Management Discussion and Analysis

(Unless otherwise specified, financial information included in the Management Discussion and Analysis has been extracted from financial statements prepared under IFRS.)

A. Operating Results

General - Review of the Company's Operation during the Reporting Period (Business Review)

In 2005, the world's economy maintained a positive growth momentum while the global petrochemical industry remained at a prosperous stage of its growth cycle. However the rate of growth of the global petrochemical industry was slowing down. Driven by the sustained and relatively strong growth in China's economy and the global petrochemical industry, China's petrochemical industry was able to overcome the obstacles brought about by the fluctuating and high international crude oil prices, State's control on prices of domestic petroleum products and volatility of the petrochemicals market. The domestic petrochemical industry was able to maintain a relatively fast pace of growth as a whole. The domestic industry, in particular the upstream petroleum exploration segments, was able to achieve satisfactory operating results. In 2005, the Company closely monitored the changing conditions of the market, enhanced safe production, strengthened the long-cycle operation of production facilities and fundamental management, further intensified internal reform programs and strived to mitigate the adverse effects as a result of rising prices in oil, electric power, coal and transportation as well as falling prices in some of our products and the effect of typhoon Matsa. The Company's production and operation remained steady and smooth while other major technical and economic indicators such as crude oil processing volume, ethylene output and sales revenue all achieved record highs. However, economic benefits saw a substantial fall over 2004, with losses even recorded from September to December.

(1) Strived to achieve safe and smooth production, with total production output achieving a record high exceeding 8,000,000 tons

In 2005, the Company focused on a long-cycle operation of production facilities by ensuring safe production, environmental protection and management of production operation, and by optimizing raw material resources and system operation to maintain a steady increase in production output. During the year, the on-stream availability and the average load factor of the Company's major production facilities were 96.10% and 93.60%, respectively. The production volume of most product categories recorded year-on-year increases to varying degrees. Crude oil processing volume and ethylene output reached record highs again, with total production output exceeding 8,000,000 tons for the first time at 8,654,800 tons, up 9.94% over the previous year. No industrial or environmental pollution accidents took place during the year.

In 2005, the Company processed 9,493,000 tons of crude oil, up 4.21% over the previous year (of which 9,153,600 tons were imported crude oil, up 6.80% over the previous year). The Company produced 876,500 tons of gasoline, down 4.55% over the previous year; 3,199,400 tons of diesel oil, up 12.71%; 689,500 tons of jet fuel, down 3% over the previous year; 962,400 tons of ethylene, up 0.67% over the previous year; 523,000 tons of propylene, down 0.53% over the previous year; 1,067,100 tons of synthetic resins, up 0.71% over the previous year; 493,800 tons of synthetic fibre monomers, up 18.16% over the previous year, 595,800 tons of synthetic fibre polymers, up 13.01% over the previous year; and 356,600 tons of synthetic fibres, down 1.06% over the previous year. Meanwhile, the quality of the Company's products was consistently maintained at a premium level, and the Company remained as the largest ethylene and acrylic fibre producer in China.

(2) Increase in prices of petrochemical products slowed down despite strong demand

In 2005, the overall price level of petrochemical products was higher than those in 2004 as a result of a substantial increase in international crude oil prices which remained volitile at high levels, a relatively strong domestic demand for petrochemical product and a combination of other factors. However, increase in product prices slowed down remarkably. For the year ended 31 December 2005, the weighted average prices (exclusive of tax) of the Company's synthetic fibres, resins and plastics, intermediate petrochemicals and petroleum products increased by 8.50%, 8.12%, 18.37% and 22.55%, respectively over the previous year.

(3) Impact of crude oil costs

International oil prices continued to surge and remained at high levels in 2005 for the third consecutive year. In the second half of the year, in particular, oil prices climbed to historic highs. On 30 August 2005, the WTI ("West Texas Intermediate") crude oil prices on the New York Stock Exchange exceeded US$70, setting the record price of US$70.85 per barrel. According to the statistics of China Petroleum and Chemical Industry Association, the annual average price of Brent crude oil increased by 42.48% from US$38.04 per barrel in 2004 to US$54.20 per barrel in 2005. For the year ended 31 December 2005, the Group processed 9,493,000 tons of crude oil (inclusive of oil processed on a sub-contracting basis), representing an increase of 383,600 tons over the previous year. Of this volume, offshore oil accounted for 339,400 tons and imported oil accounted for 9,153,600 tons. Of the Group's cost of sales, crude oil costs accounted for RMB29,576.4 million or 68.96% of the Group's annual cost of sales. The average cost of crude oil processed was RMB3,208.22 per ton, up 39.13% over the previous year. Rises in crude oil prices and processing volume increased the Group's costs of crude oil by RMB9,961 million.

(4) The Company monitored market changes closely and capitalized on price trends, with product sales continuing to grow along with output

In 2005, the Company closely monitored changing market conditions, adhered to the principle of achieving full production capacity to meet sales demand, controlling sales pace and focusing on the matching of both production volume and pricing. The Company was able to maintain product price levels higher than the average price levels of its counterparts in general. In the second half of 2005, the Company continued to work in accordance with the Sinopec Corp.'s reforms in respect of the sales and marketing setup for petrochemical products and achieved a smooth transition towards a matching of production, sales, market and manpower, ensuring that product sales would grow along with output. The Group sold 8,629,100 tons of products during 2005, up 9.47% over the previous year. The output to sales ratio reached 99.70%. Management of sales contracts and receivables stepped up as well, with a receivable recovery ratio of 100.02% during 2005.

(5) Project construction proceeded smoothly, with progress made in the preliminary work for new development projects

In 2005, the Company worked hard on the construction of key projects by actively advancing the preliminary work for new development projects. The 8,000,000 tons/year atmosphere and vacuum distillation plant commenced operation in February 2005 to increase its preliminary processing capacity of crude oil to 14,000,000 tons/year. The construction of a raw material supply pipeline, a joint venture project between SPC and Shanghai Secco Petrochemical (the "Shanghai Secco"), came into operation upon mechanical completion in June 2005. The second phase expansion of the PTA Plant to 400,000 tons/year was completed in November 2005 and was successfully commissioned on the first test run. The construction of the 3,300,000 tons/year diesel hydrogenation project and the 380,000 tons/year ethylene glycol project proceeded on schedule. A pre-stage work office dedicated to the Phase V project was also set up for optimizing, registering and approving new development project proposals. Among these proposals, the third phase ethylene expansion plan was submitted to the State Development and Reform Commission, and went through the on-site research and assessment conducted by authoritative organizations.

The Shanghai Secco 900,000 tons/year ethylene joint venture project between the Company, Sinopec Corp. and BP Chemicals East China Investments Ltd. commenced operation in the first half of 2005, whereby 642,000 tons of ethylene were produced during the year.

(6) Strived to promote technology upgrades in production and operation

In 2005, the Company made new achievements in carrying out technology upgrades on production and operation. The development of proprietary PTA technology for a large-scale complete plant was completed. The Company made promising results in the industrial experimentation of PTT polymers, experimentation of the industrial application of locally-made catalyst for No. 4PE Plant, and experimentation of industrial application of the 250 tons/hour waste water recycling. Progress was made in the development of new products such as flattened and "V" acrylic fibres. Progress was also made in APC technology application in continous reformer PTA plant. According to statistics, the Company's output of new products was 607,600 tons during the year, up 17.23% over the previous year; output value of new products amounted to RMB5,626 million, up 29.18% over the previous year; output value ratio was 13.35%, up 0.71 percentage point over the previous year. 799,400 tons of synthetic resins of various types were produced, and the ratio of special resins was 81.36%, up 0.19 percentage point over the previous year; 197,600 tons of differentiated synthetic fibres were produced, and the ratio of differentiated synthetic fibres was 55.47%, up 11.48 percentage points over the previous year. Forty-one patent applications were submitted during the year, of which 40 were invention patents.

