

SINOPEC SHANGHAI PETROCHEMICAL CO LTD

Form 20-F

June 27, 2005

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## **SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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### **FORM 20-F**

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**REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

**OR**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2004

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-12158

(Exact name of Registrant as specified in its charter)

# **Sinopec Shanghai Petrochemical Company Limited**

(Translation of Registrant's name into English)

**People's Republic of China**

(Jurisdiction of incorporation or organization)

**No. 48 Jinyi Road, Jinshan District, Shanghai, PRC 200540**

(Address of principal executive offices)

**Securities registered or to be registered pursuant to Section 12(b) of the Act.**

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
<b>American Depositary Share Class H Ordinary Shares, par value RMB1.00 per Share</b>	<b>New York Stock Exchange The Stock Exchange of Hong Kong Limited</b>

**Securities registered or to be registered pursuant to Section 12(g) of the Act.**

**None**

(Title of Class)

**Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.**

**None**

(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

**2,330,000,000 H Shares**

**4,870,000,000 Domestic Shares**

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark which financial statement item the registrant has elected to follow. Item 17  Item 18

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**CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS**

Information in this Annual Report which does not relate to historical financial information may be deemed to constitute forward-looking statements. The words or phrases "may", "will", "expect", "anticipate", "plan", "will likely result", "estimate", "project", "believe", "intends to" or "identify" forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are subject to risks and uncertainties that could cause actual results to differ materially from historical results and those presently anticipated or projected in the forward-looking statements. We caution readers not to place undue reliance on any forward looking statements, which speak only as of the date made. We undertake no obligations update any forward-looking statements to reflect event a circumstance after the date on which the statements are made or reflect the occurrence of unanticipated events. Among the factors that could cause our actual results in the future to differ materially from the forward-looking statements are crude oil allocations, effects of the macroeconomic policy of The People's Republic of China and government control of currency conversion.

**EXCHANGE RATES**

Unless otherwise specified, references in this Annual Report to "US dollars" or "US\$" are to United States dollars, references to "HK dollars" or "HK\$" are to Hong Kong dollars and references to "Renminbi" or "RMB" are to Renminbi yuan, the legal tender currency of the PRC.

We have translated amounts in this Annual Report from Renminbi to US dollars for your convenience. Except for Item 18. Financial Statements and where otherwise noted, we have used the average of the buying and selling exchange rate published daily by the People's Bank of China (the "PBOC Rate") on December 31, 2004 of US\$ 1.00 = RMB8.2765. The convenience translations do not mean that the Renminbi amounts could have been or could be converted into US dollars at that rate or at any other rate. The noon buying rate in New York City for cable transfers in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York (the "Noon Buying Rate") on December 31, 2004 was US\$ 1.00 = RMB8.2765.

**OTHER CONVENTIONS**

References to "we" or "us" are references to Sinopec Shanghai Petrochemical Company Limited and our subsidiaries, unless the context requires otherwise. Before our formation, these references relate to the petrochemical businesses carried on by Shanghai Petrochemical Complex.

References to "China" or the "PRC" are references to The People's Republic of China which, for the purpose of this Annual Report and for geographical reference only, excludes Hong Kong, Macau and Taiwan.

References to our "A Shares" are references to 720,000,000 of our domestic shares, par value RMB1.00 per share, which are ordinary shares subscribed for and traded exclusively in the Shanghai Stock Exchange by and between Chinese investors.

References to our "domestic shares" are references to all of our domestic shares, par value RMB1.00 per share, which are ordinary shares held by Chinese investors.

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References to our H Shares are references to our overseas-listed foreign ordinary shares, par value RMB1.00 per share, which are listed and traded on the Stock Exchange of Hong Kong Limited ( HKSE ) under the number 338 .

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Rated Capacity is the output capacity of a given production unit or, where appropriate, the throughput capacity, calculated by estimating the number of days in a year that the production unit is expected to operate, including downtime for regular maintenance, and multiplying that number by an amount equal to the unit's optimal daily output or throughput, as the case may be.

All references to tons are to metric tons.

References to sales volume are to sales to entities other than us, our divisions and subsidiaries, unless otherwise noted.

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**Table of Contents****PART I****ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS.**

Not applicable.

**ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE.**

Not applicable.

**ITEM 3. KEY INFORMATION.***A. Selected Financial Data.*

Our statements of operations and cash flow data for each of the years ended December 31, 2002, 2003 and 2004 and the balance sheet data as of December 31, 2003 and 2004 are derived from our consolidated financial statements included in Item 18. Financial Statements. Our statements of operations and cash flow data for the years ended December 31, 2000 and 2001 and the balance sheet data as of December 31, 2000, 2001 and 2002 are derived from consolidated financial statements not included in this Annual Report. Our selected consolidated financial data should be read in conjunction with our consolidated financial statements, and the notes thereto, and Item 5. Operating and Financial Review and Prospects. Our consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ( IFRS ). IFRS vary in certain significant respects from accounting principles generally accepted in the United States of America ( U.S. GAAP ). Information relating to the nature and effect of such differences is presented in Item 18. Financial Statements Consolidated Financial Statements Note 30.

## Selected Consolidated Financial Data

(in thousands, except per share and per ADS data)

	Years Ended December 31,					
	2000	2001	2002	2003	2004	2004 <sup>(a)</sup>
	(RMB)	(RMB)	(RMB)	(RMB)	(RMB)	(US\$)
<b>STATEMENTS OF OPERATIONS DATA</b>						
Amounts in accordance with IFRS:						
Net sales:						
Synthetic fibers	3,612,231	3,215,835	3,374,252	4,092,590	4,751,773	574,094



