Management Discussion and Analysis

1. Operating environment

1.1 Macro-environment

In the first half of 2005, the global economy continued to show good development prospects. The world petroleum consumption surpassed 82 million barrel/day ("bbl/d"), representing an increase of more than 2% from that of the same period last year. The PRC's macroeconomy sustained stable growth, with a Gross Domestic Product (GDP) growth rate of 9.5% when compared to that of the same period last year and a Consumer Price Index (CPI) growth rate of 2.3% when compared to that of the same period last year. The domestic petroleum consumption increased steadily. The national crude oil throughput rose by 7.9% from that of the same period last year to 145 million tonnes. The apparent consumption of petroleum products (including gasoline, diesel and kerosene) amounted to 79.87 million tonnes, representing an increase of 5.56% from that of the same period last year.

1.2 International oil prices

In the first half of 2005, the world oil refinery industry continued to remain relatively robust, with strong demand for petroleum. International crude oil prices continued to rise substantially on high levels. Brent crude oil price continued to reach record high, reaching as high as 58.47 $/bbl. The average dated price (FOB) of Brent crude oil for the first half of the year was 49.69 $/bbl, representing a rise of 47.67% from that of the same period last year.

The petroleum product prices in the Singapore market surged in volatility following the crude oil price fluctuations. In the first half of the year, the average prices of 95# gasoline and diesel in the Singapore market were 56.32 $/bbl and 59.53 $/bbl respectively, representing increases of 11.67 $/bbl or 26.14% and 19.89 $/bbl or 50.18% respectively as compared with those of the same period last year.

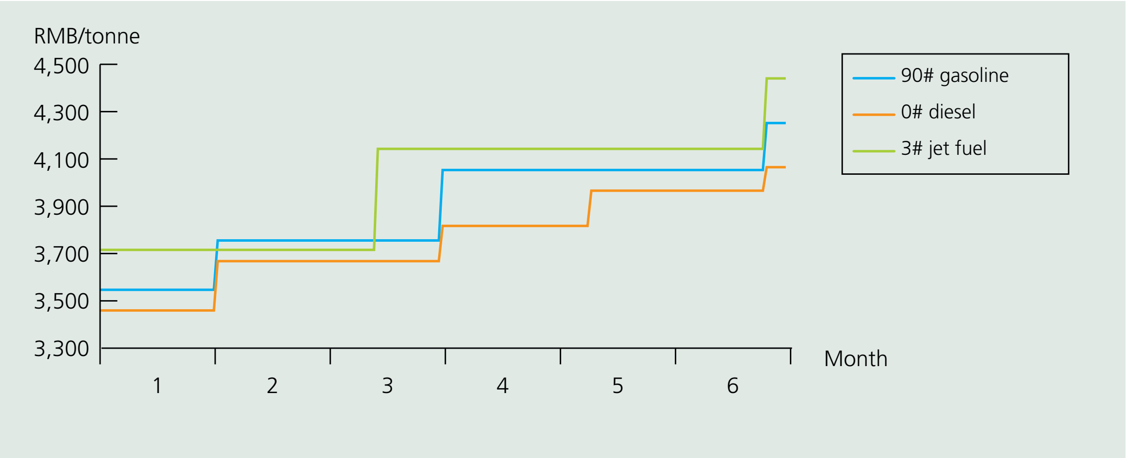
Dated price movements of Brent crude oil and those of gasoline and diesel in the Singapore market in the first half of 2005

Source of information: the Platts

1.3 Domestic petroleum product prices

In the first half of 2005, the State Development and Reform Commission made adjustments to gasoline prices in March, May and June respectively and adjustments to diesel prices in May and June. Prices of jet fuel were also adjusted in March and June respectively. The Company made adjustments to the ex-factory prices of gasoline and diesel in January, February and April respectively. In the first half of the year, the average ex-factory price of gasoline, diesel and jet fuel produced by the Company was RMB3,302.72 per tonne, representing an increase of 21.22% when compared to that of the same period last year.