(7) Enhanced corporate management and intensified internal reform programs

In 2005, the Company achieved positive results in further enhancing its corporate management and intensifying its internal reform programs. The Internal Control Manual of Shanghai Petrochemical was in use in March 2005 upon approval by the Board. The ERP ("Enterprise Resource Plan") system came into operation in June 2005, promoting the improvement of business flows, enhancement of cost control, regulating of business conduct and raising of management level. In line with the requirement of a minimized managerial hierarchy, part of the management and business functions were integrated and centralized to further increase professional management capabilities. The quality of the Company's workforce was raised by stepping up their educational training by level and category. The Company strived to promote the establishment of a corporate culture and increase the management efficiency and level on a continuous basis. The Company also achieved the objective of implementing internal programs for reforming the auxiliary businesses and centralizing the sales and distribution system. As at 31 December 2005, the Company's work force was reduced by 2,970 employees including voluntary resignations and retirees, representing 10.44% of the total number of 28,451 as at the end of 2004.

(8) Analysis of the reasons for the significant fall in operating results for the year

As a result of a combination of factors such as higher international crude oil prices, the State's control over domestic petroleum products, increased costs of electric power, coal and transportation, decrease in prices of some of the Company's products and the effect of typhoon Matsa in the second half of 2005, the Company failed to effectively mitigate the effect of worsening economic conditions since the second half of the year despite some achievements made after a series of measures had been taken in an attempt to increase output and revenue while reducing costs and expenses. The significant fall in the operating results during the reporting period was mainly attributable to the following reasons:

i. The Group's production costs rose significantly as a result of fluctuating and high international crude oil prices. Given that crude oil costs accounted for a major proportion up to 68.96% of the Group's annual costs of sales and that the average costs of crude oil processed increased by 39.13% over the previous year, far more than the price increases for the Group's four major products, growth in the Group's profit was thus reduced substantially.

ii. The prosperous cycle of the petrochemical industry started in the second half of 2003 and peaked at October 2004, but then the increase in prices of petrochemical products slowed down. Since the second half of 2005, we have seen new highs set by international crude oil prices, a sluggish rise in the prices of petrochemicals and in particular, a distorted correlation between the prices of domestic petroleum products and those of international crude oil. As the Group's petroleum products accounted for a major proportion, up to 48.05%, of crude oil processing volume, the distorted correlation existing between prices of domestic petroleum products and prices of crude oil caused heavy losses to the Company's oil refining business. Despite a subsidy of RMB632.8 million granted by the Ministry of Finance, the Company was unable to fully make up the loss of approximately RMB1,370 million (inclusive of sales tax) arising from the sales of petroleum products so much, so that total profits of the Group fell remarkably in the second half of 2005 over the first half, with losses recorded from September to December.

iii. Shanghai Secco (in which the Company owns a 20% interest) commenced operation smoothly in the first half of 2005. However, a substantial loss was incurred in 2005 as a result of a one-off amortization of all start-up expenses for the current year. Accordingly, the loss from the investment in Shanghai Secco aggregated at RMB152.1 million on the basis of the Company's proportion of investment therein.

Critical Accounting Policies

The Group's financial condition and results of operations are sensitive to accounting methods, assumptions and estimates that underlie the preparation of the financial statements. The Group bases the assumptions and estimates on historical experience and on various other assumptions that the Group believes to be reasonable and which form the basis for making judgements about matters that are not readily apparent from other sources. On an on-going basis, management evaluates its estimates. Actual results may differ from those estimates as facts, circumstances and conditions change.

The selection of critical accounting policies, the judgements and other uncertainties affecting application of those policies and the sensitivity of reported results to changes in conditions and assumptions are factors to be considered when reviewing the financial statements. The principal accounting policies are set forth in financial statements. The Group believes the following critical accounting policies involve the most significant judgements and estimates used in the preparation of the financial statements.

Impairments

If circumstances indicate that the net book value of a long-lived asset may not be recoverable, the asset may be considered "impaired", and an impairment loss may be recognised in accordance with IAS 36 "Impairment of Assets". The carrying amounts of long-lived assets are reviewed periodically in order to assess whether the recoverable amounts have declined below the carrying amounts. These assets are tested for impairment whenever events or changes in circumstances indicate that their recorded carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to recoverable amount. The recoverable amount is the greater of the net selling price and the value in use. It is difficult to precisely estimate selling price because quoted market prices for the Group's assets are not readily available. In determining the value in use, expected cash flows generated by the assets are discounted to their present value, which requires significant judgement relating to level of sale volume, selling price and amount of operating costs. The Group uses all readily available information in determining an amount that is a reasonable approximation of recoverable amount, including estimates based on reasonable and supportable assumptions and projections of sale volume, selling price and amount of operating costs.

Depreciation

Property, plant and equipment are depreciated on a straight-line basis over the estimated useful lives of the assets annually in order to determine the amount of depreciation expense to be recorded during any reporting period. The depreciation expense for future periods is adjusted if there are significant changes from previous estimates.

Impairment for bad and doubtful debts

The Group estimates impairment losses for bad and doubtful debts resulting from the inability of the customers to make the required payments. The Group bases the estimates on the aging of the accounts receivable balance, customer credit-worthiness, and historical write-off experience. If the financial condition of the customers were to deteriorate, actual write-offs would be higher than estimated.

Summary

The following table sets forth the Group's sales volumes and net sales, net of sales taxes, for the years indicated (prepared under IFRS):

	For the Years ended 31 December								
	2005			2004			2003		
	Sales Volume ('000 tons)	**Net Sales (Millions of RMB)**	**% of Total**	Sales Volume ('000 tons)	Net Sales (Millions of RMB)	% of Total	Sales Volume ('000 tons)	Net Sales (Millions of RMB)	% of Total
Synthetic Fibres	**355.2**	**4,764.0**	**10.6**	384.4	4,751.8	12.3	395.4	4,092.6	14.1
Resins and Plastics	**1,505.8**	**13,958.3**	**30.9**	1,409.7	12,086.0	31.3	1,389.8	8,864.3	30.6
Intermediate Petrochemicals	**1,010.5**	**6,556.0**	**14.5**	1,075.8	5,896.6	15.3	1,021.8	3,851.3	13.3
Petroleum Products	**5,400.0**	**17,955.0**	**39.7**	4,828.9	13,101.9	33.9	4,650.4	10,329.1	35.7
All others	**-**	**1,957.0**	**4.3**	-	2,827.8	7.2	-	1,805.4	6.3
Total	**8,271.5**	**45,190.3**	**100.0**	7,698.8	38,664.1	100.0	7,457.4	28,942.7	100.0

The following table sets forth a summary statement of income for the years indicated (prepared under IFRS):