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Resins and plastics	6,005,305	5,635,697	6,440,673	8,864,266	12,085,967	1,460,187
Intermediate petrochemicals	2,232,250	2,105,342	2,555,035	3,851,333	5,896,580	712,405
Petroleum products	7,429,253	7,735,154	7,991,243	10,329,149	13,101,919	1,582,931
Trading and others	1,449,516	925,738	1,361,766	1,805,345	2,827,820	341,648
Cost of sales	19,039,986	18,803,044	19,853,928	26,396,224	33,223,604	4,013,967
Profit from operations	1,417,322	394,185	1,429,629	2,006,403	5,025,152	607,122
Net financing costs	272,186	227,758	400,656	392,021	292,008	35,279
Income before income tax and minority interests	1,080,645	145,797	1,045,038	1,590,365	4,696,229	567,383
Net income	856,510	116,049	916,365	1,401,690	3,971,103	479,805
Basic earnings per share(b)	0.12	0.02	0.13	0.20	0.55	0.07
Basic earnings per ADS(b)	11.90	1.61	12.73	19.47	55.15	6.66
Amounts in accordance with US GAAP						
Cost of sales	18,847,738	18,610,796	19,665,176	26,207,472	33,069,429	3,995,340
Profit from operations	1,609,570	586,433	1,628,525	2,221,729	5,191,926	627,271
Income before income taxes and minority interests	1,272,893	362,363	1,264,930	1,812,736	4,899,844	591,983
Taxation	229,674	33,641	115,956	174,435	665,714	80,429
Reconciliation to net income in accordance with US GAAP:						
Net Income under IFRS	856,510	116,049	916,365	1,401,690	3,971,103	479,805
Adjustments to net income under IFRS:						
Foreign exchange gains and losses	37,054	37,054	37,054	37,054	2,473	299
Capitalization of property, plant and equipment	21,703	21,703	21,703	21,703	21,707	2,623
Depreciation charge on revalued property, plant and equipment	133,491	133,491	129,995	129,995	129,995	15,707
Capitalized interest on investment in associates		24,318	20,996	7,045	36,841	4,451
Goodwill and negative goodwill amortization			10,144	322	12,599	1,522
Cumulative effect of adopting SFAS No.142			19,828			
Deferred Tax effect of the above adjustments	(28,837)	(32,485)	(31,462)	(29,370)	(28,653)	(3,462)
Net Income under US GAAP	1,019,921	300,130	1,124,623	1,568,439	4,146,065	500,945
Basic earnings per share(b)	0.14	0.04	0.16	0.22	0.58	0.07
Basic earnings per ADS(b)	14.17	4.17	15.62	21.78	57.58	6.96
CASH FLOW DATA						
Amounts in accordance with IFRS						
Net cash flow generated from operating activities	2,472,956	2,387,891	1,798,320	2,276,957	4,589,711	554,547
Depreciation	1,514,710	1,359,642	1,585,823	1,850,013	1,794,120	216,773
Capital expenditures	1,572,923	4,358,176	2,404,293	1,284,868	2,205,957	266,533
Amounts in accordance with US GAAP						
Depreciation	1,210,674	1,055,606	1,288,779	1,552,969	1,531,657	185,050

- (a) Translated solely for convenience into US dollars based on the PBOC Rate of US\$1.00 = RMB8.2765 on December 31, 2004. No representation is made that the Renminbi amounts could have been, or could be, converted into United States dollars at that rate.
- (b) The calculation of earnings per share is based on the weighted average number of shares outstanding during the year of 7,200,000,000 in each of 2004, 2003, 2002, 2001, and 2000, respectively. Earnings per ADS is calculated on the basis that one ADS is equivalent to 100 shares.

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	December 31,					
	2000	2001	2002	2003	2004	2004 <sup>(a)</sup>
	(RMB)	(RMB)	(RMB) (in thousands)	(RMB)	(RMB)	(US\$)
<b>BALANCE SHEET DATA</b>						
Amounts in accordance with IFRS:						
Property, plant and equipment, net	11,726,871	11,894,420	15,809,493	16,020,104	15,206,325	1,837,289
Total assets	21,701,310	24,325,601	26,085,919	27,101,481	28,276,601	3,416,493
Short term debt(b)	3,200,245	4,106,041	4,002,315	5,574,729	5,000,305	604,157
Long term debt (excluding current portion)	1,863,776	3,463,747	4,590,891	3,206,848	2,014,614	243,414
Shareholders' equity	13,501,634	13,063,831	13,980,196	15,021,886	18,416,989	2,225,215
Amounts in accordance with US GAAP						
Property, plant and equipment, net	10,796,068	11,299,220	15,403,045	15,802,408	15,142,804	1,829,614
Total assets	20,910,128	23,840,352	25,808,928	26,991,239	28,341,321	3,424,312
Shareholders' equity	12,710,452	12,578,582	13,703,205	14,911,644	18,481,709	2,233,035

- (a) Translated solely for convenience into US dollars based on the PBOC Rate of US\$1.00 = RMB8.2765 on December 31, 2004. No representation is made that the Renminbi amounts could have been, or could be, converted into United States dollars at that rate.
- (b) Including current portion of long term debt.

**Dividends**

The following table sets forth certain information concerning the dividends since January 1, 1994:

Dividend Period	Dividend per Share
Jan. 1, 1994-June 30, 1994	RMB 0.04 (US\$0.0048)
July 1, 1994-Dec. 31, 1994	RMB0.085 (US\$0.0103)
Jan. 1, 1995-June 30, 1995	RMB 0.04 (US\$0.0048)
July 1, 1995-Dec. 31, 1995	RMB 0.09 (US\$0.0109)
Jan. 1, 1996-June 30, 1996	RMB 0.04 (US\$0.0048)
July 1, 1996-Dec. 31, 1996	RMB 0.08 (US\$0.0097)
Jan. 1, 1997-Dec. 31, 1997	RMB 0.06 (US\$0.0072)
Jan. 1, 1998-Dec. 31, 1998	RMB 0.03 (US\$0.0036)
Jan. 1, 1999-Dec. 31, 1999	RMB 0.05 (US\$0.0060)
Jan. 1, 2000-Dec. 31, 2000	RMB 0.06 (US\$0.0072)
Jan. 1, 2001-Dec. 31, 2001	No dividend
Jan. 1, 2002-Dec. 31, 2002	RMB 0.05 (US\$0.0060)
Jan. 1, 2003-Dec. 31, 2003	RMB 0.08 (US\$0.0097)
Jan. 1, 2004-Dec. 31, 2004	RMB 0.20 (US\$0.0242)

See also Item 8. Financial Information Consolidated Statements and Other Financial Information Dividend Policy.

**Exchange Rates**

The Chinese government controls its foreign currency reserves in part through direct regulation of the conversion of Renminbi into foreign exchange and through restrictions on foreign trade. See Item 10. Additional Information.

