

## 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 2004, the Company's turnover and other operating revenues were RMB 619.8 billion and the operating profit was RMB 63.1 billion, representing an increase of 38.0% and 62.2% over those in the previous year respectively. These results are largely attributable to a number of factors. First, the international crude oil prices continued to be volatile and remained at a high level, the chemical industry was on the up trend cycle, and the

domestic economy consistently maintained fast growth, all of which resulted in strong demand for chemical products and high prices of chemical products, which, in turn, provided favorable conditions for the Company to maximise its returns. Second, by taking the advantage of the favorable opportunities, the Company proactively developed the market, increased the sales of refined oil products, maintained steady growth in oil and gas production and increased the throughput of

crude oil and production of chemical products. In addition, the Company continued to strive for better operating results through strengthening internal management, furthering corporate reforms and improving asset structure.

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

	Years ended 31 December		Changes (%)
	2004	2003	
	RMB millions		
<b>Turnover and other operating revenues</b>	<b>619,783</b>	<b>449,001</b>	<b>38.0</b>
Of which: Turnover	597,197	429,949	38.9
Other operating revenues	22,586	19,052	18.5
<b>Operating expenses</b>	<b>(556,714)</b>	<b>(410,118)</b>	<b>35.7</b>
Of which:			
Purchased crude oil, products and operating supplies and expenses	(443,590)	(313,238)	41.6
Selling, general and administrative expenses	(31,843)	(27,228)	16.9
Depreciation, depletion and amortization	(32,342)	(27,951)	15.7
Exploration expenses (including dry holes)	(6,396)	(6,133)	4.3
Personnel expenses	(18,634)	(16,972)	9.8
Employee reduction expenses	(919)	(1,040)	(11.6)
Taxes other than income tax	(16,324)	(13,581)	20.2
Other operating expenses, net	(6,666)	(3,975)	67.7
<b>Operating profit</b>	<b>63,069</b>	<b>38,883</b>	<b>62.2</b>
Net finance costs	(4,371)	(4,463)	(2.1)
Investment income, share of profit less losses from associates and gain from issuance of shares by a subsidiary	908	621	46.2
<b>Profit from ordinary activities before taxation</b>	<b>59,606</b>	<b>35,041</b>	<b>70.1</b>
Taxation	(17,815)	(10,645)	67.4
<b>Profit from ordinary activities after taxation</b>	<b>41,791</b>	<b>24,396</b>	<b>71.3</b>
Minority interests	(5,772)	(1,972)	192.7
<b>Profit attributable to shareholders</b>	<b>36,019</b>	<b>22,424</b>	<b>60.6</b>

**(1) Turnover and other operating revenues**

In 2004, the Company's turnover and other operating revenues were RMB 619.8 billion, of which, the turnover was RMB 597.2 billion, representing an increase of 38.9% compared with 2003. In 2004, the Company captured the opportunity of the increased prices of crude oil and petrochemical products in the

international market, expanded the sales volume of its major petrochemical products and optimized marketing structure. In 2004, the Company's other operating revenues went up to RMB 22.6 billion, representing an increase of 18.5% compared with 2003. The increase in "other operating revenues" were mainly due to the increase in sales revenue from

its sale of raw and auxiliary materials to Sinopec Group Company and third parties.

The following table sets forth the Company's external sales volume, average realized prices and their changes in percentage from 2003 to 2004.

	Sales volume (thousand tonnes)			Averaged realized prices (RMB/tonne)		
	2004	2003	Changes (%)	2004	2003	Changes (%)
Crude oil	6,012	7,219	(16.7)	1,872	1,493	25.4
Natural gas (million cubic meters) (RMB/thousand cubic meters)	3,775	3,405	10.9	609	591	3.0
Gasoline	27,353	23,356	17.1	3,765	3,298	14.2
Diesel	60,419	47,290	27.8	3,221	2,794	15.3
Kerosene	5,680	4,810	18.1	2,923	2,361	23.8
Basic chemical feedstock	6,664	5,712	16.7	4,429	3,642	21.6
Synthetic resin	5,401	5,097	6.0	7,986	6,017	32.7
Synthetic rubber	556	555	0.2	10,238	8,513	20.3
Synthetic fibre	1,741	1,720	1.2	10,818	9,300	16.3
Monomers and polymers for synthetic fibre	2,704	2,622	3.1	8,022	5,791	38.5
Chemical fertilizer	2,622	2,001	31.0	1,355	1,165	16.3

Most of the crude oil and a small portion of the natural gas produced by the Company were internally used for refining and chemicals production. The remaining was sold to the refineries of Sinopec Group Company and other customers. In 2004, the turnover from crude oil and natural gas that were sold externally amounted to RMB 16.0 billion, accounting for 2.6% of the Company's turnover and other operating revenues, representing an increase of 6.9% compared with that in 2003. The increase was mainly due to the increase in crude oil price and expansion of natural gas business.

