A. Operating Results

General

The Company's financial performance has been affected by factors arising from operating in a planned economy which are beyond its control. However, with China's WTO accession, the impact of these factors has been gradually reducing.

In 2001, we faced the twin challenges of poor demand, resulting from the current worldwide economic downturn and downturn in the petrochemical industry. These factors combined to dramatically drive down the prices for our products and our profits for 2001. Although the average price of crude oil also declined in the same period, it was not enough to offset price pressures. We expect this pressure to continue through 2002 and to begin to abate as the world economy recovers. Competition from regional producers will continue unabated due to China's WTO commitments which reduced tariffs on petrochemical products to the current range of 3.5% to 17%. To the extent that trade restrictions are relaxed further, foreign competition may increase. However, the prices of our major products are already near to those of imports after tariff reduction. Therefore, we do not expect that the impact of tariff reductions will be severe.

Summary

The following table sets forth our sales volumes and net sales, net of sales taxes for the years indicated:

	Year Ended 31 December								
	1999			2000			**2001**		
	Net Sales			Net Sales			**Net Sales**		
	Sales Volume ('000 tons)	(Millions of RMB)	% of Total	Sales Volume ('000 tons)	(Millions of RMB)	% of Total	**Sales Volume ('000 tons)**	**(Millions of RMB)**	**% of Total**
Synthetic Fibres	310	2,698	19.2	359	3,612	17.4	**358**	**3,216**	**16.4**
Resins and Plastics	727	4,291	30.6	863	6,006	29.0	**918**	**5,636**	**28.7**
Intermediate Petrochemicals	648	1,853	13.2	566	2,232	10.8	**653**	**2,105**	**10.8**
Petroleum products	2,908	4,208	30.0	3,458	7,429	35.8	**3,958**	**7,735**	**39.4**
Trading and Others	-	987	7.0	-	1,450	7.0	**-**	**926**	**4.7**
Total	4,593	14,037	100.0	5,246	20,729	100.0	**5,887**	**19,618**	**100.0**

The following table sets forth a summary statement of income for the periods indicated:

	Year Ended 31 December					
	1999		2000		**2001**	
	Millions of RMB	% of Net Sales	Millions of RMB	% of Net Sales	**Millions of RMB**	**% of Net Sales**
Net Sales	14,036.6	100.0	20,728.6	100.0	**19,617.7**	**100.0**
Cost of Sales	(12,532.6)	(89.3)	(19,040.0)	(91.9)	**(18,803.0)**	**(95.8)**
Gross Profit	1,504.0	10.7	1,668.6	8.1	**814.7**	**4.2**
Selling and Administrative Expenses	(275.0)	(2.0)	(360.9)	(1.7)	**(363.2)**	**(1.9)**
Operating Income	1,229.0	8.7	1,327.7	6.4	**451.5**	**2.3**
Other Operating Income	122.0	0.9	155.4	0.7	**160.0**	**0.8**
Other Operating Expenses	(261.8)	(1.9)	(65.8)	(0.3)	**(217.3)**	**(1.1)**
Share of Losses of Associates	-	-	(64.5)	(0.3)	**(20.6)**	**(0.1)**
Net Financing Costs	(368.3)	(2.6)	(272.2)	(1.3)	**(227.8)**	**(1.2)**
Income Before Tax	720.9	5.1	1,080.6	5.2	**145.8**	**0.7**
Income Tax	(99.2)	(0.7)	(200.8)	(1.0)	**(1.2)**	**(0.0)**
Income After Tax	621.7	4.4	879.8	4.2	**144.6**	**0.7**

Results Of Operations

Year Ended December 31, 2001 Compared with Year Ended December 31, 2000:

Net sales

Net sales decreased by 5.36% to RMB19,617.8 million in 2001 compared with RMB20,728.6 in 2000. In the year 2001, the market demand for petrochemical products weakened significantly and forced widespread price declines. The weighted average price of our primary products being synthetic fibers, resins and plastics, intermediate petrochemicals and petroleum products for 2001 decreased approximately10.87%, 11.72%, 18.30% and 9.03% respectively as compared with 2000. These effects were partially offset by an increase in total sales volume.

i) *Synthetic Fibers*

Net sales of synthetic fibers decreased by 10.97% to RMB3,215.8 million from RMB3,612.2 million in 2000 primarily due to a 10.87% decrease in their weighted average price and a 0.12% decrease in sales volume as compared with 2000.

