

increased by RMB 1.0 billion, or 5%, to RMB 19.3 billion in 2000 as compared to 1999. The increase was primarily attributable to the increase in operating lease charges, which was up by RMB 2.5 billion from RMB 0.4 billion in 1999 to RMB 2.9 billion in 2000. The Company entered into a land use rights lease contract and a property lease contract with Sinopec Group Company effective as at 1 January 2000. Under the two contracts, the Company paid approximately RMB 2.4 billion as rental payment to Sinopec Group Company in 2000. Although sales of the Company increased significantly, the Company managed to control the selling, general and administrative expenses other than operating lease charges in part due to:

- efforts made by the Company to better control its customers' credits to reduce provisions for bad and doubtful debts; and
- efforts made by the Company to implement cost reduction programs to better control its logistics to reduce transportation and storage costs.

Depreciation expenses. Depreciation, depletion and amortisation expenses increased by approximately 12% from RMB 17.9 billion in 1999 to RMB 20.1 billion in 2000 due primarily to:

- an increase in the depreciable value of property, plant and equipment as a result of a revaluation effected on 30 September 1999, offset in part by a decrease in depreciation expenses resulting from the distribution of certain assets to Sinopec Group Company on 31 December 1999 as part of the reorganisation; and
- commencement of operations of newly constructed or acquired facilities including a significant number of service stations and the resulting commencement of depreciation of such facilities.

Personnel and other expenses. Personnel expenses slightly increased by approximately 4% from RMB 12.5 billion in 1999 to RMB 13.0 billion in 2000. The increase was primarily due to the payment of year-end performance bonuses to employees in 2000 in connection with the better operating results of the Company.

Taxes other than income tax, which primarily consisted of consumption tax, increased by approximately 28% from RMB 9.5 billion in 1999 to RMB 12.2 billion in 2000 primarily as a result of increased sales volume, including both external

and intersegment sales volume, of gasoline and diesel from the Company's refineries which were subject to consumption tax. Net other operating expenses decreased from RMB 3.2 billion in 1999 to RMB 0.5 billion in 2000 due primarily to the decrease in impairment loss on long-lived assets and the cessation of allocation of staff quarters under the housing reform policy after 31 December 1999.

Operating Profit; Finance Cost and Other; Profit attributable to Shareholders

Operating profit of the Company increased by RMB 19.4 billion, or 126%, from RMB 15.4 billion in 1999 to RMB 34.8 billion in 2000. Operating profit increased because turnover and other operating revenues of the Company grew faster than their operating expenses. The increase in turnover and other operating revenues outpaced the increase in operating expenses as a result of a number of factors including the increases in the average realised sales prices of most of the products other than in some petrochemicals where the Company was unable to pass along the increases in the costs of raw materials, and the implementation of many cost reduction programs by the Company. However, the most important factor that contributes to the increase in profit attributable to shareholders is that the higher refined product prices more than offset the higher crude oil cost.

Net finance costs decreased by RMB 5.4 billion, or approximately 53%, from RMB 10.2 billion in 1999 to RMB 4.8 billion in 2000 largely as a result of a decrease in interest expenses of RMB 3.5 billion, and to a lesser extent, an increase of foreign exchange gains less losses of RMB 2.3 billion which primarily resulted from the depreciation of Japanese yen against renminbi in 2000. Interest expenses decreased principally due to:

- a distribution of certain assets and associated liabilities which were retained by Sinopec Group Company but were included in the historical financial statements of the Company consolidated prior to 1 January 2000, to Sinopec Group Company on 31 December 1999;
- Sinopec Group Company's assumption of RMB 13.1 billion of bank loans of the Company on 31 December 1999;
- Sinopec Group Company's assumption of RMB 5.8 billion of bank loans in April 2000 in consideration of the Company transferring to it

- an equivalent amount of receivables; and
- a conversion of short- and long-term debt of RMB 35.6 billion into an interest free 20-year subordinated loan from Sinopec Group Company as at 30 April 2000.

