1. OPERATING ENVIRONMENT

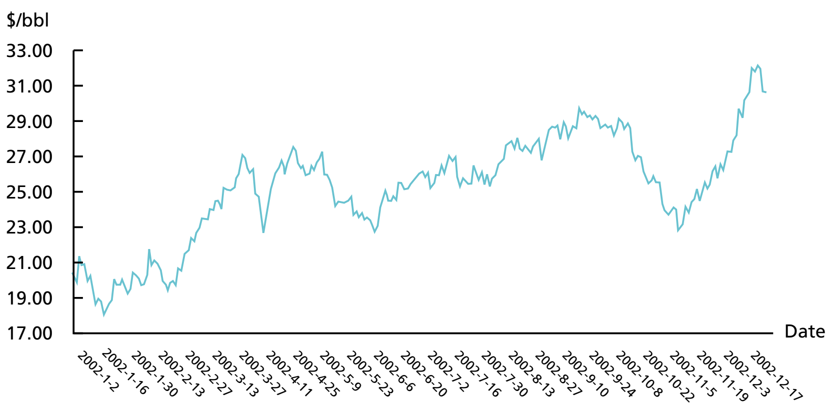
1.1 Macro-environment

In 2002, the global economy experienced a gradual recovery, while China's economy entered a new period of moderately rapid growth. The GDP of China increased by 8 per cent as compared with that of last year. The total domestic throughput volume of crude oil in 2002 amounted to 219.55 million tonnes, representing a 4.60 per cent increase from that of 2001. In 2002, the consumption of petroleum products (including gasoline, diesel, and kerosene) amounted to 120.44 million tonnes, representing a 5.07 per cent increase from that of 2001.

1.2 International oil prices

In 2002, the price of crude oil in the international market began to rise after it reached rock bottom at the beginning of the year. Basically, the international crude oil price was moving in an upward direction. The average dated price of Brent crude oil in the Singapore market for the whole year of 2002 was 24.96 $/bbl, representing a slight increase of 0.07 $/bbl from that of 2001.