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 2004, the external sales revenue of petroleum products by these two segments were RMB 406.2 billion, accounting for 65.5% of the Company's

turnover and other operating revenues, representing an increase of 40.2% compared with that in 2003. The increase was mainly due to the rise of gasoline and diesel prices and also due to the Company's proactive efforts in increasing sales volume, optimising marketing structure and expanding the market of other refined petroleum products. The sales revenue of gasoline, diesel and kerosene was RMB 314.2 billion, accounting for 77.4% of the total sales revenue of petroleum products, representing an increase of 42.5% over that in 2003. The sales revenue of other refined petroleum products was RMB 92 billion, accounting for 22.6% of the total sales revenue of petroleum products, representing an increase of 33.2% compared with 2003.

The Company's external sales revenue of chemical products was RMB 126 billion, accounting for 20.3% of its turnover and other operating revenues, representing an

increase of 37% compared with that in 2003. The increase was mainly due to the fact that the Company captured the opportunity of the significant increase of chemical product prices and the increase of sales volume by the Company.

**(2) Operating expenses**

In 2004, the Company's operating expenses amounted to RMB 556.7 billion, representing an increase of 35.7% compared with 2003. The operating expenses mainly consisted of the following:

*Purchased Crude Oil, Products, and Operating Supplies and Expenses*

In 2004, the Company's costs for purchased crude oil, products and operating supplies and expenses were RMB 443.6 billion, accounting for 79.7% of the total operating expenses, representing an increase of 41.6% compared with 2003. The costs of

purchased crude oil was RMB 232.6 billion, accounting for 41.8% of the total operating expenses, representing an increase of 41.5% compared with 2003. To meet the increasing demands in the market associated with the rapid growth of the Chinese economy, the Company increased its throughput of crude oil purchased from third parties. In 2004, the throughput of the Company's crude oil purchased externally was RMB 100.62 million tonnes (excluding amounts processed for third parties), representing an increase of 13.6% compared with 2003. Average cost for crude oil purchased externally in 2004 was RMB 2,312 per tonne, representing an increase of 24.6% compared with 2003.

In 2004, the Company's other purchase expenses were RMB 211 billion, accounting for 37.9% of the total operating expenses, up by 41.7% compared with 2003. This increase was mainly due to the increase in costs of refined oil products and chemical feedstock purchased externally.

#### *Selling, general and administrative expenses*

In 2004, the Company's selling, general and administrative expenses totalled RMB 31.8 billion, representing an increase of 16.9% compared with 2003. Such an increase was largely due to:

- An increase in the total sales volume of refined oil products and an increase of sales through retail and direct distribution. The increase in sales volume resulted in an increase of selling expenses, such as transportation cost, by RMB 1.9 billion compared with 2003.
- An increase in repairing and maintenance expenses by RMB 1.1 billion compared with 2003 due to the additions of property, plant and equipment and the increase in maintenance activities related to petrol stations.
- An increase in operating lease rentals by RMB 700 million compared with that in 2003. The increase was mainly due to the increase in rental of operating

facilities such as petrol stations from third parties and rental of land and buildings from related parties.

- Active promotion of Sinopec's overall image, which resulted in increased advertising expenses by RMB 700 million compared with 2003.

#### *Depreciation, depletion and amortization*

In 2004, the Company's depreciation, depletion and amortization were RMB 32.3 billion, up by 15.7% over 2003. The increase was mainly because of the additions of property, plant and equipment as a result of capital expenditure.

#### *Exploration expenses*

In 2004, the Company's exploration expenses were RMB 6.4 billion, representing an increase of 4.3% compared with 2003. The increase was principally due to the increase by the Company of its investment in exploration activities in major new blocks in the western and southern parts of China.

#### *Personnel expenses*

In 2004, the Company's personnel expenses were RMB 18.6 billion, representing an increase of 9.8% compared with 2003. The increase was largely due to the implementing by the Company of the market-rate based employee compensation system resulting in increased employee wages and salaries. The new compensation system also resulted in an increase of contribution to staff retirement plans accordingly.