	For the Years ended 31 December					
	2005		2004		2003	
	(Millions of RMB)	**% of Operating revenues**	(Millions of RMB)	% of Operating revenues	(Millions of RMB)	% of Operating revenues
Synthetic fibres						
Operating revenues	**4,781.8**	**10.4**	4,778.0	12.1	4,115.0	14.0
Operating expenses	**(4,518.4)**	**(9.8)**	(4,527.6)	(11.5)	(4,002.7)	(13.5)
Operating profit	**263.4**	**0.6**	250.4	0.6	112.3	0.5
Resins and plastics						
Operating revenues	**14,010.3**	**30.5**	12,154.4	30.8	8,907.4	30.1
Operating expenses	**(12,519.6)**	**(27.3)**	(10,267.8)	(26.0)	(8,279.5)	(28.0)
Operating profit	**1,490.7**	**3.2**	1,886.6	4.8	627.9	2.1
Intermediate petrochemicals						
Operating revenues	**6,586.5**	**14.3**	5,941.6	15.1	3,879.8	13.1
Operating expenses	**(5,605.5)**	**(12.2)**	(4,390.8)	(11.1)	(3,282.4)	(11.1)
Operating profit	**981.0**	**2.1**	1,550.8	3.9	597.4	2.0
Petroleum Products						
Operating revenues	**18,616.5**	**40.5**	13,692.4	34.8	10,834.6	36.6
Other income	**632.8**	**1.4**	-	-	-	-
Operating expenses	**(19,696.2)**	**(42.9)**	(12,705.8)	(32.3)	(10,382.5)	(35.1)
Operating profit	**(446.9)**	**(1.0)**	986.6	2.5	452.1	1.5
Others						
Operating revenues	**1,960.8**	**4.3**	2,836.2	7.2	1,830.3	6.2
Operating expenses	**(1,721.0)**	**(3.7)**	(2,485.4)	(6.3)	(1,613.6)	(5.5)
Operating profit	**239.8**	**0.6**	350.8	0.9	216.7	0.7
Total						
Operating revenues	**45,955.9**	**100.0**	39,402.5	100.0	29,567.1	100.0
Other income	**632.8**	**1.4**	-	-	-	-
Operating expenses	**(44,060.7)**	**(95.9)**	(34,377.4)	(87.2)	(27,560.7)	(93.2)
Operating profit	**2,528.0**	**5.5**	5,025.2	12.8	2,006.4	6.8
Share of (losses)/profits of associates	**(61.0)**	**(0.1)**	(36.9)	(0.1)	(24.0)	(0.1)
Net financing costs	**(179.4)**	**(0.4)**	(292.0)	(0.7)	(392.0)	(1.3)
Income before tax	**2,287.6**	**5.0**	4,696.3	11.9	1,590.4	5.4
Income tax	**(366.3)**	**(0.8)**	(637.1)	(1.6)	(145.1)	(0.5)
Income after tax	**1,921.3**	**4.2**	4,059.2	10.3	1,445.3	4.9
Attributable to:						
Equity shareholders of the Company	**1,850.5**	**4.0**	3,971.1	10.1	1,401.7	4.8
Minority interests	**70.8**	**0.2**	88.1	0.2	43.6	0.1
Income after tax	**1,921.3**	**4.2**	4,059.2	10.3	1,445.3	4.9

Results of operations

Year ended 31 December 2005 compared with year ended 31 December 2004.

Net sales

Total net sales increased by 16.88% to RMB45,190.3 million in 2005 as compared with RMB38,664.1 million in 2004. In 2005, the demand for petrochemical products remained strong, driving the product prices to rise. However, the rise slowed down remarkably. The weighted average prices of synthetic fibres, resins and plastics, intermediate petrochemicals and petroleum products for 2005 increased to varing degrees as compared with 2004.

Synthetic fibres

Net sales of synthetic fibre products increased by 0.26% to RMB4,764.0 million in 2005 as compared with RMB4,751.8 million in 2004. Although the weighted average price of synthetic fibres increased by 8.50%, the profit margin of synthetic fibre products was narrowed due to the raw material cost of synthetic fibres remained at high level. As such, the sales volume of synthetic fibres decreased by 7.60% compared with 2004 as a result of decrease in the sales volume of certain major synthetic fibre products to varying degrees other than industrial fibre and acrylic top.

Net sales of synthetic fibre products accounted for 10.54% of the Group's total net sales in 2005, a decrease of 1.75% compared with 2004.

Resins and plastics

Net sales of resins and plastics increased by 15.49% as compared with RMB12,086.0 million in 2004 to RMB13,958.3 million in 2005. Weighted average price increased by 8.12% as compared with 2004 and sales volume increased by 6.82% as compared with 2004. Among the Group's resins and plastics products for 2005, the sales volume of polyester pellet, polyethylene and polypropylene increased by 20.29%, 2.88% and 2.12%, respectively, with the Group's average sales price increased by 1.83%, 8.29% and 16,53%, respectively.

Net sales of resins and plastics accounted for 30.89% of the Group's total net sales in 2005, decreased by 0.37% as compared with 2004.

Intermediate petrochemicals

Net sales of intermediate petrochemicals increased by 11.18% as compared with RMB5,896.6 million in 2004 to RMB6,556.0 million in 2005 with weighted average price increased by 18.37% as compared with 2004. Sales volume decreased by 6.07% as compared with 2004. Among the Group's intermediate petrochemical products, the weighted average prices of the Group's major products such as ethylene, pure benzene, butadiene and ethylene oxide increased respectively by 2.88%, 7.43%, 37.36% and 16.81%, while the sales volumes of pure benzene, butadiene and ethylene oxide increased by 3.77%, 2.80% and 11.72%, except for ethylene, the sales volume of which decreased by 2.59%.

Net sales of intermediate petrochemicals accounted for 14.51% of the Group's total net sales in 2005, a decrease of 0.72% as compared with 2004.

Petroleum products

Net sales of petroleum products increased by 37.04% as compared with RMB13,101.9 million in 2004 to RMB17,955.0 million in 2005, with an increase of 22.55% in the weighted average price and 11.82% in sales volume of these products as compared with 2004. The weighted average price of gasoline, diesel oil and jet fuel increased by 28.30%, 21.69% and 29.00%, respectively, with sales volumes increased by 20.94%, 11.96% and 13.18%.

Net sales of petroleum products accounted for 39.73% of the Group's total net sales in 2005, an increase of 5.84% as compared with 2004.

The Group received a cash government grant from the Ministry of Finance of the PRC of RMB632.8 million in respect of the distortion of the correlation of domestic refined petroleum product prices and the crude oil prices during the year ended 31 December 2005. There are no unfilled conditions and other contingencies attached to the receipt or usage of this government grant. There is no assurance that the Group will continue to receive such grant in the future.

Trading and other activities

Revenues for trading and other activities decreased by 30.79% to RMB1,957.0 million in 2005 as compared with RMB2,827.8 million in 2004.

Operating expenses

Operating profit of the Group decreased by 49.69% to RMB2,528.0 million in 2005 as compared with RMB5,025.2 million in 2004. The Group's operating expenses increased by 28.17% to RMB44,060.7 million in 2005 as compared with RMB34,377.4 million in 2004, mainly due to the increase in international crude oil prices. Of which, the operating expenses of resins and plastics, intermediate petrochemicals and petroleum products amounted to RMB12,519.6 million, RMB5,605.5 million and RMB19,696.2 million, respectively, representing increases of 21.93%, 27.66% and 55.02% as compared with 2004. Operating expenses of synthetic fibres and trading and other activities amounted to RMB4,518.4 million and RMB1,721.0 million, respectively, representing decreases of 0.20% and 30.76% as compared with 2004.

Synthetic fibers

Operating expenses of synthetic fibers decreased by RMB9.2 million as compared with 2004, mainly due to the sales volume of synthetic fibers decreased by 7.60% as compared with 2004.

Resins and plastics

Operating expenses of resins and plastics increased by RMB2,251.8 million as compared with 2004, mainly due to the raw material costs such as ethylene and propylene increased. Sales volume of polyester chips increased by more than 70,000 tons or 6.81% as compared with 2004 which was also contributed to the increase in cost of sales and selling expenses of resins and plastics.

Intermediate petrochemicals

Operating expenses of intermediate petrochemicals increased by RMB1,214.7 million as compared with 2004, due to the raw material cost such as naphtha increased.

Petroleum products

Operating expenses of petroleum products increased by RMB6,990.4 million as compared with 2004, mainly due to the continuous increase in prices of crude oil (major production raw material of the Group), which has directly led to a significant increase in the cost of sales and selling expenses of petroleum products. The weighted average cost of crude oil processed increased by 39.13% to RMB3,208 in 2005 as compared with RMB2,306 in 2004.

Trading and other activities

Operating expenses of trading and other activities decreased by RMB764.4 million as compared with 2004.

