products

In 2003, the Company's external sales revenue of chemical products was RMB 80.7 billion, accounting for 18.2% of its turnover and other operating revenues, representing an increase of 27.9% compared with that of RMB 63.1 billion in 2002. The increase was mainly due to the significant increase in both chemical products prices and sales volumes of major chemical products as a result of strong domestic demand for chemical products. In 2003, the Company completed the revamp of certain of its ethylene and other downstream facilities, which increased the Company's production capacity of certain chemical products. In 2003, the external sales volumes of synthetic resin, synthetic fiber, synthetic rubber, synthetic fiber monomer and polymer were, respectively, 4.52 million tonnes, 1.33 million tonnes, 550 thousand tonnes and 2.41 million tonnes, representing an increase of 18%,

12.7%, 7.8% and 33.9%, respectively, compared with 2002. The external sales prices of such products were, respectively, RMB 6,042 per tonne, RMB 9,639 per tonne, RMB 8,513 per tonne and RMB 5,788 per tonne, representing an increase of 15.2%, 14.3%, 31.6% and 7.9%, respectively, compared with 2002.

(2) Operating expenses

In 2003, the Company's operating expenses were RMB 405.8 billion, representing an increase of 28.3% compared with 2002. The operating expenses mainly consisted of the following:

Purchased crude oil, products, and operating supplies and expenses

The Company's purchased crude oil, products and operating supplies and expenses were RMB 312.5 billion, accounting for 77% of the operating expenses, up by RMB 74.9 billion compared with 2002, representing an increase of 31.5%. Among others:

- Purchased crude oil expenses were RMB 164.3 billion, accounting for 40.5% of the total operating expenses, up by RMB 45 billion compared with 2002, representing an increase of 37.7%.

To meet the increasing demands in the market associated with the rapid growth of the Chinese economy, the Company increased its crude oil throughput. In 2003, the Company's crude oil throughput was 116.66 million tonnes (excluding amounts processed for third parties), representing an increase of 11.23 million tonnes, or 10.7%, compared with 2002. Of the Company's crude oil throughput, the Exploration and Production Segment supplied 28.08 million tonnes, down by 1.46 million tonnes compared with 2002, representing a decrease of 4.9%. The Company processed 88.58 million tonnes of crude oil purchased from

third parties, up by 12.69 million tonnes compared with 2002, representing an increase of 16.7%. Since March 2003, crude oil price in the global market has gradually increased. The Company's average cost for crude oil purchased from third parties in 2003 was RMB 1,855 per tonne, up by RMB 283 per tonne compared with 2002, representing an increase of 18%.

- In 2003, the Company's other purchase expenses were RMB 148.2 billion, accounting for 36.5% of the total operating expenses, up by RMB 29.9 billion compared with 2002, representing an increase of 25.3%. This increase was mainly due to the increased costs of oil products and chemical feedstock caused by the increase in crude oil price.

Selling, general and administrative expenses

In 2003, the Company's selling, general and administrative expenses were RMB 25.9 billion, up by RMB 4.4 billion compared with 2002, representing an increase of 20.5%. This increase was largely due to:

- In 2003, provision for bad debts increased by RMB 1.15 billion compared with 2002.
- In connection with the upgrade of production facilities and improved technologies, the Company disposed of certain low efficiency production equipment in 2003 causing an increase in the expense related to disposal of relevant spare parts by RMB 500 million compared with 2002.
- Expenses in research and development increased by RMB 0.59 billion compared with 2002.
- Operating lease rentals increased by RMB 0.39 billion compared with 2002, mainly because the Company leased some additional petrol stations to further expand its distribution channels of oil products.

- After the expansion and upgrading of some chemical facilities, sales volume of chemical products increased. In addition, proportion of retail over the total sales volume of refined oil products, and total sales volume of refined oil products increased. Accordingly, the selling expenses (such as transportation costs) increased by RMB 690 million compared with 2002;

Depreciation, depletion and amortization

In 2003, the Company's depreciation, depletion and amortization were RMB 26.7 billion, up by 5.5% over 2002. The increase was mainly because of the addition of property, plant and equipment as a result of capital expenditure.

Exploration expenses

In 2003, the Company's exploration expenses were RMB 6.1 billion, representing an increase of 38.6% compared with 2002. The increase was principally because the Company continued to increase investment in the exploration activities, especially in those major new blocks in the western and southern part of China.

Personnel expenses

In 2003, the Company's personnel expenses were RMB 16.2 billion, representing an increase of 12.5% compared with 2002. The increase was largely because the Company introduced a market-rate based employee compensation system reform. As a result, wage, salary and welfare expenses increased by RMB 1.6 billion.

