Management's Discussion and Analysis

Mr. Shi Jianxun
Executive Director, General Manager

On behalf of the Group's management team, I am pleased to provide the following discussion and analysis of the Group's 2002 financial results. Please note that the information set out in this section does not form part of the accounts audited by PricewaterhouseCoopers, the international independent auditors, as set forth in this annual report and should be read in conjunction with the information contained in the Consolidated Accounts and Notes thereto (the "Accounts") presented in the annual report. The information presented below analyses the Group's consolidated results of operations and shareholders' equity as prepared in accordance with International Financial Reporting Standards ("IFRS"). For an analysis of the Group's accounts as prepared in accordance with generally accepted accounting principles in the United States of America ("US GAAP"), please refer to the Company's annual report on Form 20-F to be filed with the Securities and Exchange Commission of the United States of America, which will be provided to any shareholder upon written request.

For numerous reasons, including those relating to the economic reform programs of the PRC government, changes in PRC government policies concerning crude oil supply, pricing and allocation and the introduction of new taxes or changes in existing taxes such as consumption tax, income tax and value added tax, the Consolidated Financial Statements may not be indicative of our future financial results.

The Group's historical financial performance has been affected significantly by factors arising from operating in a planned economy which are beyond our control. Although government controls have relaxed over time, controls over allocation and pricing of crude oil and petroleum products still exist. We believe that these controls are intended to enable the PRC government to control and moderate the effect of changes in availability and pricing of crude oil and petroleum products and should provide generally for greater stability in our operating results with respect to crude oil costs and petroleum product sales.

The PRC entered into the WTO on December 11, 2001. As part of its WTO accession commitments, the PRC government will gradually eliminate import quota and import license systems, reduce tariff, and permit foreign invested enterprises to engage in domestic distribution and retail for all of our major products. The PRC will also eliminate state trading for our major products exclusive of petroleum products and chemical fertilizer. These commitments, once being carried out, may cause the prices for our raw materials and products to be more aligned with those in the international markets and thus affecting the stability in our operating results.

In 2002, we experienced an increase in net sales as a result of increased demand in the international markets for petrochemical products that have favorably affect product prices in the domestic market. However, our gross profit led to operating and net loss as a result of expenses from shutting down manufacturing assets, exchange loss and write-down of the carrying value of property, plant and equipment.

The Company shut down certain less efficient manufacturing facilities during 2002. The four main categories of products manufactured by us continued to be petroleum products, petrochemical and organic chemical products, chemical fertilizers and inorganic chemical products, and synthetic rubber products.

We have identified the accounting policies below as critical to our business operations and the understanding of our results of operations. For a detailed discussion on the application of these and other accounting policies, see Note 2 to the Consolidated Financial Statements. The application of these policies may require management to make judgments and estimates that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of our financial statements, and the reported amounts of revenue and expenses during the reporting period. Management uses historical experience and all available information to make these estimates and judgments, and different amounts could be reported using different assumptions and estimates.

- Revenue recognition. The Company's revenue recognition policy is critical because our revenue is a key component to our results. We follow very specific and detailed accounting guidelines in measuring revenue. However, certain judgments affect the application of our revenue policy. Should changes in conditions cause management to determine these criteria are not met for certain future transactions, revenue recognized for any reporting period could be adversely affected.

- Provision for accounts receivables. Accounts receivables are carried at original invoice amount less provision for impairment. The Company specifically analyzes historical bad debts, receivable ageings, customer concentrations, customer credit-worthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

- Inventories. Inventories are stated at the lower of cost or net realizable value. We estimate net realizable value based on intended use, current market value and inventory ageing analyses. We write down our inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

- Impairment of long-lived assets. The Company reviews long-lived assets for possible impairment by evaluating whether the carrying amount of assets exceed its recoverable amount. The Company's judgment regarding the existence of impairment indicators is based on legal factors, market conditions and operational performance of our assets. Future adverse changes in legal environment, market conditions or poor operating results could result in losses or an inability to recover the carrying value of the long-lived assets, thereby possibly requiring an impairment charge in the future.

The table below sets forth the Group's sales volume, net sales volume and proportions of total net sales for the periods indicated.

	2002			2001		
	Sales Volume *('000 tons)*	**Net Sales** *(RMB millions)*	*% of Net Sales*	Sales Volume *('000 tons)*	Net Sales *(RMB millions)*	*% of Net Sales*
Petrochemical and organic chemical products	**1,586.4**	**5,750.1**	**43.8**	1,618.5	5,386.5	43.0
Petroleum products	**2,784.1**	**5,166.2**	**39.3**	2,645.9	5,207.9	41.6
Synthetic rubber products	**110.9**	**782.6**	**6.0**	108.6	781.7	6.2
Chemical fertilizers and inorganic chemical products	**141.5**	**123.3**	**0.9**	144.8	107.1	0.9
Other	**N/A(1)**	**1,316.2**	**10.0**	N/A(1)	1,035.3	8.3
Total	**4,622.9(2)**	**13,138.4**	**100**	4,517.8(2)	12,518.5	100

(1) Sales volume includes certain products, the measurement of which in tons does not provide a meaningful comparison vis-à-vis products in other product categories.

