**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 2004 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 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 the 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, our 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 2004, the world economy continued to improve. China's economy also continued to grow rapidly. We experience dramatic increases in product prices as well as increases in sales volume of most of our major products due to significant rises in the market prices of our petrochemical products and strong demand for our petrochemical products. Demand for our products reflects China's continued economic growth and market concerns about the rapidly rising price of crude oil.

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 analyzes, 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 analyzes. 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.

- Property, plant and equipment. We record property, plant and equipment initially at cost less accumulated depreciation. Subsequent to their initial recognition, the value of property, plant and equipment are carried at revalued amount, being the estimated fair value at the date of revaluation less accumulated depreciation and impairment losses. Revaluations are performed by independent qualified appraisers on a regular basis to ensure that the carrying amount does not differ materially from what would be determined using fair value at the balance sheet date. As disclosed in Note 12 to our consolidated financial statements, our most recent revaluation of property, plant and equipment was carried out as of December 31, 2003.

- 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 our sales volume, sales volume 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 to products in other product categories. Sales volume under the category of "total" does not include sales volume under the category of "other".

| | **2004** | | | 2003 | | |
|---|---|---|---|---|---|---|
| | **Sales Volume** | **Net Sales** | **% of Net Sales** | Sales Volume | Net Sales | % of Net Sales |
| | ***('000 tons)*** | ***(RMB thousands)*** | | *('000 tons)* | *(RMB thousands)* | |
| Petrochemical and organic chemical products | **1,875.0** | **12,768,259** | **40.1** | 1,837.1 | 7,783,091 | 37.7 |
| Petroleum products | **5,469.3** | **13,377,835** | **42.0** | 4,382.3 | 9,320.066 | 45.1 |
| Synthetic rubber products | **131.4** | **1,793,689** | **5.6** | 128.8 | 1,133,031 | 5.5 |
| Chemical fertilizers and inorganic chemical products | **554.0** | **664,246** | **2.1** | 241.0 | 164,861 | 0.8 |
| Other | **N/A** | **3,253,394** | **10.2** | N/A | 2,251,760 | 10.9 |
| Total | **8,029.7** | **31,857,423** | **100.0** | 6,589.2 | 20,652,809 | 100.0 |

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

| | Year ended December 31, 2004 | | Year ended December 31, 2003 | |
|---|---|---|---|---|
| | RMB thousands | % of Net Sales | RMB thousands | % of Net Sales |
| Sales | 31,857,423 | 100.0 | 20,652,809 | 100.0 |
| Cost of sales | (28,821,880) | (90.5) | (19,125,842) | (92.6) |
| Distribution costs and administrative expenses | (465,246) | (1.5) | (603,389) | (2.9) |
| Profit from operations | 2,593,028 | 8.1 | 895,318 | 4.3 |
| Interest expense | (270,071) | (0.8) | (429,782) | (2.1) |
| Taxation | 171,418 | 0.5 | (270) | – |
| Net profit | 2,544,510 | 8.0 | 427,609 | 2.1 |

## Operating Results

### Year ended December 31, 2004 compared with Year ended December 31, 2003

Total net sales increased by 54.3% to RMB31,857.4 million in 2004 compared with RMB20,652.8 million in 2003. This increase was primarily due to dramatic increases in product sales prices and increases in sales volume of our major products. These increases reflect increasing market prices and demand for petrochemical products resulting from increasing crude oil prices and strong economic growth in China.

Net sales of petrochemical and organic chemical products increased by 64.1% to RMB12,768.3 million in 2004 from RMB7,783.1 million in 2003, accounting for 40.1% of aggregate net sales in 2004, up from 37.7% in 2003. The weighted average price of petrochemical and organic chemical products increased by 47.3% when compared to 2003 primarily due to increase in the price of propylene, ethylene and acrylic acid. Sales volume of petrochemical and organic chemical products rose only slightly as our production facilities were already operating at capacity compared with 2003.

Net sales of petroleum products increased by 43.5% to RMB13,377.8 million in 2004 from RMB9,320.1 million in 2003, accounting for 42.0% of aggregate net sales in 2004, down from 45.1% in 2003. The increase in net sales was due to an increase of sales volume by 24.8% and an increase of weighted average price of products in this segment by 13.4% in 2004 compared with 2003. The increase in sales volume was primarily due to an increase in the volume of crude oil processing.

Net sales of synthetic rubber increased by 58.3% to RMB1,793.7 million in 2004 from RMB1,133.0 million in 2003, accounting for 5.6% of aggregate net sales in 2004, slightly up from 5.5% in 2003. The weighted average price of synthetic rubber increased by 22.2% over 2003 due to increases in the prices of ethylene-propylene rubber and styrene butadiene rubber, while sales volume increased only slightly.

Net sales of chemical fertilizers and inorganic chemical products increased by 302.9% to RMB664.2 million in 2004 from RMB164.9 million in 2003, accounting for 2.1% of aggregate net sales in 2004, up from 0.8% in 2003. Sales volume increased by 129.9% and the weighted average price of products in this segment also increased significantly by 75.0% primarily due to the increase in sales volume of liquid ammonia and other inorganic chemical, which commercial prices are higher than our previous inorganic chemical products, after our synthetic ammonia unit commenced operation.