Employee reduction expenses

As part of its voluntary staff reduction plan, the Company incurred approximately RMB 1 billion as staff reduction expenses for approximately 21,000 employees who voluntarily terminated their employment with the Company in 2003.

Taxes other than income tax

In 2003, the Company's taxes other than income tax were RMB 13.5 billion, representing an increase of 13.4% compared with 2002. The increase was largely because of the increase of consumption tax and surcharges as a result of the increased sales volume of gasoline and diesel of the Company.

Other operating expenses, net

In 2003, the Company's other operating expenses (net) were RMB 3.9 billion, representing an increase of RMB 2.8 billion compared with 2002. The increase was largely due to:

- To facilitate its long-term development strategy, the Company further improved its asset structure and its overall asset quality. In 2003, the Company incurred a net loss of RMB 2.22 billion on disposal of certain low efficiency assets, which included RMB 90 million from the Exploration and Production Segment, RMB 740 million from the Refining Segment, RMB 370 million from the Marketing and Distribution Segment, RMB 1.01 billion from the Chemicals Segment, and RMB 10 million from others, up by RMB 1.42 billion compared with 2002.
- In order to allocate its internal resources more efficiently, the Company revised the production plans for certain less efficient facilities in 2003, and accordingly made a provision for impairment of long-lived assets of RMB 0.88 billion representing the difference between the expected recoverable value and the net book value of these assets.

(3) Operating profit

In 2003, the Company's operating profit was RMB 37.3 billion, representing an increase of 30% compared with 2002.

(4) Net finance costs

In 2003, the Company's net finance costs were RMB 3.8 billion, down by RMB 400 million compared with 2002, representing a decrease of 9.5%. This was primarily because the Company further reduced the aggregate amount of its short-term loan and adjusted its financing structure to include, among others, certain US dollar loans. The interest expense was RMB 3.7 billion in 2003, decreased by RMB 0.4 billion compared with 2002.

(5) Profit from ordinary activities before taxation

In 2003, the Company's profit from ordinary activities before taxation was RMB 34.1 billion, representing an increase of 35.9% compared with 2002.

(6) Taxation

In 2003, the Company's taxation was RMB 10.6 billion, representing an increase of 37.7% compared with 2002.

(7) Minority interests

In 2003, the Company's minority interests were RMB 1.9 billion, representing an increase of 72.7% compared with 2002.

(8) Profit attributable to shareholders:

In 2003, the Company's profit attributable to shareholders was RMB 21.6 billion, representing an increase of 32.5% compared with 2002.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

2 DISCUSSIONS ON RESULTS OF SEGMENT OPERATIONS

The Company divides its 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

financial data discussed in the section have not eliminated the inter-segment transactions. In addition, the operating revenue, data of each segment include the "other operating revenues" of the segment.

The following table shows 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.

	Year ended December 31		As a percentage of consolidated operating revenues before elimination of inter-segment sales		As a percentage of consolidated operating revenues after elimination of inter-segment sales	
	2003	2002	2003	2002	2003	2002
	RMB billions		%		%	
Exploration and Production Segment						
External sales ⁽¹⁾	23.0	18.2	3.1	3.1	5.2	5.3
Inter-segment sales	47.3	39.4	6.4	6.8		
Operating revenues	70.3	57.6	9.5	9.9		
Refining Segment						
External sales ⁽¹⁾	62.2	49.2	8.4	8.5	14.0	14.2
Inter-segment sales	211.6	164.6	28.5	28.4		
Operating revenues	273.8	213.8	36.9	36.9		
Marketing and Distribution Segment						
External sales ⁽¹⁾	238.8	184.7	32.2	31.9	53.9	53.5
Inter-segment sales	2.6	2.3	0.4	0.4		
Operating revenues	241.4	187.0	32.6	32.3		
Chemicals Segment						
External sales ⁽¹⁾	84.9	67.2	11.4	11.6	19.2	19.5
Inter-segment sales	7.4	7.9	1.0	1.4		
Operating revenues	92.3	75.1	12.4	13.0		
Corporate and others segment						
External sales ⁽¹⁾	34.2	25.8	4.6	4.5	7.7	7.5
Inter-segment sales	29.4	19.9	4.0	3.4		
Operating revenues	63.6	45.7	8.6	7.9		
Operating revenues before elimination of inter-segment sales	741.4	579.2	100.0	100.0		
Elimination of inter-segment sales	(298.3)	(234.1)				
Consolidated operating revenues	443.1	345.1			100.0	100.0

Notes:(1) including other operating revenues.