(2) Excluding sales volume of "Other." See Note (1).

The following chart sets forth our financial information for the periods indicated:

	Year ended December 31, 2002		Year ended December 31, 2001	
	RMB millions	*% of Net Sales*	*RMB millions*	*% of Net Sales*
Sales	**13,138.4**	**100**	12,518.5	100
Cost of sales	**(12,519.0)**	**(95.3)**	(12,541.9)	(100.2)
Distribution costs, administrative expenses and employee separation costs and expenses for shut down of manufacturing assets	**(1,115.8)**	**(8.5)**	(1,278.5)	(10.2)
Loss from operations	**(506.0)**	**(3.9)**	(1,308.5)	(10.5)
Interest expense	**(474.4)**	**(3.6)**	(598.9)	(4.8)
Income taxes	**(1.1)**	**–**	(0.8)	–
Net loss	**(1,023.1)**	**(7.8)**	(1,817.4)	(14.5)

OPERATING RESULTS

Year ended December 31, 2002 compared with Year ended December 31, 2001

Aggregate net sales increased by 5.0% to RMB13,138.4 million in 2002 compared with RMB12,518.5 million in 2001.

Net sales of petrochemical and organic chemical products increased by 6.8% to RMB5,750.1 million in 2002 from RMB5,386.5 million in 2001, accounting for 43.8% of aggregate net sales in 2002, up from 43.0% in 2001. This increase was primarily due to the increased product prices in the international market for petrochemical products, which in turn resulted in similar price increases in the domestic market. In 2002, the weighted average price for products in this segment increased by 9.7% from 2001. In particular, the weighted average price of styrene, a product that accounts for 10.0% of our total sales, increased by 22.6% from 2001. Sales volume for petrochemical and organic chemical products in 2002 decreased by 2.0% from 2001.

Net sales of petroleum products remained substantially unchanged, decreasing slightly to RMB5,166.2 million in 2002 from RMB5,208.0 million in 2001 and accounting for 39.3% of aggregate net sales in 2002, down from 41.6% in 2001. Although the weighted average price of petroleum products increased by 2.3% and sales volume increased by 5.2% over 2001, there was no corresponding increase to net sales due to decrease in the sales volume of solvent oil, which has a substantially higher unit price than other products in the composition of the weighted average price.

Net sales of synthetic rubber increased by 0.1% to RMB782.6 million in 2002 from RMB781.7 million in 2001, accounting for 6.0% of aggregate net sales in 2002, down from 6.2% in 2001. The increase in net sales was attributable primarily to an increase in sales volume as a result of a stronger domestic market. The sales volume of synthetic rubber products increased by 2.1% compared with 2001 and the weighted average price of such products decreased by 1.9% from 2001.

Net sales of chemical fertilizers and inorganic chemical products increased by 15.2% to RMB123.3 million in 2002 from RMB107.1 million in 2001, accounting for 0.9% of aggregate net sales in both 2002 and 2001. The increase in net sales was attributable primarily to an increase in sales volume of inorganic chemicals and other products that fall within this category of products. The sales volume of chemical fertilizer and inorganic chemical products decreased by 2.3% compared with 2001 and the weighted average price of such products increased by 17.8% from 2001.

Revenue from other products and services increased by 27.1% to RMB1,316.2 million in 2002 from RMB1,035.3 million in 2001, primarily due to an increase in the sales volume of water, electricity and steam and other services to RMB392.8 million in 2002 from RMB197.5 million in 2001.

Cost of sales decreased by 0.2% to RMB12,519.0 million in 2002 from RMB12,541.9 million in 2001, representing 95.3% and 100.2% of aggregate net sales from 2002 and 2001, respectively. The decrease in cost of sales was due primarily to a decrease in domestic crude oil prices. In 2002, the weighted average price of crude oil we purchased fell by 3.9% from RMB1,810 per ton in 2001 to RMB1,740 per ton in 2002, reflecting decreases in crude oil prices in international markets. In 2002, we processed 4.56 million tons of crude oil, up from 4.34 million tons in 2001.