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The following table sets forth information concerning exchange rates between Renminbi and US dollars for the periods indicated:

<u>Period</u>	<u>Noon Buying Rates (RMB/US\$)</u>			
	<u>Period End</u>	<u>Average<sup>(1)</sup></u>	<u>High</u>	<u>Low</u>
2000	8.2774	8.2784	8.2799	8.2768
2001	8.2766	8.2772	8.2786	8.2676
2002	8.2800	8.2772	8.2800	8.2669
2003	8.2767	8.2771	8.2800	8.2765
2004	8.2765	8.2768	8.2774	8.2764
December, 2004	8.2765		8.2767	8.2765
January, 2005	8.2765		8.2765	8.2765
February, 2005	8.2765		8.2765	8.2765
March, 2005	8.2765		8.2765	8.2765
April, 2005	8.2765		8.2765	8.2765
May, 2005	8.2765		8.2765	8.2765
Latest Practicable Date, June 21, 2005	8.2765			

Source: The noon buying rate in New York for cable transfers payable in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York.

Note: (1) Determined by averaging the rates on the last business day of each month during the respective period.

***B. Capitalization and Indebtedness.***

Not applicable.

***C. Reasons for the Offer and Use of Proceeds.***

Not applicable.

***D. Risk Factors.***

**Our operations may be adversely affected by the cyclical nature of the petroleum and petrochemical market and by the volatility of prices of crude oil and refined oil products.**

Most of our revenues are attributable to petrochemical products which have historically been cyclical and sensitive to the availability and price of feedstocks and general economic conditions. Markets for many of our products are sensitive to changes in industry capacity and output levels, cyclical changes in regional and global economic conditions, the price and availability of substitute products and changes in consumer demand, which from time to time have had a significant impact on product prices in the regional and global markets. Historically, the markets for these

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products have experienced alternating periods of tight supply, causing prices and margins to increase, followed by periods of capacity additions, possibly resulting in oversupply and declining prices and margins. As tariffs and other import restrictions are reduced and the control of product allocation and pricing is relaxed in China, the markets for many of our products have become increasingly subject to the cyclical nature of regional and global markets. Historically, international prices of crude oil have fluctuated widely due to many other factors that are beyond our control. We cannot assure you that future growth in demand for our products will be sufficient to alleviate any existing or future conditions of excess industry capacity or that such conditions will not be sustained or further aggravated by anticipated or unanticipated capacity additions

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or other events. In addition, we expect that the volatility and uncertainty of the prices of crude oil and petrochemical products will continue. Increasing crude oil prices and declines in prices of petrochemical products may adversely affect our business and results of operations and financial condition.

**Our development plans have significant capital expenditure and financing requirements, which are subject to a number of risks and uncertainties.**

The petrochemical business is a capital intensive business. Our ability to maintain and increase our revenues, net income and cash flows depends upon continued capital spending. Our current business strategy contemplates capital expenditures for 2005 of approximately RMB 2,700 million (US\$326.22 million), which will be provided through financing activities and use of our own capital. Our actual capital expenditures may vary significantly from these planned amounts due to our ability to generate sufficient cash flows from operations, investments and other factors that may be beyond our control. In addition, there can be no assurance as to whether, or at what cost, our capital projects will be completed or the success of these projects if completed.

As of March 31, 2005, we had aggregate outstanding indebtedness of approximately RMB 6,261 million (US\$ 765.48 million). China Petroleum & Chemical Corporation ( Sinopec Corp ), our controlling shareholder, did not provide any guarantee or credit support for our debt for the year ended December 31, 2004 and for the three-month period ended March 31, 2005.

Our ability to obtain external financing in the future is subject to a variety of uncertainties including:

our future results of operations, financial condition and cash flows;

the condition of the economy in China and the markets for our products;

the cost of financing and the condition of financial markets; and

the issuance of relevant government approvals and other project risks associated with the development of infrastructure in China.

Our failure to obtain sufficient funding for our operations or development plans could adversely affect our business, results of operations and financial condition.

**We could face increased competition.**

Eastern China, our principal market, has enjoyed stronger economic growth and a higher demand for petrochemical products than other regions of China. As a result, we believe that competitors will try to expand their sales and build up their distribution networks in our principal market. We believe this trend will continue and probably accelerate. Increased competition may have a material adverse effect on our financial condition and results of operations.

**We may not be able to pass on all cost increases from rising crude oil prices.**

We currently consume large amounts of crude oil to manufacture our products. While we try to match crude oil cost increases with sales price increases, our ability to pass on cost increases to our customers is dependent on market conditions and government regulations. There may be periods during which we cannot fully cover increases in crude oil prices by increases in the sale prices of our products. This may have a material adverse effect on our financial condition, results of operations or cash flows.

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### **Related party transactions; non-competition; conflicts of interests.**

We have engaged from time to time and will continue to engage in a variety of transactions with Sinopec Corp and China Petrochemical Corporation, the controlling shareholder of Sinopec Corp, and their various subsidiaries or affiliates who provide a number of services to us, including sales and marketing, educational and community services. Our transactions with these companies are governed by a number of service and other contracts, the terms of which were negotiated on an arm's length basis. Our business and results of operations could be adversely affected if Sinopec Corp refuses to engage in such transactions or if it seeks to amend our contracts with it in a way adverse to us. In addition, Sinopec Corp has interests in businesses which compete or are likely to compete, either directly or indirectly, with our businesses. Because Sinopec Corp is our controlling shareholder and its interests may conflict with our own interests, Sinopec Corp may take actions that favor itself over our interests.

### **We are controlled by Sinopec Corp, whose interests may not be aligned with yours.**

As of May 31, 2005, Sinopec Corp owned 55.56% of our shares. Accordingly, it has voting and management control over us, and its interests may be different from your interests and the interests of our other shareholders. Subject to our Articles of Association and applicable laws and regulations, Sinopec Corp will be in a position to cause us to declare dividends, determine the outcome of corporate actions requiring shareholder approval or effect corporate transactions without the approval of the holders of the H shares and ADSs. Any such increase in our dividend payout would reduce funds available for reinvestment in our business and any such actions or transactions could adversely affect us or our minority shareholders. Additionally, Sinopec Corp completed its initial public offering of shares in late 2000. As a public company, Sinopec Corp may experience changes in its own business strategy and policies. Although we are not currently aware of any such changes, they could, in turn, lead Sinopec Corp to change its policies or practices toward us in ways that we cannot predict, with corresponding unpredictable consequences for our business.