Profit from ordinary activities before taxation of RMB 30.2 billion in 2000 was significantly higher than the RMB 6.5 billion amount for 1999 principally because of increased operating profit and reduced interest expense of the Company. Taxation of the Company went up significantly to RMB 9.4 billion in 2000 because of increased profit from ordinary activities before taxation and increased effective profit tax rate of the Company. The latter was mainly attributable to the absence of profit tax refunds and cessation of special allowance relating to exploration and production activities of the Company in 2000. Profit from ordinary activities after taxation and minority interests were RMB 20.8 billion and RMB 1.8 billion, respectively, in 2000 compared to RMB 6.2 billion and RMB 1.5 billion, respectively, in 1999. Minority interests increased by 20% due to increased contribution from the Company's non-wholly owned subsidiaries to the profit from ordinary activities after taxation reflecting stronger financial performance of these subsidiaries in 2000 compared with 1999.

Profit attributable to shareholders increased from RMB 4.7 billion in 1999 to RMB 19 billion in 2000. Earnings per share calculated with the weighted average number of shares in issue during 2000 was RMB 0.26.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The Company improved the return on capital employed, or ROCE, from 5.1% in 1999 to 10.0% in 2000. The ROCE is defined as the ratio of after tax operating profit to the amount of capital employed. After tax operating profit is defined as the product of operating profit and one minus the effective income tax rate. The amount of capital employed is defined as the total capital less the amount of excess cash, where total capital is the sum of debt (including shareholders' loans), minority interests and shareholders' equity, and excess cash is the sum of cash and cash equivalents and time deposits.

Discussion of Segment Operations

The Company began reorganising its operations into four principal business segments and a corporate and others segment in early 2000.

Although in 1999 the Company had not divided its operations into these segments, for the purposes of the following discussion, the 1999 financial results have been reconstructed on a segment basis.

Unless otherwise indicated, intersegment transactions have not been eliminated from the financial data discussed in this section and the operating revenue data for each of the business segments discussed in this section include, in addition to turnover, other operating revenues for each such segment. For other operating revenues of each of the Company's operating segments, see note 34 on the accounts.

The following table lists operating revenues by segment, the contribution of external sales and intersegment sales as a percentage of

consolidated operating revenues before elimination of intersegment sales, and the contribution of external sales as a percentage of consolidated operating revenues (i.e., after elimination of intersegment sales) for the years indicated.

	Year Ended 31 December		Consolidated Operating Revenues Before Elimination of Intersegment Sales		Consolidated Operating Revenues After Elimination of Intersegment Sales	
	2000 RMB	1999 RMB	2000	1999	2000	1999
	(in billions)		Percent		Percent	
Operating Revenues						
Exploration and production						
External sales ⁽¹⁾	11.0	6.5	2	2	3	3
Intersegment sales	46.2	24.7	8	7		
Total operating revenue	57.2	31.2	10	9		
Refining						
External sales ⁽¹⁾	70.9	51.6	13	14	22	22
Intersegment sales	162.2	87.0	29	25		
Total operating revenue	233.1	138.6	42	39		
Marketing and distribution						
External sales ⁽¹⁾	175.0	120.7	32	34	53	50
Intersegment sales	0.7	0.1	—	—		
Total operating revenue	175.7	120.8	32	34		
Chemicals						
External sales ⁽¹⁾	57.5	60.5	10	17	17	25
Intersegment sales	3.4	2.2	1	1		
Total operating revenue	60.9	62.7	11	18		
Corporate and others						
External sales ⁽¹⁾	14.5	0.7	3	—	5	—
Intersegment sales	11.5	0.4	2	—		
Total operating revenue	26.0	1.1	5	—		
Total operating revenue before intersegment eliminations	552.9	354.4	100	100		
Elimination of intersegment sales	(224.0)	(114.4)				
Consolidated operating revenues	328.9	240.0			100	100

(1) Includes other operating revenues. See note 34 on the accounts for other operating revenues of each of the Company's operating segments.

The following table lists operating revenues, operating expenses and operating profit by segment before elimination of intersegment transactions for the years indicated.