The following table shows the operating revenues, operating expenses and operating profit by each segment before elimination of the inter-segment transactions for the periods indicated, and the percentage change from 2002 to 2003.

	Year ended December 31		Percentage change from 2002 to 2003 (%)
	2003	2002	
	RMB billions		
Exploration and Production Segment			
Operating revenues	70.3	57.6	22.0
Operating expenses	51.1	42.8	19.4
Operating profit	19.2	14.8	29.7
Refining Segment			
Operating revenues	273.8	213.8	28.1
Operating expenses	267.8	207.8	28.9
Operating profit	6.0	6.0	0.0
Marketing and Distribution Segment			
Operating revenues	241.4	187.0	29.1
Operating expenses	229.5	178.6	28.5
Operating profit	11.9	8.4	41.7
Chemicals Segment			
Operating revenues	92.3	75.1	22.9
Operating expenses	90.1	74.5	20.9
Operating profit	2.2	0.6	266.7
Corporate and others segment			
Operating revenues	63.6	45.7	39.2
Operating expenses	65.6	46.8	40.2
Operating profit	(2.0)	(1.1)	81.8

(1) 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.

In 2003, operating revenues of the segment were RMB 70.3 billion, representing an increase of 22% compared with 2002. The increase was mainly due to the rise of crude oil price in 2003.

In 2003, average realized price of crude oil sold by this segment was RMB 1,620 per tonne, representing an increase of 22.9% compared with 2002. Average realized price of natural gas was RMB 596 per thousand cubic meters, representing an increase of 4.2% compared with 2002. Sales volume of crude oil was 35.75 million tonnes, representing an increase of 0.6% compared with 2002. Sales volume of natural gas was 3.5 billion cubic meters, representing an increase of 6.1% compared with 2002.

In 2003, the segment's operating expenses were RMB 51.1 billion, up by RMB 8.3 billion compared with 2002, representing an increase of 19.4%. The increase was primarily because:

- In 2003, the segment continued to implement its strategy featuring "expansion of resources", and increased investment in exploration activities in a number of new blocks in the western and southern part of China. As a result, the exploration expenses (including the costs of dry holes) increased by RMB 1.77 billion compared with 2002.
- Due to the increase of downhole operation activities and rise of fuel and other costs as a result of the increase in crude oil price, the lifting cost of crude oil and natural gas was up by RMB 1.04 billion compared with 2002.

- Other expenses including supply of materials were up by RMB 800 million compared with 2002.
- In 2003, as a result of the employee compensation system reform, wages, salaries and welfare expenses were up by approximately RMB 700 million compared with 2002.
- In 2003, depreciation, depletion and amortization were RMB 9.4 billion, up by RMB 400 million compared with 2002, due to the addition of fixed assets resulted from the segment's capital investments.
- Provision for impairment losses of assets was up by RMB 310 million compared with 2002.
- Due to the increase of sales revenues royalties for compensation of the use of mineral resources increased. In addition, land lease rentals increased due to the increase in leased land area. The sum of these two items was up by RMB 220 million compared with 2002.
- Disposal of spare parts increased by approximately RMB 100 million compared with 2002.

Compared with 2002, in light of the high crude oil price, this segment increased its workload of certain downhole operation in order to maintain a stable production of crude oil, and incurred additional expenses to resume production activities that were affected by stormy tide and flood. As a result, the unit lifting cost of crude oil and natural gas increased from US\$ 6.12 per barrel in 2002 to US\$ 6.47 per barrel in 2003, representing an increase of 5.7%.

In 2003, the segment's operating profit was approximately RMB 19.2 billion, which was 29.7% higher than that in 2002.

(2) 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, and selling gasoline, diesel and kerosene to the Marketing and Distribution Segment, and selling other refined petroleum products to domestic and overseas customers.

In 2003, the segment's operating revenues were RMB 273.8 billion, up by RMB 60 billion compared with 2002, representing an increase of 28.1%. The increase was mainly due to the increase in the sales prices and sales volumes of various refined petroleum products.

In 2003, the sales revenues of gasoline realized by the segment were RMB 55.8 billion, accounting for 20.4% (which was

0.2 percentage lower than that of 2002) of this segment's operating revenues and representing an increase of 26.5% compared with 2002.

In 2003, the sales revenues of diesel realized by the segment were RMB 99.7 billion, accounting for 36.4% (which was 0.9 percentage lower than that of 2002) of this segment's operating revenues and representing an increase of 24.9% compared with 2002.

In 2003, the sales revenues of chemical feedstock realized by the segment were RMB 49.9 billion, accounting for 18.2% (which was similar to that of 2002) of this segment's operating revenues and representing an increase of 28.3% compared with 2002.

