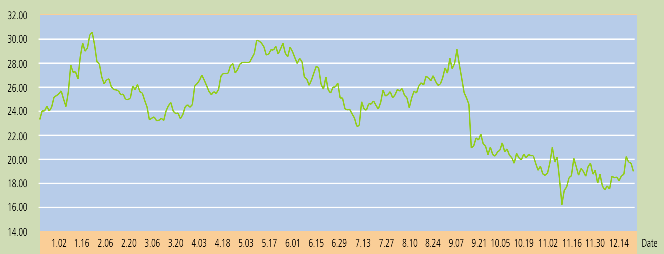
## 1. OPERATING ENVIRONMENT

In the year of 2001, the PRC economy continued to maintain a relatively satisfactory growth rate in GDP of 7.3 per cent despite the significant slowdown of the world economy. The total domestic crude oil processing volume in 2001 amounted to 193 million tonnes, representing a decline of 1.56 per cent from that of 2000. The consumption of petroleum products was 114.6 million tonnes, up by 4.9 per cent from that of 2000.

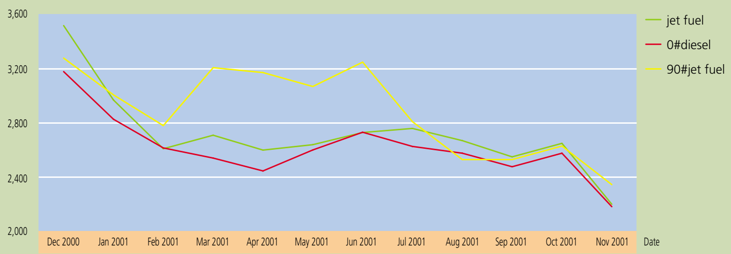
In 2001, the price of crude oil in the international market fluctuated with a downward trend. The price of BRENT crude oil had reached its lowest record in the last two years. The average crude oil spot price for the year stood at US$24.89 per barrel, 12.8 per cent lower than that of 2000.

Prices of BRENT crude oil in the Singapore market in 2001




*Source of information: the Platts*

The movement of ex-factory prices of the Company's major petroleum products in 2001 (inclusive of VAT and consumption tax)




The discrepancy in the prices between gasoline and crude oil continued in the Singapore market during the three months of June, July and August 2001, which led to a significant decline in the domestic prices of gasoline and diesel. Since October 2001, the State government has fine-tuned the domestic pricing mechanism for petroleum products, pegging the domestic prices against those in the Singapore, Rotterdam and New York markets. As a result, there was an increase in the actual petroleum product prices in the PRC, which led to an improvement in the operating environment of the domestic refineries.

In 2001, the Company's refining gross profit was US$3.93 per barrel, which was higher than that of 2000.

## 2. ANALYSIS OF OPERATING RESULTS [1]

### 2.1 Turnover

**Table 1: Sales volume, average selling price and turnover**

| | 2000 | **2001** | % change |
|---|---|---|---|
| Sales volume ('000 tonnes) | 9,990.5 | **9,827.3** | -1.63 |
| Average selling price (RMB/tonne) | 2,148.31 | **1,996.48** | -7.07 |
| Turnover (RMB million) | 21,690.00 | **19,827.66** | -8.59 |
| Including turnover of subsidiaries (RMB million) | 227.30 | **207.54** | -8.69 |

The Company's sales volume was 9.83 million tonnes in 2001, 1.63 per cent lower than that of 2000. This was mainly due to enhanced processing techniques, adjustment to product mix and rise in the petroleum product inventory.

In accordance with the price movement of petroleum products in the international market, 11 adjustments were made to the domestic petroleum product prices during the year, with the average product selling prices decreased by 7.07 per cent year on year. The Company's turnover amounted to RMB19.8 billion, a decrease of 8.59 per cent from that of the previous year.

[1] The following discussion should be read together with the audited combined financial statements and their notes.

