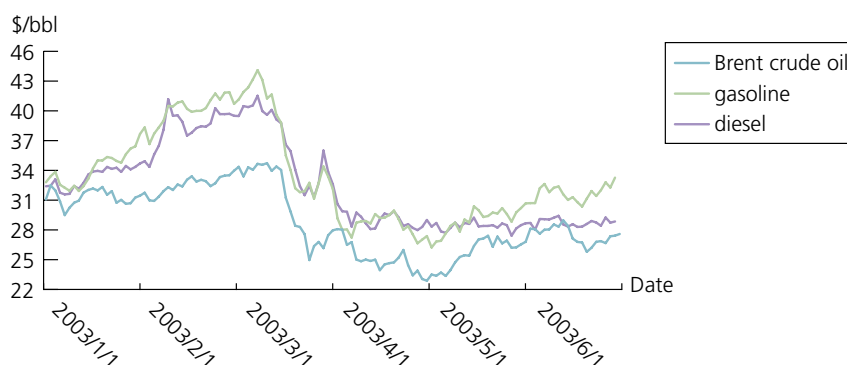


Management Discussion and Analysis¹

1. Operating environment

In the first half of 2003, the international oil prices experienced significant fluctuations at high levels as a result of the US-Iraqi war. The average dated price of Brent crude oil in the Singapore market for the first half of the year was 28.87 \$/bbl, up by 5.54 \$/bbl from that of the same period last year. The average prices of gasoline, diesel and jet fuel were 33.39 \$/bbl, 32.60 \$/bbl, and 32.42 \$/bbl respectively, representing increases of 6.48 \$/bbl, 6.77 \$/bbl and 6.96 \$/bbl respectively from those of the same period last year. The increase in the average price of petroleum products was greater than that of crude oil.

Price movement of dated Brent crude oil, gasoline and diesel in the Singapore market in the first half of 2003

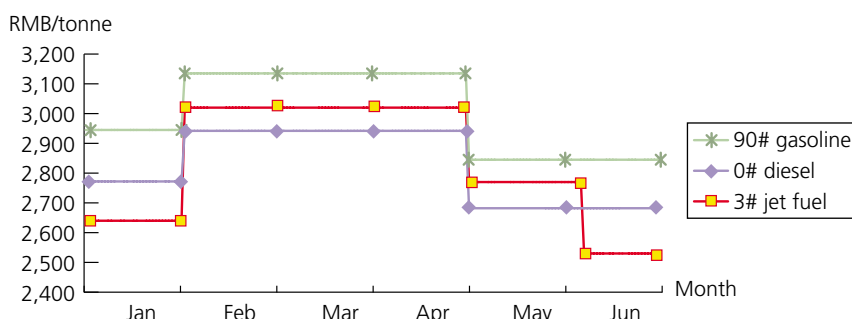


Source of information: the Platts

During the first half of 2003, the SARS outbreak had caused a short-term impact on certain areas within the China economy. However, the economic growth of China had not been deterred by the epidemic. China's GDP increased by 8.20 per cent when compared with that of the same period last year. The total domestic throughput of crude oil in the first half of 2003 amounted to 114 million tonnes, representing a 7 per cent increase from that of same period last year. The consumption of petroleum products (including gasoline, diesel and kerosene) amounted to 60.39 million tonnes, representing a 3.20 per cent increase from that of the same period last year.

According to the current domestic pricing mechanism for petroleum products, the Chinese government adjusted the prices of gasoline and diesel in February and May 2003 respectively. Prices of jet fuel were adjusted in February, May and June.

The movement of ex-factory prices (inclusive of tax) of the Company's 90# gasoline, 0# diesel, 3# jet fuel in the first half of 2003



¹ The following discussion should be read together with the reviewed financial statements and its notes from page 2 to page 13 contained in this interim report.

2. Throughput of feedstock

In the first half of 2003, the Company's throughput of feedstock rose by 5.48 per cent to 6,233,200 tonnes when compared with that of the same period last year and remained as the largest throughput in the domestic refining industry.

The following table shows the composition of the throughput of feedstock.