The movement of ex-factory prices of the Company's petroleum products in the first half of 2005 (inclusive of tax)



2. Feedstock throughput, refining margin and unit complete expense

2.1 Feedstock throughput

The following table shows the composition of the Company's feedstock throughput:

Unit: '000 tonnes

		2005 1st half	Percentage share (%)	2004 1st half	Percentage share (%)
By feedstock type	Imported crude oil	8,114.66	95.82	7,412.73	91.40
	Off-shore crude oil	203.90	2.41	635.76	7.84
	On-shore crude oil	0.00	0.00	50.00	0.62
	Purchased feedstock	149.68	1.77	11.28	0.14
By business type	The Company's own operation	7,929.51	93.64	7,410.51	91.38
	Third-party processing	538.73	6.36	699.26	8.62
	Total	8,468.24	100.00	8,109.77	100.00

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In the first half of 2005, the Company fully exploited its large-scale production advantage and overall advantages to increase its feedstock throughput and realise high utilisation of its refining facilities, with the aim of meeting market demand. The Company's feedstock throughput for the first half of the year was 8,468,200 tonnes, representing a 4.42% increase when compared to that of the same period last year. The Company still ranked the first among other refineries in the PRC in terms of total throughput, accounting for 5.84% of the national crude oil processing volume.

In the first half of the year, imported crude oil processed by the Company amounted to 8,114,700 tonnes and accounted for 95.82% of the Company's total feedstock throughput, representing an increase of 4.42 percentage points when compared with that of the same period last year. The imported crude oil processed by the Company accounted for 12.8% of the total volume of imported crude oil of the country.

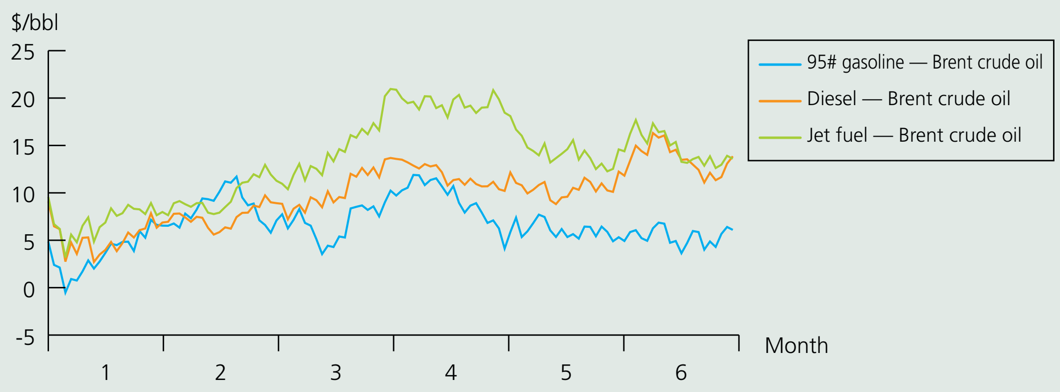
The Company continued to develop the third-party processing business. In the first half of the year, the Company processed 538,700 tonnes of crude oil for third-party processing business.

2.2 Refining margin

In the first half of 2005, the Company's refining margin (including the PX and PP businesses) amounted to RMB296.70 per tonne (about 4.91 $/bbl), representing a decrease of RMB50.98 per tonne (about 0.84 $/bbl) or 14.61% when compared to that of the same period last year.

The formula of calculating the refining margin is as follows: the refining business' net sales less feedstock costs, and divided by feedstock throughput (excluding third-party processing business).

Spread prices of petroleum products in the Singapore market in the first half of 2005



Source of information: the Platts

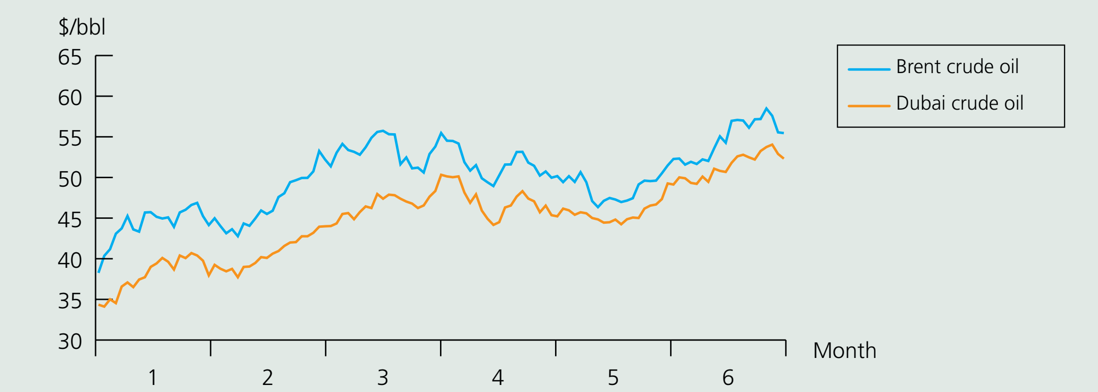
In the first half of 2005, the global petroleum consumption continued to increase with substantial rise in petroleum product prices. Refining margin in the international market continued to surge when compared with that of the same period last year.