#### *Employee reduction expenses*

In 2004, in accordance with the Company's voluntary employee reduction plan, and in connection with the acquisition of petrochemical and catalyst assets from and the disposal of downhole assets to Sinopec Group Company, the Company recorded employee reduction expenses of approximately RMB 0.9 billion relating to the reduction of approximately 24,000 employees, down by RMB 0.1 billion compared with that in 2003.

#### *Taxes other than income tax*

In 2004, the Company's taxes other than income tax were RMB 16.3 billion, representing an increase of 20.2% compared with 2003. The increase was largely due to the increase of consumption tax and associated city construction taxes and education surcharges as a result of the increased sales volume of gasoline and diesel of the Company.

#### *Other operating expenses, net*

In 2004, the Company's other operating expenses, net were RMB 6.7 billion, representing an increase of 67.7% compared with 2003. The increase was largely due to the following reason: In order to allocate its internal resources more efficiently, the Company revised the production plans in 2004, and accordingly made a provision for impairment loss 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 amounting RMB 3.9 billion, representing an increase of RMB 3 billion compared with 2003. Meanwhile, disposals of assets decreased in 2004.

### **(3) Operating profit**

In 2004, the Company's operating profit was RMB 63.1 billion, representing an increase of 62.2% compared with 2003.

### **(4) Net finance costs**

In 2004, the Company's net finance costs were RMB 4.4 billion, down by 2.1% compared with 2003.

### **(5) Profit from ordinary activities before taxation**

In 2004, the Company's profit from ordinary activities before taxation was RMB 59.6 billion, representing an increase of 70.1% compared with 2003.

### **(6) Taxation**

In 2004, the Company's taxation was RMB 17.8 billion, representing an increase of 67.4% compared with 2003.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

### (7) Minority interests

In 2004, the Company's minority interests were RMB 5.8 billion, representing an increase of 192.7% compared with 2003. The increase was mainly due to the return of the subsidiaries of the Company increased as compared with 2003.

### (8) Profit attributable to shareholders

In 2004, the Company's profit attributable to shareholders was RMB 36 billion, representing an increase of 60.6% compared with 2003.

## 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 this section have not eliminated the inter-segment transactions. In addition, the operating revenue data of each segment have included 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.

	Years ended 31 December		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	
	2004	2003	2004	2003	2004	2003
	RMB millions		%	%	%	%
<b>Exploration and Production Segment</b>						
External sales <sup>(1)</sup>	25,253	22,975	2.5	3.0	4.1	5.1
Inter-segment sales	60,053	47,287	5.9	6.3		
<b>Operating revenues</b>	<b>85,306</b>	<b>70,262</b>	<b>8.4</b>	<b>9.3</b>		
<b>Refining Segment</b>						
External sales <sup>(1)</sup>	68,574	56,018	6.7	7.4	11.1	12.5
Inter-segment sales	289,699	217,755	28.5	28.9		
<b>Operating revenues</b>	<b>358,273</b>	<b>273,773</b>	<b>35.2</b>	<b>36.3</b>		
<b>Marketing and Distribution Segment</b>						
External sales <sup>(1)</sup>	343,595	238,758	33.8	31.7	55.4	53.2
Inter-segment sales	2,831	2,602	0.3	0.3		
<b>Operating revenues</b>	<b>346,426</b>	<b>241,360</b>	<b>34.1</b>	<b>32.0</b>		
<b>Chemicals Segment</b>						
External sales <sup>(1)</sup>	132,183	96,425	13.0	12.8	21.3	21.5
Inter-segment sales	12,510	7,415	1.2	1.0		
<b>Operating revenues</b>	<b>144,693</b>	<b>103,840</b>	<b>14.2</b>	<b>13.8</b>		
<b>Corporate and others</b>						
External sales <sup>(1)</sup>	50,178	34,825	4.9	4.6	8.1	7.7
Inter-segment sales	32,046	30,371	3.2	4.0		
<b>Operating revenues</b>	<b>82,224</b>	<b>65,196</b>	<b>8.1</b>	<b>8.6</b>		
<b>Operating revenues before elimination of inter-segment sales</b>	<b>1,016,922</b>	<b>754,431</b>	<b>100.0</b>	<b>100.0</b>		
<b>Elimination of inter-segment sale</b>	<b>(397,139)</b>	<b>(305,430)</b>				
<b>Consolidated operating revenues</b>	<b>619,783</b>	<b>449,001</b>			<b>100.0</b>	<b>100.0</b>

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 2003 to 2004.