Revenue from other products and services increased by 44.5% to RMB3,253.4 million in 2004 from RMB2,251.8 million in 2003, primarily due to the construction or expansion of certain facilities by downstream enterprises such as PetroChina Company Limited, Jilin Branch and JCGC Group companies which resulted in a significant increase in our supply of raw materials and services to them in 2004.

Cost of sales increased by 50.7% to RMB28,821.9 million in 2004 from RMB19,125.8 million in 2003, representing 90.5% and 92.6% of total net sales in 2004 and 2003, respectively. The increase in cost of sales was due primarily to the dramatic increase in the cost of crude oil, that comprises the major component of our cost of sales, in 2004 and also to increases in the volume of products that we produced and sold in 2004. In 2004, we processed 6.4 million tons of crude oil, up from 5.7 million tons in 2003. The weighted average price of our crude oil increased by 25.4% to RMB2,351 per ton in 2004 from RMB1,875 per ton in 2003.

Distribution costs and administrative expenses decreased by 22.9% from RMB603.4 million in 2003 to RMB465.2 million in 2004, primarily because of a decrease in the provision for impairment of receivables and other current assets from RMB100.7 million in 2003 to RMB12.4 million in 2004 and our energy saving efforts.

Based on the above factors, our profits from operations increased by 189.6% in 2004 to RMB2,593.0 million compared with a profit of RMB895.3 million in 2003.

Interest expenses decreased by 37.2% from RMB429.8 million in 2003 to RMB270.1 million in 2004. The decrease in interest expenses was primarily due to early repayment of outstanding loans from other banks by borrowing lower interest loans to repay higher interest loans in 2003 which led to significant decrease in the amount of highet interest loans. We also reduced our total amount of borrowings to RMB3,982.1 million in 2004 from RMB6,509.9 million in 2003.

In 2004, we had a net foreign exchange loss of RMB8.7 million, compared with a net foreign exchange loss of RMB36.6 million in 2003. Such increase was due to the fluctuations of foreign exchange rate in 2004, especially the change in the exchange rate of RMB with Japanese Yuan and RMB with Euro. Our outstanding foreign currency loans are subject to float in foreign exchange rate.

Our share of profit of a jointly controlled entity was increased to RMB36.1 million in 2004 from RMB9.7 million in 2003 reflecting increased profitability of Jilin Province BASF JCIC NPG Co., Ltd.

Based on the foregoing, our profit before tax increased by 453.0% to RMB2,356.6 million in 2004, compared with a profit before tax of RMB426.1 million in 2003.

In 2004, our income tax benefit was RMB171.4 million as compared with income tax expense of RMB0.27 million in 2003, primarily due to recognition and realization of deferred income taxes that were not recognized in 2003.

Our minority interests were RMB16.5 million in 2004, compared with the minority interests of RMB1.8 million in 2003 due to the increase of the subsidiaries' losses.

Based on the foregoing, our net profit increased by RMB2,116.9 million to RMB2,544.5 million in 2004 compared with 2003.

## LIQUIDITY AND CAPITAL RESOURCES

We depend upon cash flow from operation, loans from affiliates and banks, and equity financing to satisfy our ongoing liquidity and capital needs. Our cash position in 2004 decreased by RMB20.9 million compared to an increase of RMB2.7 million in 2003.

Net cash provided by operating activities decreased to RMB3,074.8 million in 2004 compared with RMB3,578.3 million in 2003. This decrease of cash inflow reflects a significant increase in profit attributable to shareholders to RMB2,544.5 million in 2004 compared to RMB427.6 million in 2003 but was impacted by an increase of RMB1,115.5 million in inventories compared with limited inventory growth in 2003 primarily related to increased purchases of crude oil in anticipation of further rises in the price of crude oil. Cash inflow was also impacted by both (i) an increase in accounts and other receivables of RMB256.5 million in 2004 compared with a decrease in of RMB330.0 million in 2003 and (ii) continued increases in accounts payable and accorded liabilities reflecting ongoing growth in the volume of raw materials purchased from PetroChina and corresponding accounts payable to PetroChina. Accounts payable and accrued liabilities increased by RMB1,045.4 million in 2004 compared to an increase of RMB1,831.0 million in 2003.

Net cash used in investing activities decreased to RMB567.8 million in 2004 from RMB722.1 million in 2003. The decrease was primarily due to a decrease in capital expenditures for the fixed assets in 2004, but also reflects a higher level of capital expenditure in 2003 due to payments for acquisition of Jilian in that period.

Net cash used in financing activities decreased to RMB2,527.8 million in 2004 from RMB2,853.5 million in 2003. This decrease in cash outflow was primarily due to a net repayment of borrowings of RMB2,527.8 million in 2004 compared with a net repayment of borrowings of RMB2,853.5 million in 2003.

As at December 31, 2004, our current assets were RMB3,327.8 million compared to RMB2,055.9 million in 2003, primarily reflecting an increase in inventories. Our current liabilities were RMB7,628.8 million compared to RMB7,716.3 million reflecting a decrease in short-term borrowings that was partially offset by increases in our accounts payable and accrued liabilities.