### **Our business operations may be adversely affected by present or future environmental regulations.**

We are subject to extensive environmental protection laws and regulations in China. These laws and regulations permit:

the imposition of fees for the discharge of waste substances;

the levy of fines and payments for damages for serious environmental offenses; and

the central government, at its discretion, to close any facility which fails to comply with orders and require it to correct or stop operations causing environmental damage.

Our production operations produce substantial amounts of waste materials. In addition, our production facilities require operating permits that are subject to renewal, modification and revocation. We believe that our operations substantially comply with all applicable Chinese environmental laws and regulations as they have been previously interpreted and enforced. The Chinese government, however, has moved, and may move further, toward more rigorous enforcement of applicable laws, and toward the adoption of more stringent environmental standards. There can be no assurance that Chinese national or local authorities will not impose additional regulations or apply more rigorous enforcement of such regulations which would require additional expenditures on environmental matters.





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### **Our business may be limited or adversely affected by government regulations.**

The central and local Chinese governments continue to exercise a certain degree of control over the petrochemical industry in China by, among other things:

- mandating distribution channels for our petroleum products;
- setting the allocations and pricing of certain resources and services;
- assessing taxes and fees payable;
- setting import and export quotas and procedures; and
- setting safety, environmental and quality standards.

As a result, we may face significant constraints on our flexibility and ability to expand our business operations or to maximize our profitability. In the past, we have benefited from favorable regulatory policies that have, for example, reduced the competition we face from illegal imports of petroleum products. Existing policies that favor our industry may change in the future and our business could be adversely affected by any such changes.

### **Our development plans require regulatory approval.**

We are currently engaged in a number of construction and expansion projects. Most of our projects are subject to governmental review and approval. The timing and cost of completion of these projects will depend on numerous factors, including approvals from relevant government authorities and general economic conditions in China.

While in general we attempt to obtain governmental approval as far in advance as practicable, we may not be able to control the timing and outcome of these governmental reviews and approvals. If any of our important projects required for our future growth are not approved, or not approved on a timely basis, our results of operations and financial condition could be adversely affected.

### **China's entry into the World Trade Organization, or WTO, may significantly increase foreign competition in our lines of business.**

China joined the WTO on December 11, 2001. As part of its membership, China has committed to eliminate some tariff and non-tariff barriers to foreign competition in the domestic petrochemical industry that benefited us in the past. In particular, China has reduced tariffs on imported petrochemicals products that compete with ours to 2.8% to 14.2% from 5% to 17%, and

permits increasing levels of foreign investment in the domestic petrochemicals industry, allowing foreign investors to own 100% of a domestic petrochemicals company from December 11, 2004;

will gradually relax restrictions on the import of crude oil by non-state owned companies;

will grant foreign-owned companies the right to import petrochemical products;

will permit foreign companies to distribute and market petroleum products in both retail and wholesale markets in China.

As a result of these measures, we will likely face increased competition from foreign companies and imports in the near future and longer term. Overall, we think that China's WTO entry will also create substantial amounts of new investment and business in China, with a corresponding increase in sales opportunities for us. We do, however, believe that our products have been and will continue generally to be competitive with imported products in the PRC. Tariff reductions, however, could reduce our profit margins or otherwise negatively impact our revenue from certain products, including a small number of significant products. The PRC government may also reduce the tariffs imposed on production equipment that we may import in the future, as well as the restrictions on availability of imported raw materials (such as crude oil) currently enforced by the PRC. Although we are confident that we may be able to capture additional sales, the net effect of China's accession to the WTO on our business and results of operations remains to be seen.

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### **Political and economic policies in China could affect our business in unpredictable ways.**

The economy of China differs from the economies of most countries belonging to the Organization for Economic Co-operation and Development in a number of respects, including:

structure;

level of government involvement;

level of development;

level of capital reinvestment;

control of foreign exchange; and

allocation of resources.

Before its adoption of reform and open-door policies beginning in 1978, China was primarily a planned economy. Since that time, the Chinese government has been reforming the Chinese economic system, and has also begun reforming the government structure. These reforms have resulted in significant economic growth and social progress. Although the Chinese government still owns a significant portion of the productive assets in China, economic reform policies since the late 1980s have emphasized autonomous enterprises and the utilization of market mechanisms. We currently expect that the Chinese government will continue these reforms, further reduce government intervention and rely more heavily on market mechanisms to allocate resources. Although we believe these reforms will have a positive effect on our overall and long-term development, we cannot predict whether changes to China's political, economic and social conditions, laws, regulations and policies will have any adverse effect on our current or future business or results of operations.

### **If the Chinese government changes current regulations that allow us to make payments in foreign currencies, we could have trouble making our foreign exchange payments.**

The Renminbi currently is not a freely convertible currency. We receive most of our revenue in Renminbi. A portion of our Renminbi revenue must be converted into other currencies to meet our foreign currency obligations. We have substantial requirements for foreign currency, including:

debt service costs on foreign currency-denominated debt;

purchases of imported equipment;

payment of any cash dividends declared in respect of the H shares; and

import of crude oil and other materials.

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Under existing foreign exchange regulations in China, we may undertake current account foreign exchange transactions, including the payment of dividends, without prior approval from the State Administration of Foreign Exchange by producing commercial documents evidencing the foreign exchange transactions, provided that they are processed through Chinese banks licensed to engage in foreign exchange transactions. The Chinese government has stated publicly that it intends to eventually make the Renminbi freely convertible in the future. However, uncertainty exists as to whether the Chinese government may restrict access to foreign currency for current account transactions if foreign currency becomes scarce in China.

Foreign exchange transactions under the capital account (international revenues and expenditures that increase or decrease debt or equity, including principal payments in respect of foreign currency-denominated obligations) continue to be subject to limitations and require the prior approval of the State Administration of Foreign Exchange. These limitations could affect our ability to obtain foreign exchange through debt financing, or to make capital expenditures in foreign currency.

If the Chinese government restricts our ability to make payments in foreign currency, we could have trouble making our foreign exchange payments and could even default on our obligations.

### **Fluctuations in the value of the Renminbi could reduce our profits or our dividends.**

Although the official exchange rate for the conversion of Renminbi to U.S. dollars has been stable, the exchange rate of the Renminbi may become volatile against the U.S. dollar or other currencies in the future.

