Principal Operations

The Company's principal business consists of the production and sale of petroleum products, petrochemical and organic chemical products, synthetic rubber products, chemical fertilizers and inorganic chemical products. Under IAS, the Group's turnover during the six months ended 30th June, 2001 was RMB5,985 million (approximately HK$5,640 million), representing an increase of 3.2 per cent as compared with the first six months of 2000. Under PRC accounting standards, the Group's income from principal operations for the six months ended 30th June, 2001 was RMB6,000 million (approximately HK$5,654 million) representing an increase of 0.3 per cent as compared with the same period of 2000. Due to the price decrease in the Company's petrochemical products and the increased accounting provisions for bad and doubtful debts, the Group recorded a loss of RMB671 million (approximately HK$632 million) under IAS, and RMB642 million (approximately HK$605 million) under PRC accounting standards. *(Amounts in Renminbi have been converted into Hong Kong dollars at a rate of HK$1.00 = RMB1.0612, as announced by the People's Bank of China as at 30th June, 2001. No representation is made that the Renminbi amounts could have been, or could be, converted into Hong Kong dollars at that rate.)*

During the six months ended 30th June, 2001, crude oil prices in the international markets remained high which led to corresponding high crude oil prices in the PRC domestic market. The prices in the petrochemical product markets decreased as a result of a decrease in demand due to the global economic slowdown notwithstanding the high cost in crude oil. The weighted average price of petrochemical products, net sales of which accounted for approximately 43 per cent of the Group's aggregate net sales, decreased by 23.4 per cent as compared with the first half of 2000. The sales of petrochemical products decreased by 7.2 per cent, despite an increase in sales volume by 21 per cent as compared with the first half of 2000. As a result, the Group suffered a loss in its principal business during the six months ended 30th June, 2001.

During the six months ended 30th June, 2001, due to the adjustment of gasoline and diesel oil prices by the PRC government, the weighted average price and sales volume of petroleum products, which accounted for 46.5 per cent of the Group's sales, increased by 22.5 per cent. An increase of 13.9 per cent, as compared with the same period in 2000. As a result, the turnover of petroleum products increased by 39.6 per cent which partially offset the loss in the principal business.

The Company's key production units maintained steady operations during the first half of 2001 and production volume of major products increased comparatively as compared with the first half of 2000. The production volume of ethylene products increased by 24.5 per cent to 230,000 tons as compared with the same period in 2000. During the six months ended 30th June, 2001, the Company processed 2.12 million tons of crude oil, representing an increase of 6 per cent as compared with the first six months of 2000. The weighted average price of such crude oil was RMB1,901 per ton (including value added tax), representing an increase of 1.2 per cent as compared with RMB1,879 per ton in the first six months of 2000.

During the six months ended 30th June, 2001, the Group adopted the following practical measures to counter the adverse effects of the domestic market conditions. Through strengthening management and cost control, certain targets of production ratio of ethylene, consumption ratio, production ratio of light oil, and loss ratio of processing crude oil were improved as compared with the first six months of 2000. The financial cost decreased by 13.2 per cent and investment income increased by 146 per cent, as compared with the first six months of 2000. Despite these changes, due to the poor market condition, the high crude oil price and the price decrease in petrochemical products, for the six months of 2001, the Company suffered a loss of RMB641 million. Following a detailed analysis of the actual conditions and requirements of the Group and the amount of receivables and operating conditions of its customers, the Company decided to transfer RMB300 million from reserve for bad debts during the six months ended 30th June, 2001. The inventory loss was RMB30 million.

Investments (Projects funded by methods other than issuance of new shares)

During the six months ended 30th June, 2001, the major upgrading projects consisted of an expansion project for the 300,000 t/a ethylene unit, an upgrading project for the 300,000 t/a synthetic ammonia unit and an expansion project for the catalytic cracking unit. Currently, the above-mentioned upgrading projects are proceeding on schedule. The total investment was RMB320 million as at 30th June, 2001.