In 2003, the sales revenues of refined petroleum products other than gasoline,

diesel and chemical feedstock were RMB 63.9 billion, accounting for 23.3% (which was 0.9 percentage higher than that of 2002) of this segment's operating revenues and representing an increase of 33.4% compared with 2002. The growth of the sales revenues of these products was faster than that of gasoline and diesel, mainly because the segment actively reinforced its efforts in marketing these refined petroleum products in response to the changes in the market. To seize the opportunities, the Company further optimized its product-mix, and produced a larger quantity of those refined petroleum products with higher added values.

The following table shows the sales volumes, average realized prices and the percentage change of various kinds of refined petroleum products of the segment in 2002 and 2003.

	Sales Volume (million tonnes)			Average realized prices (RMB per tonne)		
	2003	2002	Change (%)	2003	2002	Change (%)
Gasoline	21.25	19.34	9.9	2,624	2,281	15.0
Diesel	41.46	37.53	10.5	2,404	2,127	13.0
Chemical feedstock	21.91	20.09	9.1	2,277	1,934	17.7
Other refined petroleum products	29.64	25.99	14.0	2,157	1,843	17.0

In 2003, the operating expenses of the segment were RMB 267.8 billion, representing an increase of 28.9% compared with 2002. The increase is largely because of the rise of crude oil price, as well as the Company's efforts in increasing the throughput of crude oil.

In 2003, the average crude oil cost was RMB 1,824 per tonne, up by RMB 295 per tonne compared with 2002, representing an increase by 19.3%. Crude oil throughput was 116.66 million tonnes (excluding amounts processed for third parties), up by 11.23 million tonnes compared with 2002, representing an increase of 10.7%. In 2003, the total crude oil costs were RMB 212.8 billion, accounting for 79.5% of the

segment's operating expenses, representing an increase of 32%, or RMB 51.6 billion, compared with 2002. In addition, the proportion accounted for by the total crude oil costs in the Refining Segment's operating expenses in 2003 went up by 1.9 percentage compared with 2002.

In 2003, refining margin was US\$4.09 per barrel (defined as the sales revenues less the crude oil costs and refining feedstock costs and taxes other than income tax; divided by the throughput of crude oil and refining feedstock), up by US\$0.13 per barrel compared with US\$3.96 dollars per barrel in 2002, representing an increase of 3.3%.

In 2003, the unit refining cash operating cost (defined as operating expenses less the purchasing costs of crude oil and refining feedstock, depreciation and amortization, taxes other than income tax, other business expenses and adjustments; and divided by the throughput of crude oil and refining feedstock) was US\$2.00 per barrel, down by US\$0.02 per barrel compared with US\$2.02 per barrel in 2002, representing a decrease of 1%. This reflected the segment's continued efforts in lowering its costs, while the increased throughput also diluted the expenses on a unit basis.

In 2003, operating profit of the Refining Segment was RMB 6 billion, similar to that in 2002.

(3) Marketing and Distribution Segment

The business activities of the Marketing and Distribution Segment consist of purchasing petroleum products from the Refining Segment and third parties, wholesale and distribution of petroleum products to domestic customers, directly selling petroleum products to certain special customers, and retail of petroleum products and provision of related services through its retail distribution network.

In 2003, the segment's operating revenues were RMB 241.4 billion, representing an increase of 29.1% compared with 2002. This increase was mainly due to of the increase in the total sales volume and sales prices of petroleum products, and in particular the higher percentage accounted for by the retail volume of gasoline, diesel and high-grade gasoline in the total sales volume. In 2003, total sales volume of petroleum products was 83.86 million tonnes, representing an increase of 10.25 million tonnes, or 13.9%, compared with 2002.

The percentage of the retail and the distribution sales in the total sales volume

of the segment increased further. The percentage of retail sales of gasoline and diesel in the segment's operating revenue increased from 43.7% in 2002 to 45.8% in 2003. The percentage of distribution sales of gasoline and diesel in the segment's operating revenue increased from 8.5% in 2002 to 11.2% in 2003. The percentage of wholesale sales of gasoline and diesel in the segment's operating revenue decreased from 31.9% in 2002 to 25.1% in 2003.

In 2003, the percentage of retail sales of gasoline and diesel in the total sales volume of gasoline and diesel increased from 44.8% in 2002 to 48.9% in 2003, representing an increase of 4.1 percentage. The percentage of distribution sales of gasoline and diesel in the total sales volume increased from 9.9% in 2002 to 13.3% in 2003, up by 3.4 percentage. The percentage of wholesale sales of the total sales volume of gasoline and diesel decreased from 38.1% in 2002 to 30.6% in 2003, down by 7.5 percentage. The increase in the retail percentage in the total sales volume was due to a number of factors

including, among others, its continued efforts to build additional retail sales outlets, to further optimize the locations of its existing petrol stations, to further improve the service quality, and to further increase the throughput per petrol station.