Substantially all of our revenues are denominated in Renminbi, while most of our crude oil purchases and equipment purchases and some of our debt repayments are denominated in foreign currencies. Any future Renminbi devaluation could increase our costs. This could in turn raise our costs of operations and harm our profitability. Any devaluation of the Renminbi may adversely affect the value of any dividends payable on our H shares and ADSs in foreign currency terms.

### **Interpretation and enforcement of Chinese laws and regulations is uncertain.**

The Chinese legal system is based on statutory law. Under this system, prior court decisions may be cited as persuasive authority, but do not have the binding effect of precedents. Since 1979, the Chinese government has been developing a comprehensive system of commercial laws and considerable progress has been made in the promulgation of laws and regulations dealing with economic matters, such as corporate organization and governance, foreign investment, commerce, taxation and trade. As these laws, regulations and legal requirements are relatively new, and because of the limited volume of published case law and judicial interpretations and the non-binding nature of prior court decisions, the interpretation and enforcement of these laws, regulations and legal requirements involve greater uncertainty than in other jurisdictions.

### **You may not enjoy shareholders' protections that you would be entitled to in other jurisdictions.**

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As most of our business is conducted in China, our operations are governed principally by the laws of China. Chinese legal provisions for the protection of shareholders' rights and access to information are different and less developed than those applicable to companies formed in the United States, Hong Kong, the United Kingdom and other developed countries or regions. You may not enjoy shareholders' protections under Chinese law that you would be entitled to in other jurisdictions.

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**Our Articles of Association require you to submit your disputes with us and other persons to arbitration. You will have no legal right to a court proceeding.**

Our Articles of Association require a holder of H shares and ADSs having a claim against, or a dispute with, us, our directors, supervisors, executive officers or a holder of our domestic shares relating to any rights or obligations conferred or imposed by our Articles of Association, the Chinese Company Law or any other Chinese laws or regulations relating to our affairs, to submit the dispute or claim to the China International Economic and Trade Arbitration Commission or to the Hong Kong International Arbitration Center for arbitration. Our Articles of Association further provide that the arbitrator's award shall be final and binding on all parties.

## **ITEM 4. INFORMATION ON THE COMPANY.**

### ***A. History and Development of the Company***

#### **General Information**

We were established in the People's Republic of China as a joint stock limited company under the Chinese Company Law on June 29, 1993 as Shanghai Petrochemical Company Limited. On October 12, 2000, we changed our name to Sinopec Shanghai Petrochemical Company Limited. Our registered office is at No. 48 Jinyi Road, Jinshan District, Shanghai, China 200540. Our telephone number there is (86-21) 5794-1941.

#### **Our Predecessor**

Our predecessor, Shanghai Petrochemical Complex (the "Complex"), was founded in 1972 as one of the first large scale Chinese petrochemical enterprises using advanced imported technology and equipment. Prior to June 29, 1993, the Complex was wholly-owned by China Petrochemical Corporation, at the time a ministerial level enterprise (before its restructuring in 1998, "Sinopec"). The Complex's location was chosen because of accessibility by water and land transportation to Shanghai, the major industrial city of China, and the availability of reclaimable land. The Complex was initially under the administration of the Ministry of Textile Industry and in 1983 was placed under the administration of Sinopec.

The Complex and we, as its successor, have undergone four major stages of construction. The first stage of construction (1972-1976) included reclamation of land and the installation of 18 production units. The second stage of construction (1980-1986) increased the Complex's capacity for processing crude oil and doubled its capacity for synthetic fiber production. The third stage of construction (1987-1992) primarily consisted of the installation of a 300,000 ton Rated Capacity ethylene unit, an additional crude oil refining unit and other units for the production of petrochemical products. The third stage of construction completed our transition from a synthetic fiber producer to a highly integrated producer of a wide variety of petrochemical products. The fourth stage of construction (2000-2002) mainly included the 700,000 ton Ethylene Expansion Project and Coal-Fired Power Plant Expansion Project which is described under Item 4. Information on the Company - Property, Plant and Equipment - Capital Expansion Program.



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Over the past twenty years, the Complex built up an infrastructure system to support its production needs. The Complex has its own facilities to supply water, electricity, steam and other utilities and to treat waste water, as well as ocean and inland waterway wharfs and railroad and road transportation facilities.

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### **Our Initial Public Offering and Listing**

We were established as a subsidiary of Sinopec on June 29, 1993. In preparation for our initial public offering of ordinary shares, all the assets and liabilities of the Complex were transferred to us and to Sinopec Shanghai Jinshan Industrial Company ( *JI* ), a separate subsidiary of Sinopec newly established as a state-owned enterprise. The Complex's non-core businesses and assets, such as housing, stores, schools, transportation and medical services were transferred to *JI*. The Complex then ceased to exist as a legal entity. In 1998, Sinopec was restructured into a limited liability company under the name of China Petrochemical Corporation ( *Sinopec Group* ). In a subsequent reorganization, Sinopec Group transferred its interest in us to its subsidiary, Sinopec Corp on February 25, 2000. In 1997, *JI* was dissolved and its subsidiaries were transferred to Sinopec. Sinopec Group now provides community services to us that were formerly provided by *JI*.

Our H Shares are listed on the HKSE. Our American Depositary Shares ( *ADSs* ), each representing 100 H Shares, are listed on the New York Stock Exchange ( *NYSE* ). Our A Shares are listed on the Shanghai Securities Exchange. We were the first Chinese joint stock limited company to have securities concurrently traded in Hong Kong, the United States and China. On January 31, 1994, our A Shares were included in the Shanghai Securities Exchange Stock Index.

### **Description of Principal Capital Expenditures and Divestitures**

Late in 2001, we established a Sino-foreign equity joint venture, Shanghai Secco Petrochemical Company Limited ( *Secco* ), together with BP Chemicals East China Investments Limited ( *BP* ) and Sinopec Corp. We own 20%, while BP and Sinopec Corp own 50% and 30% of the equity interest of *Secco*, respectively. *Secco* was established to build and operate a 900,000 ton Rated Capacity ethylene petrochemical manufacturing facility, to manufacture and market ethylene, polyethylene, styrene, polystyrene, propylene, acrylonitrile, polypropylene, butadiene, aromatics and by-products, to provide related after-sales services and technical advice with respect to such petrochemical products and by products, and to engage in polymers application development. *Secco* is expected to complete construction in 2005. *Secco*'s registered capital is US\$901,440,964 out of which we are obligated to contribute an amount equivalent to US\$180,287,952 in Renminbi prior to the end of 2005. As of December 31, 2004, our contribution amounted to RMB 1,200.5 million (US\$ 145.1 million). We have been financing and expect to continue to finance this project with revenues received from our operation. For a description of capital expansion projects related to our facilities, please see [Item 4. Information on the Company Property, Plant and Equipment Capital Expansion Program](#).

