

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## General

This discussion should be read in conjunction with the information in the audited financial statements contained in this annual report. The information presented below interprets the Company's financial statements prepared in accordance with IFRS. For the Company's financial statements as prepared in accordance with the accounting principles generally accepted in the United States of America, please see the Company's annual report on Form 20-F filed with the Securities and Exchange Commission of the United States of America, a copy of which will be provided to any shareholder upon written request.



*Mr. Xu Hongxing  
Executive Director  
and General Manager*

The information set out below does not form part of the financial statements audited by KPMG, the auditors of the Company, and is included for information purposes only.

The Company is one of the largest producers of ethylene, resins and plastics in the PRC. The vast majority of the Company's products fall within three principal product groups: (i) resins and plastics, (ii) synthetic rubber, and (iii) basic organic chemical products. In 2002, the Company accounted for approximately 13.6% of the total ethylene production in the PRC. The Company is a leading producer in the PRC of LDPE, cis-polybutadiene rubber, phenol, acetone, SBS and polypropylene .

The Company's principal raw material is cracking feedstock, substantially all of which is purchased from the Parent Company. The Company mainly uses light industrial oil as its cracking feedstock. The Company also uses naphtha, and VGO, cracking wax oil, and hydrogenated raffinate oil as substitute of light industrial oil developed and used by the Company on its own. Since the establishment of Sinopec Group in 1998, prices of light industrial oil and naphtha have been determined by the State Development and Planning Commission ("SDPC") of the PRC and the Sinopec Group together. During the reporting period, the average State price of light industrial oil fluctuated in line with the crude oil price and such average State price of light industrial oil for 2002 decreased by approximately 7.8%, as compared with the price in 2001.

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## Operating Results

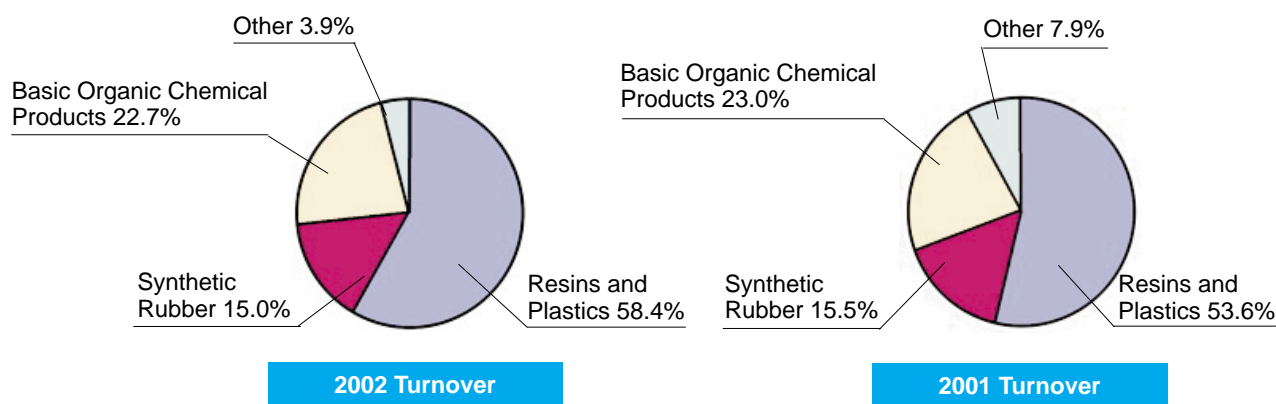
For the year ended 31 December 2002, the Company's total sales increased to RMB 9,443.1 million from RMB 5,975.3 million in 2001, representing an increase of 58.0%. This increase in sales was largely attributable to the increase by larger margins in the production and sales volumes of major products upon completion of the expansion of Ethylene Plant. Due to the market conditions, the prices of petrochemical products in China were maintained at a relatively low level in the first half of 2002, which has resulted in a decrease of 7.0% in the weighted average sales price of the eight principle products of the Company (representing 74.0% and 79.1% of the total sales revenue of 2001 and 2002 respectively). However, the sales volume of these eight principal products increased by 81.6% in 2002 as compared with that of 2001, and thus increased the sales revenue by large margins. During the reporting period, the profit of the Company before taxation was RMB 330.7 million, with an increase in the profit in the amount of RMB 740.9 million, as compared with a loss before taxation of RMB 410.2 million in 2001. The Company recorded a net profit of RMB 209.1 million in 2002, with an increase of RMB 481.6 million, as compared with a net loss of RMB 272.5 million in 2001.



