BUSINESS REVIEW AND PROSPECTS

BUSINESS REVIEW

In the first half of the year 2001, while the global economy has experienced a general slow down in growth, the economy of the PRC has continued to maintain its rapid growth with a 7.9% growth in the GDP for the PRC in that period, which was driven by the continued increase in domestic consumer demand and the high increase in domestic investment in the PRC. In turn, this led to a stable growth in domestic demand in the PRC for refined oil and petrochemical products. According to the Company's statistics, the apparent consumption of refined oil products (including gasoline, diesel and kerosene and jet fuel) during the first half of this year increased 3.59%, and the apparent consumption of petrochemical products (ethylene as the calculating basis) increased 7.2% against the same period last year. The Company believes this is highly conducive to creating a positive market environment.

The Company positively organised its production operations in response to the market in the first half of 2001 and had improved operating results. The turnover and other operating revenue was RMB 164.307 billion, an increase of 10.0% against the same period last year; operating profit was RMB 15.859 billion (based on International Accounting Standards), an increase of 8.48% against the same period last year; and profit attributable to shareholders was RMB 9.580 billion (based on International Accounting Standards), an increase of 27.51% against the same period last year.

The Company continued its internal corporate reorganisation and stepped up its reform of its corporate governance structure, with new results. Sinopec Corp. issued 2.8 billion A shares in the PRC's domestic equity market at a price of RMB 4.22 per share listing on the Shanghai Stock Exchange on 8 August 2001. A total of RMB 11.816 billion of proceeds was raised, which will be used largely to fund the acquisition of China National Star Petroleum Corporation ("China National Star") and the construction of the Ningbo-Shanghai-Nanjing crude oil pipeline and Maoming-Guizhou-Kunming pipeline for refined oil.

(1) Exploration and Production Segment

The international crude oil price stayed relatively high during the first half of 2001. The Platt's Singapore average spot quote for Brent in the first half of the year was US$26.76 per barrel which was US$0.12 per barrel higher than US$26.64 per barrel in the same period last year and was down US$1.78 per barrel from the average price of US$26.64 per barrel in the year 2000.

Domestic pricing for crude oil in the first half of 2001 closely followed the price for crude oil in the international market fluctuating at a high price level.

During the first half of 2001, the Company made the most of the advantageous opportunity presented by high oil prices, and adhering to the unified principle of "reserves, production, profit", continued its expansion in upstream businesses, achieving good results in its exploration and production activities. The Company increased its production of crude oil and made significant increases in its natural gas production. In particular, the Company extracted 156.6 thousand million tonnes of crude oil which, due to high oil prices, was economically viable to extract. A number of quality gas/oil wells and blocks were discovered in promising areas, which are estimated to increase oil reserves which can be economically extracted by 142.6 mmbbls, crude oil production capacity by 8.66 mmbbls and gas production capacity by 3.53 billion cubic feet (bcf), which provides a good end to production operations for the first half of the year.

Operating Summary of Exploration and Production Segment

	First Half, 2001	First Half, 2000	Change (%)
Oil production (mmbbls)	123.23	122.92	0.25
Natural gas production (bcf)	44.4	40.6	9.36

(2) Refining Segment

In the first half of 2001, the domestic pricing mechanism for crude oil in the PRC has become increasingly market oriented. From March 2001, the State Development Planning Commission is no longer making monthly announcements of domestic crude oil prices. Instead, Sinopec Corp. and domestic crude oil suppliers determine the domestic crude oil price by reference to the crude oil price on the international market after negotiation of adjustments, and then file that price with the State Development Planning Commission. Since June 2000 the pricing for domestic refined oil products has been linked to the refined oil prices in the Singapore market.

Over the first half of 2001, the refining segment's allocation of crude oil resources and refinery throughput was reasonable based on the market conditions. Apart from processing part of its high cost crude oil inventories, the Company purchased 50.92 million tonnes of crude oil, of which the amount of low cost high sour crude oil increased dramatically compared to the same period last year. The Company's total processing volume of crude oil during the first half of this year accounted for 51% of the nation's total processing volume of crude oil. Relying on technological advances and systematic management, the Company has adjusted its product mix, increased its product quality, reduced its production costs and improved all major technological and economic indicators.

(3) Marketing and Distribution Segment

During the first half of 2001, as a result of factors such as the general slow-down in the growth of the global economy and a reduction in exports from the domestic market, the growth rate for domestic consumption of refined oil products (gasoline, diesel, kerosene and jet fuel) was 3.59%, being below than expected. In addition, there was an oversupply of refined products in the Company's principal market during the first half of the year due to the increase in refinery throughput in the PRC which meant that product prices failed to reach expected levels and caused an increase in competition.