Analysis of Financial Conditions (In accordance with PRC accounting standards)

1. Analysis of changes in Balance Sheet

Items	As at 30th June, 2001 (Unaudited) *RMB*	As at 31st December, 2000 (Audited) *RMB*	Increase *(%)*	Cause of changes
Total assets	**16,456,219,745**	17,710,708,378	–7.1	(1)
Accounts receivable, net	**2,315,612,082**	2,690,775,845	–13.9	(2)
Inventories, net	**1,889,948,532**	1,771,250,391	6.7	(3)
Long-term investment	**254,158,201**	243,774,101	4.3	(4)
Fixed assets, net	**9,221,964,547**	9,599,143,536	–3.9	(5)
Long-term liabilities	**5,361,942,287**	7,580,101,582	–29.3	(6)
Shareholders' equity	**5,043,087,996**	5,687,245,224	–11.3	(7)

(1) Primarily due to increases in depreciation and reserve for bad debts.

(2) Primarily due to repayment of unsettled fees from last year and increase in reserve for bad debts.

(3) Mainly due to an increase in inventories of the raw chemical materials such as raw materials for crude oil and light naphtha during the reporting period.

(4) Mainly due to the profits generated by the associated companies of the Company during the reporting period, as a result of which the Company's income increased accordingly based on the equity method.

(5) Primarily due to an increase in depreciation.

(6) Mainly due to the Company's repayment of part of the principals and interests in respect of loans relating to a 300,000 t/a ethylene unit.

(7) Primarily due to the Company's net loss recorded during the reporting period.

2. Analysis of changes in Profit and Loss Account

Items	For the six months ended 30th June, 2001 (Unaudited) RMB	2000 (Unaudited) RMB	Increase (%)	Cause of changes
Profit from principal operations	**312,249,224**	802,293,603	–61.1	Increase in cost of sales
Net profit/(loss)	**(641,897,074)**	44,934,697	–1529	Increase in the administrative expenses and cost of sales

3. Analysis of other changes in financial data (fluctuation of more than 30%)

Items	As at 30th June, 2001 (Unaudited) RMB	As at 31st December, 2000 (Audited) RMB	Increase (%)	Cause of changes
Cash and bank balances	**44,578,374**	228,964,237	–80.5	(1)
Notes receivable	**102,307,499**	0	–	(2)
Dividend receivable	**1,803,000**	0	–	(3)
Other debtors	**138,684,557**	652,892,738	–78.8	(4)
Long-term deferred expenses	**178,878,696**	276,530,160	–33.3	(5)
Short-term borrowings	**4,585,180,000**	1,989,440,000	130.5	(6)
Deposits from customers	**193,917,431**	131,724,927	47.2	(7)
Welfare fund payable	**6,603,805**	0	–	(8)
Other payables	**111,864,323**	762,344,517	–85.3	(9)
Accrued expenses	**117,293,032**	0	–	(10)
Long-term borrowings within one year	**509,110,000**	1,054,391,381	–51.7	(11)
Other long-term loans	**1,331,600,000**	3,067,784,135	–56.6	(12)
Accumulated losses	**(1,512,458,444)**	(864,213,661)	75	(13)

	For the six months ended 30th June, 2001 (Unaudited)	2000 (Unaudited)		
Selling expenses	**23,431,365**	15,946,088	46.9	(14)
Administrative expenses	**630,849,697**	393,948,739	60.1	(15)
Investment income	**12,244,100**	4,974,991	146.1	(16)
Non-operating income	**8,232,834**	119,886	6767.2	(17)
Non-operating expenses	**39,200,497**	3,654,028	972.8	(18)
Taxation	**756,482**	15,224,610	–95.0	(19)
Minority interests	**1,121,906**	10,821,759	–89.6	(20)

(1) Mainly due to the severance payments made to employees.

(2) To improve collections from customers, the Company requested certain customers to settle their outstanding debts by notes.

(3) Dividends receivable from associated companies of the Company.

(4) Mainly due to increased repayment of other receivables.

(5) Primarily due to the amortisation of major maintenance expenses for fixed assets.

(6) Primarily due to an increase in short-term bank loans to repay part of the long-term loans with higher interest rate.

(7) Primarily due to a request to customers for payment upon delivery.

(8) Welfare fund payable to employees.

(9) Severance payment of employees and interest expenses.

(10) Accrued financial expenses, power expenses and maintenance expenses.

(11) Mainly due to the repayment of long-term loans due within one year.