	Years ended 31 December		Changes (%)
	2004	2003	
	RMB millions		
<b>Exploration and Production Segment</b>			
Operating revenues	85,306	70,262	21.4
Operating expenses	59,692	51,102	16.8
<b>Operating profit</b>	<b>25,614</b>	<b>19,160</b>	<b>33.7</b>
<b>Refining Segment</b>			
Operating revenues	358,273	273,773	30.9
Operating expenses	352,330	267,700	31.6
<b>Operating profit</b>	<b>5,943</b>	<b>6,073</b>	<b>(2.1)</b>
<b>Marketing and Distribution Segment</b>			
Operating revenues	346,426	241,360	43.5
Operating expenses	331,710	229,417	44.6
<b>Operating profit</b>	<b>14,716</b>	<b>11,943</b>	<b>23.2</b>
<b>Chemicals Segment</b>			
Operating revenues	144,693	103,840	39.3
Operating expenses	125,972	100,297	25.6
<b>Operating profit</b>	<b>18,721</b>	<b>3,543</b>	<b>428.4</b>
<b>Corporate and others</b>			
Operating revenues	82,224	65,196	26.1
Operating expenses	84,149	67,032	25.5
<b>Operating profit</b>	<b>(1,925)</b>	<b>(1,836)</b>	<b>4.8</b>

#### (1) Exploration and Production Segment

Most of the crude oil and a small portion of the natural gas produced by Exploration and Production Segment were used for the Company's refining and chemical operations. Most of the natural gas and a small portion of crude oil produced were sold to refineries owned by Sinopec Group Company and third party customers.

In 2004, the operating revenues of this segment were RMB 85.3 billion, up by 21.4% over 2003, largely due to the increase in sales volume and the sales price of crude oil compared with those in 2003.

In 2004, this segment sold 36.26 million tonnes of crude oil, representing an increase of 1.4% compared with 2003; 3.9 billion cubic meters of natural gas were sold, up by 11.6% compared with that in 2003. The average realized price of crude oil was RMB1,956 per tonne (approximately USD 33.3/barrel), representing an increase of 20.7% compared with that in 2003; the average realized price of natural gas was RMB 616 per thousand cubic meters, up by 3.3% compared with that in 2003.

In 2004, the operating expenses of this segment were RMB 59.7 billion, up by 16.8% compared with that in 2003. This increase was mainly due to the following reasons:

- The depreciation, depletion and amortization of the segment increased by RMB 2.6 billion compared with 2003. This change was caused by the additions of oil and gas properties as a result of an increase in capital expenditure incurred in this segment;
- The rise of fuel cost as a result of the increase in oil and gas production and fuel prices, resulting in an increase of the operating expenses by approximately RMB 1 billion compared with 2003;
- Other operating expenses including expenses related to the sales of materials were up by RMB 1.3 billion compared with 2003;
- Exploration expenses (including dry holes) were up by RMB 0.3 billion compared with 2003;
- Due to the increase of sales revenues of crude oil, the natural resources compensation fee increased accordingly. Land and building rental increased due to the increase of leased land and buildings. In addition, safety insurance fund also increased. The total of these items was up by RMB 0.5 billion compared with 2003.

In 2004, in light of the high crude oil price, this segment increased its workload of certain downhole operation. As a result, the lifting cost of crude oil and natural gas increased by 3.9% from USD 6.47 per barrel in 2003 to USD 6.72 per barrel in 2004.

In 2004, this segment's operating profit was approximately RMB 25.6 billion, representing an increase of 33.7% compared with that in 2003.

**(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, selling gasoline, diesel and kerosene to the Marketing and Distribution Segment, and selling other

refined petroleum products to domestic and overseas customers.

In 2004, the segment's operating revenues were RMB 358.3 billion, up by 30.9% compared with 2003. The increase was mainly due to the increase in the sales prices and

sales volumes of various refined petroleum products.

The following table shows the sales volumes, average realized prices and the percentage changes of various kinds of refined petroleum products of the segment from 2003 to 2004.

	Sales volume (thousand tonnes)			Average realized prices (RMB per tonne)		
	2004	2003	Changes (%)	2004	2003	Changes (%)
Gasoline	21,420	21,255	0.8	2,977	2,624	13.5
Diesel	50,271	41,461	21.2	2,890	2,404	20.2
Chemical feedstock	23,165	21,914	5.7	2,682	2,277	17.8
Other refined petroleum products	31,710	29,639	7.0	2,583	2,155	19.9

In 2004, the sales revenues of gasoline realized by the segment were RMB 63.8 billion, representing an increase of 14.4% compared with 2003, accounting for 17.8% of this segment's operating revenues, down by 2.6 percentage points compared with 2003.