Operating Summary of Refining Segment

	First Half, 2001	First Half, 2000	Change
Crude processing volume (mbbls/day)	2,109.0	2,094.0	0.72%
Of which:			
Sour crude processing volume (mbbls/day)	396.7	283.5	39.93%
Refinery utilisation (%)	80.4	80.0	0.4
Gasoline, diesel, kerosene and jet fuel production (million tonnes)	30.53	29.94	1.97%
Of which:			
gasoline (million tonnes)	9.721	9.724	(0.03%)
diesel (million tonnes)	18.55	17.78	4.33%
kerosene and jet fuel (million tonnes)	2.26	2.44	(7.38%)
Diesel to gasoline ratio	1.91	1.83	0.08
Light product yield (%)	70.58	70.10	0.48
Composite commercial yield (%)	91.70	91.99	(0.29)

Note: the crude oil processing volume is converted at 1 tonne=7.35 barrels

Operating Summary of Marketing and Distribution Segment

	First Half, 2001	First Half, 2000	Change (%)
Total sales of refined oil products (thousand tonnes)	33,670	32,480	3.66
Of which:			
wholesale (thousand tonnes)	13,960	22,680	(38.45)
distribution volume (thousand tonnes)	5,480	not applicable	not applicable
retail (thousand tonnes)	14,230	9,800	45.20
Throughput per petrol station (tonne/station)	1,394	1,356	2.80
Percentage of total sales constituted by retail sales (%)	42.3	30.2	12.1
Total number of petrol stations	27,749	20,527	35.18
Of which, number of franchised sites	4,184	2,990	39.93

In the first half of 2001, despite the business environment of intense competition, the Company focused on expanding its sales volume of refined products, retail sales volume of refined products and distribution volume. The Company's market share for refined oil products in its principal market was 84.7%, and its share of the retail market has increased from 56% in the first half of last year to 66% in the reporting period. In the same period, the Company has further improved and developed its retail network, and in the last half year, has revamped 1,100 existing petrol stations and added 3,306 petrol stations.

During the first half of 2001, the Company actively rationalised its allocation of resources, and cut distribution costs, increased internal reform, streamlined management hierarchy, merged a number of local-level oil companies and reduced management expenses.

(4) Chemical Segment

Benefiting from the continued growth of the economy in the PRC, the domestic consumption of chemical products has maintained its growth in the first half of 2001. The apparent domestic consumption of synthetic resin, synthetic rubber, synthetic fiber and monomers/polymer for synthetic fiber was 11.6563 million tonnes, 0.8243 million tonnes, 4.2396 million tonnes, and 6.5676 million tonnes respectively, representing increases of 21%, 19%, 20%, and 32% respectively compared with the first half of last year. However, the PRC still imports large quantities of chemical products in order to satisfy demand.

During the first half of this year, the pricing for petrochemical products in domestic markets has dropped to different extents due to the impact of the global economic slow-down, an oversupply of petrochemical products in Asia, a drop in the prices of petrochemical products in the international market and a 2% reduction in tariffs on imports of certain synthetic resin and monomers for synthetic fibers and other products. At the same time, due to the high price of crude oil on the international market, the price of chemical feedstock, such as naphtha, remained high.

In the first half 2001, the majority of the Company's chemical production facilities were running at full-load except for those at planned revamping. The ethylene production was up 6.3% compared with the same period last year. There were new developments in the adjustment of product mix, and product quality and grade continued to increase. The Company's production of performance compound for synthetic resin for the first half of the year was 681 thousand tonnes, up 10.7% over the same period last year and the production of differential fiber was 162.4 thousand tonnes, up 2.5% over the same period last year. The sales to production ratio for the Company's key petrochemical products was 101.1% and the direct sales ratio was 57.8%. In addition, the Company actively promoted the electronic commerce of its chemical products. The sales of chemicals through electrconic commerce reached RMB 7.4 billion, being 5 times more than last year. The Company believes this will help to consolidate its market share and increase the percentage of its direct sales.

Production of Major Chemicals in the Chemical Segment

	First Half, 2001 (thousand tonnes)	First Half, 2000 (thousand tonnes)	Change (%)
Ethylene	1,146.0	1,078.3	6.28
Synthetic resin	1,677.7	1,460.1	14.90
Of which: Performance compound resins	681.0	615.0	10.73
Synthetic rubber	200.7	150.6	33.27
Monomers and polymer for synthetic fiber	1,843.5	1,937.2	(4.84)
Synthetic fiber	493.1	524.5	(5.99)
Of which: differential fiber	162.4	158.4	2.53
Urea	1,176.4	2,116.7	(44.42)

In the first half of 2001, the Company pursued its costs cutting program and, based on its focus on reducing the outsourcing cost of crude oil and other major raw materials, reducing consumption of materials and energy and sales expenses and general and administrative expense, has had good results in cutting costs and increasing efficiency. During the first half of this year, the four business segments together reduced costs by a total of RMB 1.382 billion, and achieved 63.1% of the annual cost reduction target of RMB 2.19 billion. Of that amount, the exploration and production segment saved RMB 190 million, the refining segment saved RMB 385 million, the chemicals segment saved RMB 522 million and the marketing and distribution segment saved RMB 285 million.

