



Chairman's Statement

On behalf of the board (the "Board") of directors (the "Directors") of Daqing Petroleum and Chemical Group Limited ("Daqing Pechem" or the "Company" and together with its subsidiaries, the "Group"), I am pleased to present the annual report of the Group for the year ended 30 June 2004. The Group's profit before tax for the year ended 30 June 2004 was HK\$84.6 million, representing a decrease of 17.2% as compared with the previous financial year. The net profit was HK\$66.8 million, representing a decrease of 20.9% over the previous financial year. Profit of the Group was primarily derived from the sale of lubricants and anti-corrosive coating.

The basic and diluted earnings per shares of the Company were HK7.1 cents and HK7.0 cents, respectively.

The Board do not recommend the payment of a final dividend for the year ended 30 June 2004 (2003: HK0.11 cent per ordinary share).

BUSINESS REVIEW

The year of 2003 was the unprecedented harsh time to the Group since its establishment. The business environment was adversely affected by certain factors, such as international political instability due to the U.S. led the coalition troops to start the War with Iraq, the incessant increase of crude oil price, and the increased cost of raw materials due to the overheating of the economy of the People's Republic of China (the "PRC") entailed the demand of raw materials soared up. These had a drastic negative impact on the Group's overall business performance.

In the first quarter of the year, the Group's business developed rapidly in line with the continuously vigorous improvement of the PRC's economy. A growth was recorded in the overall turnover. Regrettably, the net profit of the year did not keep pace with the growth of the turnover. The fundamental reason was the global, especially the PRC, demand for different kinds of chemicals rose rapidly. During the past year or so, raw material prices had continued to rise, and in some products, even shortages had occurred. Rivals in the industry had taken a wait-and-see attitude towards the adjustment of sales prices, the increase in costs can only be partially passed to customers which created pressure on the profit margin of the Group's overall business.

The Group has implemented certain measures to cope with the unfavorable operating environment, for instance, launching appropriate pricing policies, effective cost-control measures, closely monitoring the market condition. The satisfactory result for the year demonstrated the effectiveness of these measures. Besides, product quality continued to be a matter of foremost interest of the Group.

As such, the Group is dedicated to extending its business in other areas of the petrochemical industry in order to diversify its business risk and stabilise the gross profit margin. The Directors have identified vinyl acetate to be the targeted development project. Vinyl acetate is an essential organic chemical, mainly applying to papermaking, construction and textile industries. Its profit margin is less sensitive to the fluctuation of crude oil prices comparing with lubricant and coating businesses. Currently, the annual domestic demand for vinyl acetate is estimated to be over 1,200,000 tonnes in the PRC. In respect of the market price of vinyl acetate in the PRC, it has been continuously mounting at present. It represents an accumulated increase of over 50% from early 2004.

BUSINESS REVIEW (Cont'd)

The Group has established a joint venture company with Daqing Gaoxinqu Qinglian Petroleum and Chemical Co. Limited ("Qinglian") in the name of Mudanjiang Dongbei Chemical Engineering Company Limited (牡丹江東北化工有限公司), of which, 55% interest is held by the Group. Located in the Mudanjiang City, Heilongjiang Province, the joint venture is mainly engaged in the production of vinyl acetate, and is the sole vinyl acetate production plant in the northeastern region of the PRC.

The renovation of Mudanjiang Plant ran smoothly and was completed in the third quarter of 2004. Currently, the vinyl acetate plant is under a trial run. It is expected that the mass production of Mudanjiang vinyl acetate plant will be commenced in the fourth quarter of 2004 and the annual production capacity is expected to reach 15,000 tonnes. The upgrade project phase 2 is expected to be commenced in the second half of 2005. Upon the completion of the project, the production capacity of the vinyl acetate plant is expected to be further enhanced up to 45,000 tonnes per annum.

Mudanjiang vinyl acetate plant adopts the production method of petrochemical technique of calcium carbide methodology (電石法化工工藝方法) for production. Under the situation of high crude oil prices, the cost effectiveness and market competitiveness would be greater than those competitors in the industry who adopt the production method of petrochemical technique of acetylene methodology (乙炔法化工工藝方法). It is anticipated to bring considerable profits for the Group in the future.

PROSPECTS

The Group is considering the possibility of acquiring other petrochemical plants or businesses in the northeastern region in the PRC, in order to take the business opportunity created by the PRC government's policy in relation to the reform and restructure of the existing state-owned industry in the region. Under such policy, the local government will provide liberal preferential measures to new joint ventures which are engaged in reforming and restructuring the existing state-owned plant and factories. The Group proposes to actively seek other acquisition opportunities for both vertical and horizontal integration in the petrochemical industry for the Group to keep on growing healthily. The Group is confident that it will establish itself as the leader in the petrochemical industry in the northeastern region in the PRC.

On behalf of the Company, I would like to extend my heart-felt gratitude to our staff, shareholders, investors, customers and business partners who have given continuous support to the Group.

Chan Yuk Foebe

Chairman and Executive Director

18 October 2004