**Table 2: Sales volume and turnover by products**

| | 2000 | | **2001** | |
|---|---|---|---|---|
| | Turnover *(RMB million)* | Sales volume *('000 tonnes)* | **Turnover *(RMB million)*** | **Sales volume *('000 tonnes)*** |
| Gasoline | 3,973.20 | 1,722 | **3,421.44** | **1,627** |
| Diesel | 8,547.50 | 3,705 | **8,724.20** | **4,247** |
| Kerosene | 2,391.40 | 1,036 | **1,844.34** | **832** |
| Others: | | | | |
| Urea | 562.30 | 551 | **576.89** | **568** |
| Chemical feed oil | 2,244.83 | 1,014 | **2,027.09** | **973** |
| Fuel oil | 947.64 | 706 | **281.65** | **228** |
| LPG | 993.56 | 364 | **1,101.68** | **458** |
| Solvent oil | 149.40 | 56 | **124.40** | **52** |
| Intermediate chemicals | 1,042.90 | 350 | **1,105.37** | **388** |
| Asphalt | 475.21 | 369 | **361.90** | **277** |
| Miscellaneous | 134.70 | 117 | **51.17** | **177** |
| Subsidiary companies | 227.27 | | **207.54** | |
| Total | 21,689.96 | 9,990 | **19,827.66** | **9,827** |

In 2001, the Company continued to adjust its product mix in accordance with the market demand. The Company enhanced the processing of oil residues and increased the output of gasoline, kerosene and diesel. The Company's diesel to gasoline output ratio increased from 2.2 in 2000 to 2.55 in 2001, while the light product yield increased by 2.7 percentage points to 75.19 per cent when compared to that of 2000. The aggregate output of LPG and propylene increased to about 100,000 tonnes, whereas the output of high value-added products such as BTX and polypropylene ("PP") also increased in varying degrees. However, the sales volume of fuel oil fell by 480,000 tonnes.

**Table 3: Domestic and export sales volume**

| | 2000 *('000 tonnes)* | **2001 *('000 tonnes)*** | % change |
|---|---|---|---|
| Domestic | 9,139.9 | **9,040.6** | -1.09 |
| Export | 850.6 | **786.7** | -7.51 |
| Total | 9,990.5 | **9,827.3** | -1.63 |

In 2001, the Company continued to emphasize on meeting the growing demand of the domestic market and adjusted the proportion of its output for exports accordingly. As a result, the export volume was lower than that of 2000. The exported products were mainly gasoline and jet fuel, allowing the Company's product mix to better meet domestic demand.

### 2.2 Cost of sales

**Table 4: Cost of sales**

| | 2000 *(RMB'000)* | **2001** ***(RMB'000)*** | % change |
|---|---|---|---|
| Raw material | 18,233,555 | **16,192,113** | -11.20 |
| Direct labor | 58,555 | **66,852** | +14.17 |
| Manufacturing overheads | 1,811,905 | **1,965,955** | +8.50 |
| Total | 20,104,015 | **18,224,920** | -9.35 |

In the year of 2001, the Company's raw material cost decreased by 11.20 per cent from that of 2000 due to decline in international crude oil prices, increased processing volume of sour and heavy crude oil, and the Company's measures of capturing the opportunities to purchase crude oil at low price in the international market and transporting crude oil by large tankers.

Cost of direct labor only increased by RMB8.3 million in 2001.

Manufacturing overheads for the year increased by RMB154.05 million due to an increase of RMB71.9 million in maintenance expenses incurred from the scheduled overhaul and an increase of RMB50.26 million in depreciation charges for the new facilities commenced operation during the year.

As a result, the Company's cost of sales decreased by RMB1,879.1 million or 9.35 per cent from that of 2000.

### 2.3 Selling, administration and financial expenses

**Table 5: Selling, administration and financial expenses ("S, G&A expenses")**

| | 2000 *(RMB'000)* | **2001** ***(RMB'000)*** | % change |
|---|---|---|---|
| Selling expenses | 268,488 | **278,468** | +3.72 |
| Administration expenses | 483,234 | **520,868** | +7.79 |
| Financial expenses | 115,929 | **127,959** | +10.38 |
| Total | 867,652 | **927,295** | +6.87 |

In 2001, the increase of RMB9.98 million in selling expenses was attributed to the change in the accounting treatment in some of the Company's subsidiaries. Certain expenses, which had been treated as cost of goods sold in previous year, were booked as selling expenses in 2001.

Administration expenses increased by RMB37.63 million, mainly due to the increase in the labor insurance and medical insurance premium of RMB24.43 million, and inventory losses increased by RMB12.87 million.