<i>Unit: '000 tonnes</i>		2003 first half	Proportional share (%)	2002 first half	Proportional share (%)
By feedstock type	Imported crude oil	4,594.96	73.72	4,640.44	78.53
	Off-shore crude oil	925.42	14.85	519.33	8.79
	On-shore crude oil	704.41	11.30	710.75	12.03
	Purchased feedstock	8.42	0.13	38.77	0.65
By business type	General business	5,805.21	93.13	5,725.98	96.90
	Imported material	N/A	N/A	71.59	1.21
	processing business				
	Third-party processing business	428.00	6.87	111.72	1.89
Total		6,233.21	100.00	5,909.29	100.00

In the first half of 2003, the Company intensified its efforts on the development of its third-party processing business. The throughput of crude oil for third-party processing business for the first half of the year reached 428,000 tonnes, which represented an increase of 283.10 per cent from that of the same period last year. As a result, the Company further enlarged its total sales volume. To accommodate the planned overhauls for the Company's production facilities, the composition of crude oil for processing had been properly adjusted. Pursuant to the adjustments, the throughput of sour crude oil decreased by approximately 100,000 tonnes to 3,150,200 tonnes, while that of off-shore crude oil increased by 78.20 per cent to 925,400 tonnes when compared with that of the same period last year.

3. Analysis of major operating results

In the first half of 2003, the profit attributable to shareholders of the Group reached RMB524 million, which represented a 15.91 per cent increase from that of the same period last year and reached a record high as compared with the same period in the past years.

<i>Unit: RMB '000</i>	2003 first half	2002 first half	Changes %
Net sales	12,938,169	9,401,856	37.61
Gross profit	1,036,603	857,894	20.83
EBITDA	1,155,044	961,400	20.14
EBIT	781,700	623,014	25.47
Profit from ordinary activities			
before taxation	748,786	593,385	26.19
Profit attributable to shareholders	524,407	452,413	15.91
Earnings per share (RMB Yuan/share)	0.21	0.18	16.67

3. Analysis of major operating results (continued)

3.1 Net sales

The Group's net sales for the first half of 2003 amounted to RMB12,938 million, representing a 37.61 per cent increase from that of the same period last year. The following table shows the composition of net sales and sales volume:

	2003 first half		2002 first half	
	Net sales (RMB '000)	Sales volume ('000 tonnes)	Net sales (RMB '000)	Sales volume ('000 tonnes)
Gasoline	2,140,041	883	1,439,210	822
Diesel	5,250,545	2,289	4,252,627	2,361
Kerosene	1,191,609	481	873,051	480
Others:				
Chemical feed oil	1,156,220	489	996,880	544
Fuel oil	35,127	23	39,150	38
BTX	548,628	158	384,292	151
LPG	910,347	337	526,065	273
Solvent oil	168,129	64	60,583	28
Propylene	333,162	83	190,701	66
Asphalt	333,055	219	156,775	134
Urea	320,380	277	303,453	285
Purchased LPG	345,550	131	N/A	N/A
Miscellaneous	65,580	55	68,487	136
Income from subsidiaries and other revenue	139,796	N/A	110,582	N/A
Total	12,938,169	5,489	9,401,856	5,318

In the first half of 2003, the Company took a market-oriented approach in arranging its production structure. Accordingly, the diesel to gasoline ratio dropped from 2.82 to 2.41, with the output of gasoline rising by 20.90 per cent from that of the same period last year to 1,035,000 tonnes (140,500 tonnes of which are for third-party processing business). Of the total output of gasoline, high-octane gasoline (no. 93 and up) accounted for 58.26 per cent, reflecting the Company's responsiveness to market changes. The output of both gasoline and diesel ranked the highest in the domestic refining industry, while that of jet fuel ranked the third in the domestic industry.

The Company continued to focus on optimising its product mix, striving to produce more high value-added products. The aggregate sales volume of the high value-added products such as LPG, solvent oil, propylene, BTX increased by approximately 123,300 tonnes (excluding purchased LPG). The high-grade paving asphalt accounted for 92.25 per cent of the sales volume of asphalt products.

In the first half of 2003, the proportional share of the Company's self-distributed products in the total sales volume increased by approximately 5 percentage points to 37.82 per cent. At the same time, the Company made timely adjustments to the ex-factory prices of its self-distributed products. Compared with that of the same period last year, the average price of the Company's self-distributed products sold in the domestic market rose by 39.21 per cent to RMB2,287.83 per tonne, the percentage increase in which exceeded that of the average price of all other products by 6 percentage points. Profit contribution from self-distributed products to the Group thus increased further.