Sales of synthetic fibers as a percentage of net sales in 2001 declined by 1.04% to 16.39% as compared with 2000. Although polyester filaments experienced a slight increase of 4.59% in average selling price as compared with 2000, the prices of other synthetic fibers declined to various extents. Compared with 2000, the average selling price of acrylic staple fiber decreased by 13.55% while its sales volume increased by 6.58%. The average selling price of polyester staple fiber and its sales volume decreased by 17.66% and 1.79%, respectively. The sales volume of polyester filaments increased by 3.75%.

ii) *Resins and Plastics*

Net sales of resins and plastics decreased by 6.15% as compared with last year to RMB5,635.7 million. The weighted average selling price decreased by 11.72% while sales volume increased by 6.30%. Sales of resins and plastics as a percentage of net sales declined by 0.24% to 28.73% as compared with 2000. Among our resins and plastics, the average selling price and sales volume of PVA increased by 19.19% and 13.01%, respectively, compared with 2000. The average prices of polyester chips, LDPE, HDPE and polypropylene decreased by 27.35%, 12.51%, 10.36% and 6.89% respectively, as compared with 2000. The sales volumes of these products increased by 11.91%, 4.62%, 4.69% and 5.27% respectively, as compared with 2000.

iii) *Intermediate Petrochemicals*

Net sales of intermediate petrochemicals decreased by 5.69% to RMB2,105.3 million from RMB2,232.3 million in 2000. The weighted average price decreased by 18.30% as compared with 2000. This was partially offset by an increase of 15.43% in sales volume. Sales of intermediate petrochemicals as a percentage of net sales was 10.8%. Among intermediate petrochemicals, the selling prices of ethylene, benzene, ethylene glycol and butadiene decreased by 14.61%, 26.36%, 16.09% and 7.26% respectively, as compared with 2000. The sales volumes of these products increased by 7.82%, 3.70%, 49.51% and 11.04% respectively, as compared with 2000.

iv) *Petroleum Products*

Net sales of petroleum products increased slightly by 4.12% to RMB7,735.2 million as compared with 2000, accounting for 39.43% of the total net sales, despite a decrease of 9.03% in their weighted average prices. This was primarily the result of an increase of 14.45% in sales volume as compared with 2000. Prices for our gasoline, diesel and jet oil decreased by 7.01%, 12.46% and 1.86% respectively, as compared with 2000. The sales volume of gasoline decreased by 9.25% and the sales volumes of diesel and jet oil increased by 36.52% and 8.96% respectively.

v) Trading and other activities

Revenues from trading and other activities decreased by 36.12% from RMB1,449.5 million in 2000 to RMB 925.7 million in 2001.

Cost of sales

Cost of sales decreased only slightly by 1.24% to RMB18,803.0 million, or 95.84% of net sales in 2001, primarily due to an increase in processing volume of crude oil as a result of our further strengthening operation and administration of our production facilities to take advantage of the decrease in the average price of crude oil.

i) Crude oil

Crude oil is our primary raw material and the only significant raw material we purchase from outside sources. In 2001, we processed 6,632,100 tons crude oil, representing an increase of 620,500 tons from 2000. The weighted average cost of crude oil per ton decreased by 8.21% as compared with 2000 to RMB1,654 in 2001. Total crude oil costs increased by 2.61% to RMB10,969.7 million in 2001, accounting for 58.34% of the total cost of sales.

In China, the supply and price of crude oil have experienced some changes in recent years, and the domestic crude oil price is now generally in line with international crude oil prices. The supply and price of crude oil are key factors in determining our profitability. Starting from March 2001, the indicative price of crude oil will be calculated jointly by China National Petroleum Corporation ("CNPC") and China Petroleum Corporation ("Sinopec Group") based on the principles and methods determined by The State Development Planning Commssion and in view of the prevailing international market prices, while the price of crude oil from domestic offshore and foreign sources is generally allocated to us at prevailing international market prices. Our average cost of foreign and domestic offshore crude oil in 2001 was RMB1,697 per ton and RMB1,573 per ton, respectively. In 2001, we processed nearly 820,000 tons of domestic offshore crude oil and 4,384,300 tons of foreign crude oil.

In 2001, our average cost for domestic crude oil from the Daqing oil field was RMB1,722 per ton and the average cost of Shengli crude oil was RMB1,356 per ton. In 2001, we processed 832,500 tons of Daqing crude oil and 595,900 tons of Shengli crude oil.

ii) Other ancillary materials

Expenses for other ancillary materials decreased significantly to RMB2,413.5 million. Depreciation expenses decreased from RMB1,514.7 million in 2000 to RMB1,359.6 million in 2001. This was primarily due to an extensive review of the useful lives of certain plant, machinery, equipment and others. Since 1 January, 2001, the estimated useful life of plant, machinery, equipment and others was revised from 5 to 13 years to 5 to 14 years. Repair and maintenance cost was RMB 645.5 million, about the same as that in 2000.