(12) Mainly due to repayment of certain loans with higher interest rate financed by short-term borrowings with lower interest rate.

(13) Primarily due to the net loss of RMB640 million.

(14) Primarily due to the expenses increase in light of the change in marketing strategy.

(15) Primarily due to the RMB330 million of reserves for bad debts and obsolete inventories during the reporting period.

(16) Due to the increase in profit of the Company's associated companies during the reporting period.

(17) Income from disposal of assets.

(18) Primarily due to losses from shutdown of production units in response to changes in market situations.

(19) Because of the net loss of the Company during the reporting period, tax expense has decreased.

(20) Due to decrease in profits of subsidiaries.

Impact of the Macro-Environment on the Company

The domestic petrochemical industry is expected to face increasing competition when China enters the World Trade Organisation ("WTO"). The profitability of certain products of the Group may decrease accordingly. To offset these adverse effects, the Company intends to reduce its cost of production and adjust its product mix.

Prospects

During the second half of 2001, the board of Directors expects a reduction in product prices following an adjustment of prices for crude oil and petroleum products by the PRC government. The board of Directors also expects that the prices for the petrochemical and organic chemical products will remain low. The Company will face an increasing competitive market. Based on cost control and steady production, the Company will focus on adjusting product mix, strengthening marketing management and improving financial management system to reduce the adverse impact on the results for the second half of 2001. At the same time, the Company will also focus on the expansion project of its 300,000 t/a ethylene unit, the upgrading project for the 300,000 t/a synthetic ammonia unit and the expansion project for the catalytic cracking unit to further the development of the Company.

Management Discussion and Analysis (In accordance with IAS)

Analysis of 5 per cent Turnover In Major Products In Total Turnover

1. *Petrochemical and organic chemical products*

   Net sales of petrochemical and organic chemical products decreased by 7.2 per cent to RMB2,575 million in the first half of 2001 from RMB2,776 million in the first half of 2000. This decrease in sales was primarily due to a 23.4 per cent decrease in the weighted average price compared with the first half of 2000. The sales volume of this product segment increased by 21 per cent as compared with the same period of 2000, which partially offset the effects of the decrease in the product prices.

   These products accounted for 43 per cent of the aggregate net sales in the first half of 2001, down from 47.9 per cent in the first half of 2000.

2. *Petrochemical products*

   Net sales of petroleum products increased by 39.6 per cent to RMB2,780 million in the first half of 2001 from RMB1,992 million in the first half of 2000. The increase in net sales is attributable primarily to a 22.5 per cent increase in the weighted average price of petroleum products, and a 13.9 per cent increase in sales volume as compared with the first half of 2000.

   These products accounted for 46.5 per cent of aggregate net sales in the first half of 2001, up from 34.3 per cent in the first half of 2000.

3. *Synthetic rubber*

   Net sales of synthetic rubber products increased by 12.2 per cent to RMB407 million in the first half of 2001 from RMB363 million in the first half of 2000. The increase in net sales is attributable primarily to a 3.97 per cent increase of in the weighted average price and a 7.9 per cent increase in sales volume as compared with the first half of 2000.

   These products accounted for 6.8 per cent of the aggregate net sales in the first half of 2001, up from 6.3 per cent in the same period of 2000.

Analysis of changes in Profit and Loss Account

Aggregate net sales increased by 3.2 per cent to RMB5,985 million in the first six months of 2001 as compared to RMB5,801 million in the first half of 2000.

Cost of sales increased by 14 per cent to RMB5,704 million in the first half of 2001 from RMB5,001 million in the first half of 2000, primarily due to a 10.3 per cent increase in the crude oil cost. In addition, increase in depreciation was mainly due to the increase in amortisation of major maintenance expenses for fixed assets since the second half of 2000.

Gross profit decreased by 64.8 per cent as compared with the first half of 2000 due to an increase in the cost of sales.

Selling expenses and administrative expenses increased by 52.9 per cent to RMB633 million in the first half of 2001 from RMB410 million in the first half of 2000, primarily due to an increase in reserve for bad debts of RMB300 million in the first half of 2001 from RMB17 million in the first half of 2000.

Based on the above factors, the Group recorded an operating loss of RMB383 million in the six months ended 30th June, 2001 as compared to an operating profit of RMB385 million for the same period in 2000.