3. Analysis of major operating results (continued)

3.1 Net sales (continued)

The average price of all of the products (excluding purchased LPG) during the first half of 2003 increased by 33.58 per cent to RMB2,333.87 per tonne (excluding consumption tax). The increase in the average price of products as represented by RMB586.66 per tonne was higher than the increase in the average price of processed crude oil as represented by RMB466.27 per tonne, which effectively alleviated the cost pressure arising from the upsurge in feedstock price.

Net sales of the Group by geographic region for the first half of 2003

Geographic region	Share of net sales
Domestic	87.49%
Other countries and regions	12.51%
Total (RMB million)	<u>12,938</u>

During the first half of 2003, the Company continued to focus on meeting domestic demand, while increasing its exports by capitalising on its niche in product quality and throughput and prompt response to market opportunities. In the first half of 2003, the export volume of diesel increased substantially by 400.48 per cent to 209,700 tonnes when compared with that of the same period last year, while that of jet fuel rose by 52.69 per cent to 146,400 tonnes when compared with that of the same period last year.

3.2 Cost of sales

The cost of sales of the Group for the first half of 2003 amounted to RMB11,902 million, representing an increase of 39.30 per cent from that of the same period last year. The rise was mainly due to the increase in feedstock price. The cost of feedstock accounted for 91.05 per cent of the total cost of sales.

The average price of processed crude oil for the first half of the year rose by 34.18 per cent to RMB1,830.48 per tonne (equivalent to the CIF price of about 29.28 \$/ bbl), mainly due to high oil prices triggered by the US-Iraqi war, substantial increase in the expenses of off-shore transportation for crude oil and risk premium. The average price of processed imported crude oil for the first half of 2003 increased by 31.98 per cent to RMB1,833.46 per tonne (equivalent to the CIF price of about 29.69 \$/bbl) when compared with that of the same period last year and was 30.18 \$/bbl lower than the average price of imported crude oil in China. The average price of processed off-shore crude oil and that of on-shore crude oil rose by 40.10 per cent and 44.08 per cent respectively to RMB1,859.35 per tonne and RMB1,774.91 per tonne respectively when compared with those of the same period last year.

In the first half of 2003, the Company's cost of direct labour increased by RMB11.66 million to RMB45.85 million when compared with that of the same period last year. The increase was due to the reclassification of some of the expenses as a result of the streamlined management structure implemented in the first half of 2002. Owing to increases in depreciation charges and fuel and power expenses, manufacturing overheads increased by RMB4.02 million to RMB1,018.91 million when compared with that of the same period last year.

3. Analysis of major operating results (continued)

3.3 Expenses during the period

In the first half of 2003, the Group tightened its control on various expenses. Despite an increase of 5.48 per cent in feedstock throughput on the same period last year, the total amount of selling and administrative expenses and net financing costs merely increased by 4.45 per cent to RMB274 million as compared with that of the same period last year. Compared with those of the same period last year, selling expenses rose by RMB18.60 million to RMB46.35 million, administrative expenses dropped by RMB12.69 million to RMB191.10 million and net financing costs increased by RMB5.78 million to RMB36.70 million.

The decrease in administrative expenses was mainly attributable to the reallocation of certain staff from administrative department to sales department. As a result, the labour cost included in administrative expenses decreased, while the labour cost included in selling expenses increased accordingly.

The net financing costs increased because the capitalisation of interest expense had ceased after the completion of the construction of some of the facilities and short-term loans for working capital had increased.

3.4 Profit attributable to shareholders

<i>Unit: RMB'000</i>	2003 first half	2002 first half	Changes %
Profit from ordinary activities before taxation	748,786	593,385	26.19
Income tax expense	(224,379)	(140,972)	59.17
Profit attributable to shareholders	524,407	452,413	15.91

In the first half of 2003, the Group's profit from ordinary activities before taxation of the Group was RMB749 million. Due to recycling of "three kinds of waste materials" and technical transformation programme, the Group enjoyed preferential enterprise income tax policy, which enabled the Group to offset an enterprise income tax expense of RMB33.95 million (2002 first half: RMB43.08 million). As a result, profit attributable to shareholders rose by 15.91 per cent from RMB452 million for the same period of 2002 to RMB524 million for the period under review. The increase in profit attributable to shareholders in the first half of the year was less than the increase in profit from ordinary activities before taxation because the tax refund derived from the recycling of "three kinds of waste materials" is less than that of same period of last year.