Selling and administrative expenses

Selling and administrative expenses increased from RMB360.9 million in 2000 to RMB363.2 million in 2001 resulting from an increase in marketing activities and the subsequent increase in our product sales volumes.

Operating profit

Operating profit decreased dramatically by 65.99% from RMB1,327.7 million in 2000 to RMB451.5 million in 2001. This dramatic change was the result of the widespread price decreases of our products discussed above. A decrease of 8.21% in average crude oil processing prices was not enough to offset the drop in sales. Similarly, although we were able to increase production volume and slightly adjust our product mix to focus on higher margin products, price pressures were simply too great.

Other operating income

Other operating income increased by 2.95% from RMB155.4 million in 2000 to RMB160.0 million in 2001. This principally comprised of revenue from services, revenue from joint ventures and other investments, and deferred income amortization.

Other operating expenses

Other operating expenses increased by 230.23% from RMB65.8 million in 2000 to RMB217.3 million in 2001. This was primarily due to our payment of RMB171 million to approximately 1,500 employees in connection with the termination of their employment.

Net financing costs

Net financing costs fell from RMB272.2 million in 2000 to RMB227.8 million in 2001 due mainly to the restructuring of our borrowings to benefit from a decrease in interest rates, thus lowering our financing costs.

Income before tax

Income before tax decreased by 86.51% from RMB1,080.6 million in 2000 to RMB145.8 million. This decrease was mainly attributable to the decrease in net sales as a result of the decrease in product prices.

Income tax

Income tax in 2001 was RMB1.16 million (2000: RMB200.8 million). Decrease in tax charge was due to decrease in profit and an income tax refund of RMB19,318,000 during the year relating to the purchase of equipment produced in the PRC for technological improvements pursuant to the document "Cai Shui Zi(1999) No.290" issued by the Ministry of Finance and the State Administration of Taxation of the PRC on 8 December 1999. This reflected a tax rate of 15% rather than the usual 33%. This preferential rate was first applied to us under approval from the Chinese tax authorities effective from January 1, 1993. According to a notice issued by the Ministry of Finance and the State Taxation Bureau, the first nine H Share listed companies (including the Company) were permitted to pay income tax at a 15% tax rate for 1996 and 1997. In 1998, 1999, 2000 and 2001, the tax privilege was not revoked by relevant government authorities. However, we cannot be sure whether the Ministry of Finance will maintain the 15% tax rate in coming years.

Income after tax

Income after tax decreased by 83.56% from RMB879.8 million in 2000 to RMB144.6 million, due primarily to the decrease in net sales.

B. Liquidity and Capital Resources

Our primary sources of capital are operating cash flow and loans from unaffiliated banks. Our primary uses of capital are costs of goods sold, operating expenses and capital expenditures. Costs of goods sold amounted to RMB18,803.0 million, and capital expenditures amounted to RMB4,358.2 million. Net cash generated from operatations amounted to RMB2,387.9 million and new bank loans amounted to RMB5,726.2 million. In 2002, we expect that these sources of capital will be sufficient.

Sources of Liquidity

Cash generated from operations

Net cash generated from operations was about the same as in 2000. This was primarily due to a decrease in inventories of RMB617.4 million in 2001, as compared with an increase in inventories of RMB1,133.4 million in 2000.

Debtors, bills receivable, other receivables and payments in advance increased by RMB72.2 million in 2001, as compared with an increase of RMB346.3 million in 2000. Amounts due to parent companies and fellow subsidiaries decreased by RMB144.1 million in 2001, as compared with an increase of RMB875.5 million in the beginning of 2000. Our income before tax decreased by RMB934.8 million to RMB145.8 million in 2001. Although we experienced a significant decline in profits, comparisons of these figures reflect an effective reduction in occupation and use of our funds caused by further strengthening our administration of inventories, accounts receivables and accounts payables.

Borrowings

Our borrowings increased by RMB2,505.8 million in 2001 to RMB7,569.8 million. Short term borrowings increased during 2001 by RMB723.0 million. Short term borrowings were principally used to meet our needs for working capital in our production and operation. In 2001 we had a higher demand for working capital due to a large increase in the output of petrochemical products as compared with 2000. All of the short term borrowings were RMB borrowings with floating interest rates.