As at December 31, 2004, we had a negative working capital of RMB4,301.0 million, compared with a negative working capital of RMB5,660.4 million as at December 31, 2003. The decrease of negative working capital was primarily due to increases in inventories and accounts receivable and decrease of current liabilities. Inventories increased to RMB2,606.1 million in 2004 from RMB1,568.1 million in 2003, primarily due to an increase in our stock of crude oil due to increases in price and in the volume of crude oil held. Accounts receivable increased to RMB265.2 million in 2004 from RMB184.8 million in 2003, primarily attributable to an increased payment of receivables by PetroChina and its affiliates in 2004 compared with 2003. Accounts payable and accrued liabilities increased to RMB4,429.7 million in 2004 from RMB3,613.0 million in 2003, primarily attributable to an increased volume and price of purchase of crude oil and other raw materials purchased from PetroChina. We have historically relied on short term funding to satisfy our short-term obligations through the refinancing of indebtedness and other measures. In accordance with the facility undertaking letter from China Petroleum Finance Company Limited, or CP Finance, a subsidiary of our ultimate shareholder CNPC, dated February 6, 2004, CP Finance provides us with a loan facility up to RMB8 billion which will expire on December 31, 2005. As at December 31, 2004, the outstanding amount under that loan facility was RMB2,874.3 million. With this facility and cash generated from our operations, we believe that we have more than sufficient resources to meet our foreseeable working capital needs. In the event that cash generated from our operations fails to meet our working capital needs in 2005, we will seek an extension of this credit facility. Our gearing ratio was 15.0% as at December 31, 2004 and 48.7% as at December 31, 2003 (gearing ratio is calculated as the ratio between long-term debt and the sum of equity and long-term debt).

As at December 31, 2004, our liquidity ratio was 43.6%, quick ratio was 9.5%, and inventory ratio was 1,375.5%.

As at December 31, 2004, borrowings were RMB3,982.1 million, a decrease of RMB2,527.8 million as compared with December 31, 2003, among which short-term borrowings were RMB3,086.1 million, representing a decrease of RMB1,015.9 million as compared with December 31, 2003, and long-term borrowings were RMB896.0 million, representing a decrease of RMB1,511.9 million as compared with December 31, 2003. These changes reflected our efforts to reduce borrowings in 2004. As a result, our interest expense decreased from RMB429.8 million in 2003 to RMB270.1 million in 2004.

As at December 31, 2004, the weighted average interest rate of our borrowings ranged from 5.11% to 5.15%. Fixed-rate borrowings represented 89.6% of the total borrowings. As at December 31, 2004, the maturity of 15.7% of the long-term borrowings was within one year, the maturity of 15.7% of the long-term borrowings was between one year and two years, the maturity of 61.2% of the long-term borrowings was between two and five years and the maturity of 7.4% 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, 2004, all of our short-term borrowings were denominated in Renminbi. All of our long-term borrowings were foreign currency-denominated loans with a total amount of RMB1,063.1 million requiring repayment in the relevant foreign currency. These loans include foreign currency loans equivalent to RMB333.2 million through JCGC companies. The foreign currencies in which our loans are denominated include United States Dollar, Japanese Yen and Euro Dollar. In addition to foreign exchange risk that may arise from these foreign currency loans, we also have foreign exchange risk related to our payments for imported raw materials and machinery, which require us 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 2004, we had a net foreign exchange loss of RMB8.7 million, compared with a net foreign exchange loss of RMB36.6 million in 2003. Such increase was due to the fluctuations of foreign exchange rate in 2004, especially the change in the exchange rate of RMB with Japanese Yen and RMB with Euro Dollar. The outstanding foreign currency loans will have impact on our foreign exchange risk resulted from the fluctuation of foreign exchange rate.

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

- obtaining the 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 2004.

## CAPITAL EXPENDITURE

In 2004, we completed the 150,000 tons/year small-scale ethylene energy saving renovation project and technological renovation project. Our overall expenditures for the purchase of property, plant and equipment increased to RMB642.1 million in 2004.

We anticipate our capital expenditure for 2005 to be approximately RMB200 million . The capital for these expenditures is expected to be financed by our operating income.

## RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES, ETC.

Prior to 2004, we had a research and development department engaged in the research and development of technologies, products, processes and equipment for our businesses. In 2004, in order to enhance our standard of research and development, we decided not to keep such research and development department in our Company, instead, we entrusted an experienced research institution under our controlling shareholder to do the research and development work.

Our expenditures for research and development were approximately, RMB3.9 million, RMB1.8 million and RMB2.7 million in 2002, 2003 and 2004, respectively.

### Significant Investment

Unless otherwise disclosed in this annual report, we did not make any significant investment in the year ended December 31, 2004.

### 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, 2004.

### Employees

As at December 31, 2004, the number of our employees was 20,445. Our employees' total remuneration for the year ended December 31, 2004 was RMB747.8 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, 2004.

### Contingent Liabilities

Unless otherwise disclosed in this annual report, we did not have contingent liabilities as at December 31, 2004.