

The petrochemical industry picked up gradually in 2003 amid global economic recovery and ongoing strong economic growth in China, while the domestic petrochemical market saw positive developments with increasing demand and continued price recovery. The Company achieved record highs in crude oil processing, product output and sales in 2003 as it leveraged fully the capacity expansion and technological upgrade resulted from the commissioning of the "Phase IV" facilities and other major projects. As a result, the Company made significant improvements in its operating results and maintained a trend of positive development.

### **Leveraging on the advantage of additional capacity to maintain steady growth in product output**

In 2003, the Company endeavoured to increase the load factor of its production units and the overall quality of its production operations by adhering to the principles of safety, stability, optimisation and enhancement and leveraging fully on its additional capacity resulting from the Phase IV Project and the upgraded high sulphur-content crude oil processing unit. As a result, the Company achieved steady growth in product output. The utilisation rate and load factor of the Company's major production units were 93.69% and 102.20%, respectively. Crude oil processing volume and the output volume of ethylene, propylene, plastics and synthetic fibres have reached record highs, as the production volume of major product categories recorded year-on-year increase to varying degrees. A total of 7,248,200 tons of commercial products were produced, an increase of 14.25% compared to the previous year.

The Company achieved another record in crude oil processing volume in 2003 with 8,610,100 tons of crude oil being processed, an increase of 15.91% compared to the previous year (of which 6,714,000 tons were imported crude oil, representing an increase of 29.08% compared to the previous year and accounting for 78% of the total volume of crude oil processed). Compared to the previous year, gasoline output increased by 0.89% to 894,800 tons, while diesel output increased by 11.45% to 2,487,600 tons. The output of ethylene and propylene increased by 18.53% and 24.44% to 948,300 tons and 533,100 tons, respectively, compared to the previous year. The output of synthetic fibre monomers and synthetic fibre polymers amounted to 421,300 tons and 507,600 tons, respectively, representing increases of 10.71% and 7.02% respectively compared to the previous year. The output of synthetic fibres increased by 5.24% to 315,500 tons, while the output of synthetic resins increased by 34.72% to 900,500 tons, compared to the previous year. The Company remained the largest ethylene producer in China, and it met all annual production targets set in respect of its major product categories. Meanwhile, the quality of the Company's products was consistently maintained at a premium level.

## **Recovery of petrochemical market resulting in increase in product prices**

Global economic recovery was slow in the first six months of 2003, underpinned by volatility in the face of a host of events, including the Iraqi War, a strong Euro, depreciation in the US dollar and the SARS outbreak. China's economic growth slowed down in the second quarter in the wake of SARS after recording rapid expansion in the first quarter, but recovered strongly in the second half of the year as the epidemic came under control, in tandem with prominent signs of global economic recovery. Fluctuation in prices of petrochemical products was underpinned by slowdown following initial growth before reverting to a continuous rebound. Average prices were higher compared to the previous year, resulting in improved overall profitability for the petrochemical sector. As at 31 December 2003, the weighted average prices of the Company's synthetic fibres, resin and plastics, intermediate products and petroleum products increased by 11.5%, 13.6%, 16.0% and 14.0%, respectively, on a year-on-year basis.

## **Impact of crude oil costs**

The fluctuations of international crude oil prices in 2003 was underpinned by volatility at relatively high levels. The Brent benchmark averaged at US\$28.85 per barrel for the year, was 15.58% higher as compared to the previous year. As at 31 December 2003, the Company processed 8,610,100 tons of crude oil, and increase of 1,181,700 tons compared to the previous year, including 39,300 tons from Daqing, 1,377,700 tons from Shengli, 479,000 tons from offshore oilfields and 6,714,100 tons of imported crude oil. Crude oil costs accounted for RMB15,765 million or 59.53% of the Company's cost of sales. The average cost of crude oil processing increased by 19.61% to RMB1,843 per ton (before VAT but after transportation costs). The Company's crude oil costs increased by RMB4,320 million as a result of the increase in crude oil prices and processing volume.