The following table sets forth a summary of the income statement for the years of 2002 and 2001:

	<u>2002</u> <u>(RMB'000)</u>	<u>2001</u> <u>(RMB'000)</u> (Restated)
Turnover	<b>9,443,061</b>	5,975,255
Costs of sales	<b><u>(8,368,029)</u></b>	<u>(5,660,191)</u>
Gross profit	<b>1,075,032</b>	315,064
Selling, general and administrative expenses	<b>(530,571)</b>	(565,412)
Other expenses, net	<b><u>(2,903)</u></b>	<u>(100,296)</u>
Profit/(loss) from operation	<b>541,558</b>	(350,644)
Net financing costs	<b><u>(210,830)</u></b>	<u>(59,579)</u>
Profit/(loss) from ordinary activities before taxation	<b>330,728</b>	(410,223)
Income tax(expense)/benefit	<b><u>(121,629)</u></b>	<u>137,756</u>
Profit/(loss) attributable to shareholders	<b><u><u>209,099</u></u></b>	<u><u>(272,467)</u></u>
Basic earnings/(loss) per share	<b><u><u>RMB 0.062</u></u></b>	<u><u>(RMB 0.081)</u></u>
Basic earnings/(loss) per ADS	<b><u><u>RMB 3.100</u></u></b>	<u><u>(RMB 4.038)</u></u>

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The following table sets forth a summary of the financial data of the Company respectively for the past five years:

	<u>2002</u> (RMB'000)	2001 (RMB'000) (Restated)	2000 (RMB'000) (Restated)	1999 (RMB'000) (Restated)	1998 (RMB'000) (Restated)
Total assets	<b>10,259,807</b>	10,758,196	8,649,826	8,534,176	7,965,755
Total liabilities	<b>5,237,860</b>	5,945,348	3,429,551	3,470,192	3,195,312
Net assets	<b>5,021,947</b>	4,812,848	5,220,275	5,063,984	4,770,443
Turnover	<b>9,443,061</b>	5,975,255	7,852,913	6,489,746	5,413,662
Profit/(loss) from operations	<b>541,558</b>	(350,644)	623,056	631,839	250,532
Profit/(loss) attributable to shareholders	<b>209,099</b>	(272,467)	358,731	357,393	126,771
Dividend attributable to the year	<b>No dividend declared</b>	No dividend declared	134,960	202,440	67,480

The following table sets forth the Company's turnover, net of VAT, by principal product groups for the years of 2002 and 2001:

	<u>2002</u>		<u>2001</u>	
	Turnover (RMB '000)	Percentage of Turnover	Turnover (RMB '000)	Percentage of Turnover
Resins and Plastics	<b>5,514,147</b>	<b>58.4</b>	3,203,189	53.6
Synthetic Rubber	<b>1,418,899</b>	<b>15.0</b>	925,512	15.5
Basic Organic Chemical Products	<b>2,140,185</b>	<b>22.7</b>	1,373,201	23.0
Others	<b>369,830</b>	<b>3.9</b>	473,353	7.9
Total	<b>9,443,061</b>	<b>100</b>	5,975,255	100.0

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The following table sets forth the Company's sales, net of VAT, by geographical analysis for the years of 2002 and 2001:

	2002		2001	
	Turnover (RMB Million)	Percentage of Turnover	Turnover (RMB Million)	Percentage of Turnover
Northeastern China	160.5	1.7	167.3	2.8
Northern China	5,316.5	56.3	2,886.1	48.3
Eastern China	2,889.6	30.6	1,864.3	31.2
Central-southern China	47.2	0.5	657.3	11.0
Northwestern China	198.3	2.1	41.8	0.7
Southwestern China	698.8	7.4	191.2	3.2
Exports	132.2	1.4	167.3	2.8
Total	<u>9,443.1</u>	<u>100</u>	<u>5,975.3</u>	<u>100.0</u>

The following table sets forth the percentages of total turnover of the principal operating expenses associated with the Company's business:

	2002 (%)	2001 (%)
Turnover	100.0	100.0
Less expenditure		
Raw materials	62.4	67.4
Utility (fuels and power) expenses	12.9	13.1
Depreciation	8.5	8.8
Wages and bonus	2.5	3.5
Other overheads	2.9	2.7
Selling, general and administrative expenses	5.0	8.7
Other expenses, net	<u>0.1</u>	<u>1.7</u>
Operating margin/(loss)	<u>5.7</u>	<u>(5.9)</u>