The percentage of high-grade gasoline in the total sales volume of gasoline further increased, from 27.1% in 2002 to 35.5% in 2003, representing an increase of 8.4 percentage.

The sales revenues of four major product categories (gasoline, diesel, kerosene including jet fuel and fuel oil) of the segment were RMB 232.6 billion, constituting 96.4% of the segment's operating revenues, representing an increase of 29.1% compared with 2002.

The following table shows the sales volumes, average realized prices, respective percentages of change of the four product categories in 2002 and 2003, including break-down information of different sales channels for gasoline and diesel.

	Sales Volumes (million tonnes)			Average realized prices (RMB per tonne)		
	2003	2002	Change (%)	2003	2002	Change (%)
Gasoline	23.53	21.36	10.2	3,295	2,857	15.3
of which: Retail	14.68	12.34	19.0	3,450	3,062	12.7
Direct sales to customers	0.79	0.72	9.7	2,682	2,313	16.0
Distribution	1.62	1.04	55.8	3,152	2,693	17.0
Wholesale	6.44	7.26	(11.3)	3,051	2,585	18.0
Diesel	47.92	44.50	7.7	2,789	2,405	16.0
of which: Retail	20.29	17.16	18.2	2,954	2,562	15.3
Direct sales to customers	4.34	4.01	8.2	2,511	2,219	13.2
Distribution	7.88	5.48	43.8	2,772	2,398	15.6
Wholesale	15.41	17.85	(13.7)	2,659	2,297	15.8
Kerosene including jet fuel	4.57	4.34	5.3	2,350	2,112	11.3
Fuel oil	6.37	2.11	201.9	1,670	1,427	17.0

In 2003, this segment's operating expenses were RMB 229.5 billion, up by 28.5% compared with 2002. Among others, purchasing costs of gasoline and diesel were RMB 180.8 billion, constituting 78.8% of the segment's operating expenses. Average purchased prices of gasoline and diesel went up by 14.3% and 13.7%, respectively, compared with 2002, to RMB 2,693 per tonne and RMB 2,450 per tonne,

respectively. The purchasing volume of gasoline and diesel went up by 10.2% and 7.7%, respectively, compared with 2002, to 23.53 million tonnes and 47.92 million tonnes, respectively.

In 2003, the segment's cash operating cost per tonne of petroleum products (defined as the operating expenses less the purchasing costs, taxes other than income tax,

depreciation and amortization, and divided by the sales volume) was RMB 174.95 per tonne, up by 5.4% compared with RMB 166 per tonne in 2002. This increase was primarily because of the increased percentage of retail and distribution sales of petroleum products in the total sales volume, which in turn increased transportation and labor costs.

In 2003, the segment's operating profit was RMB 11.9 billion, representing an increase of 41.7% compared with 2002. This increase was due to a number of factors, including its continued efforts to focus on market demands, to increase the percentage of retail and distribution sales volumes in the total sales volume, to further optimize the deployment of resources and to increase the total sales volume of petroleum products. As a result, the segment managed to achieve reasonably good operating results over the full year.

(4) Chemicals Segment

The business activities of the Chemicals Segment include purchasing chemical

feedstock from the Refining Segment and third parties, producing, marketing and distribution of petrochemical products and inorganic chemical products.

In 2003, the segment's operating revenues were RMB 92.3 billion, representing an increase of 22.9% compared with 2002. This increase was mainly because sales volumes and sales prices of all major categories of chemical products except chemical fertilizers significantly increased. The segment expanded its production capacities in 2003 as a result of the commencement of production of certain revamped chemical facilities.

The sales revenues of the six major product categories of this segment (basic organic chemicals, synthetic resin, synthetic rubber, synthetic fiber, synthetic fiber monomer and polymer, chemical fertilizer) were approximately RMB 83.1 billion, constituting 90.0% of the segment's operating revenues, representing an increase of 26.3% compared with 2002.

The following table sets forth the sales volumes, average realized prices and respective percentage changes of these six major categories of chemical products of the segment in 2002 and 2003.