## **New inroads in marketing and sales**

The Company achieved its annual business target and completed sales of 7,498,900 tons of products in 2003, an increase of 14.70% compared to the previous year, as a result of sound market judgement enabling the Company to secure market opportunities by making timely adjustment to its marketing strategy and enhancing sales management. The marketing department collaborated with various business departments to produce analysis and forecasts in specific areas. Market investigation and research were enhanced to increase the overall accuracy of market intelligence analysis and provide a solid basis for the formulation or adjustment of marketing strategies. Efforts were made to lower purchase costs by organising the procurement of crude oil and major chemical feedstock in a timely manner to capitalise on opportunities available in the market. Ongoing improvements were made to the coordination of domestic and external trading of glycol, the export of pure benzene, gasoline / diesel and industrial polyester filament, and the re-export processing of mixed xylene, which resulted in sound economic benefits. In 2003, the Company's export value grew by 46.71% to RMB1,506 million and the volume of export products grew by 51.45% to 703,500 tons as compared to the previous year. Management of contracts and receivables were enhanced and marketing outlets were further optimised, resulting in a 100.27% receivable collection ratio in 2003. Through customer assessments, adjustments were made to customer mix and sales deployment, thereby further enhancing sales distribution channels. Supplies management was further enhanced with stock clearing and disposal being highly effective.

### **Capital expenditure projects in smooth progress**

In 2003, the Company made diligent efforts to procure project construction in accordance with the principles of "first-rate management, clearly defined delegation, accountability." Projects were under sound control in terms of safety, quality, progress and expenditure. The project for propylene capacity expansion in the catalytic cracking unit was successfully completed during the first half of 2003. The 130,000-ton/year acrylonitrile unit upgrade project started operation in April, while the selective hydro-desulphurisation of catalytic gasoline project was completed and commissioned at the end of June to alleviate the shortage in supply of propylene and acrylonitrile and improve the quality of clean gasoline. With the torch gas recovery programme commencing trial run at the end of the year to recycle daily approximately 1 million tons of combustive gas discharged from the ethylene and aromatic production units each day, the Company was able to achieve its goals in energy conservation, cost reduction and environmental protection. The new 7,000-ton/year pentane unit built by the chemical institute started operation at the end of October and produced compliant products of high-purity pentane. Construction of the 150,000-ton/year polyester upgrade project commenced on 10 June and completion is scheduled in June 2004 and installation of major equipment is currently underway.

Construction of the joint venture ethylene project with China Petroleum & Chemical Corporation and BP Chemicals East China Investments Limited has been progressing smoothly with equipment installation currently underway. Major production units are expected to successively commence operation from 2005 onwards.

### **Technological breakthroughs and achievements in product development**

The Company's enhanced efforts in technological breakthroughs and product development in 2003 resulted in new achievements, as 13 projects passed the technical assessment of China Petrochemical Corporation, 4 projects passed the new product assessment by the Shanghai Municipal Government and 48 projects passed the Company's assessment. Effective development and marketing of new products, such as 1.33dtex ultra-polished polyester staple for sewing, dull polyester chips, dope dyeing acrylic fiber, specialised oil solution for the two-step production of cotton type acrylic fiber and specialised benchmark transparent polypropylene for medical use were rewarded with positive results. The Company produced a total of 1,437,500 tons of new products (including 721,400 tons of clean gasoline), at par with the previous year, while the output value ratio for new products was 17.03%. Compared to the previous year, the ratio of special synthetic resins and the ratio of differentiated synthetic fibre were 77.62% and 40.51%, an increase by 7.85 and 10.51 percentage points, respectively. Meanwhile, production to sales ratio for new products was significantly improved by 6.68 percentage points to 94.58% compared to 2002.

## **Further strengthening of financial management, audit supervision and efficiency monitoring**

The Company continued to enhance its financial management, audit supervision and efficiency monitoring in 2003. Efforts were made in the breakdown and implementation of various indicators such as profits and expenses (costs) on cash operation. Budget management and cost review were enhanced and expenditures were stringently controlled. Enhanced capital management and improved efficiency in fund application and proactive moves to restructure short-term loans have significantly lowered financial expenses. Tax rebates for domestically made equipment in technological upgrade projects were also vigorously pursued. Internal management standards were raised and operational risks were mitigated by conducting internal control, audit and assessment on sales management, supply management, equipment management and financial management. Meanwhile, proactive efforts were made towards the implementation of full-process auditing of construction projects, external investment auditing and auditing on special issues and entertainment fees, in a bid to strengthen risk management and regulate business practices. Measures were also being adopted to broaden the scope of efficiency monitoring with in-depth investigations.

