

We have seen a prosperous year last year for the global petroleum and petrochemical industry. The growth of the industry was driven by an overall growth of the world's economy. China's petrochemical industry showed an unprecedented affluence and had strong increase in demand growth as a result of continued rapid growth of the national economy and an upsurge of international crude oil prices. The price level of crude oil continued to rise, and the economic efficiency of the petroleum and the petrochemical sector increased remarkably. In 2004, the Company capitalized on market opportunities, ensured safe production, improved management structure, enlarged market sales and intensified internal reforms. The Company recorded substantial improvement in our production, reforms development and economic efficiency. The Company achieved record highs in crude oil processing, production output and product sales and maintained significant growth in terms of its operating results compared to 2003.

Ensured safe operation and optimized resources allocation to maintaining steady growth in product output

Leveraging the good opportunity of robust domestic demand of the petrochemical market, the Company conscientiously carried out its work in the HSE (Health, Safety and Environment) management and production operational management in 2004. It endeavored to increase efficiency of its production plants and the overall quality of its production operation. Through effective allocation of crude oil and major intermediate feedstock, optimization of operation system and rationalization of its facilities turnaround and maintenance plans, the Company achieved steady growth in product output. The on-stream availability and average efficiency of the Company's major production plants were 94.36% and 94.24%, respectively, in 2004. The production volume of most product categories recorded year-on-year increases to varying degrees. A total of 7,268,100 tons of commercial products (excluding products output on a sub-contracted basis) were produced, a slight increase compared to the previous year.

The Company achieved another record in crude oil processing volume in 2004 with 9,109,400 tons of crude oil being processed, an increase of 5.80% compared to the previous year (of which 8,570,700 tons were imported crude oil, representing an increase of 27.64% compared to the previous year and accounting for 94% of the total volume of crude processed). Compared to the previous year, gasoline output increased by 2.63% to 918,300 tons, while diesel output increased by 14.11% to 2,838,600 tons. The output of jet fuel rose 23.45% over the previous year to 710,900 tons, while the output of ethylene grew 0.81% to 956,000 tons and the output of propylene decreased by 1.37% to 525,800 tons. Compared to the previous year, the output of synthetic resins decreased by 1.99% to 882,600 tons; synthetic fibre monomers fell by 0.81% to 417,900 tons; synthetic fibre polymers rose 3.86% to 527,200 tons; and synthetic fibres dropped 6.09% to 296,300 tons. Meanwhile, the quality of the Company's products was consistently maintained at a premium level, and the Company remained the largest ethylene producer in China.

With strong market demand for petrochemical products, overall product prices rose and continued to stay at high levels.

The demand for petrochemical products grew strongly in 2004 and the average prices of petrochemical products were remarkably higher than those of the previous year. As a result, the economic efficiency of the whole sector stayed at its historic best. As at 31 December 2004, the weighted average prices of the Company's synthetic fibres, resin and plastics, intermediate petrochemical products and petroleum products increased by 19.43%, 34.50%, 45.42% and 22.16%, respectively, on a year-on-year basis.

Impact of crude oil costs

The international crude oil prices surged to a record high in 2004. The prices remained at a high level at the beginning of the year and rose continuously throughout. In the third quarter, the prices rose sharply to over US\$55 per barrel in October (West Texas Intermediate crude oil, "WTI"). The Brent benchmark averaged at US\$38.20 per barrel, 33% higher as compared to US\$28.83 per barrel in 2003. As at 31 December 2004, the Company processed 9,109,400 tons of crude oil (including processed on a sub-contract basis), an increase of 499,300 tons over the previous year, including 79,400 tons from Shengli, 459,300 tons from offshore oilfields and 8,570,700 tons from oversea. Crude oil costs accounted for RMB19,616 million or 59.04% of the Company's annual cost of sales. The average cost of crude oil processed increased by 25.10% to RMB2,305.86 per ton (before VAT but after transportation costs). The Company's total crude oil costs increased by RMB3,851 million as a result of the increase in crude oil prices and processed volume.

Captured market opportunities and adjusted marketing strategies to accomplish simultaneous growth in product sales and production volume

In 2004, the Company successfully captured market opportunities and made timely adjustments to its marketing strategies through stabilizing its marketing channels and strengthening sales management, thereby ensuring simultaneous growth in product sales and production volume. The Company achieved sales of 7,272,900 tons of products, excluding processed oil products. The output to sales ratio reached 100.07%. At the same time, ongoing improvements were made to the coordination of domestic and foreign trading of certain products and to the re-export of processed products. The volume of export products were 492,300 tons, with the export value amounting to RMB1.44 billion for the year. The Company continued to strengthen sales contract management and receivable control, achieving a receivables collection ratio of 100.29% during the year.