	Sales Volumes (million tonnes)			Average Realized Prices (RMB per tonne)		
	2003	2002	Change (%)	2003	2002	Change (%)
Basic organic chemicals	7.80	7.23	7.9	2,815	2,748	2.4
Synthetic resin	4.52	3.83	18.0	6,042	5,247	15.2
Synthetic rubber	0.55	0.51	7.8	8,513	6,468	31.6
Synthetic fiber	1.33	1.18	12.7	9,639	8,435	14.3
Synthetic fiber monomer and polymer	2.41	1.80	33.9	5,788	5,362	7.9
Chemical fertilizer	2.03	2.72	(25.4)	1,165	1,084	7.5

In 2003, the segment's operating expenses were RMB 90.1 billion, up by RMB 15.6 billion compared with 2002, representing an increase by 20.9%. Partly because the segment expanded and upgraded certain ethylene and other downstream facilities, production significantly increased. As a result, expenses on various feedstock and auxiliary materials, other variable expenses and fixed costs all increased. Among others:

- Consumption of feedstock and auxiliary materials was up by 2.74 million tones, the average unit price was up by RMB 228 per tonne. As a result, the purchase costs of feedstock, operating supplies and related expenses were up by approximately RMB 12.6 billion compared with 2002.
- The losses on disposal of low-efficiency assets were up by RMB 890 million as a result of the segment's efforts to optimize its asset structure.
- Provision for the impairment losses on assets was up by RMB 450 million.
- The losses on disposal of spare parts were up by RMB 270 million.

- Selling expenses were up by RMB 180 million, due to the increases in the production and sales volumes.
- Depreciation and amortization were RMB 8 billion, up by RMB 140 million.

In 2003, the segment's operating profit was RMB 2.2 billion, representing an increase of approximately RMB 1.6 billion compared with 2002. This increase was largely because the segment has completed expansion and upgrading of certain of its facilities, which resulted in the increase of production and sales volumes of major products. In addition, the increase of the sales prices of a number of major products also contributed to the increased operating profit.

(5) Corporate and others

The business activities of Corporate and Others mainly consist of import and export business activities of its subsidiaries, research and development activities of the Company, and managerial activities of its headquarters.

In 2003, the operating revenues of Corporate and Others were approximately RMB 63.6 billion, representing an increase of 39.2%

compared with 2002. Its operating revenues mainly consisted of the consolidated operating revenues of Sinopec International Co., Ltd. and its subsidiaries. The increase was largely because the Company increased its import and export trading volume and other business transactions to capture the opportunities presented by the high prices of crude oil and petroleum products.

In 2003, the operating expenses of Corporate and Others were about RMB 65.6 billion, representing an increase of 40.2% compared with 2002. This increase was largely because the purchasing costs of Sinopec International Co., Ltd. and its subsidiaries increased concurrently with its increased revenue.

In 2003, the operating losses of Corporate and Others were about RMB 2 billion, representing an increase of RMB 900 million compared with 2002. This decrease was primarily because the Company's headquarters and research institutes incurred RMB 1.6 billion research and development expenses in 2003, up by about RMB 500 million compared with 2002. In addition, expenses of RMB 120 million related to the stock appreciation rights were recorded in 2003 under Corporate and Others.

3 ASSETS, LIABILITIES, SHAREHOLDERS' FUNDS, AND WORKING CAPITAL

The Company's primary sources of funding were from operating activities, short-term and long-term borrowings, and primary uses of funds were for operating expenses, capital expenditures and repayments for short-term and long-term loans.

(1) Assets, liabilities and shareholders' funds

Unit: RMB millions

	As at December 31		
	2003	2002	Changes
Total assets	400,818	389,343	11,475
Current assets	99,328	103,982	(4,654)
Non-current assets	301,490	285,361	16,129
Total liabilities	207,053	201,511	5,542
Current liabilities	122,005	119,440	2,565
Non-current liabilities	85,048	82,071	2,977
Minority interests	25,866	24,009	1,857
Net assets	167,899	163,823	4,076
Shareholders' funds	167,899	163,823	4,076
Share capital	86,702	86,702	—
Reserves	81,197	77,121	4,076

At the end of 2003, the Company's total assets were RMB 400.818 billion, total liabilities were RMB 207.053 billion, minority interests were RMB 25.866 billion, shareholders' funds was RMB 167.899 billion. Changes in the assets and liabilities items compared with those at the end of 2002 and the principal reasons for such changes are as follows:

The Company's total assets were RMB 400.818 billion, up by RMB 11.475 billion over those at the end of 2002. Of which, current assets were RMB 99.328 billion, down by RMB 4.654 billion compared with those at the end of 2002. The change was mainly because the Company's cash and time deposits decreased by RMB 1.769 billion in 2003. At the same time, the Company reinforced its management control over working capital, reduced the occupancy of funds by various current assets. As a result, the accounts receivable were down by RMB 1.516 billion, and the prepaid expenses and other current assets reduced by RMB 1.307 billion. Non-current assets were RMB 301.490 billion at the end of 2003, up by RMB 16.129 billion compared with those at the end of 2002. The change was primarily because property, plant and

equipment were up by RMB 7.159 billion, while the construction in progress were up by RMB 7.281 billion.

