

Report of the Board of Directors²

The Board of Directors hereby presents the report of the Directors and the audited financial statements for the year ended 31 December 2003.

PRINCIPAL ACTIVITIES

The Company is principally engaged in the production and sale of gasoline, diesel, kerosene, naphtha, LPG, solvent oil, fuel oil, intermediate petrochemical products, asphalt, urea and petrochemical products such as PX, PP.

SUBSIDIARIES AND ASSOCIATES

Details of the subsidiaries and associates of the Company are set out in notes 15 and 16 to the financial statements.

RESULTS AND DIVIDEND

The Group's results for the year ended 31 December 2003 and the Company's and the Group's financial positions as at that date are set out on page 40 to 96 of this annual report. The Group's profit attributable to shareholders for the year 2003 was RMB1,088 million, representing an increase of 11.79% from that of 2002.

An interim dividend of RMB0.05 per share was paid on 20 October 2003 (2002: RMB0.04 per share). The Board of Directors recommended the payment of a final dividend of RMB0.09 per share in respect of the year ended 31 December 2003 (2002: RMB0.08 per share).

RESERVES

Details of movements of the Group's reserves during the year are set out in the Consolidated Statement of Changes in Shareholders' Equity.

PROPERTY, PLANT AND EQUIPMENT

Details of movements of the Group's property, plant and equipment during the year are set out in note 13 to the financial statements.

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



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MAJOR CUSTOMERS AND SUPPLIERS

The proportions of major customers and suppliers in the Group's total sales and purchase for the year are shown as follows:



	Percentage share of the Group's total amount	
	Sales	Purchase
The largest customer	58.48%	
The aggregate amount of the five largest customers	70.65%	
The largest supplier		50.92%
The aggregate amount of the five largest suppliers		99.74%

Neither the directors nor the supervisors nor their respective associates own any beneficial interests in the aforesaid five largest customers and suppliers.

None of the shareholders holding 5% or more interest in the share capital of the Company has any beneficial interests in the said suppliers and customers with the exception of China Petroleum & Chemical Corporation ("Sinopec Corp"), the Company's controlling shareholder, which holds 100% equity interests in the largest customer of the Group, Sinopec Sales Huadong Company, 70% equity interests in the second largest customer, China International United Petroleum & Chemicals Company Limited, 100% equity interests in the fourth largest customer, Sinopec Beijing Yanshan Company, and 70% equity interests in the second largest supplier, China International United Petroleum & Chemicals Company Limited, 100% equity interests in the third largest supplier, Sinopec Pipeline Storage & Transport Company.

PENSION FUND

Details of the pension fund are set out in note 8 to the financial statements. Contribution to the pension fund charged to the Group's consolidated income statement for the year ended 31 December 2003 was RMB101,035,000.

SUMMARY OF FIVE-YEAR FINANCIAL INFORMATION

A summary of the results and the consolidated balance sheet of the Group for the past five financial years is set out on page 6 of the Annual Report.



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EXTERNAL INVESTMENT

The Company together with BP Global Investment Ltd has established a joint-venture company (“JVC”) for the sale of LPG. The total investment amount of the JVC is US\$25 million, with a registered capital of US\$10 million. The Company and BP Global Investment Ltd each hold 50 per cent interest of the JVC. The JVC has officially begun its operation since October 2003. The Company will sell all of the LPG produced by the Company to the JVC.

SHARE CAPITAL

The structure of the Company’s share capital as at 31 December 2003 was as follows:

	Number of shares	Percentage share of total issued share capital
State-owned legal person shares	1,800,000,000	71.32%
H shares	723,754,468	28.68%
Total share capital	2,523,754,468	100.00%

SHAREHOLDING OF SUBSTANTIAL SHAREHOLDERS

Substantial Shareholders

Save as disclosed below, the Directors of the Company are not aware of any persons (other than a Director or Supervisor or chief executive of the Company or his/her respective associate(s)) who, as at 31 December 2003, had an interest or short position in the shares or underlying shares of the Company which was recorded in the register to be kept under section 336 of the Securities and Futures Ordinance (“SFO”):

Name of shareholder	Nature	Class of Shares	Capacity	Note	Number of shares/ underlying shares	% to	
						entire issued capital	all issued H shares
Sinopec Corp	Long position	State-owned legal person shares	Corporate	a	1,800,000,000	71.32	N/A
BP p.l.c.	Long position	H shares	Corporate	b	237,600,000	9.41	32.83
JP Morgan Chase & Co.	Long position	H shares	Investment manager/ Other	c	84,444,100	3.35	11.67
	Lending pool	H shares	Other	c	19,820,100	0.79	2.74
FMR Corp	Long position	H shares	Investment manager		37,954,000	1.50	5.24

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Notes:

- (a) Sinopec Corp held the above 1,800,000,000 State-owned legal person shares in the Company. China Petrochemical Corporation (“Sinopec Group Company”) is the ultimate controlling shareholder of the Company, and is a State-authorized investment institution and a State-holding company. It has a 55.06% equity interest in Sinopec Corp.
- (b) ARCO Asia Pacific Investments Limited, which was a controlled corporation of BP p.l.c., had a direct holding in the above 237,600,000 H shares.
- (c) The shares in which JP Morgan Chase & Co. were deemed to be interested were held via JF Asset Management Limited, J.P. Morgan Fleming Asset Management (UK) Limited and JPMorgan Chase Bank respectively.
- (d) For the latest disclosure of interests filings for the Company’s substantial shareholders, please refer to the “Disclosure of Interests” section on the website of The Stock Exchange of Hong Kong Limited (the “Stock Exchange”) at www.hkex.com.hk.

TRUST DEPOSIT AND OVERDUE TIME DEPOSIT

The Company did not have any trust deposit or any overdue time deposit as at 31 December 2003.

LOCAL TAX POLICIES

Details are set out in note 9 to the financial statements.

REDEMPTION OF THE COMPANY’S CONVERTIBLE BONDS

In accordance with the terms of the Company’s convertible bonds, all of the Company’s US\$200 million convertible bonds issued on 19 December 1996 reached their maturity as at 19 December 2003. As at that day, holders of the Company’s approximately US\$580,000 convertible bonds not yet converted chose to redeem their bonds. The Company paid US\$580,000 at the face amount to these bondholders.

PURCHASE, SALE AND REDEMPTION OF THE COMPANY’S SHARES

For the year ended 31 December 2003, neither the Company nor its subsidiaries had purchased, sold or redeemed any of the Company’s shares.

MATERIAL CONTRACT

On 16 October 2003, the Company and Sinopec Yizheng Chemical Fibre Company Limited (“Yizheng Chemical”) entered into an agreement for the sale of PX produced by the Company during the trial processing. The details were published in Hong Kong newspapers, South China Morning Post and Wen Wei Po, on 17 October 2003. For the year ended 31 December 2003, the Company sold 38,900 tonnes of PX to Yizheng Chemical for the net sales amount of RMB192,617,100 in accordance with the abovementioned agreement. The sales amount was less than 3% of the Group’s consolidated net tangible assets value as disclosed in the audited consolidated financial statements for the year ended 31 December 2002 or unaudited interim financial report for the six-month period ended 30 June 2003. As described below, Yizheng Chemical is a connected person of the Company under the Rules Governing the Listing of Securities (“Listing Rules”) on The Stock Exchange of Hong Kong Limited (“Stock Exchange”).

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On 10 November 2003, the Company and Yizheng Chemical entered into an agreement on the purchase and sales of PX (the “Agreement”). The Agreement is effective until 31 December 2005. The price of PX is determined in accordance with the pricing formula in the Agreement, which is based on the ICIS CFR N. E. Asia Spot Price and Contract Price. The details of the Agreement were published in Hong Kong newspapers, South China Morning Post and Wen Wei Po, on 12 November 2003.

Yizheng Chemical is 42% held by Sinopec Corp., which is also the holding company of the Company, and therefore Yizheng Chemical is a connected person of the Company under the Listing Rules. The sales under the Agreement therefore constitutes connected transactions and requires independent shareholders’ approval. On 27 December 2003, the Company held an extraordinary general meeting, at which transactions contemplated under the Agreement were approved. Relevant details were published in Hong Kong newspapers, South China Morning Post and Wen Wei Po, on 29 December 2003.

On 9 January 2004, the Stock Exchange agreed, with conditions, to grant the Company a waiver from strict compliance with the disclosure in respect of ongoing connected transactions made under the Agreement for the three financial years ending 31 December 2005. During the aforesaid period, the Company need not comply with the Listing Rules’ requirements in relation to the disclosure in respect of sales under the Agreement, but has to fulfil the requirements stipulated in the waiver. The details about the conditions for granting the waiver from strict compliance with the disclosure in respect of ongoing connected transactions were published in the circular sent to all shareholders on 2 December 2003.

For the year ended 31 December 2003, the Company, in accordance with the Agreement, sold to Yizheng Chemical 20,200 tonnes of PX, with a net sales value of RMB100,856,400.

INTERESTS OF DIRECTORS AND SUPERVISORS

As at 31 December 2003, neither the Directors nor the Supervisors of the Company has any interests and short positions in the shares, underlying shares and debentures of the Company or any associated corporation (within the meaning of Part XV of the SFO) which was recorded on the register required to be kept under section 352 of the SFO or otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies.

For the latest disclosure of interests filings for the Directors or the Supervisors of the Company, please refer to the “Disclosure of Interests” section on the Stock Exchange’s website at www.hkex.com.hk.

STAFF REDUCTION EXPENSES

Details are set out in note 5 to the financial statements.