Dated prices of Brent crude oil in the Singapore market in 2002

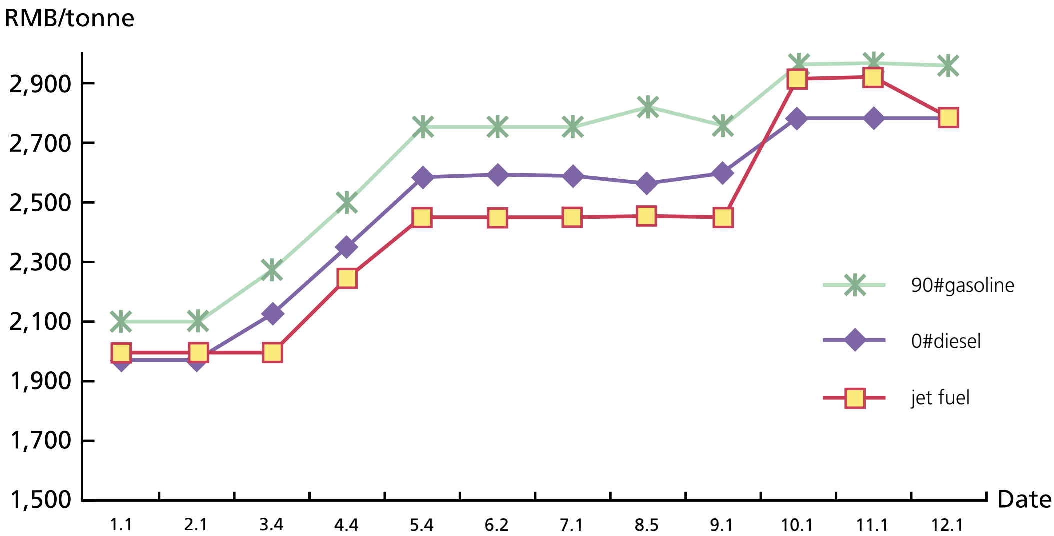


Source of information: the Platts

1.3 Domestic price of petroleum products

According to the new domestic pricing mechanism for petroleum products implemented since October 2001, the domestic prices of gasoline and diesel were pegged against the weighted average prices in the three markets of Singapore, Rotterdam and New York. Although ex-factory prices of gasoline and diesel were adjusted to lower levels in January 2002, there were four upward adjustments made in March, April, May and October, as a result of rising international petroleum product prices. These upward price adjustments together with an improved order in the domestic petroleum product market helped enhance the operating environment of domestic refineries.

The movement of ex-factory prices of the Company's major products in 2002 (inclusive of tax)



2. ANALYSIS OF OPERATING RESULTS[1]

2.1 Throughput volume of feedstock

In 2002, the Company's throughput volume of feedstock rose by 11.29 per cent to 11,946,300 tonnes year on year, which remained as the largest throughput volume in the domestic refining industry. The following table shows the composition of the throughput volume of feedstock:

Unit: '000 tonnes

		2002	**Proportional share (%)**	2001	Proportional share (%)
By feedstock type	Imported crude oil	**9,186.80**	**76.90**	9,107.10	84.84
	Off-shore crude oil	**1,324.10**	**11.08**	939.40	8.75
	On-shore crude oil	**1,371.90**	**11.48**	675.40	6.29
	Purchased feedstock	**63.50**	**0.54**	12.50	0.12
By business type	General business	**11,393.00**	**95.37**	10,600.40	98.75
	Imported material processing business	**168.80**	**1.41**	134.00	1.25
	Third-party processing business	**384.50**	**3.22**	–	–

The Company continued to have imported crude oil processing as the core operation.

Against the backdrop of a controlled national throughput volume, the Company achieved a higher growth rate in throughput volume as compared with the average rate of the country. Such accomplishment evidenced the preferential policy implemented by China Petroleum & Chemical Corporation ("Sinopec Corp") on enterprises with niche. At the same time, the Company resumed third-party processing business, thus further increasing its total throughput volume and product output volume.

2.2 Analysis of major operating results

In 2002, the profit attributable to shareholders of the Group reached RMB973 million, which represented a 109.75 per cent increase from that of last year and reached a record high.

The following table shows the major income and expenses listed on the Group's consolidated income statement for the reported period:

	2002 ***(RMB'000)***	2001 *(RMB'000)*	Changes (%)
Turnover	**22,484,667**	20,764,580	8.28
Less: Business taxes and surcharges	**990,170**	936,920	5.68
Net sales	**21,494,497**	19,827,660	8.41
Cost of sales:	**19,484,384**	18,522,639	5.19
– Raw materials	**17,465,690***	16,524,919	5.69
– Direct labor	**74,580**	67,942	9.77
– Manufacturing overheads	**1,944,114**	1,929,778	0.74
Gross profit	**2,010,113**	1,305,021	54.03
Selling, administrative and other operating expenses	**552,471**	529,025	4.43
Profit from operations	**1,457,884**	746,882	95.20
Net financing costs	**74,650**	127,959	-41.66
Profit from ordinary activities before taxation	**1,393,066**	622,029	123.96
Profit attributable to shareholders	**973,257**	463,999	109.75

*Note: *Including the purchase cost of RMB421,409,000 for LPG bought from outside.*

[1] *The following discussion should be read together with the Group's financial statements and their notes contained in the annual report for this year.*

2.2.1 Net sales

The Group's net sales for 2002 amounted to RMB21,494 million, representing an increase of RMB1,666 million or 8.41 per cent from RMB19,828 million of 2001, which were due to increased sales volume of major products and optimization of product mix. The following table shows the composition of net sales:

	2002		2001	
	Net sales *(RMB'000)*	**Sales volume *('000 tonnes)***	Net sales *(RMB'000)*	Sales volume *('000 tonnes)*
Gasoline	**3,508,047**	**1,710**	3,421,440	1,627
Diesel	**9,153,915**	**4,630**	8,724,204	4,247
Kerosene	**1,974,748**	**962**	1,844,341	832
Others:				
Urea	**612,700**	**579**	576,890	568
Chemical feed oil	**2,050,853**	**1,017**	1,992,119	957
Fuel oil	**53,893**	**51**	281,651	228
LPG	**1,237,433**	**556**	1,101,682	458
Solvent oil	**195,997**	**85**	124,401	52
Intermediate petrochemical products	**1,440,282**	**477**	1,105,370	388
Asphalt	**506,453**	**387**	361,898	277
Purchased LPG	**418,476**	**157**	–	–
Miscellaneous	**123,045**	**221**	86,120	193
Income from subsidiaries	**218,655**	**–**	207,544	–
Total	**21,494,497**	**10,832**	19,827,660	9,827

While increasing the output and sales volume of major products, the Company also strove to enhance the processing intensity of fuel oil and worked all-out to optimize product mix. The light oil yield increased by 2.14 percentage points to 73.83 per cent when compared with that of 2001, while the sales volume of commodity fuel oil decreased by 177,700 tonnes year on year. The sales volume of diesel, kerosene and gasoline ranked the first, the third and the third among domestic refineries respectively. The aggregate sales volume of high value-added products such as LPG, solvent oil, propylene and BTX also increased by approximately 220,000 tonnes (excluding purchased LPG) or 24.50 per cent – a growth rate exceeded that of the total sales volume. The high-grade paving asphalt accounted for 96.75 per cent of the total sales volume of asphalt, while the sales volume of SBS-modified asphalt exceeded 10,000 tonnes.

Net sales by geographic region for the year:

Geographic region	**Share of net sales**
Domestic	89.38%
Other countries and regions	10.62%
Total (RMB million)	21,494

In 2002, the Company continued to focus on meeting domestic demand. The Company also put much emphasis on processing imported crude oil and third-party processing business, and adjusted the proportion of its output for exports accordingly. As a result, the export volume increased year on year. The exported products were mainly gasoline, allowing the Company's product mix to better satisfy domestic market needs. Meanwhile, the Company, for the first time, succeeded in developing and exporting low-sulphur dual-purpose kerosene ("DPK"), which further extended its coverage in international market.

2.2.2 Cost of sales

Although cost of sales rose slightly on increased throughput volume, the percentage rise in cost of sales was less than that of throughput volume. This was mainly because of a lower unit processing cost of feedstock. In 2002, the processing volume of heavy and sour crude oil accounted for 68.98 per cent (if excluding third-party processing business, the figure would be 71.27 per cent) of total throughput volume, representing an increase of 4.56 percentage points from that of last year. During the year, the Company captured the opportunities arisen from the crude oil market, adopted measures including transporting crude oil by large tankers, and benefited from the inventory of low-cost crude oil at the start of the year. As a result, the average processing price of crude oil for the year was RMB1,504.90 per tonne (about 24.90 $/bbl), representing a decline of RMB60.07 per tonne or 3.84 per cent from that of last year.

Despite the increase in the throughput volume of feedstock, manufacturing overheads rose only by a slight percentage of 0.74 per cent and basically remained at the same level of the previous year. Cost of direct labor increased by RMB6.64 million.

2.2.3 Expenses during the period

In 2002, the Group tightened its control on various expenses. The total amount of selling expenses, administrative expenses and net financing costs dropped by 8.99 per cent to RMB573 million year on year. Selling expenses rose by RMB2.14 million to RMB67.18 million, while administrative expenses fell by RMB5.41 million to RMB431.16 million and net financing costs decreased by RMB53.31 million to RMB74.65 million.

The rise in selling expenses was mainly attributable to increase in total sales volume of products. Decline in administrative expenses was not only a result of the various cost control measures imposed by the Group, but was also attributable to the implementation of a flattened management structure which lower related expenses and changes in classification of some expenses. The significant decrease in net financing costs was mainly due to reduced interest expenses following the redemption of the convertible bonds in December 2001.