Cost of sales

Cost of sales increased by 29.09% to RMB42,887.7 million in 2005 as compared with RMB33,223.6 million in 2004, accounted for 94.90% of the net sales for 2005, primarily due to a significant increase in the price of crude oil which was the Group's major raw material in 2005.

Crude Oil

In 2005, the Group processed 9,493,000 tons of crude oil (of which 274,000 tons were processed on a sub-contracting basis) an increase of 383,600 tons as compared with 9,109,400 tons in 2004 (602,500 tons of sub-contracting processing in 2004). The volume of crude oil processed by the Group of imported oil and offshore oil, were 9,153,600 tons and 339,400 tons, respectively.

Total cost of crude oil processed by the Group in 2005 was RMB29,576.4 million, an increase of 50.78% as compared with RMB19,615.6 million in 2004 and accounted for 68.96% of the cost of sales. The weighted average cost of crude oil for the Group was RMB3,208.22 per ton representing an increase of 39.13% as compared with 2004. The weighted averaged costs of imported oil and offshore oil were RMB3,219 per ton and RMB2,930 per ton, respectively.

Other expenses

Expenses for other ancillary materials was RMB6,954.0 million in 2005, an increase of 14.16% as compared with RMB6,091.6 million in 2004 primarily due to a significant increase in the purchasing costs of intermediate petrochemicals such as naphtha and acrylonitrile during the reporting period. During the reporting period, the Group did not have significant capital expenditure project completed and new acquisition of fixed assets. Depreciation decreased from RMB1,794.1 million in 2004 to RMB1,705.1 million in 2005. Energy and power costs increased to RMB892.0 million due to an increase in the price of coal and electricity in 2005. Labor and maintenance costs decreased to RMB1,168.5 million and RMB896.0 million, respectively, during the year.

Selling and administrative expenses

Selling and administrative expenses was RMB444.4 million, an increase of 8.90% as compared with RMB408.1 million due to a significant increase in the Group's income from principal operations as compared with 2004.

Operating income

Operating income was RMB2,528.0 million, a significant decrease of 49.69% as compared with RMB5,025.2 million in 2004, primarily due to a significant increase in the Group's cost of production as a result of rising crude oil prices during the reporting period. The distorted correlation between international crude oil prices and domestic petroleum product prices which was subject to the State's control has also led to a decrease in the Group's operating efficiency in 2005.

Other operating income

Other operating income was RMB238.6 million in 2005, a decrease of 13.86% as compared with RMB277.0 million in 2004.

Other operating expenses

Other operating expenses decreased by 29.10% from RMB284.2 million in 2004 to RMB201.5 million in 2005, primarily due to the decrease in employee reduction expenses during the reporting period.

Net financing costs

The Group's net financing costs was RMB179.4 million in 2005, a decrease of 38.56% as compared with RMB292.0 million in 2004, which was primarily due to a decrease in the balance of bank borrowings as compared with 2004, appreciation of RMB and realized foreign exchange gain of RMB57.1 million.

Profit before tax

The Group's profit before tax was RMB2,287.6 million in 2005, a decrease of 51.29% as compared with RMB4,696.2 million in 2004.

Income tax

The Group's income tax decreased by 42.51% to RMB366.3 million in 2005 as compared with RMB637.1 million in 2004. This decrease was primarily due to a substantial decrease in total profit.

The Group continued to pay income tax at a preferential rate of 15% in 2004. This preferential rate was first applied to us under approval from State tax authorities effective from 1 January, 1993. According to relevant taxation regulation issued by the Ministry of Finance and the State Administration of Taxation, the first nine H-Share listed companies (including the Company) were permitted to pay income tax at a 15% tax rate for years in 1996 and 1997. From 1998 to 2005, the tax privilege was not revoked by the relevant government authorities. However, the Group is unable to confirm whether the Ministry of Finance will maintain the 15% tax rate in 2006.

Profit after tax

Profit after tax was RMB1,921.3 million in 2005, a significant decrease of 52.67% as compared with RMB4,059.2 million in 2004.

B. Analysis of the Company's principal operations and performance

(a) Principle operations by segment or product (prepared under PRC Accounting Rules and Regulations)

By segment	Income from principal operations (RMB'000)	Cost of sales (RMB'000)	Gross profit margin (%)	Increase/ decrease of income from principal operations compared to last year (%)	Increase/ decrease of cost of sales compared to last year (%)	Increase/ decrease of gross profit margin compared to last year (percentage points)
Synthetic fibres	4,781,787	4,352,965	8.97	0.08	-0.57	Increase 0.6 percentage points
Resins and plastics	14,010,287	11,631,710	16.98	15.27	21.03	Decrease 3.95 percentage points
Intermediate petrochemicals	6,586,556	5,024,854	23.71	10.86	30.12	Decrease 11.29 percentage points
Petroleum products	18,616,544	18,955,210	-1.82	35.96	60.54	Decrease 15.59 percentage points
Trading and others	1,902,633	1,640,374	13.78	-32.92	706.20	Decrease 3.32 percentage points
Including: connected transactions	19,870,978	19,023,005	4.27	34.64	41.66	Decrease 4.74 percentage points

Price-setting principles of connected transactions	The directors of the Company (including independent non-executive directors) believe that the connected transactions were conducted on normal commercial terms which are no less favourable than those offered to or by any third party and were conducted in ordinary course of business. This was confirmed by the independent non-executive directors of the Group.
Description on the necessity and continuity of connected transactions	The purchases by the Company from Sinopec Corp. and its associates of crude oil-related materials and sales of petroleum products by the Company to them were conducted in accordance with the State's relevant policy and applicable State tariffs or State guidance prices. As long as the State does not revoke its control over purchases of crude oil, sales of petroleum products and pricing thereof, such connected transactions will continue to happen. The Company sells petrochemicals to Sinopec Corp. and its associates and Sinopec Corp. and its associates act as an agency for the sale of petrochemicals in order to reduce the Company's inventories, expand its trading, distribution and sales networks and improve our bargaining power with our customers. The Company accepts transportation, design, construction and installation, insurance agency and financial services from Sinopec and its associates in order to secure steady and reliable services at reasonable prices.

(b) Principal operations by geographical location

Geographical location	Income from principal operations RMB'000	Increase/decrease of income from principal operations compared to the previous year (%)
Eastern China	43,325,545	15.95
Other regions in China	2,544,244	30.87
Exports	86,114	-8.29

C. Liquidity and Capital Resources

The Group's primary sources of capital are operating cash flow and loans from unaffiliated banks. The Group's primary uses of capital are costs of goods sold, operating expenses and capital expenditures.

Capital Resources

Net cash inflows from operating activities (prepared under IFRS)

The Group's net cash inflow provided from operating activities was RMB3,943.6 million in 2005, a decrease of RMB646.1 million as compared with RMB4,589.7 million in 2004. Due to the increase in the costs of the Group's crude oil being higher than the increase in sales prices of various major products during the reporting period, net cash inflows from profit before tax net of depreciation was RMB3,992.7 million in 2005, a decrease of RMB2,497.6 million of net cash flow as compared with RMB6,490.3 million in 2004. Increased inventories balance at the end of the year led to an increase in cash outflow by RMB387.2 million in 2005 (as compared with an increase in cash outflow by RMB223.5 million during the same period of the previous year). Change in year-end amount of operating payables and other payables led to an increase in cash outflow by RMB223.0 million in 2005 (as compared with an increase in cash outflow by RMB376.9 million during the same period in the previous year). Decrease in the year-end balances of debtors, bills receivables and deposits led to an increase in operating cash inflow by RMB1,170.9 million in 2004 (as compared with a decrease in cash inflow of RMB515.0 million during the same period in the previous year). In addition, the Group's income tax payment decreased significantly due to a significant decrease in profit during the reporting period. In 2005, income tax payment led to a cash outflow of RMB431.0 million (as compared with RMB673.2 million cash outflow in 2004).