Distribution costs, administrative expenses and expenses for shut down of manufacturing assets decreased by 12.7% from RMB1,278.5 million in 2001 to RMB1,115.8 million in 2002. Administrative expenses decreased by 34.4% from RMB1,216.3 million in 2001 to RMB797.4 million in 2002, primarily due to provision for impairment of prepaid expenses and other current assets of RMB51.5 million and RMB323.8 million for the write-down of the carrying value of fixed assets being made in 2002, whereas provision for impairment of receivables of RMB599.6 million was made in 2001. In the meantime, expenses for shut down of manufacturing assets was RMB283.4 million, while there were no such expenses in 2001.

Based on the above factors, the Group's loss from operations decreased from RMB1,308.5 million in 2001 to RMB506.0 million in 2002.

Interest expenses decreased by 20.8% from RMB598.9 million in 2001 to RMB474.4 million in 2001. The decrease in interest expenses was primarily due to our continued adjustment of our loan structure by borrowing short-term loans with lower interest rates to repay some long term loans with higher interest rates as well as a decrease in the total amount of the bank loans from 2001.

Exchange loss increased by 177.1% from RMB17.6 million in 2001 to RMB48.7 million in 2002. In addition, exchange gain decreased 88.5% from RMB67.0 million in 2001 to RMB7.7 million in 2002. This resulted in a net exchange loss of RMB41.0 million in 2002 compared to a net exchange gain of RMB49.4 million in 2001. The increase in exchange loss in 2002 was primarily due to the increase in value of the Euro Dollar against RMB. The decrease in exchange gain in 2002 was primarily due to a decrease in value of the Japanese Yen against RMB.

Our net loss in 2002 was RMB1,023.1 million, a decrease of 43.7% from a net loss of RMB1,817.4 million in 2001. This decrease in net loss was due primarily to increase in net sales and decrease in cost of sales and administrative expenses.

LIQUIDITY AND CAPITAL RESOURCES

The Group depends upon cash flow from operation, loans from affiliates and banks, and equity financing to satisfy our ongoing liquidity and capital needs. During 2002, our cash position was a decrease of RMB4.1 million compared to a decrease of RMB192.0 million in 2001. Although cash outflow for investing activities decreased from 2001, the Company continued to use cash for investing activities.

During 2002, net cash provided by operating activities decreased to RMB1,329.0 million compared with net cash provided by operating activities of RMB1,772.5 million in 2001. This decrease was primarily due to the fact that there was a sharp increase in inbound net cash flow as a result of large amount of repayments from a related party in 2001, while no such repayment was made in 2002.

Net cash used for investing activities decreased from RMB867.2 million in 2001 to RMB863.4 million in 2002. The decrease was primarily due to fewer capital expenditures in 2002, which more than offset the acquisition of our jointly controlled entity, Jilian. In December 2002, we acquired the remaining 35% equity interest in Jilian for a cash consideration of RMB135.0 million and integrated its business into ours. Jilian was subsequently dissolved in the same month.

Net cash used for financing activities decreased from RMB1,097.3 million in 2001 to RMB469.8 million in 2002. This was primarily due to net repayment of borrowings of RMB468.0 million in 2002 compared with net repayment of borrowings of RMB1,096.9 million in 2001. Most of the borrowings we repaid in 2002 were long-term bank loans with higher interest rate. We did not issue any new shares in both 2001 and 2002.

As at December 31, 2002, our current assets were RMB2,466.2 million and current liabilities were RMB7,722.9 million. The reason we had a larger amount of current liabilities than current assets was primarily due to the increase of provision for bad debts, provision for diminution in value of inventories and provision for impairment based on our principles of being prudent. Furthermore, we have adjusted our loan structure by borrowing short-term loans with lower interest rates to repay some long term loans with higher interest rates. Our net current liabilities increased from RMB4,695.5 million in 2001 to RMB7,722.9 million as a result of increases in trade payables, short term loans from a fellow subsidiary and current portion of long-term borrowings.

As at December 31, 2002, we had a negative working capital of RMB5,256.7 million, compared with a negative working capital of RMB2,061.9 million as at December 31, 2001. Although we need to pay close attention to our working capital and liquidity position, we do review it on a regular basis and have always been able to satisfy our short-term obligations through the refinancing of indebtedness and other measures. China Petroleum Finance Company Limited, a subsidiary of CNPC, our ultimate shareholder, provides us with a loan facility up to RMB5 billion which will expire on December 31, 2003. As of December 31, 2002, the outstanding amount under that loan facility was RMB3.58 billion. On 11th April, 2003, China Petroleum Finance Company Limited agreed to increase the loan facility to RMB8 billion and extend the expiration date to December 31, 2004. With this facility, we believe that we have more than sufficient resources to meet our foreseeable working capital needs. Our gearing ratio was 64.8% as at December 31, 2002, and 65.8% as at December 31, 2001 (gearing ratio is calculated as the ratio between long-term debt and the sum of equity and long-term debt).

As at December 31, 2002, the Group's liquidity ratio was 31.9%, quick ratio was 13.9%, and inventory ratio was 972.7%.