In 2004, the sales revenues of diesel realized by the segment were RMB 145.3 billion, representing an increase of 45.7% compared with 2003, accounting for 40.5% of this segment's operating revenues, up by 4.0 percentage points compared with 2003.

In 2004, the sales revenues of chemical feedstock realized by the segment were RMB 62.1 billion, representing an increase of 24.5% compared with 2003, accounting for 17.3% of this segment's operating revenues, down by 0.9 percentage points compared with 2003.

In 2004, the sales revenues of refined petroleum products other than gasoline, diesel and chemical feedstock were RMB 81.9 billion, representing an increase of 28.3% compared with 2003, accounting for 22.8% of this segment's operating revenues, down by 0.5 percentage points compared with 2003.

In 2004, the operating expenses of the segment were RMB 352.3 billion, representing an increase of 31.6% compared with 2003.

The increase was principally due to the increase of processing volume and price of crude oil.

In 2004, the average cost of crude oil was RMB 2,261 per tonne, representing an increase by 24.0% compared with 2003. Refining throughput was 128.84 million tonnes (excluding amounts processed for third parties), representing an increase of 10.4% compared with 2003. In 2004, the total crude oil costs were RMB 291.3 billion, representing an increase of 36.9% compared with 2003, accounting for 82.7% of the segment's operating expenses, up by 3.2 percentage points compared with 2003.

In 2004, with oil prices remaining at a high level, the Company strived to minimize purchase cost of crude oil and transportation cost and increase the revenue of refined oil products, and expanded the sales market of refined petroleum products other than gasoline, diesel and kerosene. However, the increase of refined oil price was less than that of crude oil. The refining margin was USD 3.86 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), down by USD 0.23 per barrel compared with USD 4.09 per barrel in 2003, representing a decrease of 5.6%.

In 2004, the 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 USD 1.98 per barrel, down by USD 0.02 per barrel compared to 2003, representing a decrease of 1%. This change was mainly due to the continued reduction in costs and increased throughput in this segment.

In 2004, the operating profit of the Refining Segment was RMB 5.9 billion, similar to that in 2003.

**(3) Marketing and Distribution Segment**

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

In 2004, the operating revenues of this segment were RMB 346.4 billion, up by 43.5% compared with 2003. The increase was due to the increase in sales volume and prices of refined oil products and the sustained optimization of marketing structure, which further increased the retail and distribution ratios of gasoline and diesel.

In 2004, the operating revenues from retail of gasoline and diesel were RMB 299.9 billion, accounting for 86.6% of the operating revenues of this segment. In 2004, the percentage of retail sales in the total sales volume of gasoline and diesel increased from 48.9% in 2003 to 54.6% in 2004, representing an increase of 5.7 percentage

points. The percentage of sales of gasoline and diesel by distribution in the total sales volume increased from 13.3% in 2003 to 20.3% in 2004, up by 7 percentage points. The percentage of wholesale sales in the total sales volume of gasoline and diesel decreased from 37.8% in 2003 to 25.1% in 2004, down by 12.7 percentage points.

The following table shows the sales volumes, average realized prices and respective percentage changes of the four product categories in 2003 and 2004 including breakdown information of different sales channels for gasoline and diesel.

	Sales Volume (thousand tonnes)			Average realized prices (RMB per tonne)		
	2004	2003	Changes (%)	2004	2003	Changes (%)
<b>Gasoline</b>	<b>27,508</b>	<b>23,533</b>	<b>16.9</b>	<b>3,762</b>	<b>3,295</b>	<b>14.2</b>
Of which: Retail	18,416	14,676	25.5	3,911	3,450	13.4
Distribution	2,890	1,621	78.3	3,536	3,152	12.2
Wholesale	6,202	7,236	(14.3)	3,426	3,011	13.8
<b>Diesel</b>	<b>61,097</b>	<b>47,921</b>	<b>27.5</b>	<b>3,215</b>	<b>2,789</b>	<b>15.3</b>
Of which: Retail	29,997	20,291	47.8	3,351	2,954	13.4
Distribution	15,123	7,880	91.9	3,211	2,772	15.8
Wholesale	15,978	19,750	(19.1)	2,963	2,626	12.8
<b>Kerosene</b>	<b>5,623</b>	<b>4,573</b>	<b>23.0</b>	<b>2,923</b>	<b>2,350</b>	<b>24.4</b>
<b>Fuel oil</b>	<b>9,685</b>	<b>6,370</b>	<b>52.0</b>	<b>1,793</b>	<b>1,670</b>	<b>7.4</b>