Raw material expenses were the largest component of the operating expenses. In 2002 and 2001, approximately 52.2% and 52.3%, respectively, of cost of goods sold were expenses relating to purchases of cracking feedstock. In 2002, the total cracking feedstock expense was RMB 4,365.8 million, as compared with RMB 2,959.6 million in 2001, representing an increase of RMB 1,406.2 million, or 47.5%. This increase was largely due to the operation with full load in 2002 with respect to the expansion of the ethylene units, which has resulted in a large increase in the demand for cracking feedstock. Although the price of the light industrial oil was increased from RMB 1,670 per ton at the beginning of 2002 to RMB 2,575 per ton (including 17% VAT) at the end of 2002, which is in line with the fluctuation of the prices of crude oil and domestic finished oil, the average price of the cracking feedstock in 2002 decreased by 8.0% as compared with the price in 2001.

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The following table sets forth the changes in the State price of light industrial oil, the principal raw material of the Company, in 2002 and 2001 (including VAT):

RMB per ton

Month Year	1	2	3	4	5	6	7	8	9	10	11	12
2001	2,430	2,260	2,540	2,465	2,520	2,615	2,575	2,260	2,190	2,250	1,800	1,800
2002	1,670	1,795	1,925	2,185	2,325	2,325	2,375	2,375	2,375	2,575	2,575	2,575

Since a significant portion of the Company's expenses has been either fixed (as in the case of depreciation expense for a given piece of equipment) or consisted of stable unit costs (as in the case of cracking feedstock), fluctuations in sales, particularly those principally caused by changes in sales volume or raw material prices, caused fluctuations in profitability. In 2002, due to the large increase in the sales volume of the Company and the decrease in the price of raw materials, the operations margin of the Company increased from -5.9% in 2001 to 5.7% in 2002.

### Year ended 31 December 2002 compared with year ended 31 December 2001

Turnover increased to RMB 9,443.1 million in 2002 from RMB 5,975.3 million in 2001, representing an increase of RMB 3,467.8 million or 58.0%, and this was mainly due to the large increase in the production and sales volume of principal products of the Company upon expansion of its production. Due to the market condition, the price of petrochemical products of China was maintained at a low level in the first half of 2002, and the weighted average sales price of the Company's eight principal products, which accounted for 74.0% and 79.1%, respectively, of total sales revenue of 2001 and 2002, decreased by 7.0% in 2002. However, the sales volume of these eight principal products increased by 81.6% in 2002 as compared with that of 2001, and thus increased the sales revenue by large margins.

Sales of resins and plastics, which accounted for 58.4% of the Company's total sales, increased by approximately 72.1% from RMB 3,203.2 million in 2001 to RMB 5,514.1 million in 2002. This increase was principally attributable to the fact that the Ethylene Project of the Company was utilised, which enhanced the output of resin and plastic products which increase from 553,000 tons per year to 1,055,000 tons per year. Although the weighted average price of resin and plastic products decreased by 10.1% in 2002, as compared with that of 2001, the large increase in the sales volumes has nevertheless resulted in a large increase in the sales revenue.

Sales of synthetic rubber, which accounted for 15.0% of total sales, increased by approximately 53.3% from RMB 925.5 million in 2001 to RMB 1,418.9 million in 2002. The increase was primarily due to an increase in both the sales volume and the sales price of synthetic rubber products in 2002.

Sales of basic organic chemical products, which accounted for 22.7% of total sales, increased by approximately 55.9% from RMB 1,373.2 million in 2001 to RMB 2,140.2 million in 2002, primarily as a result of an increase in the output after renovation of the phenol and acetone units of the Company as well as an increase in the sales price resulting from the restoration of market share.

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Sales of other products, which accounted for 3.9% of total sales, decreased by approximately 21.9% to RMB 369.8 million in 2002 from RMB 473.4 million in 2001.

Cost of sales increased to RMB 8,368.0 million in 2002 from RMB 5,660.2 million in 2001. The increase was mainly due to an increase in the output, which has resulted in an increase in the consumption of raw materials, and an increase in depreciation of the units newly put into use. The Company's gross margin increased from RMB 315.1 million in 2001 to 1,075.0 million in 2002, as gross profit mounted up from 5.3% in 2001 to 11.4% in 2002.