As at December 31, 2002, borrowings were RMB9,363.5 million, a decrease of RMB163.5 million as compared with December 31, 2001, among which short-term borrowings were RMB5,536.7 million, representing an increase of RMB1,995.2 million as compared with December 31, 2001, and long-term borrowings was RMB3,826.8 million, representing a decrease of RMB2,158.8 million as compared with December 31, 2001. These changes reflected our adjustment of loan structure by borrowing short-term loans with lower interest rates to repay some long term loans with higher interest rates. As a result, our interest expense decreased from RMB598.9 million in 2001 to RMB474.4 million in 2002.

As at December 31, 2002, the weighted average interest rate of our borrowings range from 5.43% to 6.26%. Fixed-rate borrowings represent 66.8% of the total borrowings. As at December 31, 2002, the maturity of 30.3% of the long-term borrowings was within one year, the maturity of 22.1% of the long-term borrowings was between one year and two years, the maturity of 36.7% of the long-term borrowings was between two and five years and the maturity of 10.9% of our long-term borrowings was above five years.

We do not have seasonal demands for capital. The terms and conditions of our existing bank loans do not restrict our ability to pay dividends on our shares.

As at December 31, 2002, all of our short-term borrowings were denominated in Renminbi. Among the long-term borrowings, foreign currency-denominated loans were in an amount of RMB2,527 million which needs to be repaid in the relevant foreign currency, among which there was a loan of RMB1,186 million from Jilin Group Corporation. The foreign currencies for denomination include United States Dollar, Japanese Yen and Euro Dollar. We also have foreign exchange risk in making payment related to import of raw materials and machinery, in which it needs to convert Renminbi into the applicable foreign currency. In addition, dividends for H shares are payable in foreign currency. We believe fluctuations in foreign currency exchange rates will continue to have a significant impact on us. In 2002, we had a net foreign exchange loss of RMB41.1 million, compared with a net foreign exchange gain of RMB49.5 million in 2001.

The Group's ability to obtain external financing in the future and the cost of such financing are subject to a variety of uncertainties, including:

– obtaining PRC government approvals required to access domestic or international financing or to undertake any project involving significant capital investment, which, depending on the circumstances, may include one or more approvals from the State Development and Reform Commission, the State Administration of Foreign Exchange, the Ministry of Commerce and the China Securities Regulatory Commission;

– our future results of operations, financial condition and cash flows;

– the cost of financing and the condition of financial markets; and

– the potential changes in monetary policy of the PRC government with respect to bank interest rates and lending practices.

We are not aware of any off-balance sheet type arrangements such as special purpose entities that require separate disclosure in this Management's Discussion and Analysis.

Our cash and cash equivalents are denominated in Renminbi. We did not engage in any hedging activities relating to foreign exchange, interest rates or other risks in 2002. We did not exercise our Ethylene Project Option which expired on December 31, 2002.

CAPITAL EXPENDITURE

In 2002, we completed technical upgrades of 140,000 t/a styrene, 1,400,000 catalytic cracking facilities and 60,000 t/a AES projects. We also completed construction work for the technological upgrades of the 300,000 t/a synthetic ammonia facilities. Our overall capital expenditures in 2002 were approximately RMB791.7 million.

We anticipate our capital expenditure for 2003 to be approximately RMB140.0 million mainly for technical upgrades of individual equipment. The capital for these expenditures is expected to be financed by our operating income and loans.

SIGNIFICANT INVESTMENT

The Group did not make any significant investment in the year ended December 31, 2002.

MATERIAL ACQUISITIONS AND DISPOSALS

In December 2002, the Company acquired the remaining 35% equity interest in Jilian, a jointly controlled entity, for a cash consideration of RMB135.0 million and integrated its business into the business of the Group. Jilian was subsequently dissolved in the same month and thereafter became a branch of the Company. The acquired business did not contribute significant revenues and operating profit to the Company for the year ended December 31, 2002, but the Company believes that it will be beneficial to its long term development.

The Group did not make any other material acquisition or disposals of subsidiaries and associated companies in the year ended December 31, 2002.

EMPLOYEES

As of December 31, 2002, the number of employees of the Group was 22,725. The employee's remuneration for the year ended December 31, 2002 was RMB517.4 million.

CHARGES ON ASSETS

The Group did not have charges on any of its other principal assets as at December 31, 2002 except for Jilian's mortgage on machinery and equipment with a net carrying value of RMB261.0 million as security for a RMB120.0 million bank loan, which was assumed by the Company upon its acquisition of the remaining 35% equity interest in Jilian.

CONTINGENT LIABILITIES

The Group did not have any contingent liabilities as at December 31, 2002.

Shi Jianxun
General Manager and Executive Director

Jilin, PRC
April 24, 2003