In 2004, this segment's operating expenses were RMB 331.7 billion, up by 44.6% compared with 2003. The increase was mainly due to the increase in procurement expenses, of which, purchase costs for gasoline and diesel were RMB 260.9 billion, representing an increase of 44.3% compared with 2003, accounting for 78.7% of the segment's operating expenses. In 2004, average purchased prices of gasoline and diesel went up by 12.1% and 18.8% respectively compared with 2003, to RMB 3,019 per tonne and RMB 2,910 per tonne. The purchase volume of gasoline and diesel went up by 16.9% and 27.5% respectively compared with

2003, to 27.51 million tonnes and 61.10 million tonnes.

In 2004, the unit segment's cash operating cost 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 167.11 per tonne, down by 4.48% compared with 2003. This decrease was primarily due to the effect of increase in sales volume and decrease in costs.

In 2004, the Marketing and Distribution Segment's operating profit was RMB 14.7 billion, up by 23.2% compared with 2003.

#### (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 2004, the operating revenues of the Chemicals Segment were RMB 144.7 billion, up by 39.3% compared with 2003. The increase was mainly due to an increase in prices and sales volume of major chemical products.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

In 2004, the sales revenues of the Company's six major chemical products (i.e. basic organic chemicals, synthetic resin, synthetic rubber, synthetic fibre, synthetic fibre monomers and polymers and chemical fertilizer) totalled

approximately RMB 124.7 billion, up by 33.7% compared with 2003, accounting for 86.2% of the total operating revenues of this segment.

The following table set forth the sales volume, average realized price and percentage of changes for each of these six categories of chemical products of this segment from 2003 to 2004.

	Sales volumes (thousand tonnes)			Average realized prices (RMB per tonne)		
	2004	2003	Changes %	2004	2003	Changes %
Basic organic chemicals	7,384	7,208	2.4	4,292	3,377	27.1
Synthetic resin	5,402	5,097	6.0	7,986	6,017	32.7
Synthetic rubber	563	555	1.4	10,247	8,513	20.4
Synthetic fibre	1,741	1,720	1.2	10,818	9,300	16.3
Synthetic fibre monomer and polymer	2,704	2,622	3.1	8,022	5,791	38.5
Chemical fertilizer	2,659	2,034	30.7	1,355	1,165	16.3

In 2004, the operating expenses of the segment were RMB 126 billion, up by 25.6% compared with 2003. This change was primarily caused by the price increase of various raw materials, the increased consumption of various raw materials and auxiliary materials with the increase in the production of this segment, as well as the increased variable expenses and fixed costs. More specifically, the increase was due to the following reasons:

- Affected by the increase in the consumption of raw materials and auxiliary materials and the increase in their unit prices, the purchasing costs for raw materials, operating supplies and other related expenses increased by approximately RMB 21.9 billion compared with 2003.
- Materials sales and other business expenses were up by RMB 1.8 billion compared with 2003.

- Provision for impairment losses on low efficient facilities for fertilizer and caprolactam was RMB 2.0 billion, representing an increase of RMB 1.6 billion.

In 2004, operating profit for the Chemicals Segment was RMB 18.7 billion, representing an increase of RMB 15.2 billion compared with 2003. The percentage of operating profit of the Chemicals Segment in the Company's total operating profit increased from 9% in 2003 to 29.6% in 2004, representing an increase of 20.6 percentage points.

### (5) Corporate and others

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

In 2004, the operating revenues of Corporate and Others were RMB 82.2 billion, representing an increase of 26.1% compared with 2003. The increase was largely due to the fact that China Petrochemical International Co., Ltd. and its subsidiaries increased their trading volume in importing and exporting crude oil and refined oil products and other business transactions.

In 2004, the operating expenses were about RMB 84.1 billion, representing an increase of 25.5% compared with 2003. This increase was largely due to the fact that the purchase costs of China Petrochemical International Co., Ltd and its subsidiaries have increased to keep up with the increased operating revenues.

The operating losses were about RMB 1.9 billion, representing an increase of RMB 0.1 billion compared with 2003.