### ***B. Business Overview***

We are one of the largest petrochemical companies in China based on 2004 net sales and ethylene production. Our highly integrated petrochemical complex processes crude oil into a broad range of products in four major product areas:

synthetic fibers,

resins and plastics,

intermediate petrochemicals, and

petroleum products.

Based on 2004 sales volumes, we are a leading Chinese producer in each of our principal synthetic fibers and resins and plastics products. We believe that we are also a leading competitor in sales of petroleum products and intermediate petrochemicals in our regional markets.

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Our net sales in each of 2004, 2003 and 2002 are summarized as follows:

**Net Sales of RMB38,664 million (US\$4,671.54 million) in 2004**

Synthetic fibers	12.29%
Resins and plastics	31.26%
Intermediate petrochemicals	15.25%
Petroleum products	33.89%
Trading and others	7.31%
Total:	100%

**Net Sales of RMB28,943 million (US\$3,496.93 million) in 2003**

Synthetic fibers	14.14%
Resins and plastics	30.63%
Intermediate petrochemicals	13.31%
Petroleum products	35.69%
Trading and others	6.23%
Total:	100%

**Net Sales of RMB 21,723 million (US\$2,624.41 million) in 2002**

Synthetic fibers	15.53%
Resins and plastics	29.65%
Intermediate petrochemicals	11.76%
Petroleum products	36.79%
Trading and others	6.27%
Total:	100%

In 2004, our net sales were RMB38,664 million (US\$4,671.54 million) and operating margin was 12.8%.

We derive a substantial portion of our revenues from customers in Eastern China (principally Shanghai and its six nearby provinces), an area that has experienced economic growth above the national average in recent years. We believe that we are well-positioned to take advantage of opportunities which may arise through the growth of the Chinese economy generally and in this area in particular. Shown by geographic region, our net sales by product category for each of 2004, 2003 and 2002 are as follows:

**2004 Net Sales by Region (%)**

	<u>Eastern China</u>	<u>Other parts of China</u>	<u>Exports</u>
Synthetic fibers	92.96	6.18	0.86
Resins and plastics	88.87	11.00	0.13
Intermediate petrochemicals	94.06	5.24	0.70
Petroleum products	99.97	0.00	0.03

**2003 Net Sales by Region (%)**

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	<u>Eastern China</u>	<u>Other parts of China</u>	<u>Exports</u>
Synthetic fibers	86.14	12.98	0.88
Resins and plastics	88.67	11.27	0.06
Intermediate petrochemicals	89.54	6.20	4.26
Petroleum products	89.59	0.00	10.41

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## 2002 Net Sales by Region (%)

	<u>Eastern China</u>	<u>Other parts of China</u>	<u>Exports</u>
Synthetic fibers	82.91	16.57	0.52
Resins and plastics	92.35	7.58	0.07
Intermediate petrochemicals	83.22	9.37	7.71
Petroleum products	88.54	1.58	9.88

**Business Strategy**

Our strategy is to develop our leading role in the Chinese petrochemical industry by increasing production capacities, particularly for higher-margin products, and improving operating efficiencies. In the long term, we aim to increase annual production of ethylene from the current 900,000 tons to more than one million tons. This would give us the feedstock we need to significantly expand our production of higher-margin products. In order to pursue this goal, we are positioning ourselves for larger-scale projects and acquisitions by maintaining our financing capacity.

In the near-term, our goal is to:

*streamline production* by increasing our capacity to produce key intermediate products such as ethylene and propylene and

produce *higher-margin products*, including certain resin and plastic products, and intermediate petrochemicals by adding or expanding production capacity.

In order to support our ethylene expansion and to provide additional capacity and flexibility, we also plan to expand and renovate our oil refining capabilities. Doing so should permit us to produce additional feedstock for our ethylene expansion. By adding processing units to refine vacuum gas oil ( VGO ) and residual oil, we should be able to produce more higher-margin petroleum products such as gasoline and diesel products and certain intermediate petrochemical products which can be sold or used as feedstock for our own downstream products.

We, on a continuous basis, are also implementing plans for improving operating efficiencies. These are designed to: (i) gain incremental improvements in capacity utilization from our existing facilities; (ii) reduce maintenance downtime by adopting more sophisticated maintenance and repair techniques; (iii) produce better cost control by implementing additional financial and operational reporting systems; and (iv) enable us to monitor market conditions and adjust our pricing and product mix responsively.

**Principal Products**

We produce over 60 different types of products representing a broad range of synthetic fibers, resins and plastics, intermediate petrochemicals and petroleum products. We use many of the important petroleum products and intermediate petrochemicals we produce in producing our own downstream products. The following table shows our 2004 net sales by major product as a percentage of total net sales together with the typical uses of these products.