With capital expenditure projects successfully completed, the framework for a new phase of development was basically taking shape

In 2004, the Company continued to capitalize on its major project construction and positively undertook the preparation work for its new round development. At the end of 2003, the construction of 8,000,000 ton/year atmosphere and vacuum distillation plants commenced. Soon after mechanical completion was completed on 15 December 2004, we commenced preparation for production. Its auxiliary project, the 3,300,000 ton/year hydrogenated diesel project commenced construction on 27 December 2004. Expansion of the capacity of the PTA plant to 400,000 ton/year was completed at the end of September 2004. The expanded plant was successfully commissioned on 1 October 2004. The 150,000 ton/year PET plant that adopted the three-kettle process was successfully commissioned on 1 September 2004. A 72-hour test-run was then completed at the beginning of October 2004. In July 2004, the construction of the technology upgrade project for industrial polyester filament of 12,000 ton/year commenced, and was completed at the end of the year. Its fifth production line was successfully commissioned on 28 December 2004. The feasibility study report on a new 380,000 ton/year glycol project was approved by the State Development and Reform Commission in July 2004. The project commenced construction on 25 January 2005. Preparation for future developments such as project proposal optimization, project registration and project approval submission is now underway.

Mechanical completion of the 900,000 ton/year Shanghai Secco Petrochemical Company Limited, jointly invested by the Company, China Petroleum & Chemical Corporation and BP Chemicals East China Investments Limited was completed as scheduled on 30 December 2004. Commissioning of the major production plants will gradually commence in the first quarter of 2005.

Actively carried out research and development of technology and new product focusing on the Company's core businesses

In 2004, the Company made new breakthrough in its efforts on technology and products research and development and had successfully completed upgrade of its existing plants. The 150,000 ton/year PET plant adopted the three-kettles process and the selective hydro-desulphurisation of catalytic gasoline project had passed the technology assessment conducted by Sinopec Group. The designing of a 400,000 ton/year proprietary PTA plant, the industrialized experimentation of membrane separation, purification of hydrogen from diesel hydrogenation process, as well as the industrialized experimentation of isopentene isomerization, all proceeded smoothly. The research on antibacterial polypropylene fibres has made good progress.

According to publicly available statistics, 518,300 tons of new products (excluding clean gasoline) were produced by the Company in 2004. The output value of new product was RMB4.355 billion, representing an increase of 38.61% from the previous year. The output value ratio for new products was 12.64%, an increase of 2.16 percentage points from the previous year. 789,000 tons of synthetic resins of various types were produced, and the ratio of special resins was 81.17%, an increase of 3.55 percentage points from the previous year. 158,500 tons of differentiated synthetic fibres were produced, and the ratio of differentiated synthetic fibre was 43.99%, an increase of 3.48 percentage points from the previous year. 56 patents were applied for during the year, of which 46 were inventory patents. The Company's technology centre was granted "Achievement Award for Technologies Centre Endorsed by the State" by the State Development and Reform Commission.

Further strengthened corporate management and further intensified internal reforms

In 2004, the Company focused on the development of informatization project of ERP ("Enterprise Resources Planning"), which was adopted as an important means to facilitate gradual attainment of international standards and advancement of management expertise with respect to management concepts, systems and capabilities. Since the development of the project duly commenced on 11 March, an ERP project development team was formed and successfully completed a series of work relating to business process design, system configuration, development of reporting and access points, collection of primary data, training of end users, construction of network and plant, as well as distribution and installation of terminal equipment. The ERP system commenced simulation operation on 3 November 2004 and official operation on 15 December. The system now operates steadily as a whole. The implementation of the ERP project contributed to improving the business workflow, enhancing cost control, standardizing operation activities, preventing management faults, and raising management standards. At the same time, the Company proactively carried out various internal restructuring work such as separating the principal business from the auxiliary business, down sizing by restructuring the management hierarchy and reducing managerial and supporting staff.

Outlook and Business Initiatives for 2005

In 2005, the international situation is expected to experience extensive changes, which will be characterized by peace, development and cooperation. However, there are also increasing factors causing instability and uncertainty in the world's peace and development. The world economy is on the track to recovery. We expect that in 2005 the PRC economy will continue its upward rising trend. Following the implementation of macro-economic control measures, the overheating aspect of the economy was mitigated, with the factors contributing to instability and uncertainty being suppressed. Sectors demonstrating weaknesses were strengthened. All of these will lay a sound foundation for a stable and fast growth of the economy. The continued development of the global as well as the domestic economy will bring attractive opportunities to the development of the petroleum and petrochemical industry. In 2005, notwithstanding the commissioning of major joint-venture projects such as Shanghai Secco and Nanjing Yanba, general growth in demand for petrochemical products in the Asia-Pacific region and world-wide is expected to exceed the growth in our production capacity. As a result, production and sales are expected to remain strong as the world's petrochemical industry will continue to grow. On the other hand, although the overall macro-economic environment is improving, petrochemical enterprises are still subject to a number of instable and uncertain factors, such as volatility in international crude oil prices; increasing pressure on inflation; further fulfillment of the PRC's obligations for its WTO accession; intensified market competition; persisting short supply of coal, power and transportation facilities; and increasing pressure on environmental protection. All of these factors will have an impact on the production and operation of the petrochemical industry in the PRC, thereby increasing costs and risks to the petroleum and petrochemical industry.