Interests expenses increased by 6.3 per cent to RMB340 million in the first half of 2001 from RMB320 million in the first half of 2000, primarily due to a sharp increase in loan balance when compared to the first half year of 2000. Exchange gain is a result of the termination of the fixed exchange rate contract with JCGC around the end of 2000. The exchange gains or losses are now borne by the Company.

The share of profit of associated companies increased to RMB12.24 million in the first half of 2001 from RMB4.98 million in the same period of 2000, primarily due to an increase in the net profit of associated companies. Jilian (Jilin) Petrochemicals Limited generated profit of RMB21.45 million, and Jilin Province BASF FCIC NPG, Ltd, which recorded a loss in the first half of 2000, generated profit of RMB0.4 million in the first six months of 2001.

The tax expense decreased from RMB15.87 million in the first half of 2000 to RMB0.756 million in the first six months of 2001, primarily due to a net loss in the first half of 2001.

Net loss in the first six months of 2001 was RMB670 million, a decrease of RMB717 million from net profit of RMB46 million in the first half of 2000, due to the higher level of the crude oil prices in the international markets and the price decrease in the Company's petrochemical products and the increased accounting provisions for bad and doubful debts.

Liquidity and Capital Resources

As at 30th June, 2001, the Group's liquidity ratio was 80.7 per cent, quick ratio was 49.9 per cent, and inventory ratio was 307 per cent.

As at 30th June, 2001, total borrowings of the Group was RMB10,456 million, a decrease of RMB168 million as compared with 31st December, 2000, among which short-term borrowing was RMB5,094 million, representing an increase of RMB2,050 million as compared with 31st December, 2000, and long-term borrowings was RMB5,360 million, representing a decrease of RMB2,218 million as compared with 31st December, 2000. These decreases resulted from the Group's adjustment of loan structure to reduce the financial expenses during the reporting period which the Group borrowing more short-term loans with lower interest rate to repay long-term loans with higher interest rate. There is no significant change in the Group's capital requirements.

Capital Structure of the Group

The Company depends upon cash flows from operations, loans and equity financing to satisfy its ongoing liquidity and capital needs. During the first six months of 2001, net cash inflow from operating activities increased to RMB105 million. Net cash outflow amounted to RMB564 million in the first six months of 2000. This increase was mainly due to an increase in the sales of products of the Company. The Group's loss of RMB671 million during the reporting period resulted from the reserve for bad debts and depreciation expenses. This has no effects on the Group's cash flow.

Net cash outflow from investing activities was RMB123 million as compared with RMB260 million in the first half of 2000. The decrease was primarily due to an increase in the cash inflow due to the disposal of fixed assets, and lower capital expenditures.

Net cash outflow from financing activities was RMB167 million in the first half of 2001, as compared with net cash inflow of RMB928 million. The decrease was primarily due to the increase in finance and loans in the first half of 2000 and decrease in loan capital during the report period.

As at 30th June, 2001, the Company's current assets amounted to RMB4,949 million and current liabilities amounted to RMB6,132 million. The gearing ratio of the Company was 50.7 per cent as at 30th June, 2001, and 56.3 per cent for the first half of 2000 (gearing ratio is calculated based on the ratio between long term debt and the sum of equity and long term debt). The Company reviews its working capital and liquidity position on a regular basis and has always been able to satisfy its short term obligations through the refinancing of indebtedness and other measures. As a result, the Company has not been required to generate or obtain significant additional amounts of cash or equivalent assets. Although no assurance can be given, the Company believes that it should be able to continue to utilize such methods to supplement its ability to meet its short-term obligations. Each of CNPC and PetroChina Company Limited has undertaken to the Company that it will treat the Company no less favorable than any of the other companies directly or indirectly under its control. As a result, the Company believes that it has sufficient resources to meet its foreseeable working capital needs.

Exchange Rate Risk

As at 30th June, 2001, the Company had about RMB2,320 million of foreign currency-denominated loans that were mainly related to the ethylene project. The Company believes that fluctuations in foreign currency exchange rates will have a significant impact on the Company. During the six months ended 30th June, 2001, the Group's foreign exchange income was RMB40 million.