2.2.4 Profit attributable to shareholders

In 2002, the Group's profit from ordinary activities before taxation was RMB1,393 million. Due to recycling of "three kinds of waste materials", the Group enjoyed preferential enterprise income tax policy, which could offset an enterprise income tax expense of RMB43.077 million (2001: RMB69.697 million). As a result, the profit attributable to shareholders rose by 109.75 per cent from RMB464 million of 2001 to RMB973 million in 2002.

3. REFINING MARGIN

In 2002, the Company's refining margin defined as the refining business's net sales less feedstock expenses, and divided by the throughput volume of feedstock (excluding the third-party processing business) was RMB271.97 per tonne (about 4.50 $/bbl), representing a 14.50 per cent increase from the previous year. The rise in refining margin was mainly due to lower processing cost of feedstock and increase in net sales brought forth by an optimized product mix.

In 2002, in the face of a RMB9.26 million increase in technology development cost and upsurges in other expenses, the Company strengthened management and the use of circulating fluidized-bed (CFB) boiler to reduce consumption of power from outside. As a result, the unit refining cash operating cost was maintained at RMB84.41 per tonne (about 1.40 $/bbl), which represented only a slight increase of RMB2.64 per tonne and remained at a leading level in the domestic industry.

Given that increase in throughput volume has lowered unit fixed costs and a new standardised depreciation period has been adopted for main manufacturing facilities since 1 January 2002, the depreciation expense of the refining business was lowered. The reduced depreciation expense together with a decline in net financing costs contributed to a 3.70 per cent decrease in unit complete expense to RMB152.11 per tonne (about 2.52 $/bbl) for the year.

Unit complete expense and unit refining cash operating cost

(RMB/tonne)	**2002**	2001	Changes (%)
Unit complete expense *(note 1)*	**152.11**	157.96	-3.70
Unit refining cash operating cost *(note 2)*	**84.41**	81.77	3.23

Notes:

1. Refining complete expense refers to the whole costs and expenses of the refining business (excluding chemical business and subsidiaries) for the reported period except for the cost of feedstock. Unit complete expense = Refining complete expense/feedstock throughput volume.

2. Refining cash operating cost = Refining complete expense-depreciation and amortisation-net financing costs. Unit refining cash operating cost = Refining cash operating cost/feedstock throughput volume.

4. ASSETS, LIABILITIES, SHAREHOLDERS' EQUITY AND CASH POSITION

4.1 Assets, liabilities and shareholders' equity

As at 31 December 2002, the Group's total assets, total liabilities and shareholders' equity amounted to RMB11,678 million, RMB3,230 million and RMB8,447 million respectively, representing increases of 15.97 per cent, 33.62 per cent and 10.39 per cent respectively. Assets-liabilities ratio (total liabilities/ total assets) was 27.66 per cent, representing an increase of 3.65 percentage points year on year. Return on net assets for the whole year was 12.09 per cent, representing an increase of 5.95 percentage points from 6.14 per cent of last year. The ROCE (return on capital employed) stood at 11.20 per cent, representing an increase of 4.26 percentage points from 6.94 per cent of the previous year. The Company's assets structure remained healthy, with satisfactory returns on capital and strong debt repayment ability.

Assets, liabilities and shareholders' equity
Unit: RMB'000

	2002	2001	Changes
Current assets	**3,309,779**	2,765,460	544,319
Non-current assets	**8,367,819**	7,303,903	1,063,916
Total assets	**11,677,598**	10,069,363	1,608,235
Current liabilities	**2,200,292**	1,437,468	762,824
Non-current liabilities	**1,030,000**	980,059	49,941
Total liabilities	**3,230,292**	2,417,527	812,765
Shareholders' equity	**8,447,306**	7,651,836	795,470
Including: Share capital	**2,523,755**	2,523,755	–
Reserves	**4,682,249**	4,475,751	206,498

