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 2003 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 "Consolidated Financial Statements") presented in the annual report. The information presented below analyzes 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.

Our 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, as being carried out, gradually 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 2003, the world economy has gradually recovered from a recession. Although affected by the outbreak of Severe Acute Respiratory Syndrome, China's economy continued to grow rapidly in 2003. Due to the rise of crude oil price and increase in demand resulting from a general growth of economy, both the price and sales volume of most of our major products increased significantly in 2003 compared with 2002.

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. Our 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. We specifically analyze historical bad debts, ageing receivables, 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. We review long-lived assets for possible impairment by evaluating whether the carrying amount of assets exceed its recoverable amount. Our 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 and proportions of total net sales for the periods indicated. For purposes of the table, "N/A" represents sales volume for certain products, the measurement of which in tons does not provide a meaningful comparison vis-àj-vis products in other product categories. Sales volume under the category of "total" does not include sales volume under the category of "other".

	2003			2002		
	Sales Volume ('000 tons)	**Net Sales (RMB thousands)**	**% of Net Sales**	Sales Volume ('000 tons)	Net Sales (RMB thousands)	% of Net Sales
Petrochemical and organic chemical products	**1,837.1**	**7,783,091**	**37.7**	1,586.4	5,750,075	43.8
Petroleum products	**4,382.3**	**9,320,066**	**45.1**	2,784.1	5,166,188	39.3
Synthetic rubber products	**128.8**	**1,133,031**	**5.5**	110.9	782,559	6.0
Chemical fertilizers and inorganic chemical products	**241.0**	**164,861**	**0.8**	141.5	123,325	0.9
Other	**N/A**	**2,251,760**	**10.9**	N/A	1,316,240	10.0
Total	**6,589.2**	**20,652,809**	**100.0**	4,622.9	13,138,387	100.0

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

	Year ended December 31, 2003		Year ended December 31, 2002	
	RMB thousands	**% of Net Sales**	RMB thousands	% of Net Sales
Sales	**20,652,809**	**100.0**	13,138,387	100.0
Cost of sales	**(19,125,842)**	**(92.6)**	(12,518,955)	(95.3)
Distribution costs, administrative expenses and expenses for shut down of manufacturing assets	**(603,389)**	**(2.9)**	(1,115,785)	(8.5)
Profit/(loss) from operations	**895,318**	**4.3**	(506,036)	(3.9)
Interest expense	**(429,782)**	**(2.1)**	(474,370)	(3.6)
Taxation	**(270)**	**–**	(1,116)	–
Net profit/(loss)	**427,609**	**2.1**	(1,023,099)	(7.8)

Operating Results

Year ended December 31, 2003 compared with Year ended December 31, 2002

Aggregate net sales increased by 57.2% to RMB20,652.81 million in 2003 compared with RMB13,138.39 million in 2002. This increase was due to significant increase in both price and sales volume of most of our major products resulting from a strong economic growth in China.

Net sales of petroleum products increased by 80.4% to RMB9,320.07 million in 2003 from RMB5,166.19 million in 2002, accounting for 45.1% of aggregate net sales in 2003, up from 39.3% in 2002. This increase was due to an increase of weighted average price of products in this segment by 12.8% and an increase of sales volume by 57.4% in 2003 compared with 2002.

Net sales of petrochemical and organic chemical products increased by 35.4% to RMB7,783.09 million in 2003 from RMB5,750.08 million in 2002, accounting for 37.7% of aggregate net sales in 2002, down from 43.8% in 2002. Weighted average price and sales volume of petrochemical and organic chemical products increased by 16.5% and 15.8% over 2002, respectively.

Net sales of synthetic rubber products increased by 44.8% to RMB1,133.03 million in 2003 from RMB782.56 million in 2002, accounting for 5.5% of aggregate net sales in 2002, down from 6.0% in 2002. Weighted average price of synthetic rubber products increased by 25.0% and sales volume increased by 16.2% over 2002.