	Year Ended 31 December	
	2000	1999
	RMB	RMB
	(in billions)	
Exploration and production		
Total operating revenues	57.2	31.2
Total operating expenses	(32.5)	(27.3)
Total operating profit	24.7	3.9
Refining		
Total operating revenues	233.1	138.6
Total operating expenses	(231.7)	(132.5)
Total operating profit	1.4	6.1
Marketing and distribution		
Total operating revenues	175.7	120.8
Total operating expenses	(169.3)	(118.2)
Total operating profit	6.4	2.6
Chemicals		
Total operating revenues	60.9	62.7
Total operating expenses	(58.5)	(59.0)
Total operating profit	2.4	3.7
Corporate and others		
Total operating revenues	26.0	1.1
Total operating expenses	(26.1)	(1.9)
Total operating loss	(0.1)	(0.8)

Exploration and Production Segment

Exploration and production segment consists of the activities of the Company related to exploring for and developing, producing and selling of crude oil and natural gas.

Operating revenues from the exploration and production segment increased by 83.3% from RMB 31.2 billion in 1999 to RMB 57.2 billion in 2000. The increase in operating revenues was primarily due to:

- an increase of approximately 89% in average realised prices of crude oil for external sales to approximately RMB 1,664 per tonne in 2000; and
- an increase of approximately 65% in average realised prices of crude oil for intersegment sales to RMB 1,640 per tonne in 2000.

These price increases reflected steeply rising international crude oil prices in 2000 and, to a lesser extent for intersegment sales, the change in the intersegment transfer pricing policy of the Company effective 1 January 2000. This crude oil transfer pricing policy provides that sales of

similar grades of crude oil are to be made at substantially the same prices as those for external sales of the same products. As a result of this new policy, substantially all of the external and intersegment sales of this segment are based on market prices. Total sales volume of crude oil increased slightly in 2000 compared to 1999.

Overall operating expenses increased by 19% in 2000 compared with 1999 for the exploration and production segment, primarily due to the higher depreciation, depletion and amortisation expenses in 2000 as a result of the increased capital expenditure that the Company spent on exploration and production to take advantage of the high international crude oil price. As a result of the increased exploration and production activities, exploration expenses, including dry holes expenses, was up by RMB 0.5 billion, or 20.8%, to RMB2.9 billion in 2000. The Company managed to reduce the purchased crude oil, products and operating supplies and expenses by approximately 18% in 2000 compared with 1999 primarily through the reduction of power and fuel expenses and, to a lesser extent, through reduction of raw materials expenses.

Production costs increased slightly in 2000 to RMB 54.89 per barrel from RMB 54.4 per barrel in 1999. Production costs increased in 2000 as compared with 1999 principally because, to take advantage of the high crude oil price prevailing in 2000, some of the crude oil production in 2000 was obtained from oil wells that were unprofitable or marginally profitable at the lower crude oil prices prevailing during 1999. The Company expects to reduce production from and expenses related to these less profitable wells if crude oil prices decline significantly from the current levels. Finding and developing costs increased by 81% in 2000 to RMB 43.25 per BOE from RMB 23.87 per BOE in 1999.

Operating profit in 2000 increased significantly compared to 1999 primarily as a result of high crude oil prices prevailing in 2000.

Refining Segment

Refining segment consists of the operations of the Company related to purchasing crude oil from the Company's exploration and production segment and from third parties, processing of crude oil into refined products, selling refined products principally to selected large bulk customers and internally principally to the Company's marketing and distribution segment.

Operating revenues from the refining segment increased by approximately 68% from RMB 138.6 billion in 1999 to RMB 233.1 billion in 2000. The increase in operating revenue was principally due to increases in sales revenues from the sale of diesel, gasoline and chemical feedstock.

Sales of diesel, which constitutes approximately 39% of the refining segment's operating revenue, went up in 2000 by 75% to approximately RMB 90.7 billion. The increase in sales revenues for diesel was due to:

- an increase of approximately 43% and 33% in the average realised price for intersegment sales and external sales, respectively, to approximately RMB 2,439 and RMB 2,238 per tonne; and
- an increase of approximately 23% in the combined sales volume for external and intersegment sales to approximately 37.4 million tonnes.