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

The Company's primary sources of funding were 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 31 December		Changes
	2004	2003	
Total assets	474,594	420,184	54,410
Current assets	120,271	103,039	17,232
Non-current assets	354,323	317,145	37,178
Total liabilities	250,508	222,618	27,890
Current liabilities	146,277	129,272	17,005
Non-current liabilities	104,231	93,346	10,885
Minority interests	31,046	26,051	4,995
Net assets	193,040	171,515	21,525
Shareholders' fund	193,040	171,515	21,525
Share capital	86,702	86,702	—
Reserves	106,338	84,813	21,525

The Company's total assets were RMB 474.594 billion, up by RMB 54.41 billion compared with those at the end of 2003, of which the current assets were RMB 120.271 billion, up by RMB 17.232 billion compared with those at the end of 2003. The change was mainly due to the increase in inventories as a result of price and volume increase of crude oil and petrochemical products. The Company's non-current assets were RMB 354.323 billion, up by RMB 37.178 billion compared with those at the end of 2003. The change was primarily attributable to the additions of property, plant and equipment which were up by RMB 13.392 billion in value, while the construction in progress were up by RMB 16.831 billion in value.

Total liabilities were RMB 250.508 billion, up by RMB 27.89 billion compared with those at the end of 2003, of which the

current liabilities were RMB 146.277 billion, up by RMB 17.005 billion compared with those at the end of 2003. The change was mainly due to the increase in accounts payable and bills payable in total by RMB 7.003 billion to cope with increased production volume, and the increase of the Company's short-term debt by RMB 6.975 billion. Non-current liabilities were RMB 104.231 billion at the end of 2004, up by RMB 10.885 billion compared with those at the end of 2003. The change was mainly due to the fact that long-term loans of the Company were up by RMB 10.291 billion compared with those at the end of 2003.

Shareholders' funds were RMB 193.04 billion at the end of 2004, up by RMB 21.525 billion compared with that at the end of 2003, representing an increase in the reserves by RMB 21.525 billion.

**(2) Cash flow**

In 2004, net increase in cash and cash equivalent was RMB 117 million (i.e. an increase from RMB 16.263 billion as at December 31, 2003 to RMB 16.381 billion as at December 31, 2004).

The following table shows the major items on the consolidated cash flow statements.

(Unit: RMB millions)

Major items of cash flows	Years ended 31 December	
	2004	2003
Net cash flow from operating activities	69,081	62,097
Net cash flow from investing activities	(73,992)	(50,690)
Net cash flow from financing activities	5,028	(14,473)
Net increase/(decrease) in cash and cash equivalents	117	(3,066)

- Net cash flow from operating activities was RMB 69.081 billion.

In 2004, profit from ordinary activities before taxation was RMB 59.606 billion; depreciation, depletion and amortization were RMB 32.342 billion; after adjusting the non-cash expense items, the adjusted cash flow from operating activities was RMB 100.529 billion. Major non-cash expense items were: costs of dry holes of RMB 2.976 billion, losses from disposals of properties, plants and equipment of RMB 1.686 billion, and impairment losses on long-lived assets of RMB 3.919 billion.

The changes in operating-related account receivable and payable items reduced cash inflow by RMB 14.565 billion. In order to meet the market demand, the Company expanded production and operation, as a result, the working capital required by the ordinary business increased, of which, the increase of inventory led to a decreased cash inflow of RMB 16.526 billion, the increase of bill receivable, accounts receivable and other current assets contributed to a decreased cash inflow of RMB 7.855 billion. Due to the expanded business activities and increased purchasing costs, cash inflow of accounts payable and bill payable increased by RMB 7.129 billion, and other operating-related account receivables and payables increased the cash inflow by RMB 2.687 billion.

After adjusting the non-cash expense items and account receivable and payable items with regard to the profit from ordinary activities before taxation, and deducting the cash outflow for payment of income tax totaling RMB 16.883 billion, the net cash flow from operating activities was RMB 69.081 billion.

- Net cash flow for investing activities was RMB 73.992 billion.

The net cash outflow for investing activities mainly represented the cash outflow for capital expenditure by the Company of RMB 67.583 billion and by the Company's joint ventures of RMB 6.035 billion.

- Net cash flow from financing activities was RMB 5.028 billion.

The net cash inflow from financing activities increased because the amount of newly added bank loans and other loans by the Company and its joint ventures was larger than the amount of repayments of bank loans and other loans, resulting in a cash inflow of RMB 13.645 billion. However, the effect was partly offset by the final dividend for 2003 and interim dividend for 2004 distributed by the Company, which resulted in a cash outflow of RMB 8.67 billion.