Cash flow breakdowns of the Group during the reporting period (prepared under PRC Accounting Rules and Regulations)

	2005 RMB'000	2004 RMB'000
Net cash inflow from operating activities	**4,245,115**	4,908,020
Net cash outflow from investing activities	**(1,189,242)**	(2,312,219)
Net cash outflow from financing activites	**(3,395,755)**	(2,745,677)

Borrowings

The Group's borrowings in 2005 amounted to RMB5,404.0 million, a decrease of RMB1,610.9 million compared with RMB7,014.9 million in 2004, of which, short-term borrowings decreased RMB1,073.6 million. Short-term borrowings were primarily used to meet our needs for working capital during the production and operation process, all carried floating interest rates and were denominated in Renminbi. Long-term borrowings was RMB1,477.3 million in 2005, a decrease of RMB537.3 million as compared with RMB2,014.6 million in 2004. Most of our long-term borrowings were used for capital expansion projects for the past years.

The Group managed to maintain its asset-liability ratio by enhancing control over both liabilities, including bank borrowings, and financing risks. The Group generally does not experience any seasonality in borrowings. Rather, due to the planned nature of capital expenditures, long-term borrowings can be arranged in advance of expenditures while short-term borrowings are used to meet operational needs. The terms of our existing bank loans do not restrict our ability to pay dividends on our shares.

Debt-equity ratio

The Group's debt-equity ratio was 7.3% in 2005 compared to 9.9% in 2004. The ratio is calcuated using this formular (total long-term loans)/(total long-term loans + shareholders' equity).

D. Research and Development, Patents and Licenses, etc.

The Group maintains a range of technology development units, including Petrochemical Research Institute, Polyester Fiber Research Institute and Acrylic Fibre Research Institute, for research and development with respect to new technology, new products, new production processes and equipment and environmental protection. The Group's research and development expenditures in 2003, 2004 and 2005 were RMB101.2 million, RMB74.7 million and RMB79.5 million, respectively, representing approximately 0.3%, 0.2% and 0.2% of the total sales, respectively, in those years.

The Group was not, in any material aspect, dependent on any patents, licenses, industrial, commercial or financial contracts or new production processes.

E. Off-Balance Sheet Arrangements

Please refer to page 77 headed "7. Guarantees" and note 33 to the financial statements under IFRS for details of the Group's external guarantee and capital undertakings.

F. Contractual obligations

The followings table sets forth our obligations to make future payments under contracts effective as of 31 December 2005.

	As of 31 December 2005 Payment due by period				
	Total (RMB'000)	Less than 1 year (RMB'000)	1-3 years (RMB'000)	4-5 years (RMB'000)	After 5 years (RMB'000)
Contractual obligations					
Short-term loan	2,553,537	2,553,537	-	-	-
Long-term loan	2,850,446	1,373,205	1,407,145	50,410	19,706
Total contractual obligations	5,404,003	3,926,742	1,407,145	50,410	19,706

G. Description of substantial changes in the Company's major financial data during the reporting period against the previous year (prepared under PRC Accounting Rules and Regulations)

(Details of reporting items with annual changes of 30% or more and occupying 5% or more of the Group's total assets at the reporting date or 10% or more of the net profits for the reporting period, together with reasons for the changes.)

Item	**Year ended 31December 2005 RMB'000**	Year ended 31December 2004 RMB'000	Change RMB'000	Change %	Reason for change
Profit from principal operations	**3,527,005**	6,654,977	-3,127,972	-47.00	Crude oil costs increased substantially, sluggish prices of major product and gross profit margin of the oil refining business decreased substantially.
Profit from operations	**1,723,162**	4,808,178	-3,085,016	-64.16	
Net profit	**1,704,627**	3,971,265	-2,266,638	-57.08	
Subsidy income	**632,820**	-	632,820	-	The Company received a cash government grant of RMB632.8 million from the Ministry of Finance in December 2005.
Cost of sales	**41,605,113**	32,009,082	9,596,031	29.98	Crude oil costs increased substantially.

Item	**As at 31December 2005 RMB'000**	As at 31December 2004 RMB'000	Change RMB'000	Change %	Reason for change
Short-term borrowings	**2,553,537**	3,742,727	-1,189,190	-31.77	Payment upon expiry

H. Analysis of performance and results of the companies during the reporting period, in which the Company has controlling interests or investment interests

As at 31 December 2005, the Company had equity interests of more than 50% in the following principal subsidiaries:

Company	Place of registration	Principal Activities	Place for principal activities	Class of legal person shares	Percentage of the equity held by the company	Percentage of the equity held by subsidiaries (%)	Registered Capital ('000)	Net Profit for 2005 ('000)
Shanghai Petrochemical Investment Development Company Limited	China	Investment management	China	Limited company	100	-	RMB800,000	200,771
China Jinshan Associated Trading Corporation	China	Import and export of petrochemical products and equipment	China	Limited company	67.33	-	RMB25,000	11,011
Shanghai Jinhua Industrial Company Limited	China	Trading in petrochemical products	China	Limited company	-	81.79	RMB25,500	17,524
Shanghai Jindong Petrochemical Industrial Company Limited	China	Trading in petrochemical products	China	Limited company	-	60	RMB20,000	-15,299
Shanghai Golden Way Petrochemical Company Limited	China	Production of vinyl acetate products	China	Limited company	-	75	US$3,460	7,834
Shanghai Jinchang Engineering Plastics Company Limited	China	Production of polypropylene compound products	China	Limited company	-	50.38	US$4,750	2,531
Shanghai Golden Phillips Petrochemical Company Limited	China	Production of polypropylene products	China	Limited company	-	60	US$50,000	180,926
Zhejiang Jin Yong Acrylic Fiber Company Limited	China	Production of acrylic fiber products	China	Limited company	75	-	RMB250,000	-25,892
Shanghai Petrochemical Enterprise Development Company Limited	China	Investment management	China	Limited company	100	-	RMB455,000	-38,454
Shanghai Golden Conti Petrochemical Company Limited	China	Production of Petrochemical products	China	Limited company	-	100	RMB545,776	70,657

None of the subsidiaries have issued any debt securities.

The Company's equity interests in associates comprised an equity interest of 38.26% in Shanghai Chemical Industry Park Development Co., Ltd. set up in the PRC, amounting to RMB658.5 million, and an equity interest of 20% in Shanghai Secco set up in the PRC, amounting to RMB1,336.6 million. The principal business of Shanghai Chemical Industry Park Development Co., Ltd. is the planning, development and operation of the Chemical Industry Park in Shanghai, PRC, while the principal business of Shanghai Secco is the production of petrochemicals such as ethylene.

Results analysis of the companies, in which the Group has controlling interests or investment interests and which affected 10% or more of the Group's net profit: Shanghai Golden Phillips Petrochemical Company Limited, mainly engaged in the production of polyethylene filament products and specialized materials, recorded income from principal operations of RMB1,354.0 million and profit from principal operations of RMB241.6 million.

I. Major suppliers and customers

The Group's top five suppliers during 2005 were Sinopec Transport & Storage Branch, China International United Petroleum & Chemical Company Limited, Sinopec International Co. Ltd., Sino Chemical International Oil Co. Ltd. and China National Offshore Oil Corporation. The total cost of purchases from these suppliers accounted for 74% of the total cost of purchases by the Group during the year, amounting to RMB31,166.9 million. The cost of purchases from the largest supplier amounting to RMB20,436.0 million, represented 49% of the total cost of purchases by the Group during the year.

The Group's top five customers during 2005 were Sinopec Huadong Area Sales Company, Sinopec Gaoqiao Branch, Shanghai Chlor-Alkali Chemical Company Limited, Shanghai Xinshan Chemical Industry Company Limited and Shanghai Secco. The total sales derived from these customers represented 42% of the Group's total turnover during the year, amounting to RMB19,267.7 million. The sales derived from the largest customer amounting to RMB15,855.3 million, represented 35% of the turnover during the year.