Selling, general and administrative expenses decreased by RMB 34.8 million, or 6.2%, to RMB 530.6 million in 2002 from RMB 565.4 million in 2001. This decrease was primarily due to the substantial improvement in marketing efficiency and effectiveness, attained by the reorganisation of the marketing system of the Company.

The Company's profit from operations in 2002 was RMB 541.6 million, compared with a loss of RMB 350.6 million in 2001. The Company's operating margin increased to 5.7% in 2002, as compared with -5.9% in 2001. The increase of operating margin has reflected the initial realisation of benefits from the economies of scale upon completion of the expansion of the Company.

Net financing costs have seen a comparatively large increase to RMB 210.8 million in 2002 from RMB 59.6 million in 2001, primarily due to the capitalisation of RMB 153.7 million loan interest during the period of constructions made under the Ethylene Project in 2001.

In 2002, the Company recorded a profit before taxation of RMB 330.7 million, as compared with a loss before taxation of RMB 410.2 million in 2001. The Company's net profit for 2002 was RMB 209.1 million, yielding a profit margin of 2.2%, as compared with the Company's net loss of RMB 272.5 million and net profit margin of -4.6% in 2001.

### **Liquidity and capital resources**

The Company has principally relied on funds from operations and bank loans to finance its capital expenditures and working capital.

The Company's net cash flows derived from operating activities are generally much higher than its net profit, mainly due to substantial depreciation. In 2002, the Company's net cash flows from operating activities was RMB 1,037.1 million, representing an increase of RMB 655.8 million from RMB 381.3 million in 2001, primarily due to (i) profit before taxation of RMB 330.7 million and (ii) total depreciation expenses of RMB 806.1 million, which is partly offset by (iii) an increase of inventories in the amount of RMB 247.3 million, and (iv) an increase in trade and bills receivables of RMB 104.0 million.

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The Company's short-term and long-term loans are primarily obtained from PRC financial institutions. In 2002, the Company repaid RMB 4,100 million of its short-term loans and RMB 1,701 million of its long-term loans, and borrowed RMB 4,025 million in short-term loans and RMB 1,442 million in long-term loans. As of 31 December 2002, the Company's total loans from banks decreased by 8.3% to RMB 3,703.9 million (including RMB 1,575 million of short-term loans, and RMB 201.4 million of long-term loans due within one year) from RMB 4,038.2 million (including RMB 1,650 million of short-term loans, and RMB 1,518.4 million of long-term loans due within one year) as of 31 December 2001.

The Company expects to incur capital expenditures of RMB 300.0 million, RMB 300.0 million and RMB 400.0 million in 2003, 2004 and 2005, respectively. Such capital expenditures will be used mainly for the technical improvement projects of the Company. The Company believes the net cash flows from its operating activities and new bank loans will be sufficient to cover the Company's expected capital expenditures for the above period.

### Gearing Ratio

In 2002 the Company's gearing ratio was 73.8%, as compared with 83.9% in 2001. The decrease in the gearing ratio was mainly due to the decrease in both the long-term and short-term debts. The gearing ratio is calculated by dividing the total of long-term bank loans and short-term bank loans by the total of shareholders' equity.

### Dividend policy

Following the establishment of the Company as a joint stock limited company in April 1997, the distribution of the Company's dividends is considered annually by the Board of Directors and decided by the shareholders in general meeting. Payment of future dividends will depend upon the revenue, financial condition, future earnings and other factors of the Company.

### Contingent Liabilities

As at 31 December 2002, the Company had no significant contingent liabilities.

### Purchase, Sale and Investment

Save as disclosed in this report, during the year 2002, there was no material purchase, sale or investment in connection with the Company's subsidiaries and associates.

### Pledges of Assets

During the year 2002, there was no pledge of assets by the Company.

### Exposure to Fluctuations in Exchange Rates and Any Related Hedges

The Company is exposed to foreign currency risk primarily as a result of its foreign currency denominated long-term debts and, to a limited extent, cash and cash equivalents denominated in foreign currencies. The Company had no foreign currency hedging activity in 2002.

### US GAAP Reconciliation

The Company prepares a set of financial statements in compliance with IFRS, which differs in certain respects from US GAAP. Please refer to "Supplemental Information for North American Shareholders" for reference.