The Company will proactively react to the significant changes occurring to the macro-economic environment. By fully capitalizing on the prevailing excellent business and operation environment, it endeavors to improve the quality of the overall operation of its production system, so as to maintain steady growth in product output, further improve the sales and marketing network and expand total product sales, with a view to obtaining once again outstanding operating results for the Company in 2005.

In 2005, the Company shall focus on:

- (1) Strengthening and improving the HSE (Health, Safety and Environment) management system, with emphasis on removing hidden trouble and danger to ensure a environmental friendly workplace

We will give emphasis on strengthening and improving our HSE. Software and hardware development will be strengthened. Safety surveillance administration and environmental protection work will be carried out. Staff's awareness as to safety and environmental protection will be enhanced. We will make special efforts to prevent occurrence of any serious or even the less serious health hazard or environmental incidents. Pollution discharge will be tightly controlled. All these aim to ensure safe production and sustainable development of the enterprise.

- (2) Enhancing the work on the "Three Fundamentals" so as to practically capitalize on long term plant operation

We aim to further improve and strengthen our fundamental management and infrastructure and training programs. Site management will be integrated with the management of technologies and speciality with general administration to improve the standard of production management as a whole. The Company will fully capitalize on the new 8,000,000 ton/year atmosphere and vacuum distillation plant, as well as other new and upgraded plant, so as to expand product output.

- (3) Adhering to the business principle of "Customer Orientation" to excel in product sales and material supplies

The business principle of "Customer Orientation" will be adhered to, so as to enhance the trustworthiness of its management and sales and service entities. Expansion of the sales network will be rolled out, which will in turn enhance the quality of sales and marketing activities. By doing well on product sales and purchase of crude oil, bulk chemical raw materials and fuel, we aim to reduce costs, expand sales and avert risks as much as we can.

- (4) Actively pursuing a streamlined managerial hierarchy so as to practically enhance internal control at all levels

In accordance with the requirements for a streamlined managerial hierarchy, as well as the new changes and new issues arising from the implementation of the ERP project by the Company, the restructuring and enhancement of the management system will continue. Centralized administration on the activities relating to material supplies, project construction and financial management will be adopted proactively. The pace for commercializing the system for stable and operation safeguarding and maintenance will be accelerated. Emphasis will be placed on complying with corporate governance standards and strengthening the establishment of various internal control regimes, so as to eliminate inherent problems and loopholes in management and avoid operation risks. Different types of management entities will be rationalized to achieve effective integration and to materialize a scientific, standardized and regulated management.

- (5) Capitalizing on staff training and development to enhance the overall quality of our staff

The EHR (Employee Human Resources) system will be proactively established, which will in turn form our integrated human resources management platform and enhance the analysis on human resources. Staff training and development will be strengthened. Human resources development measures will be improved to better equip our staff of the appropriate skills to suit the requirements of our production operation and further developments.

- (6) Continuous downsizing of auxiliary operations and proactively exploring new means for reforming the business structure

In accordance with the philosophy " you must leave something undone if you want to get others done and done well ", the Company will capitalize on any upcoming opportunities, and continue to intensify internal corporate reforms. Stability will be insisted as the premise to steadily facilitate the down sizing programme, restructuring and divestment of auxiliary operations. Market competitiveness will be enhanced on an ongoing basis through reforms on auxiliary operations and staff redundancy. New means to reform the corporate structure will be explored proactively.

- (7) Further developing our technology and proactively carrying out a new phase of development for the Company

The operational reality and the next round of development require that we should give full play to the supporting function of technological advancement. In view of the actual circumstances arising from the re-organized research and development system, efforts will be devoted to realignment of R&D task force. Leveraging on the development of new technologies and new products, research and development will be more coherently integrated with production operation as well as corporate development. In accordance with our development plans, preparation work for the third phase expansion of the ethylene cracker and its auxiliary projects and the construction work on major projects such as renovation on refinery facilities will be rolled out. As such, we aim to lay down a solid foundation for strengthening and expanding our core business and for enhancing the competitiveness of the Company in the international market.