Net sales of chemical fertilizers and inorganic chemical products increased by 33.7% to RMB164.86 million in 2003 from RMB123.33 million in 2002, accounting for 0.8% of aggregate net sales in 2003, down from 0.9% in 2002. Although weighted average price of products in this segment decreased by 21.2%, sales volume increased by 70.3%, which more than offset the adverse effect on net sales caused by decreased price.

Revenue from other products and services increased by 71.1% to RMB2,251.76 million in 2003 from RMB1,316.24 million in 2002, primarily due to a significant increase in our provision of materials and services to other companies in 2003.

Cost of sales increased by 52.8% to RMB19,125.84 million in 2003 from RMB12,518.96 million in 2002, representing 92.6% and 95.3% of aggregate net sales from 2003 and 2002, respectively. The increase in cost of sales was due primarily to the significant increase of the volume of products that we produced and sold in 2003. In 2003, we processed 5.66 million tons of crude oil, up from 4.56 million tons in 2002.

Distribution costs, administrative expenses and expenses for shut down of manufacturing assets decreased by 45.9% from RMB1,115.79 million in 2002 to RMB603.39 million in 2003. Administrative expenses decreased by 28.0% from RMB797.43 million in 2002 to RMB574.05 million, primarily because (i) there was no write-down of carrying value of property, plant and equipment in 2003 while such expense was RMB323.84 million in 2002; and (ii) provision for impairment of receivables and other current assets was RMB100.71 million in 2003 compared to RMB51.48 million in 2002. There were no expenses for shut down of manufacturing assets in 2003, while such expenses in 2002 were RMB283.42 million.

Based on the above factors, our profits from operations in 2003 was RMB895.32 million while there was a loss from operations of RMB506.04 million in 2002.

Interest expense decreased by 9.4% from RMB474.37 million in 2002 to RMB429.78 million in 2003. The decrease in interest expense was primarily because our repayment of borrowings exceeded new borrowings in 2003.

Our net profit was RMB427.61 million in 2003, compared with a net loss of RMB1,023.10 million in 2002. This increase in net profit was due primarily to increase in net sales and decrease in administrative expenses and expenses for shut down of manufacturing assets.

Liquidity and Capital Resources

We depend upon cash flow from operations, loans from affiliates and banks, and equity financing to satisfy our ongoing liquidity and capital needs. Our cash position in 2003 was an increase of RMB2.69 million compared to a decrease of RMB4.11 million in 2002.

Net cash provided by operating activities increased to RMB3,578.32 million in 2003 from RMB1,329.00 million in 2002. This significant increase of cash inflow was primarily due to (a) an increase in profit before taxation of RMB1,453.76 million to a profit of RMB426.12 million in 2003 from a loss of RMB1,027.64 million in 2002; and (b) an increase in payables and accrued liabilities by RMB1,830.96 million.

Net cash used for investing activities decreased to RMB722.14 million in 2003 from RMB863.35 million in 2002. The decrease was primarily due to a decrease of expenditure on purchase of property, plant and equipment to RMB675.08 million in 2003 from RMB791.73 million in 2002.

Net cash used for financing activities increased to RMB2,853.49 million in 2003 from RMB469.76 million in 2002. This significant increase in cash outflow was primarily due to a gross repayment of borrowings of RMB8,294.08 million in 2003 compared with a gross repayment of borrowings of RMB5,335.41 million in 2002. We did not issue any new shares in both 2002 and 2003.

As at December 31, 2003, our current assets were RMB2,055.89 million and current liabilities were RMB7,716.34 million. Our current liabilities slightly decreased from RMB7,722.93 million in 2002 to RMB7,716.34 million.