Management Discussion and Analysis

In the first half of 2005, under the influence of the stringent control of domestic petroleum product prices, the gap between the prices of domestic and overseas petroleum products grew larger, which caused the Company's refining margin to be lower than that of the same period last year. However, the Company's refining margin remained at a satisfactory level as a whole. The main reasons are as follows:

First, control of crude oil processing cost. In the first half of the year, the price discrepancies between sour crude oil (as represented by Dubai crude oil) and low sulphur crude oil (as represented by Brent crude oil) in the international market were still relatively large, which was an advantage to refineries specialised in sour crude oil processing in controlling the cost of crude oil. The Company fully exploited its advantages in facilities and techniques to increase the processing volume of sour crude oil. The processing volume of sour crude oil for the first half of the year amounted to 6,413,600 tonnes, representing a 28.15% increase when compared to that of the same period last year and accounting for 77% of crude oil processing volume. Moreover, the Company rationally utilised its crude oil inventories of relatively low cost. In the first half of the year, the average dated price of Brent crude oil increased by 47.67% when compared to the same period last year. The Company's average processing cost of feedstock only rose by 33.97% from that of the same period last year to RMB2,750.26 per tonne (about 45.50 $/bbl).

Dated Price Movement of Brent and Dubai Crude Oil in the First Half of 2005



Source of information: the Platts

Second, increase in the Company's average selling price attributed to petrochemical products such as PX and PP. Output of PX and PP for the first half of the year amounted to 249,600 tonnes and 102,700 tonnes respectively, representing increases of 55.03% and 55.01% respectively when compared to those of the same period last year. Owing to the contribution from petrochemical products like PX and PP, the average price of all the Company's products increased by 28.95% from that of the same period last year to RMB3,342.83 per tonne, which surpassed the 21.22% increase in the average prices of gasoline, kerosene and diesel.

Management Discussion and Analysis

2.3 Unit complete expense

In the first half of 2005, the Company's unit refining cash operating cost was RMB81.80 per tonne (about 1.35 $/bbl), representing an increase of RMB10.64 per tonne when compared to that of the same period last year. The main reasons included the increase in purchased electricity and steam as a result of increased throughput and the operation of new units, which led to the increase of RMB4.86 per tonne in variable expenses. Intra-group purchase of electricity increased by RMB2.19 per tonne, while the fee for electricity purchased from society rose by RMB2.09 per tonne, and intra-group purchase of steam increased by RMB0.39 per tonne. The second reason was the increase of RMB5.78 per tonne in fixed expenses, including maintenance fee, which rose by RMB1.33 per tonne, staff costs, which surged by RMB3.04 per tonne, and management, marketing and other fees, which increased by RMB1.41 per tonne.

In the first half of 2005, the Company's unit complete expense was RMB137.70 per tonne (about 2.28 $/bbl), representing an increase of RMB13.08 per tonne when compared to that of the same period last year. The rise in unit complete expense was mainly due to the increase of RMB10.64 per tonne in unit refining cash operating cost as well as the increase of RMB3.38 per tonne in fixed assets depreciation as a result of the operation of new units, and a decrease of RMB0.94 per tonne in financial expense from the same period last year as a result of repayment of long-term borrowings.

Unit refining cash operating cost and unit complete expense

(RMB/tonne)	2005 1st half	2004 1st half	Change (%)
Unit refining cash operating cost (note 1)	81.80	71.16	+14.95
Unit complete expense (note 2)	137.70	124.62	+10.50

Notes:

1. Refining cash operating cost = Refining complete expense less depreciation and amortisation less net financing costs. Unit refining cash operating cost = Refining cash operating cost/feedstock throughput.

2. Refining complete expenses refer to the costs and expenses of the refining business (excluding chemical fertiliser business and subsidiaries) for the period under review except for the cost of feedstock. Unit complete expense = Refining complete expenses/feedstock throughput.