Total assets as at 31 December 2002 increased by RMB1,608 million from RMB10,069 million as at 31 December 2001. Current assets were RMB3,310 million as at 31 December 2002, representing an increase of RMB544 million from that as at 31 December 2001. The increase in current assets was primarily due to the increase of cash and cash equivalents of RMB282 million and rise in trade receivables-third parties of RMB221 million. Non-current assets amounted to RMB8,368 million as at 31 December 2002, representing an increase of RMB1,064 million from that as at 31 December 2001. The increase in non-current assets was primarily due to the increase in property, plant and equipment and construction in progress by RMB1,065 million.

Total liabilities as at 31 December 2002 increased by RMB813 million from RMB2,418 million as at 31 December 2001. Current liabilities were RMB2,200 million as at 31 December 2002, representing an increase of RMB763 million from that as at 31 December 2001, mainly as a result of an increase of RMB132 million in current portion of long-term bank loans and an aggregate increase of RMB413 million in income tax payable and other taxes payable. Non-current liabilities were RMB1,030 million as at 31 December 2002, representing an increase of RMB50 million from that as at 31 December 2001.

Shareholders' equity amounted to RMB8,447 million as at 31 December 2002, representing an increase of RMB795 million from RMB7,652 million as at 31 December 2001. Of the increase in shareholders' equity, reserves rose by RMB206 million.

4.2 Cash position

In 2002, the Group's primary source of capital came from operating activities, short-term and long-term bank loans. The capital was primarily applied to operating expenses, capital expenditure and repayment of short-term and long-term bank loans. The net increase in cash and cash equivalents for the year was RMB282 million, achieving a good capital cycle.

Cash flow in 2002

Unit: RMB'000

Principal items in cash flow statement	2002	2001	Changes (%)
Net cash generated from operating activities	**2,256,564**	849,330	165.69
Net cash used in investing activities	**-1,853,064**	-1,115,992	66.05
Net cash used in financing activities	**-121,340**	-1,368,139	-91.13
Net increase/(decrease) of cash and cash equivalents	**282,160**	-1,634,801	–

In 2002, the Group's net cash generated from operating activities was RMB2,257 million, representing an increase of RMB1,407 million year on year. The cash inflow from operating activities primarily included: EBITDA of RMB2,212 million, a decline of RMB125 million in inventories, an aggregate increase of RMB153 million in trade payables-third parties, amounts due to associates and amounts due to parent companies and fellow subsidiaries. Cash outflow from operating activities was mainly due to the payment of an enterprise income tax of RMB291 million.

In 2002, the Group's net cash used in investing activities was RMB1,853 million, which was primarily applied to the construction of the second phase of the 8 million tpa refining capacity expansion project.

In 2002, the Group's net cash used in financing activities was RMB121 million. Cash inflow mainly resulted from newly acquired bank loans, which amounted to RMB2,746 million. Cash outflow was mainly caused by the bank loan repayment of RMB2,547 million, dividend payment of RMB234 million and interest payment of RMB85 million.

5. CAPITAL EXPENDITURE

Capital expenditure of the Group for the year 2002 was approximately RMB1.5 billion, of which RMB380 million was invested in 3 million tpa diesel hydrofining unit, 1.8 million tpa VGO hydro-desulfurisation unit, and 70,000 tpa sulphur recovery unit. Another RMB690 million was applied to petrochemical projects in progress, including 1 million tpa continuous catalytic reforming unit, 450,000 tpa PX project and 200,000 tpa PP project.

Capital expenditure of the Group for the year 2003 is expected to be over RMB2.0 billion. Apart from self-owned fund, the Group plans to use bank loans of approximately RMB800 million to fund its capital expenditure. The planned capital expenditure will be primarily used in petrochemical projects including 450,000 tpa PX project and 200,000 tpa PP project and fuel conversion project "replacing oil by coal as a source of energy" for chemical fertilizer units.