As at December 31, 2003, we had a negative working capital of RMB5,660.45 million, compared with a negative working capital of RMB5,256.70 million as at December 31, 2002. The slight increase of negative working capital was primarily because the increase of inventories and decrease of short-term borrowings were not enough to offset a decrease of accounts receivable and an increase of accounts payable. Inventories increased from RMB1,394.23 million in 2002 to RMB1,568.09 million in 2003, primarily due to an increase in our stock of crude oil. Accounts receivable decreased from RMB684.93 million in 2002 to RMB184.76 million in 2003, primarily attributable to an increased payment of receivables by PetroChina Group Companies, JCGC Group Companies and other customers in 2003 compared with 2002. Accounts payable and accrued liabilities increased from RMB2,186.25 million in 2002 to RMB3,614.34 million in 2003, primarily attributable to an increase of trade payables resulting from increased purchase of crude oil and an increase of advance payments for chemical products. 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 our ultimate shareholder CNPC, provides us with a loan facility up to RMB8 billion which will expire on December 31, 2005. As at December 31, 2003, the outstanding amount under that loan facility was RMB3,155.00 million. With this facility, we believe that we have more than sufficient resources to meet our foreseeable working capital needs. Our gearing ratio was 49.0% as at December 31, 2003 and 64.8% as at December 31, 2002 (gearing ratio is calculated as the ratio between long-term debt and the sum of equity and long-term debt).

As at December 31, 2003, our liquidity ratio was 26.6%, quick ratio was 6.3%, and inventory ratio was 1,291.3%.

As at December 31, 2003, borrowings were RMB6,509.90 million, a decrease of RMB2,853.59 million as compared with December 31, 2002, among which short-term borrowings were RMB4,102.00 million, representing a decrease of RMB1,434.69 million as compared with December 31, 2002, and long-term borrowings was RMB2,407.90 million, representing a decrease of RMB1,418.91 million as compared with December 31, 2002. These changes reflected our efforts in repayment of borrowings in 2003. As a result, our interest expense decreased from RMB474.37 million in 2002 to RMB429.78 million in 2003.

As at December 31, 2003, the weighted average interest rate of our borrowings range from 5.18% to 5.85%. Fixed-rate borrowings represent 74.9% of the total borrowings. As at December 31, 2003, the maturity of 27.2% of the long-term borrowings was within one year, the maturity of 9.2% of the long-term borrowings was between one year and two years, the maturity of 49.1% of the long-term borrowings was between two and five years and the maturity of 14.5% 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, 2003, all of our short-term borrowings were denominated in Renminbi. Among the long-term borrowings, foreign currency-denominated loans were in an amount of RMB1,658.90 million which need to be repaid in the relevant foreign currency, among which there was a foreign currency loan equivalent to RMB441.73 million from JCGC Group Companies. 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 2003, we had a net foreign exchange loss of RMB36.61 million, compared with a net foreign exchange loss of RMB41.05 million in 2002.

Our 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.

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 2003.

Capital Expenditure

In 2003, our 300,000t/a synthetic ammonia facility commenced operation upon completion of technical upgrade. We also acquired certain assets from JCGC Group Companies. Our overall expenditures on purchase of property, plant and equipment decreased from approximately RMB791.73 million in 2002 to RMB675.08 million in 2003.

We anticipate our capital expenditure for 2004 to be approximately RMB400.00 million mainly for technical upgrades of individual equipment. The capital for these expenditures is expected to be financed by our operating income and loans.

Research and Development, Patents and Licenses, Etc.

We have a research and development department engaged in the research and development of technologies, products, processes and equipment for our businesses.

Our expenditures for research and development were approximately, RMB11.59 million, RMB3.93 million and RMB1.76 million in 2001, 2002 and 2003, respectively.

Significant Investment

Unless otherwise disclosed in this annual report, we did not make any significant investment in the year ended December 31, 2003.

Material Acquisitions and Disposals

Unless otherwise disclosed in this annual report, we did not make any material acquisitions or disposals of subsidiaries and associated companies in the year ended December 31, 2003.

Employees

As of December 31, 2003, the number of our employees was 21,771. Our employees' total remuneration for the year ended December 31, 2003 was RMB625.70 million.

Charges on Assets

Unless otherwise disclosed in this annual report, we did not have charges on any of our principal assets as at December 31, 2003.

Contingent Liabilities

Unless otherwise disclosed in this annual report, we did not have any contingent liabilities as at December 31, 2003.

Shi Jianxun
General Manager and Executive Director

Jilin, PRC
April 20, 2004