3. Analysis of operating results[2]

3.1 Analysis of major operating results

The following table shows the major income and expenses listed on the Group's consolidated income statement for the period under review:

	2005 1st half (RMB'000)	2004 1st half (RMB'000)	Change (%)
Turnover	25,858,192	19,412,997	33.20
Less: Business taxes and surcharges	(865,365)	(832,872)	3.9
Net sales	24,992,827	18,580,125	34.51
Cost of sales	(23,186,041)	(16,527,987)	40.28
Gross profit	1,806,786	2,052,138	-11.96
Selling, administrative and other operating expenses	(284,061)	(263,036)	7.99
Operating profit before financing costs	1,584,421	1,822,389	-13.06
Net financing costs	(29,789)	(42,309)	-29.59
Profit before tax	1,576,065	1,801,062	-12.50
Profit for the period	1,261,173	1,276,487	-1.20
Basic earnings per share (RMB/share)	0.50	0.51	-1.96

2 Please refer to the Group's financial statements and notes contained in this year's interim report when reading the following text.

Management Discussion and Analysis

3.2 Net sales

The following shows the composition of the Group's net sales:

	2005 1st half		2004 1st half	
	Net sales (RMB'000)	Sales volume ('000 tonnes)	Net sales (RMB'000)	Sales volume ('000 tonnes)
Gasoline	3,669,870	1,162	2,391,251	968
Diesel	10,316,731	3,342	8,606,204	3,347
Kerosene	2,043,521	603	1,513,796	566
Naphtha	1,443,614	395	778,036	327
Other chemical feedstock	306,387	86	172,840	60
BTX (excluding PX)	881,972	131	727,769	157
PX	1,844,693	242	921,691	161
PP	955,930	104	452,644	66
Propylene	207,515	27	160,642	31
LPG	1,598,919	467	1,176,723	420
Solvent oil	168,967	45	131,241	44
Fuel oil	185,855	116	171,255	122
Asphalt	318,578	209	436,991	300
Urea	433,758	298	390,924	298
Miscellaneous and service income	63,495	77	78,707	112
Income from subsidiaries	553,022	N/A	469,411	N/A
Total	24,992,827	7,304	18,580,125	6,979

In the first half of 2005, the Group's net sales amounted to RMB24,993 million, representing an increase of RMB6,413 million or 34.51% from RMB18,580 million of the first half of 2004. The 34.51% growth in net sales exceeded the 4.42% growth in feedstock throughput. Apart from the increase in the prices of petroleum products such as gasoline, kerosene and diesel, other factors that contributed to the higher growth in net sales than that of feedstock throughput are as follows:

First, increase in product sales volume. In the first half of 2005, the sales volume of the Company's products increased by 4.66% from that of the same period last year to 7,304,000 tonnes. Increase in product sales volume was mainly attributable to two factors. First, increase in feedstock throughput led to the increase in product output. Second, benefits from the increase of 0.39 percentage point in composite commercial yield from 93.56% of the same period last year to 93.95%, which was equivalent to an increase of 33,000 tonnes of products.

Second, while the production volume of PX and PP increased by over 50% as compared to that of the same period last year, their average ex-factory prices increased by over 30% to RMB7,643.49 per tonne and RMB9,224.72 per tonne respectively. The proportion of net sales of PX and PP to the aggregate net sales was 11.21%, representing an increase of 3.98 percentage points from that of the same period last year.

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Third, the Company seized the opportunity arising from market determination of naphtha and increased naphtha production. In the first half of 2005, the Company's naphtha price reached international market level. The average ex-factory price for commodity naphtha for the first half of the year was RMB3,658.83 per tonne, representing an increase of 53.93% when compared to that of the same period last year. Through implementing technical upgrade of the light hydrocarbon recovery and non-aromatics hydrofining units and making adjustments to production techniques, the Company strove to produce more naphtha. The output of commodity naphtha in the first half of the year amounted to 394,400 tonnes, representing a 20.10% increase when compared to that of the same period last year.