## **Prospects and Plans for 2004**

The fundamental global situation in 2004 is expected to remain peaceful, eased and stable, although certain regions may see conflict, tension and turmoil. Global economic recovery is expected to gain pace while economic growth in China is expected to remain robust amid the expansion stage in the new economic cycle. Ongoing global as well as domestic economic growth is set to provide the petrochemical industry with sound opportunities. According to the trends of the petrochemical market, there is little concern for oversupply as no major new facilities will be commissioned in 2004 in China, Asia or globally. The positive economic environment is expected to provide a stimulus for rapid growth in the demand in petrochemical products. Prices of major chemical products are generally rising, in tandem with the growth cycle of the petrochemical market. However, prices of domestic petrochemical products will also be subject to increased uncertainties and risks, such as the abolition of import quota for petroleum products for state-owned trading companies, continuous import tax reductions for certain types of petrochemical products and changes in state policies regarding export rebates that affect petroleum products. As for market competition, major international players are gearing up their moves to tap the Chinese market amid industry restructuring on a global basis. Apart from posing direct competition against us in petroleum and petrochemical products, these international companies are characterised by large-scale investments across different sectors, full vertical integration and streamlined organisation. Domestic companies are expected to face intense competition from their international counterparts as the China market becomes increasingly internationalised. In terms of the Company's production operation, the Company's production capacity will remain by and large the same, but the completion and operation of the Ningbo-Shanghai-Nanjing oil pipe will bring about fundamental changes in the crude oil supply for the Company and lower transportation costs.

The Company will respond proactively to the profound changes in the macro-economic environment by capitalising on timely opportunities and favourable market conditions at the moment to enhance the overall operating quality of its production system and ensure steady growth of product output. It will continue to consolidate and expand its market share both domestically and abroad, striving to deliver better operating results in 2004.

**In 2004, the Company shall focus on:**

- (1) Full implementation of the HSE (Health, Safety and Environment) system to maintain safe and stable operation of production units in prolonged cycles

Management of basic operations will be enhanced with a special focus on safe production, striving to maintain stable operation of production units in prolonged cycles and with high loading. Meanwhile, ongoing initiatives to optimise production patterns, product mix and the operation of utilities projects will help to lower production costs and increase profitability effectively.

- (2) Fostering the modern business principle of "Customer Orientation" and procuring a "two-fold metamorphosis" in marketing

The Company will endeavour to foster the modern business principle of "Customer orientation" and procure a "two-fold metamorphosis" in marketing, towards modernised as opposed to traditional approaches and towards refined as opposed to generalised management. We intend to ensure sales of all products through close integration of production, marketing and research and development, whereby production schedules are determined by marketing requirements, while sales are enhanced by production. We will consolidate our market share and seek higher returns by making appropriate adjustments to marketing strategies and improvements to the marketing system, introducing marketing innovations and strengthening sales service. The inventory structure will also be optimised and procurement costs will be lowered through enhanced and standardised management of raw material supplies.

- (3) Advancing corporate development with a focus on comprehensive and coordinated development of staff and company

Leveraging on opportunities arising from the new growth cycle of China's petrochemical industry, development initiatives for the 10th and 11th Five-Year Plan periods will be implemented to energise the Company for sustainable development. We will persist in a people-oriented approach and foster comprehensive, coordinated and sustainable development with a focus on comprehensive and coordinated development of staff and company.

- (4) Implementation of complementary reforms in systems and mechanisms to enhance internal management

The existing management regime and mechanisms will be further reformed on a market-driven basis. Reforms of staff appraisal, allocation and training systems will continue while the management hierarchy and staff establishment are being streamlined, so that such reforms will be launched simultaneously to complement each other with a view to effectively enhance Company's management efficiency. Continued enhancements will be made to the development of systems and internal control regimes will be continuously enhanced to secure stronger controls, regulated management, removal of pitfalls and prevention of risks.

- (5) Enhancing the scientific research regime underpinned by the integration of production, learning and research to leverage the core supporting functions of technological progress

The existing management regime for scientific research will be further streamlined, to integrate production, learning and research in tandem with development towards a new form of industrialisation. The development of new technologies and applications will be hastened, while the development and marketing of new products will be enhanced. Information initiatives focusing on the development of ERP systems and optimised production management will be introduced on a gradual basis in a bid to increase core competitiveness.

- (6) Gradual implementation of business reorganisation, restructuring and segregation

The reorganisation, restructuring and segregation of various business operations will be implemented gradually and the restructuring of assets in external investments will continue, the objective of which is to separate auxiliary activities from principal businesses to procure growth and expansion of principal businesses and market orientation of auxiliary activities, in a proactive move to leverage China Petroleum and Chemical Corporation's plan to usher business reorganisation and restructuring.