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<b>Product</b>	<b>% of net sales</b>	<b>Typical Use</b>
<b>SYNTHETIC FIBERS</b>		
Polyester staple fiber	2.44	Textiles and apparel
Acrylic staple fiber	6.60	One can be woven on its own or blended with cotton into cotton-type fabrics, the other can be woven on its own or blended with wool into wool-type fabrics and acrylic top
Acrylic top	1.83	High bulk hand knitting yarn, blankets and fabrics
Polypropylene	0.31	Industrial unwoven fabric, and textiles and apparel
Others	1.1	
<b>Sub-total</b>	<b>12.29</b>	
<b>RESINS AND PLASTICS</b>		
Polyester chips	7.98	Polyester fibers, films and containers
PE pellets	12.44	Films, ground sheeting, wire and cable compound and other injection molding products such as housewares and toys
LDPE film	0.24	Agricultural greenhouse materials and packing for consumer products
PP pellets	9.28	Extruded films or sheets, injection molded products such as housewares, toys and household electric appliance and automobile parts
PVA	1.24	PVA fibers, building coating materials and textile starch
Others	0.08	
<b>Sub-total</b>	<b>31.26</b>	
<b>INTERMEDIATE PETROCHEMICALS</b>		
Ethylene	2.07	Feedstock for Polyethylene, EG, PVC and other intermediate petrochemicals which can be further processed into resins and plastics and synthetic fiber.
Ethylene oxide	1.29	Intermediate for chemical and pharmaceutical industry, dyes, detergents and adjuvant
Benzene	4.18	Intermediate petrochemical products, styrene, plastics, explosives, dyes, detergents, epoxies and nylon
Butadiene	2.22	Synthetic rubber and plastics
Ethylene glycol	0.84	Fine chemicals
Others	4.65	
<b>Sub-total</b>	<b>15.25</b>	
<b>PETROLEUM PRODUCTS</b>		
Gasoline	4.48	Transportation fuels
Diesel	19.81	Agricultural fuels
Jet Oil	3.69	Transportation fuels
Others	5.91	
<b>Sub-total</b>	<b>33.89</b>	
Trading and Others	7.31	
<b>Total</b>	<b>100.00</b>	

**Production Processes**

The key sectors in our vertically integrated production facilities are the ethylene units which produce ethylene and propylene, and our aromatics plants which principally produce paraxylene ( PX ) and benzene. Ethylene is the major raw material in the production of polyethylene ( PE ) and polyvinyl acetate ( PVA ). Ethylene is also used to make monoethylene glycol ( MEG ) which, together with pure terephthalic acid ( PTA ), is used to manufacture polyester. Propylene is the major raw material in the production of acrylonitrile and polypropylene ( PP ). These products are produced through the processing of a series of petrochemical units from crude oil. Our production processes are shown in the flow chart below.



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Our refinery units refine crude oil into five basic components: (1) atmospheric gas oil ( AGO ), (2) VGO, (3) residual oil, (4) gasoline, and (5) light diesel oil. The AGO is fed to the ethylene units primarily to produce ethylene and propylene. The VGO is further processed in a hydrocracking unit producing mainly light and heavy naphtha, liquified petroleum gas ( LPG ), diesel oil, various aromatic hydrocarbon products and jet fuel. Residual oil can be further processed into gasoline, diesel oil, LPG, propylene and other products.

### Intermediate Petrochemicals

*Ethylene* Ethylene is either directly processed into PE resins or processed into other intermediate petrochemicals. The most important of these is MEG. MEG is a key ingredient in polyester. It is produced by oxidizing ethylene in the ethylene oxide ( EO )/ethylene glycol ( EG ) unit. Ethylene is also used to produce vinyl acetate which is processed into PVA.

*Propylene* Propylene is either processed directly into PP resins or is further processed into other intermediate petrochemicals such as acrylonitrile, acetonitrile, hydroxyl acetonitrile and sodium cyanide. Acrylonitrile is used in producing acrylics.

*Vacuum gas oil* VGO is passed through the hydrocracker, and the resulting heavy naphtha is fed into the aromatics plants to produce PX and benzene. PX is processed into PTA, one of the principal raw materials in producing polyester.

### Resins and Plastics and Synthetic Fibers

We process our intermediate petrochemical products into five kinds of synthetic fiber raw materials: (1) polyester, (2) acrylonitrile, (3) PP, (4) polyethylene ( PE ) and (5) PVA. Each of these five products has its own production line or lines. We further process polyester, acrylonitrile and polypropylene into various types of synthetic fibers.

*Polyester* MEG and PTA are fed into a polymerization unit which produces polyester chips and polyester melt. Both chips and melt are used as raw materials in the production of polyester staple and filaments. Some chips are also sold to third parties.

Polyester staple fiber is a multi-strand fiber cut into short lengths which can be spun into fabric on its own or blended with cotton, wool or flax to produce textiles. Polyester filaments are a class of more highly processed polyester materials which have been drawn and oriented to produce a long thread-like fiber.

*Acrylonitrile* We produce polyacrylonitrile by feeding acrylonitrile into a polymerization unit. By passing the polyacrylonitrile through the fiber unit, acrylic fiber and acrylic staple fiber are produced, including cotton and wool type staple fibers. Wool acrylic staple fiber can be processed into acrylic wool strips.

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*Polypropylene* We produce PP resins by feeding propylene into a polymerization unit. Our fiber grade PP resin is the main ingredient for PP fiber production.

*Polyethylene* We have three sets of units producing polyethylene, two of which produce LDPE using the kettle type process, and the other unit produces all density polyethylene products using the Borstar bimodal process.

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Polyvinyl *acetate* PVA granules are produced from vinyl acetate ( VAC ), derived from ethylene.

### **Raw Materials**

#### **Crude Oil**

Crude oil is our primary raw material and the most significant raw material we purchase from outside sources. In 2004, crude oil accounted for approximately 58.58% of our total cost of sales. Accordingly, the supply and price of crude oil are key factors in determining our profitability.

*Allocation and Transportation* The Chinese government exercises centralized management and control of the distribution of all crude oil, whether from domestic or foreign sources, and major petroleum products within China. Under this system, all our crude oil must be allocated by Sinopec Corp. During 2004, we did not experience any significant problems in obtaining sufficient crude oil to meet our production needs.

Sinopec Group is responsible for preparing an annual plan on demand and supply for crude oil and petroleum products that forms the basis of the Chinese government's annual balancing plan which effectively dictates how much crude oil we will receive each year. Further, because the plan applies not only to domestic onshore oil, but also to domestic offshore oil and imported crude oil, we must consult with Sinopec Group in order to switch to domestic offshore oil or imported crude oil to reduce our cost. Likewise, under the balancing plan, some of our petroleum products are designated for sale to the subsidiaries of Sinopec Group or other designated customers and we must consult Sinopec Group to sell elsewhere. Therefore, we cannot freely sell our petroleum products to take advantage of any opportunities for higher-priced sales.