Fourth, the Company actively improved its product mix in accordance with product profitability. (1) The Company enhanced light oil yield and increased the output of light oil products. The light oil yield in the first half of the year was 75.42%, representing an increase of 0.40 percentage point or approximately 34,000 tonnes of light oil products when compared to that of the same period last year. (2) The Company raised the production volume of high value-added products such as LPG and benzene. In the first half of the year, output of LPG and benzene was 466,200 tonnes and 68,400 tonnes respectively, representing increases of 11.72% and 63.83% respectively when compared to those of the same period last year. (3) The Company capitalised on the trend for upgrading gasoline and diesel to increase the output of high-quality petroleum products. In the first half of the year, the production volume of above 93 octane gasoline for the first time surpassed 1 million tonnes, reaching 1,090,800 tonnes, representing an increase of 15.17% as compared to that of the same period last year. The Company produced for the first time 18,900 tonnes of B93# gasoline meeting Beijing standard, which is equivalent to Euro III standard. The output of #98 gasoline amounted to 5,003 tonnes, representing an increase of 2.54 times when compared to that of the same period last year. Output of car-used diesel meeting Euro II standard amounted to 483,900 tonnes, representing an increase of 2.56 times when compared to that of the same period last year.

Fifth, significant increase in profitability had been reflected in the chemical fertiliser business. In the first half of the year, the Company produced 302,800 tonnes of urea and realised profit before tax of RMB144 million, which represented an increase of 1.65 times when compared to that of the same period last year.

The Group's core operations were concentrated in the PRC and net sales were all derived from the PRC in the first half of 2005.

3.3 Cost of sales

The Group's cost of sales for the first half of 2005 amounted to RMB23,186 million, representing a 40.28% rise from that of the same period last year. The reasons include factors related to feedstock attributable to an increase of 38.19% in cost of sales. During the first half of the year, cost of processed feedstock was RMB21,983 million, accounting for 94.81% of cost of sales.

Management Discussion and Analysis

In the first half of 2005, the Company's staff costs rose by RMB9.02 million or 3.99% from that of the same period last year to RMB235.1 million due to adjustments to the rates and bases of housing fund and pension. Owing to the operation of new facilities, depreciation expenses rose by RMB16.6 million or 4.37% from that of the same period last year to RMB396.56 million.

3.4 Expenses during the period

In the first half of 2005, the Group strengthened its control of various expenses during the period. Administrative expenses, selling expenses and net financing costs together increased by 7.18% to RMB283 million when compared to that of the same period last year.

In the first half of the year, the Company's administrative expenses rose by RMB31.38 million to RMB212.11 million.

Selling expenses increased by RMB100,000 to RMB40.97 million as compared to that of the same period last year. The main reason for the increase in selling expenses was the increase of transportation and loading charges as a result of the increase in product sales.

Net financing costs dropped by RMB12.52 million to RMB29.79 million. The main reason for the drop in net financing costs was the decline in interest expenses as a result of the repayment of long-term borrowings.

3.5 Profit for the period

	2005 1st half (RMB '000)	2004 1st half (RMB '000)	Change (%)
Earnings before interests, taxes, depreciation and amortisation ("EBITDA")	2,123,809	2,342,768	-9.35
Earnings before interests and taxes ("EBIT")	1,597,798	1,841,233	-13.22
Profit before tax	1,576,065	1,801,062	-12.50
Income tax expenses	(314,892)	(524,575)	-39.97
Profit for the period	1,261,173	1,276,487	-1.20

In 2005, the Company's EBITDA was RMB2,124 million, representing a decrease of 9.35% from that of the same period last year. Depreciation and amortisation amounted to RMB526 million, representing an increase of 4.88% from that of the same period last year. EBIT amounted to RMB1,598 million, representing a drop of 13.22% from that of the same period last year. EBIT/net sales dropped from 9.91% to 6.39%. EBIT/ interest expenses rose from 48.50 times to 73.52 times.

The Company's profit before tax for the first half of 2005 amounted to RMB1,576 million. Due to recycling of "three kinds of waste materials" and the use of domestic equipment in technical transformation projects, the Company enjoyed a preferential enterprise income tax policy and could therefore offset an enterprise income tax expense of RMB196.12 million (2004 first half: RMB71.75 million). Profit for the period amounted to RMB1,261 million, representing a slight decrease of 1.21% from RMB1,276 million in the first half of 2004.

The Company's effective enterprise income tax rate in the first half of 2005 was 19.98%, representing a decrease of 9.14 percentage points from that of the same period last year.