Total liabilities were RMB 207.053 billion, up by RMB 5.542 billion compared with those at the end of 2002. Of which, current liabilities were RMB 122.005 billion, up by RMB 2.565 billion compared with those at the end of 2002. The change was mainly because the accrued expenses and other payables were up by RMB 10.826 billion, which were mainly due to the payables to China Petrochemical Corporation and its subsidiaries for the acquisition of Maoming Ethylene assets and the increased accrued expenditure. Accounts payable were up by RMB 3.227 billion, which were principally payables to third parties. As the cost of funding in the monetary market rose, the increased discount rate of bills payable resulted in the decrease in the bills payable by RMB 6.281 billion. The Company reduced the amount of short-term debt by RMB 6.751 billion, which were mainly in the form of decrease in short-term bank loans. Non-current liabilities were RMB 85.048 billion at the end of 2003, up by RMB 2.977 billion compared with those at the end of

2002. The change was mainly because long-term loans of the Company's jointly controlled entities were up by RMB 1.45 billion, and deferred tax liabilities were up by RMB 1 billion.

Shareholders' funds were RMB 167.899 billion at the end of 2003, up by RMB 4.076 billion compared with that at the end of 2002, increasing the reserves by RMB 4.076 billion.

(2) Cash Flow

In 2003, net decrease in cash and cash equivalent was RMB 2.94 billion (i.e. a decrease from RMB 18.16 billion as at December 31, 2002 to RMB 15.22 billion as at December 31, 2003). The following table shows the major items on the consolidated cash flow statements and their respective changes in 2002 and 2003.

Unit: RMB 100 millions

Major items in Cash flow Statement	2003	2002
Net cash flow from operating activities	606.30	550.46
Net cash flow from investing activities	(503.43)	(427.76)
Net cash flow from financing activities	(132.32)	(158.13)
Net decrease in cash and cash equivalents	(29.45)	(35.43)

- Net cash flow from operating activities was RMB 60.630 billion.

In 2003, profit from ordinary activities before taxation was RMB 34.081 billion, and after adjusting for the operating expenses items that have no cash flow (i.e. non-cash expense items), the adjusted cash inflow from operating activities was RMB 66.45 billion. Major non-cash expense items are: depreciation, depletion and amortization of RMB 26.735 billion, costs of dry holes of RMB 2.789 billion, losses from disposals of property, plant and equipment of RMB 2.221 billion, and impairment losses on long-lived assets of RMB 877 million.

The changes in operating-related receivable and payable items added cash inflow by RMB 3.676 billion, which was mainly because:

The Company reinforced its control over working capital, made more efforts to collect the accounts receivable, reduced the occupancy of funds by various current assets. The net value of other current assets such as accounts receivable, notes receivable, inventory and prepaid expenses declined, all the above factors contributed

to an increased cash inflow of RMB 2.271 billion.

Due to the expanded business activities, and increased purchasing costs, accounts payable increased and cash outflow was reduced by RMB 9.294 billion.

As the discount rate of notes rose and notes payable decreased, the cash outflow was increased by RMB 6.251 billion.

Other operating-related receivables and payables increased the cash outflow by RMB 1.638 billion.

After adjusting the non-cash expense items and receivable and payable items with regard to the profit from ordinary activities before taxation, and then deducting the cash outflow caused by payment for income tax totaling RMB 9.496 billion, the net cash flow from operating activities was RMB 60.630 billion.

- Net cash flow from investing activities was RMB 50.343 billion.

The net cash outflow from investing activities was mainly because the Company had cash outflow for capital expenditure of RMB 44.057 billion, and the Company's joint venture had cash outflow for capital expenditure of RMB 4.107 billion.

- Net cash flow from financing activities was RMB 13.232 billion.

The net cash outflow from financing activities was mainly because the amount of repayments of bank loans and other loans by the Company and its joint ventures was larger than the amount of newly added bank loans and other loans, thus resulting in a cash outflow of RMB 5.649 billion. In addition, the Company distributed the final dividend for 2002 and interim dividend for 2003, resulting in a cash outflow of RMB 7.803 billion.

For the cash flow situation during 2003, the Company further strengthened its control on cash management. Cash and cash equivalents were healthily reduced as funds were better used and overall efficiency was improved.