None of the directors (or their associates) or shareholders of the Company, to the knowledge of the Board, held any interest in the above suppliers and customers, namely Sino Chemical International Oil Co. Ltd., China National Offshore Oil Corporation, Shanghai Chlor-Alkali Chemical Company Limited or Shanghai Xinshan Chemical Industry Company Limited. Sinopec Transport & Storage Branch, China International United Petroleum & Chemical Company Limited, Sinopec International Co. Ltd., Sinopec Huadong Area Sales Company and Sinopec Gaoqiao Branch are subsidiaries of the Company's controlling shareholder, Sinopec Corp. The Company owns an equity interest of 20% in Shanghai Secco.

J. Others

Employees

As at 31 December 2005, the Company has 25,481 employees, among whom 16,427 were production staff, 7,050 were sales, finance and other staff, 2,004 were executives. 25.51% of the Group's staff were graduates of colleges or universities. The Group was responsible for pension for retirees amounted to 10,260 people.

Purchase, Sale and Investment

Save and except as disclosed in the annual report, during 2005, there was no material purchase or sale of our subsidiaries or associated or any other material investments.

Pledge of Assets

As at 31 December 2005, no property and equipment were pledged by the Group (31 December 2004: RMB Nil).

Accounting principles generally accepted in the United States of America ("U.S. GAAP") Reconcillation

The financial statements prepared in accordance with IFRS differ in certain significant respects from U.S. GAAP. Please see section D for supplementary information for North American shareholders. As a result of these differences and the effect after tax, profit attributable to equity shareholders of the Company reported under U.S. GAAP was higher than profit attributable to equity shareholders of the Company reported under IFRS by RMB18.9 million in 2005, RMB175.0 million in 2004 and RMB166.7 million in 2003. Shareholders' equity reported under U.S. GAAP was higher than the one reported under IFRS by RMB81.1 million as of 31 December 2005 and higher by RMB64.7 million as of 31 December 2004.

Company's Outlook on Future Developments (Business Prospects)

(i) The industry's trend and competition posed to the Company

In 2006, the global tendency towards multipolarity and economic globalization will continue. The world's economy is expected to maintain its steady growth momentum but the pace is likely to slow down. Under the effects of macro-economic measures, China's economy should maintain its steady, robust growth but the growth rate is expected to slow, with a GDP growth rate projected at around 8.8%. The sustained economic growth in both the international and domestic scenes will bring about attractive business opportunities to the petroleum and petrochemical industry. Following the commencement of operation of large-scale ethylene joint-venture projects such as Shanghai Secco and Nanjing Yangba in 2005, the 800,000-ton ethylene project in Huizhou, the l,000,000-ton ethylene renovation and expansion project in Maoming and the 600,000-ton ethylene renovation and expansion project in Lanzhou are also scheduled for completion and commencement of operation in 2006. Despite the expanding petrochemical output in China, the domestic petrochemicals market is expected to remain prosperous due to the gradually increasing demand for petroleum, natural gas, petroleum products and major petrochemicals as driven by strong economic growth. In general, the macro-economic conditions will remain positive but petrochemical companies will still be exposed to a number of unfavourable and uncertain factors: the possibility of continued high international crude oil prices; the State's control over prices of domestic petroleum products; reduction of tariffs for imported petrochemicals; declining prices of petrochemical products; continued tight supply of coal, electric power and transportation; intensification of international trade barriers and trade conflicts; and increasing pressure from environmental protection requirements. All these factors will have certain impact on the production and operation of the petrochemical industry in China, adding uncertainties and risks to the operation of petrochemical companies.

In response to the macro-economic measures and the changes taking place in the industry's growth cycle, the Company will strive to intensify reform programs, carry out restructuring, increase operational efficiency, enhance management, regulate operation and minimize operational risks. It will also capitalize on business opportunities, accelerate development and enhance core competitiveness. The Company will strive to continue to achieve satisfactory operating results in 2006.

(ii) The Company's opportunities, challenges and strategies ahead

China's Eleventh Five-year Plan will commence in 2006, during which increasing economic globalization, advancement in science and technology and recovery of the world's economy should facilitate steady growth of the global petroleum and petrochemical industry. Between 2005 and 2010, the world's economy is expected to grow at an annual average rate of between 2.8% and 3.7%. Demand for petroleum will grow between 1.2% and 1.7% per annum while demand for ethylene will grow at 4.5% per annum. China's economy will be able to maintain its steady and strong growth, with GDP per capita doubling by 2010 over 2000. Although the increase in domestic demand for petrochemicals during the period of the Eleventh Five-year Plan is expected to be slightly lower than that of the period of the Tenth Five-year Plan, the increase will remain stable, witnessed by more rising demands for product quality and variety. China's domestic demand for the three petroleum products, namely petrol, coal and diesel oil, will increase from 168,000,000 tons in 2005 to 220,000,000 tons by 2010, and the demand for ethylene will increase from 18,700,000 tons in 2005 to 24,000,000 tons by 2010. The availability of diversified, high value-added and high performance downstream ethylene products will offer room for growth which will in turn benefit the development of Chinai¯s domestic petroleum and petrochemical industry.

However, it should be noted that the domestic petrochemical industry will be encountering various challenges during the period of the Eleventh Five-year Plan as well. First, the global scramble for petroleum resources will be intensifying and ensured petroleum supply is under a great challenge. With reduced supply of domestic crude oil and increasing reliance upon imported crude oil, China is exposing itself to complex and changing risks associated with the use of international petroleum and natural gas resources. In addition, with the development of the ethylene industry in future, China will face increasing difficulties in obtaining supply of oil for petrochemical purposes and the growth of the petrochemical industry will be subject to the shortage of resources. Secondly, as the world is entering an era characterized by high oil prices with international oil prices constantly staying at a high level. China's existing pricing mechanism for petroleum products will place oil refining and the petrochemical industry under pressure from rising costs and increasing operational risks. Thirdly, as the post-transitional period comes to an end upon China's accession to the WTO, the domestic market will see significant competition from imported products as a result of increasing marketization of petroleum and petrochemical products, coupled with declining tariffs on imported products and deregulation of the right to operate foreign trade. As the markets and investments themselves become more diversified, competition from neighbouring countries (in particular, the Middle East) and from domestic industry peers will be more intensified than that during the period of the Tenth Five-year Plan. Fourthly, competition in the technology field will intensify, witnessed by petrochemical companies placed under "siege" by the technology of foreign companies. Major foreign petrochemical companies possess a great deal of state-of-the-art patented technology and branded products, and are consistently developing advanced technology, thereby giving these foreign companies a competitive edge in the field of technology. Fifthly, more stringent environmental protection requirements have been set for the Chinese petrochemical industry as a result of science achievements and the promotion of a harmonized society. Enhanced utilization of resources, development of pollution-free production and production of pollution-free products as well as emission of "no pollutants" will become necessities for the petrochemical industry, leading to increased investments and costs for the industry.

Looking ahead to the future development, the Company will strategically position itself as “a first-class China enterprise and an advanced corporation internationally”, and be committed to matching external expansion with internal development and focusing on internal development as its mission. During the period of the Eleventh Five-year Plan, led by the ethylene renovation project carried out in three phases, with a focus on olefin-polyolefine chain and aromatic hydrocarbon- polyester chain supplemented by public utility projects, the Company will continue to maintain and expand its existing economies of scale and enhance the overall economic benefits of the integrated oil refining industry, and to upgrade the Company’s overall competitiveness around the world and its capabilities for sustainable growth.

(iii) New business initiatives for 2006

In 2006, in the face of acute supply of crude oil resources, rising international oil prices, expanding petrochemical output capacity, falling prices of petrochemicals and intensifying competition, the Company will build on a low-cost strategy, unleash its potentials, optimize resource allocation and maximize effectiveness on management, production, innovation and marketing in order to enhance its competitiveness through cost reductions and optimized adjustments.