Financial expenses increased by RMB12.03 million, mainly due to additional long-term loans required for project development and reduced interest income as a result of the fall in the USD deposit interest rate.

The total S,G&A expenses increased by RMB59.65 million in 2001.

### 2.4 Unit refining cash operating cost and unit complete expenses

**Table 6: Unit refining cash operating cost and unit complete expenses**

| (RMB /tonne) | 2000 | **2001** | % change |
|---|---|---|---|
| Unit refining cash operating cost | 78.08 | **81.77** | +4.73 |
| Unit complete expenses | 151.99 | **157.96** | +3.93 |

Under the backdrop of substantial rise in the overhaul expenses, the Company managed to control its unit refining cash operating cost for 2001 at RMB81.77 per tonne (about US$1.35 per barrel), which represented only an increase of 4.73 per cent, and remained in the forefront of domestic refining enterprises. This was mainly achieved through the Company's strengthened operation management and optimized integrated efficiency of facilities.

Despite the increase of RMB50.26 million in depreciation and amortisation charges for the year, the unit complete expenses was controlled at RMB157.96 per tonne (about US$2.61 per barrel), which was significantly lower than the industry average level.

### 2.5 Profit before taxation and profit after taxation

**Table 7: Profit before taxation and profit after taxation**

| | 2000 *(RMB'000)* | **2001** ***(RMB'000)*** | % change |
|---|---|---|---|
| EBITDA | 1,502,327 | **1,621,963** | +7.96 |
| EBIT | 685,161 | **742,969** | +8.44 |
| Profit before taxation | 575,604 | **622,029** | +8.07 |
| Provision for income tax | 154,827 | **158,030** | +2.07 |
| Profit after taxation | 420,777 | **463,999** | +10.27 |

The Company's profit after taxation for the year 2001 increased by 10.27 per cent to RMB464 million when compared to that of the previous year as a result of an increase in the refining gross profit margin and cost and expenses control.

## 3. ANALYSIS OF FINANCIAL POSITION

**Table 8: Major items of the balance sheet**

| | 2000 *(RMB'000)* | **2001** ***(RMB'000)*** |
|---|---|---|
| Total liabilities | 4,146,057 | **2,417,527** |
| Including: | | |
| Long-term loans *(note)* | 2,280,341 | **965,000** |
| Short-term loans | 52,743 | **264,573** |
| Shareholders' equity | 7,450,762 | **7,766,183** |
| Total liabilities and shareholders' equity | 11,596,817 | **10,183,710** |
| Current assets | 4,465,951 | **2,665,008** |
| Current liabilities | 1,692,433 | **1,437,468** |
| Inventories | 1,525,515 | **1,362,385** |
| Trade receivables, net | 212,814 | **158,162** |
| EBIT/Interest expense | 4.34 (X) | **4.55 (X)** |
| EBITDA/Interest expense | 9.51 (X) | **9.94 (X)** |

*Note:* The Company's 2000 long-term loans included convertible bonds.

The Company's asset-liability ratio decreased from 35.75 per cent as at the end of 2000 to 23.74 per cent as at the end of 2001. This was mainly because most of the bondholders of the convertible bonds chose to exercise the right of redemption on 19th December, 2001. The Company's assets structure remained at a reasonable balance. Although the redemption of convertible bonds had led to reduction in the Company's bank deposit and had lowered the company's current ratio from 2.64X as at the end of 2000 to 1.86X as at the end of 2001, the Company's financial position remained strong.

Due to the decline in the Company's turnover in 2001, the inventory turnover decreased from 17.05X to 12.62X and the turnover of account receivables reduced from from 46.68X in 2000 to 42.05X in 2001.

## 4. CAPITAL EXPENDITURE

Capital expenditure for the year 2001 was RMB1.07 billion, of which RMB557 million was invested in the second phase of the 8 million tpa refining capacity expansion project ("RCEP"). The first phase of the RCEP project was completed in 2000 and approved by the State in July 2001. The actual investment in the first phase reflected a saving of 20.79 per cent as compared to the planned investment budget.

Capital expenditure for the year 2002 is estimated to be over RMB1.5 billion, which will be mainly used for the second phase of the 8 million tpa RCEP project, and for the construction of such chemical projects as the 450,000 tonnes-PX and 200,000 tonnes-PP projects, which are now in their planning stage, and the upgrading of the feedstock for the urea plant.