4. Assets, liabilities, total equity and cash position

As at 30 June 2005, the Group's total assets and shareholders' equity amounted to RMB15,801 million and RMB12,155 million respectively, representing increases of 1.99% and 6.49% respectively from those as at the end of 2004. Total liabilities declined by 10.62% from that as at the end of 2004 to RMB3,644 million. Gearing ratio (total liabilities/total assets) stood at 23.06%, which was lowered by 1.34 percentage points when compared to that as at the end of 2004. Current ratio and quick ratio stood at 170.75% and 74.87% respectively. Returns on capital employed ("ROCE") were 10.95%. Return on net assets for the first half of the year was 11.24%. The Company's assets structure remained healthy, with satisfactory returns on capital.

Total assets increased by RMB308 million from RMB15,493 million as at the end of 2004. Current assets amounted to RMB5,847 million, representing an increase of RMB376 million when compared to that as at the end of 2004. The increase in current assets was mainly due to an increase of RMB1,267 million in inventory and a decline of RMB1,068 million in cash and cash equivalents. Non-current assets amounted to RMB9,954 million, representing a decrease of RMB68 million when compared to that as at the end of 2004. The decrease in non-current assets was primarily due to the fact that the increase in fixed assets depreciation expenses was higher than the increase in the value of projects in construction.

Total liabilities decreased by RMB433 million from RMB4,077 million as at the end of 2004. Current liabilities amounted to RMB3,424 million, representing a decrease of RMB333 million when compared with that as at the end of 2004. The decrease in current liabilities was primarily due to a decrease in income tax payables of RMB180 million. Non-current liabilities amounted to RMB220 million, representing a decrease of RMB100 million when compared with that as at the end of 2004 mainly attributed to the decrease in long term loans.

Total equity increased by RMB741 million from RMB11,416 million as at the end of 2004. Of the total equity, reserves and retained earnings rose by RMB741 million.

As at 30 June 2005, the Group's gearing ratio was lowered from 24.41% for the same period last year to 23.06%, mainly due to the realisation of relatively good profits and control of liabilities during the period under review.

5. Capital expenditure

Capital expenditure for the first half of 2005 reached RMB495 million, which was mainly used in the newly constructed projects, including a 1 million tpa delayed coking unit and benzene extraction unit, as well as the light hydrocarbon recovery and non-aromatics hydrofining technical upgrade project and methyl tertiary-butyl ether (MTBE) capacity expansion project.

The planned capital expenditure of the Group for the second half of the year will amount to approximately RMB700 million, which is mainly used in the 1.5 million tpa integrated hydrocracking and hydrogenerating unit, the 100,000 tpa sulphur recovery unit, upgrade of berths 2# and 3#, and 120 tonnes per hour steaming unit for wastewater disposal.

6. Health, safety and environment ("HSE")

During the first half of 2005, the Company adhered to the principle of harmonic relations between the environment and energy. Persevering with sustainable development strategies, the Company engaged in developing a recycling economy and building an industrial chain that can be exploited by each unit within the Company, as well as fully implemented clean production and pushed forward with the HSE management system, thereby providing society with environmental-friendly products. The Company also realised the harmonic development between the economy and the environment and established an ecological enterprise. The Company also adhered to the people-oriented principle. It showed concern for its staff's health as well as the co-existence and development in harmony with its surrounding communities. It made contribution to the establishment of a harmonic and economical society.

In the first half of 2005, the Company insisted on pre-event management and continual improvement of the HSE principle and pushed forward with the operation of the HSE management system. Through the measures such as fine-tuning the regulations and system for safe production, intensifying management efforts in accidents and unplanned halts in operation, and strengthening risk management, the Company ensured a safe and stable operation of production.

With the "National Environmental-Friendly Enterprise" recognition as a fresh start, the Company began to carry out various types of solid work on environmental protection during the first half of the year. The Company actively pushed forward with the construction of an enterprise based on the model of internal-circulating ecology and created a quality and clean working and living environment for its staff and society. During the first half of the year, the Company's rate of meeting the standard of industrial wastewater discharge and the emission of industrial gases reached 100%. Fresh water used and wastewater discharged for processing each tonne of crude oil were 0.32 tonne and 0.09 tonne respectively, which were in line with international advanced standards.

The Company devoted to offering cleaner fuel to society. Since 1 April 2005, the Company began to apply Euro II emission standard to all of its gasoline and diesel, of which sulphur content does not exceed 500 parts per million ("ppm"). The Company also produced 5,003 tonnes of 98# gasoline that meets the Euro III standard in terms of major quality indicators and has a sulphur content less than 150 ppm.