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CORPORATE GOVERNANCE

1. Introduction to Shareholders' General Meeting

Two shareholders' general meetings were held during the period under review. The annual general meeting held on 20 June 2003 approved annual results and elected a new Board of Directors and Supervisory Committee. The extraordinary general meeting held on 27 December 2003 approved the connected transactions contemplated under the agreement on the sales and purchase of PX entered into with Yizheng Chemical. Details were published in Hong Kong newspapers, South China Morning Post and Wen Wei Po, on 23 June 2003 and 29 December 2003 respectively.

2. New Board of Directors

The annual general meeting held on 20 June 2003 elected members of the Board of Directors and the Supervisory Committee for a new term of office of three years, details of which were published in Hong Kong newspapers, South China Morning Post and Wen Wei Po, on 23 June 2003.

The structure of the Board of Directors was further streamlined with a new Board of Directors (the "Board"). The Board established three specialised committees, namely development strategy committee, reform and remuneration committee and audit committee. The Board comprises 12 directors, six of whom are executive directors, two are external directors and four are independent directors.

In accordance with the requirements from domestic and overseas regulatory bodies, the new Board amended the "Rules Governing the Convention of Board Meetings" and the work details of the three specialised committees. The Board also revised the service contracts of directors, and began to research, formulate and fine-tune the internal control system in relation to the workflow of production, operation and management of the Company's major businesses, with the aim of further standardising the Company's management procedures and averting operational risk.

During the period under review, five Board meetings and nine meetings of the Board's executive committee were convened, faithfully performed the duties as stipulated in the Company's articles of association and "Rules Governing the Convention of Board Meetings".

The audit committee convened meetings on 22 August 2003 and 16 April 2004 respectively, during which "The 2003 Interim Financial Report" and "The 2003 Annual Financial Report" were reviewed.

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3. Emoluments for Directors and Supervisors

The aggregate amount of emoluments paid to the Company's executive directors and supervisors for the year ended 31 December 2003 was RMB1,399,000 (2002: RMB1,150,000) and RMB528,000 (2002: RMB448,000) respectively. Emoluments paid to each executive director and supervisor did not exceed RMB250,000 (2002: RMB200,000). Pension fund for directors, supervisors and other employees is planned as a whole, details of which are set out in note 7 to the financial statements.

Pursuant to the approval given at the annual general meeting held on 20 June 2003, the Company entered into service contracts with all the directors and supervisors. In accordance with the service contracts, the aggregate amount of emoluments paid to independent directors and independent supervisors for the year ended 31 December 2003 was RMB70,943 and RMB35,471 respectively. Emoluments paid to each independent director and independent supervisor did not exceed RMB20,000. The aggregate amount of emoluments paid to external directors and external supervisors was RMB10,650 and RMB7,100 respectively. Emoluments paid to each external director and external supervisor did not exceed RMB20,000.

4. Investor Relations

The Company has actively and faithfully performed its duties regarding the disclosure of information and the work on investor relations. It has strictly abided by the principles of faith, regulation, transparency and timely disclosure of information. Through the various approaches and channels such as formulating results report, issuing announcements, organising roadshows at home and abroad, using telephone conferencing, a corporate website, reception of guests, response to enquiries, the Company strengthens the communication and relationship with its investors and continues to help investors to recognise its value.

5. Connected Transactions

Connected transactions of the Group during the year were conducted on normal commercial terms and in the ordinary course of business. The auditors of the Group had reviewed these transactions. Details are set out in note 32 to the financial statements. In accordance with the requirements of the Stock Exchange, the relevant connected transactions had been confirmed by the independent directors of the Company.

The auditors and independent directors of the Company had issued letters to the Board of Directors in relation to the Company's sale of PX to Yizheng Chemical and confirmed that Company had conducted the connected transactions in accordance with the conditions set under the waiver granted by the Stock Exchange.

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CODE OF BEST PRACTICE

The first meeting of the Fourth Board of Directors held on 20 June 2003 established the audit committee of the Board of Directors. The organisational structure of the audit committee is in compliance with the Code of Best Practice in Appendix 14 of the Listing Rules on the Stock Exchange. The functions of the audit committee of the Company are similar to those of an audit committee as defined under the Code of Best Practice.

The Directors were not aware of any information which reasonably indicated that the Company had not complied with the Code of Best Practice as set out in Appendix 14 of the Listing Rules on the Stock Exchange during 2003.

The Company has been aware that the new Listing Rules of the Stock Exchange has become effective since 31 March 2004. The Company will, in accordance with the requirements of the Listing Rules, continue to enhance the standard of its corporate governance.

AUDITORS

During the year under review, KPMG was appointed as the Company's auditors and had audited the Group's financial statements for the period under review. It is desired that KPMG will be reappointed as the Company's auditors as the term of KPMG's appointment is about to expire. A resolution regarding the reappointment of KPMG as the Company's auditors will be put forward at the upcoming annual general meeting.

By Order of the Board

Sun Weijun

Chairman

16 April 2004, Ningbo, the PRC