(3) Contingent liabilities

Refer to the descriptions under “Major Guarantees and Performance” in the section entitled “Disclosure of significant events”.

(4) Capital expenditure

Refer to the descriptions under “Capital Expenditure” in the section entitled “Business Review and Prospects”.

(5) Research and Development Expenses and Environmental Expenses

Research and development expenses refer to the expenses that have been recognized during the period in which they incurred. In 2003, the Company’s research and development expenses were RMB 2.111 billion, up by RMB 591 million compared with 2002, reflecting the Company’s continued commitment in technological development with the view to achieving sustained growth.

Environmental expenses refer to the normal routine pollutant discharge fees paid by the Company, excluding any capitalised costs of pollutant discharge facilities. In 2003, the Company’s environmental expenses were RMB 245 million, which was similar to those in 2002.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

(6) Analysis of financial statements prepared under the PRC Accounting Rules and Regulations

The major differences between the Company's financial statements prepared under the PRC Accounting Rules and Regulations and those under IFRS are set out in the section C of the financial statements of the Company on page 159 to page 160 of this report.

The table below sets forth each of its segments' income and profit from principal operations, costs of principal operations, taxes and surcharges, as prepared under the PRC Accounting Rules and Regulations.

	Year ended December 31	
	2003	2002
	RMB millions	RMB millions
Income from principal operations		
Exploration and Production Segment	62,223	50,327
Refining Segment	266,253	208,895
Marketing and Distribution Segment	240,812	186,707
Chemicals Segment	82,334	65,605
Others	60,600	42,775
Elimination of inter-segment sales	(295,031)	(230,125)
Income from principal operations	417,191	324,184
Costs of sales, sales taxes and surcharges		
Exploration and Production Segment	31,596	28,788
Refining Segment	254,360	198,115
Marketing and Distribution Segment	210,456	163,701
Chemicals Segment	73,116	60,429
Others	59,984	42,378
Elimination of costs of inter-segment sales	(293,037)	(230,377)
Costs of sales, sales taxes and surcharges	336,475	263,034
Profit from principal operations		
Exploration and Production Segment	28,785	21,973
Refining Segment	11,741	10,598
Marketing and Distribution Segment	30,356	23,006
Chemicals Segment	9,218	5,176
Others	616	397
Profit from principal operations	80,716	61,150

Financial data prepared under the PRC Accounting Rules and Regulations:

	As at/(year ended) December 31		
	2003	2002	Change %
Total assets	390,213	368,375	5.93
Long-term liabilities	80,109	76,152	5.20
Shareholders' funds	162,946	151,717	7.40
Profit from principal operations	80,716	61,150	32.00
Net profit	19,011	14,121	34.63

Unit: RMB millions

Analysis of changes:

Total assets: at the end of 2003, the Company's total assets were RMB 390.213 billion, up by RMB 21.838 billion compared with 2002. This was mainly because in 2003, the Company increased the investments in fixed assets, in order to meet the market demands. As a result, fixed assets was increased by RMB 21.809 billion.

Long-term liabilities: at the end of 2003, the Company's long-term liabilities were RMB 80.109 billion, up by RMB 3.957 billion compared with 2002. This was largely because the long-term loans, arranged pursuant to the Company's investment plan for projects, were increased by RMB 5.513 billion and the debentures payable of RMB 1.5 billion, which would become due in July 2004, were reclassified as current liabilities.

Shareholders' funds: at the end of 2003, shareholders' funds of the Company was RMB 162.946 billion, up by RMB 11.229 billion compared with 2002. This was principally because: first, the realized net profit in 2003 reached RMB 19.011 billion; second, in 2003, the distribution of its final dividend for 2002 totaling RMB 5.202 billion and its interim dividend for 2003 totaling RMB 2.601 billion.

Profit from principal operations: in 2003, the profit from principal operations realized by the Company was RMB 80.716 billion, up by RMB 19.566 billion compared with 2002, representing a growth rate of 32%. This was mainly because in 2003, the prices of crude oil, petroleum products and petrochemical products went up. In addition, demands for these products went up as well. The Company seized these market opportunities and managed to improve its operating results at a stable pace.

Net profit: in 2003, the net profit realized by the Company was RMB 19.011 billion, up by RMB 4.89 billion compared with 2002, representing a growth of 34.63%. The increase was mainly due to the increase of the Company's profit from its principal operations.

(7) SIGNIFICANT DIFFERENCES BETWEEN THE FINANCIAL STATEMENTS PREPARED UNDER IFRS AND U.S. GAAP

The major difference between the Company's financial statements prepared under IFRS and US GAAP are set out in the Section D of the financial statements of the Company on page 161 to page 163 of this report.