During 2004 the Company captured the opportunity of robust market demand resulting in such a remarkable increase in cash flow from operating activities. At the same time, in order to enhance its market-leading position, the Company increased its capital expenditure. In addition, the Company tightened its control on cash management and strictly controlled the scale of cash and cash equivalent, as a result, the overall efficiency of the Company 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 2004, the Company's research and development expenses were RMB 1.518 billion.

Environmental expenses refer to the normal routine pollutant discharge fees paid by the Company, excluding any capitalised costs of pollutant discharge facilities. In 2004, the Company's environmental expenses were RMB 248 million.

**(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 Section C of the financial statements of the Company on page 159 to page 160 of this report.

The following table 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.

	Years ended 31 December	
	2004 RMB millions	2003 RMB millions
<b>Income from principal operations</b>		
Exploration and Production Segment	76,023	62,223
Refining Segment	352,548	266,253
Marketing and Distribution Segment	345,671	240,812
Chemicals Segment	122,118	82,334
Corporate and Others	79,145	60,600
Elimination of inter-segment sales	(384,873)	(295,031)
Income from principal operations	<b>590,632</b>	<b>417,191</b>
<b>Cost of sales, sales taxes and surcharges</b>		
Exploration and Production Segment	36,073	31,596
Refining Segment	340,360	254,360
Marketing and Distribution Segment	306,309	210,456
Chemicals Segment	96,994	73,116
Corporate and Others	78,410	59,984
Elimination of the cost of inter-segment sales	(382,736)	(293,037)
Cost of sales, sales taxes and surcharges	<b>475,410</b>	<b>336,475</b>
<b>Profit from principal operations</b>		
Exploration and Production Segment	37,997	28,785
Refining Segment	12,005	11,741
Marketing and Distribution Segment	39,362	30,356
Chemicals Segment	25,123	9,218
Corporate and Others	735	616
Profit from principal operations	<b>115,222</b>	<b>80,716</b>

Financial data prepared under the PRC Accounting Rules and Regulations:

Unit: RMB millions

	As at 31 December/Years ended 31 December		
	2004	2003	Changes %
Total assets	460,081	390,213	17.91
Long-term liabilities	98,407	80,109	22.84
Shareholders' fund	186,350	162,946	14.36
Profit from principal operations	115,222	80,716	42.75
Net profit	32,275	19,011	69.77

**Total assets:** At the end of 2004, the Company's total assets were RMB 460.081 billion, up by RMB 69.868 billion compared with 2003. This change was mainly due to the increase of investments in fixed assets by the Company during 2004 in order to meet the market demands. As a result, fixed assets increased by RMB 40.81 billion. Current assets were up by RMB 20.138 billion, which was mainly due to the increased prices and quantity of crude oil and petrochemical products which, in turn, contributed to the increase in the value of inventory of RMB 19.003 billion. Other non-current assets were up by RMB 8.92 billion, which was mainly due to the increase in deferred tax assets and long-term deferred expenses.

**Long-term liabilities:** At the end of 2004, the Company's long-term liabilities were RMB 98.407 billion, up by RMB 18.298 billion compared with 2003. This change was largely due to the issuance of RMB 3.5 billion corporate bonds and the increase of RMB 14.866 billion in long-term loans pursuant to the Company's investment plans for various projects.

**Shareholders' funds:** At the end of 2004, shareholders' funds of the Company was RMB 186.35 billion, up by RMB 23.404 billion compared with 2003. This increase was principally due to: firstly, the realized net profit in 2004 reached RMB 32.275 billion; secondly, in 2004 the distribution

of its final dividend for the second half of 2003 amounted to RMB 5.202 billion and the interim dividend for 2004 totalled RMB 3.468 billion.

**Profit from principal operations:** In 2004, the realised profit from principal operations was RMB 115.222 billion, up by RMB 34.506 billion, representing a growth of 42.75% compared with 2003. This increase was mainly because in 2004, with the robust market demand and the rising prices of crude oil and petrochemical products, the Company captured market opportunities, expanded the total volume of production and sales, optimized marketing structure and managed to improve its operating results at a steady pace.

**Net profit:** In 2004, the net profit realized by the Company was RMB 32.275 billion, up by RMB 13.264 billion, representing a growth of 69.77% compared with 2003. The increase was mainly due to the increase in the Company's profit from its principal operations.

**(7) Significant differences between the financial statements prepared under IFRS and U.S. GAAP**

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