BUSINESS PROSPECTS

(1) Market Prospects

The Company expects the PRC economy and its industry to exhibit the following characteristics over the second half of 2001:

- **The PRC economy is expected to continue its stable growth**
  Although there is a slow down in the economy of the United States resulting in a slow down in the global economy, the PRC government will continue its active fiscal policy to expand domestic demand and to promote sustained economic growth, which will encourage steady growth in domestic demand for oil and petrochemical products, thus creating opportunity for development for the Company.

- **The PRC's accession into the World Trade Organisation ("WTO") is expected to bring both challenges and opportunities**
  It's expected that in the second half of this year, the PRC will be on the brink of joining the WTO. Based on the tariff reductions and the opening of markets, the entry of the PRC into the WTO will present the Company with both challenges and opportunities. The main challenge will be the increasingly intense and direct international competition while the opportunities will come from the stardard market environment and the increasingly globalised economy which will mean opportunities for development.

- **International crude oil prices are expected to remain relatively high**
  Based on an analysis of the global supply and demand for crude oil, the Company expects crude oil prices to reduce slightly in the latter half of 2001 relative to the price during the first half of this year. The average price for Brent spot in Singapore is expected to stay at around US$25 per barrel.

- **The oil refining margin in Asia is expected to stay at a relatively low level**
  The excessive increase in oil refining capacity in Asia and the slow-down in the rate of increase in demand, caused the utilisation rate and oil refining margin of refineries in the local area to drop. The situation is not expected to improve in the second half of 2001. In particular, during June to mid-August this year, the Singapore gasoline price fell below that for crude oil, with serious price distortions, which had a big impact on the oil refining margin.

- **Prices for chemicals are expected to continue fluctuating at low levels**
  As the pace of growth in the world economy slows down, the cyclical change for chemical products is likely to slow down, and prices will continue to fluctuate at low levels without returning to high levels.

(2) Production Operations

Faced with the challenge of severe market conditions, in the second half of the year the Company will adopt the following measures in its four segments of operations:

- **Exploration and Production Segment**
  The Company will continue to make the most of the opportunity presented by the high crude oil prices to increase its production of crude oil, which is profitable while crude oil prices are high and intends to produce a total of 267.7 mmbbls of crude oil for the year (including Sinopec National Star), an increase of 8.2% over last year and a total of 148.3 billion cubic feet of natural gas, an increase of 85.8% over last year. The Company will increase its investment in exploration in new and existing areas for oil and gas blocks with potential to increase its

replacement reserves. Relying on technological advances and systematic management, the Company will reduce costs and, in particular, its lifting costs. In addition, the Company will conclude the acquisition of Sinopec National Star to increase its upstream resources and reduce its exploration and development costs and lifting costs.

- **Refining Segment**
  Based on market demand, the Company will focus on rationalising the allocation of its resources, reduce its inventory level of refined products and refinery throughput. It is expected that the refinery throughput for 2001 will be about the same as that for 2000 (or slightly lower). Taking advantage of the benefits of centralised purchasing, the Company will strive to reduce its costs of purchases and, at the same time, increase the refinery processing volume of sour crude. With improvements in management and technology, the Company will reduce its material consumption and power consumption and reduce its cash operating costs. In accordance with market and environmental requirements the Company will adjust its product structure, improve product quality and increase its diesel to gasoline ratio.

- **Marketing Segment**
  The Company will continue to expand the turnover and market share to improve its overall competitiveness. It is expected that the sales volume of refined products in the year 2001 will be 70 million tonnes. Key initiatives include streamlining the Company's sales network and expanding retail sales. It is expected that total retail sales volume of refined products in the year 2001 will be 30 million tonnes. Other initiatives include improving pump volume per petrol station, changing the sales channels to increase the percentage of direct sales. It is expected that the total direct sales volume of refined oil products in the year 2001 will be 10 million tonnes. The Company will improve conduct cost management, rationalise the allocation of refined oil product resources, optimise the flow of refined oil products, reduce the per tonne oil transported and operation expenses. The Company will continue to reform, realize streamlining of management hierarchy by merging local level companies and reduce management expenses.

- **Chemicals Segment**
  The Company will continue to tap the synergetic advantage in terms of integrated business structure and regional location, rationalise the allocation of chemical feedstock, ensure that chemical facilities operate profitably to full load. The planned ethylene production for the year is 2.20 million tonnes. The Company aims to consolidate and unify the sales of its chemical subsidiaries and expand the proportion of its direct sales, which is planned to reach 58% before the year-end. The Company's B to B electronic commerce will be further developed with the aim of reaching RMB 15 billion by the end of the year. The Company will actively develop new products, improve product grade, increase production of high added value products, enhance management, reduce costs and increase competitiveness.

The Company will adhere to the strategy of "expanding market, increasing resources, cutting costs to improve profitability and discipline in capital expenditure" to maintain continued growth in its production business in 2001, despite severe market conditions, setting a base for future business growth.