Long term borrowings also increased in 2001, by RMB1,782.8 million to RMB 4,540.3. This was mainly due to a higher expense for Phase IV expansion project and other projects. 6.35% of the long term borrowings (comprising of 4.42% in US$ and 1.93% in yen) are at fixed rates, 82.75% of the long term borrowings (comprising of 79.06% in RMB and 3.69% in US$) are at floating rates, and the remaining of 10.90% are interest free. Almost all are used for capital expansion projects.

We keep our assets-liabilities ratio at a relatively safe level by strengthening the administration of the bank borrowings and control over the financial risks. We generally do not experience any seasonality in borrowings. Rather, due to the planned nature of capital expenditures, long term borrowings can be arranged comfortably in advance of expenditures while short term borrowings are used for operations. The terms of our existing bank loans do not restrict our ability to pay dividends on our shares.

Debt-equity Ratio

In 2001 our debt-equity ratio was 46.07%, as compared with 37.78% in 2000. The increase in the debt-equity ratio was mainly due to a significant increase in our borrowings. The debt-equity ratio is calculated by dividing the total of long term debts, short term debts and minority interests by the total of long term debts, short term debts, minority interests and shareholders' equity.

C. Other items

Foreign Exchange Risks

Since we purchase a portion of our raw materials (including crude oil) from abroad through Sinopec Corp., and also through Sinopec Corp., we export a portion of our petrochemical products, a change in exchange rates will indirectly affect the prices of our raw materials and petrochemical products which will have a discernible impact on our profitability. In addition, as discussed above, since a small part of our debts are denominated in foreign currencies, a change in the relevant exchange rates will affect the level of our interest expense which will also have an impact on our profitability.

Capital Expenditures

Phase IV expansion project

The main captital expenditure projects are the expansion of our ethylene unit, new polyethylene and polypropylene units, expansion of acrylic staple fiber facilities, expansion of our power plant (Phase I) and other technological renovation projects and investments, all scheduled for completion during 2002.

For 2001, these projects resulted in an increased capital expenditure of RMB2,785.3 million over 2000 or RMB4,358.2 million total.

We expect capital expenditures in 2002 to be approximately RMB1,730 million. This will finance completion of the projects listed above, plus work on technological renovation for our acrylonitrile and other facilities and expenditures for a crude oil transformation project designed to increase our re-fining ability and a newly developed hydrocracking plant.

We plan to fund these expenditures from operating income and available bank loans.

Ethylene Joint Venture

The Company, China Petroleum and Chemical Corporation and BP Chemicals East China Investments Limited jointly established a Sino-foreign equity joint venture company, Shanghai Secco Petrochemical Company Limited (hereinafter referred to as the "JV Company"), in China. We own 20% equity interest in the JV Company. The purpose of the JV Company will be to construct a 900,000 tons rated capacity ethylene petrochemical manufacturing facility, and to manufacture and market ethylene, polyethylene, styrene, polystyrene, propylene, acrylonitrile, polypropylene, butadiene, aromatics and by-products, to provide related after-sales services and technical advice with respect to such petrochemical products and by-products and to engage in polymers application development. It is expected that the JV Company will complete construction in 2005. The total registered capital of the JV Company is US$901,440,964, of which we will provide the Renminbi equivalent of US$180,287,952. In 2001, we have already paid approximately RMB66.12 million of the above sum. All of our contribution will be made before 2005.

Dividend policy

Payment of future dividends will depend upon our revenue, financial condition, future earnings and other factors.

Contingent Liabilities

As of 31 December, 2001, we had contingent liabilities of RMB435.6 million in respect of guarantees issued to banks in favour of our associates and joint venture companies, about the same as RMB439.4 million in 2000. Our guarantees issued to banks in favour of our associates and joint venture companies are limited to the respective share equity interest owned by us.

Purchase, Sale and Investment

Save as disclosed in this report, during the year 2001, there was no material purchase or sale of our subsidiaries or associates or any material investments.

Pledge of Assets

During the year 2001, there was no material pledge of assets.

Employees

Almost all of our employees were engaged by entering into a service contract. As of 31 December 2001, we had 32,081 employees and paid RMB1,067.4 million as the cost of employment. In addition, we offered our employees opportunities for education and training based upon our development and actual performance of the employees.

U.S. GAAP Reconciliation

We prepare a set of financial statements in compliance with IAS, which differs in certain significant respects from U.S. GAAP (Please refer to the section headed "Supplementary Information for North American Shareholders"). As a result of these differences and the effect after tax, our net income reported under U.S. GAAP was higher than net income reported under IAS by RMB184.1 million in 2001. Shareholders' equity reported under U.S. GAAP was lower than shareholders' equity reported under IAS by RMB607.1 million at 31 December 2001 and by RMB791.2 million at 31 December 2000.