As at 30 June 2003, the assets-liabilities ratio was 30.13 per cent, rising from 27.66 per cent as at 30 June 2002. The increase was mainly due to the rise in bank borrowings to meet capital expenditure requirements. Owing to the substantial increase in the Group's net sales, EBIT (earnings before interest and tax)/net sales fell from 0.07 to 0.06. Besides, EBIT/interest expense rose from 21.03 to 23.75. Return on net assets rose from 5.77 per cent in the same period last year to 6.09 per cent. During the first half of 2003, although the increase in the Group's EBIT exceeded that of capital employed, the rise in actual income tax owing to the reduction in the deductible amount of enterprise income tax resulted in a 5.49 per cent ROCE (return on capital employed). The ROCE for the first half of 2003 represented a slight decrease of 0.02 percentage point from that of the same period last year. The Group's financial condition was healthy.

4. Refining margin and unit complete expense

In the first half of 2003, the Company's refining margin [defined as (the refining business' net sales less feedstock expense) and divided by the throughput of feedstock (excluding the third-party processing business)] was RMB298.96 per tonne (about 4.95 \$/bbl), representing an increase of 0.80 \$/bbl or 19.28 per cent from 4.15 \$/bbl for the first half of 2002. The aforesaid analysis showed that the increase in the Company's refining margin was due to the increase in the net sales from the refining business as a result of an optimised product mix and increase in the average price of products during the first half of the year.

Unit complete expense and unit refining cash operating cost

<i>(RMB/tonne)</i>	2003 first half	2002 first half	Changes (%)
Unit complete expense (note 1)	152.36	143.62	6.09
Unit refining cash operating cost (note 2)	92.99	84.72	9.76

Notes:

- Refining complete expense refers to the whole costs and expenses of the refining business (excluding chemical business and subsidiaries) for the period under review except for the cost of feedstock. Unit complete expense = Refining complete expense/feedstock throughput.
- Refining cash operating cost = Refining complete expense-depreciation and amortisation-net financing costs. Unit refining cash operating cost = Refining cash operating cost/feedstock throughput.

In the first half of 2003, the Company's unit refining cash operating cost rose by merely RMB8.27 per tonne to RMB92.99 per tonne (about 1.54 \$/bbl) when compared with that of the same period last year. The rise was mainly attributable to the increase of RMB3.88 per tonne in the unit consumption of auxiliary materials from outside and consumption of power from outside as a result from the commissioning of new facilities, and an increase of RMB2.97 per tonne in unit selling expenses.

In the first half of 2003, the Company's unit complete expense rose by RMB8.74 per tonne to RMB152.36 per tonne (about 2.52 \$/bbl) from that of the same period last year. The rise in the unit complete expense was due to the increase in the unit refining cash operating cost and the increase of RMB0.18 per tonne in unit complete expense and changes in other expenses as a result of a rise in the depreciation charges of property, plant and equipment and decrease in the amortisation of intangible assets. Yet, the Company's unit complete expense remained at a leading level in the domestic industry.

5. Capital expenditure

Project	Scale	Total investment (RMB million)	Completed investment in the first half of 2003 (RMB million)	Commencement of operation
Continuous Catalytic Reforming (CCR)	1 million tpa	559	198	June 2003
Paraxylene (PX)	450,000 tpa	1,251	598	August 2003
Chemical fertiliser fuel conversion "replacing oil by coal as a source of energy"	2*410t/h+ 2*50MW	900	399	August, October 2003 ignition
Polypropylene (PP)	200,000 tpa	611	65	At the start of 2004

The Group's capital expenditure exceeded RMB1,340 million in the first half of 2003, being a historical high when compared to the same period in the past years. Of that amount, RMB796 million was invested in the construction of the 450,000 tpa PX unit and 1 million tpa CCR unit. The commissioning of the 1 million tpa CCR unit on 20 June 2003 was successful, while the PX unit produced qualified products since 3 August 2003.

For the second half of the year, the Group's capital expenditure will be primarily used in the chemical fertiliser fuel conversion project of "replacing oil by coal as a source of energy" and in the 200,000 tpa PP project.