(a) Striving to cut costs and expenses and strictly controlling cost drivers

The Company will identify the sources of costs and will implement strict control over such cost drivers as the Company’s major task. It will strengthen management, control expenses, promote optimization and reduce procurement costs of crude oil, large amount of petrochemical raw materials and fuel, thereby cutting operating costs of production facilities and other expenses arising from production and operation.

The major measures are: first, further enhance the management of safety, environmental protection, production and equipment, etc. to ensure the smooth long-cycle operation of facilities. Secondly, improve the sales supply management system and business flows and reduce procurement costs of crude oil, large amount of petrochemical raw materials and fuel as well as sales costs of products. Thirdly, improve optimization, allocation and utilization of production resources to effectively reduce energy and raw material consumption during production. Fourthly, continue to improve fundamental management, infrastructure and basic training and set up a regulated, systematic and procedural scheme aimed at preventing wrong decision-making and risks in operation.

(b) Advancing reform programs and optimizing and adjusting the structure of the corporate value chain

The Group will conscientiously implement a scientific development vision and will focus on restructuring, intensifying reform programs, and changing its growth pattern so as to optimize and adjust the structure of the corporate value chain. It will strive to improve industrial restructuring and business flows and accelerate the pace of a new round of development to enhance the Company’s overall competitiveness on a continuous basis.

The major measures are: first, restructure the operation assets in tandem with the new round of development on the basis of the "do-and-don't principle". Secondly, optimize management flow, enhance centralized management and increase management efficiency in line with the requirements of a horizontalized management and the implementation of the ERP system. Thirdly, revise the Company's development plan, implement a new-round development proposals to steadily expand the Company. Fourthly, further capitalize on new product development and application of new technologies and strive to promote technological advancement and IT construction.

(c) Focusing on people and building a quality team

The Company remains committed to stepping up effective development and utilization of human resources by improving the management of staff performance, strengthening staff training, strengthening the cultivation of management leaders, focusing on the establishment of a corporate culture, and striving to build a quality team to ensure smooth implementation of production, operation as well reform and development programs.

The major measures are: first, through focusing on people, further improve the development of human resources; implement company-wide performance management; and enhance appraisals, job rotation and incentive plan for staff. Secondly, in line with the practical needs of the Company's staff training program, production operation as well as reform and development projects for 2005-2010, actively provide staff training programs and further raise the quality of the three core teams (management, professionals and skilled operators). Thirdly, reinforce the cultivation of management leader by stepping up learning, execution and control. Fourthly, actively promote the vision of low-cost strategy, further promote the establishment of a corporate culture and create a harmonious environment within the Company.

(iv) The risks which the Company may be exposed to in its future development

(a) Characteristics of the petroleum and petrochemical industry's cycle as well as volatility of the prices of crude oil and refinery products may have an adverse impact on the Group's operation and production.

A large part of the Group's revenue is derived from the sale of petrochemicals. Historically, such products have been cyclical in nature and sensitive towards the supply and prices of raw materials as well as towards the overall economic situations. The markets where many of the Group's products are available respond sensitively to changes in industrial output and output level, the conditions of regional and global economies, cyclical changes in the prices and supply of substitutes, and changes in consumer demand. The above factors have a major impact, from time to time, on the prices of the Group's products available on the regional and global markets. Historically, these markets have been experiencing short supply during different periods of time which led to an increase in prices and profits, followed by a period of increased output which might result in oversupply and a decline in prices and profits. Given the reduction of tariffs and other import restrictions as well as China's relaxed control over the distribution and pricing of products, many of the Group's products will be subject to the impact of the petrochemical cycle of the regional and global markets. In addition, the prices of crude oil and petrochemicals will remain volatile and uncertain. Increased crude oil prices and fallen petrochemicals prices are likely to have an adverse impact on the Group's business, operating results and financial status.

(b) Substantial capital expenditures and financing requirements are needed for the Group's development plans, presenting a number of risks and uncertainties.

The petrochemical industry is a capital intensive sector. The Group's capability to maintain and increase income, net income and cash flows is conditional upon ongoing capital expenditures. The Group's capital expenditures will amount to RMB1,800 million approximately (US$223.1 million) for 2006, which will be met by financing activities and part of the Group's self-owned funds. As at 31 December 2005, the Company's outstanding liabilities totaled approximately RMB222.7 million (US$27.6 million). On 31 December 2005, Sinopec Corp. (the Group's controlling shareholder) provided guarantee to the Group's US$4.5 million long-term borrowings.

The Group's capability to secure external financing in future is subject to a number of uncertainties which include:

- the Company's operating results, financial status and cash flow in future;
- China's economic situations and the market situations for the Group's products;
- financing costs and situations of the financial market; and
- grant of government approval documents and other risks associated with the development of infra-structure projects in China, and so forth.

The Company's failure to secure sufficient financing required for operation or development plans may have an adverse impact on the Group's business, operating results and financial status.

(c) The Group may be exposed to intensifying competition.

Eastern China, a major market of the Group, has been experiencing a stronger economic growth and a higher demand for petrochemicals than other regions, which the Company believes, will prompt rival petrochemical companies to attempt to expand their sales volume and set up their sales networks in our major markets. This tendency is believed to continue and may intensify. Intensifying competition may have an adverse impact on the Group's financial status and operating results.

(d) The Group may not be able to pass on all increased costs due to rising crude oil prices.

At present, a significant amount of crude oil is being consumed by the Group for the production of petrochemical products. The Group attempted to mitigate the effect of increased costs due to rising crude oil prices by passing the increased cost to the Group's customers. However, whether the Group is able to pass on the increased costs to its customers is subject to the market conditions and the State's regulations and policies. While there was a time lag between rising crude oil prices and increasing petrochemical products prices, rising crude oil prices cannot be totally offset by increasing the sales prices of the Group's products. This may have a major adverse impact on the Group's financial status, operating results or cash flow.

(e) The Group's business operations may be affected by existing or future environmental protection regulations.

The Group is subject to the scrutiny of a number of environmental protection laws and regulations in China. Such laws and regulations permit the government to:

- levy a tax on emission of wastes;
- levy a fine and a charge on acts that have seriously damaged the environment; and
- shut down any facilities which are not in compliance with the law and request that a rectification be made or the operation which is damaging the environment be suspended, all of which at the judgement of the Central Government.

Wastes are produced during the Group's production and operation. Besides, operating permits are required for the Group's production equipment, and such permits may be subject to renewal, revision or revocation. The Group's operations are in full compliance with all applicable Chinese environment protection laws and regulations already promulgated and being enforced. However, the State has already enforced strict laws and environmental standards and may enforce stricter laws and stricter environmental standards. The Group cannot assure that the State or local government will not enact more regulations or more strictly enforce certain (existing) regulations which may cause additional expenses on environmental protection measures.

(f) The Group will be under a longstanding impact of competition and imported products from foreign companies upon China's accession to the World Trade Organization ("WTO").

As a member state of WTO, China has undertaken to lift some tariffs and non-tariff barriers imposed on foreign players in the Chinese domestic petrochemical market, while such barriers used to benefit us. In particular, the tax rates of tariffs imposed on imported petrochemicals which are in competition with the Group's products have been reduced from between 5% and 17% to between 2.8% and 14.2%, and

- participation by foreign companies in investing in China's domestic petrochemical industry will be increased;
- restrictions on import of crude oil by non-state-owned companies will be relaxed gradually;
- foreign investment enterprises will be granted with the right to import and trade in petrochemical products; and
- foreign companies will be permitted to distribute and market petroleum products in China's domestic retail and wholesale markets.

If these measures are implemented, the Group will consistently be affected by intensified competition and import from overseas. The Group believes that China's accession to the WTO will bring about a substantial amount of investments and businesses to China and accordingly, more opportunities will be available for the Group's product sales. The Group also truly believes that our products have been and will be able to maintain their competitiveness against products imported into China. However, tariff breaks on imported products may reduce our profit margins or may have an adverse impact on the revenues from the sale of some of our products, including a small number of major products. On the other hand, the Chinese Government may also lower the tariffs on our production equipment to be imported by us in future and lift the existing restrictions on the use of imported raw materials (e.g. crude oil). Although the Group is confident that it is able to capitalize on new sales opportunities, the eventual impact of China's accession to the WTO on our business and operating results remains to be seen.

(g) The Group's profits and dividends may be reduced due to fluctuations in the value of Renminbi.

Although the official exchange rate of Renminbi against the US dollar remains stable and the value of Renminbi against the US dollar has appreciated slightly over recent years, the exchange rates of Renminbi against the US dollar or other currencies may fluctuate in future. A large part of our revenues is denominated in Renminbi but some parts of revenues or the procurement of crude oil and equipment as well as certain debt repayments by the Company are denominated in foreign currencies. Any devaluation of Renminbi in future will increase our costs, which may further increase our operating costs and jeopardize our profitability. Any devaluation of Renminbi may have an adverse impact on the value of dividends payable in foreign currencies by the Company for H shares and American Depository Receipts.

(h) Risks of the possibility of a higher tax rate.

The charge for PRC income tax is currently calculated at the rate of 15%, and the Company has not received any notification by the Ministry of Finance in respect of any change to the 15% tax rate for the year 2005. However, following the tax reform of the State, the tax rate of the Company may be subject to an increase in future.

(i) Risks controllable by the majority shareholder.

Sinopec Corp., the controlling shareholder of the Group, owns 4,000,000,000 shares of the Group, representing 55.56% of the total share capital of the Group and assumes an absolute controlling position. Sinopec Corp. may, by taking advantage of its controlling position, exercise influences over the Group's production operation, funds allocations, appointments or removals of senior staff, etc, thereby producing an adverse impact on the Group's production and operation as well as shareholders' interests.

Investments by the Company

In 2005, the Group's capital expenditures amounted to RMB1,142.9 million, representing a decrease of RMB1,063.1 million as compared with RMB2,206.0 million in 2004. The expenditures in 2005 were mainly for the following projects:

Project	Total investment RMB million	Progress as at 31 December 2005
Renovation of No. 1 atmosphere and vacuum distillation facility	392.9	completed
Renovation of 400,000 tons/year PTA unit	246.0	completed
12,000 tons/year terylene industrial silk	198.0	completed
SPC-Shanghai Secco raw material supply pipeline	180.0	completed
Expansion of north southern main pipe gallery of SPC	181.7	completed
380,000 tons/year glycol facilities	1,249.0	in progress
New diesel oil hydrogenation unit	528.0	in progress

The estimated capital expenditures for 2006 amount to RMB1,800 million, mainly for the construction of projects in progress such as the 380,000 tons/year glycol facilities and the diesel oil hydrogenation unit, as well as preparatory works of other technological renovation projects.

Late in 2001, a Sino-foreign equity joint venture was set up between the Group, BP and Sinopec Corp. The Group owns 20% of the equity interest in the joint venture, while BP and Sinopec Corp. own 50% and 30%, respectively. The joint venture's total registered capital amounts to US$901.4 million, of which the Group is required to make a capital contribution in Renminbi equivalent to US$180.3 million. As of 31 December 2005, the Group had already paid up the entire capital contribution. The joint venture setup was completed in 2005.

Our planned capital expenditures will be funded by operating cash income, banking facilities or other financing.

Daily Operation of the Board

(i) The convening and the resolutions of the Board meetings

(a) The 21st meeting of the fourth session of the Board was convened on site on 23 March 2005. Announcement whereof was published in "China Securities", "Shanghai Securities News", Hong Kong "South China Morning Post" and "Hong Kong's Commercial Daily" on 24 March 2005.

(b) The 22nd meeting of the fourth session of the Board was convened on site on 28 April 2005. Announcement whereof was published in "China Securities", "Shanghai Securities News", Hong Kong's "South China Morning Post" and "Hong Kong Commercial Daily" on 29 April 2005.

(c) The 1st meeting of the fifth session of the Board was convened on site on 28 June 2005. Announcement whereof was published in “China Securities”, “Shanghai Securities News”, Hong Kong’s “South China Morning Post” and “Hong Kong Commercial Daily” on 29 June 2005.

(d) The 2nd meeting of the fifth session of the Board was convened on site on 25 August 2005. Announcement whereof was published in “China Securities”, “Shanghai Securities News”, Hong Kong’s “South China Morning Post” and “Hong Kong Commercial Daily” on 26 August 2005.

(e) The 3rd meeting of the fifth session of the Board was convened on 29 September 2005 by means of correspondence. Announcement whereof was published in “China Securities”, “Shanghai Securities News”, Hong Kong’s “South China Morning Post” and “Hong Kong Commercial Daily” on 30 September 2005.

(f) The 4th meeting of the fifth session of the Board was convened on 27 October 2005 by means of correspondence. Announcement whereof was published in “China Securities”, “Shanghai Securities News”, Hong Kong’s “South China Morning Post” and “Hong Kong Commercial Daily” on 28 October 2005.

(g) The 5th meeting of the fifth session of the Board was convened on 10 November 2005 by means of correspondence. Announcement whereof was published in “China Securities”, “Shanghai Securities News”, Hong Kong’s “South China Morning Post” and “Hong Kong Commercial Daily” on 11 November 2005.

(h) The 6th meeting of the fifth session of the Board was convened on 7 December 2005 by means of correspondence. Announcement whereof was published in “China Securities”, “Shanghai Securities News”, Hong Kong’s “South China Morning Post” and “Hong Kong Commercial Daily” on 8 December 2005.

(i) The 7th meeting of the fifth session of the Board was convened on 30 December 2005 by means of correspondence. Announcement whereof was published in “China Securities” and “Shanghai Securities News” on 4 January 2006, and in Hong Kong’s “South China Morning Post” and “Hong Kong Commercial Daily” on 3 January 2006.

(ii) Board's execution of resolutions made at shareholders' meetings

Three shareholders' meetings were convened during the reporting period. The Board strictly handled all matters within the scope of authorization as approved by the shareholders' meetings and faithfully executed the resolutions made thereat.

(a) The 2004 Profit Appropriation Plan of the Company was implemented in accordance with the resolution made at the 2004 General Annual Meeting. The announcement on dividend payment for A shares was published in the China Securities Journal and the Shanghai Securities News on 11 July 2005. Dividends for A shares and H shares were paid on 21 July 2005. Other resolutions were executed faithfully.

(b) In accordance with the resolutions made at the 2005 Extraordinary General Meeting and the 2005 Second Extraordinary General Meeting, the Company's on-going connected transactions were conducted in accordance with the terms of the Sales and Purchase Framework Agreement and the Comprehensive Services Framework Agreement and within the caps of various on-going connected transactions.

Plan for Profit Appropriation or Transfers or Additions to Statutory Reserves by the Board

Net profit of the Company for the year 2005 amounted to RMB1,704,627,000 under PRC Accounting Rules and Regulations (profit attributable to shareholders amounted to RMB1,850,449,000 under IFRS). After two transfers, each amounting to 10% of the profit after tax, or RMB170,463,000, were made to the statutory surplus reserve and the statutory public welfare fund respectively, profit available for distribution to shareholders amounted to RMB1,363,701,000 (RMB1,509,523,000 under IFRS). The Board proposed to declare a final dividend of RMB1.00 (inclusive of tax) per 10 shares. With reference to the total number of shares of 7,200,000,000 for the year ended 31 December 2005, the total dividend amount will be RMB720 million.

Audit Committee

The audit committee and the management of the Company have reviewed the accounting principles, accounting standards and discussed matters relating to auditing, internal supervising and financial reporting, including the audited report for the year ended 31 December 2005.