We have received confirmation from Sinopec Corp that we will receive an allocation of 0.55 million tons of domestic onshore and offshore crude oil and 9.15 million tons of foreign crude oil in 2005. Sinopec Corp has further confirmed that, subject to China's national crude oil policy, it will continue to allocate sufficient quantities and appropriate kinds of crude oil to us, including domestic onshore, domestic offshore and foreign crude oil, for our anticipated annual needs. We anticipate fully utilizing our 2005 allocation of crude oil. We believe that the mix of crude oil feedstocks currently available is satisfactory for our 2005 production capacity and targets. Additionally, as part of China's commitment at its accession into WTO, certain non-state-owned enterprises have been granted an increasing quota to import crude oil. Although we do not expect to obtain crude oil through this channel in the foreseeable future due to the current crude oil allocation system, this may provide us with an alternative source of crude oil supply.

*Crude Oil Mix* Our refining equipment is designed to process certain grades of crude oil. Therefore, the origin and quality of the crude oil available can be important to our business. We believe, as we are significantly increasing usage of foreign crude oil, we will continue to be able to obtain such foreign crude oil that is compatible with our refining equipment. The overall mix of foreign versus domestic crude oil we process in 2005 will depend on a variety of factors, including the amount of future allocations of domestic onshore crude oil and the availability, price, quality, processing profitability and compatibility with our refining capabilities of foreign crude oil. Provided there are no significant modifications to the existing crude oil allocation policy, we believe that sufficient supplies of crude oil will be available on the domestic or international markets for our 2005 production capacity and goals.

In 2004, our crude oil was sourced as follows:

Shengli Oilfield in Shandong Province	0.27%
Domestic offshore and foreign crude oil	99.73%
Total:	100%

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As a result of a consistent decrease in the supply of domestic crude oil, we plan to continue to significantly increase the proportion of foreign crude oil we use. While we expect our mix of crude oil feedstocks to change as a result, we believe that we will be able to maintain our processing efficiency through technological adjustments of our equipment and quality control and that increased use of imported oil will not materially adversely impact our business and results of operations.

Domestic onshore crude oil is transported by pipeline to China's east coast and then by oil tanker to our oil terminal wharf at Chenshan. Foreign and domestic offshore crude oil is supplied by tanker to our oil terminal wharf. See [Item 4D. Property, Plants and Equipment -Wharfs.](#)

In the past, we have not experienced disruption in our crude oil supply. We have on-site crude oil storage tanks capable of storing approximately 460,000 cubic meters of crude oil. This crude oil storage can provide us with approximately 20 days' supply of crude oil. Generally, these storage tanks remain nearly full to minimize the effect of any temporary disruption in the supply of crude oil.

*Pricing* The price of domestic onshore crude oil is controlled by China National Petroleum Corporation ( CNPC ) and Sinopec Group based on government pricing policies, while the price of domestic offshore and foreign crude oil is generally allocated to us at prevailing international market prices. The average cost of foreign and domestic offshore crude oil in 2004 was RMB 2,302(US\$278.1) per ton and RMB 2,472(US\$298.7) per ton, respectively. In 2004, we processed 459,300 tons of domestic offshore crude oil and 8.5707 million tons of foreign crude oil.

Beginning June 1998, the Chinese government established a unified pricing system for crude oil. Each month, the National Development and Reform Commission ( NDRC ) established an indicative price for each grade of domestic onshore crude oil based on comparable international market prices, inclusive of any duties that would have been imposed had the oil been imported. The actual price for domestic onshore oil would be such indicative price plus a surcharge. This surcharge was determined by CNPC and Sinopec Group to reflect any transportation and other miscellaneous costs that would have been incurred in having the oil delivered to various refineries. In March 2001, the NDRC ceased publishing an indicative price. Instead, the indicative price for domestic onshore oil is calculated and determined directly by CNPC and Sinopec Group based on the principles and methods formerly applied by the NDRC. Beginning in 2000, Sinopec Group adopted a new pricing mechanism for Shengli Crude Oil and now sets the price by reference to international crude oil prices. Although this more closely reflects trends in international markets, the timing of the price adjustments can result in prices that differ significantly from the then current international market prices.

In 2004, we processed 79,400 tons of Shengli Crude Oil. The average price we paid for Shengli Crude Oil was RMB1,702 (US\$205.6) per ton.

Sinopec Corp has undertaken that it will allocate crude oil to us in quantities and at prices no less favorable than the quantities received and prices paid by other enterprises that it controls. On this basis, we believe that changes in crude oil prices should not have a material effect on our competitiveness with other domestic producers. Nevertheless, any increase in the price of crude oil could have an adverse impact on our profitability to the extent that we are unable to pass cost increases on to our customers.

## Coal

Unlike crude oil, coal is not subject to government allocation. We purchase coal directly from the Datong mines in Shanxi Province. Coal is transported by rail from the mines to Qinhuangdao port and shipped by barge to Jinshanwei where it is delivered to the plant via a wharf and conveyer system.



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Our cost of coal is materially dependent on transportation charges. Although coal may be purchased from alternative sources, railroad transportation must be obtained by allocation from the Chinese government on a monthly basis.

We expect that our total requirement for coal to generate electricity in 2005 will be approximately 1.40 million tons. In 2004, we consumed approximately 1.57 million tons of coal, a decrease from 2003 of approximately 0.05 million tons.

## **Other Raw Materials**

We produce most of the raw materials used as feedstock for our operations. If any of these raw materials, other than ethylene, becomes unavailable from internal production, we believe that there are sufficient alternative sources at reasonable prices and the unavailability of raw materials from internal sources will not have a significant effect on our operations and profitability.

We purchase some ancillary raw materials from outside sources. These raw materials include methanol, ammonia, sodium hydroxide, sulfur, acetone, acrylonitrile, PTA, propylene and a variety of catalytic agents. In 2004, the total cost of these materials accounted for approximately 18.34% of our total cost of sales. We do not expect any difficulties in obtaining a supply of any of these ancillary raw materials in amounts sufficient to meet our needs in the foreseeable future.

## **Sales and Marketing**

### **Distribution**

The distribution of our petroleum products is still subject to government regulations. We are required to sell certain petroleum products to the subsidiaries of Sinopec Group or customers designated by Sinopec Group. However, we have the autonomy to decide on the distribution of our other products in line with market conditions.

We generally sell our products to larger trading companies and industrial users with whom we have long-standing relationships, including Sinopec Group or customers designated by Sinopec Group. Despite the rapid changes occurring in the market, we believe that these long-standing relationships will continue to provide us with a stable customer base. At the same time, we intend to strengthen our relationships with these existing customers, especially long-term industrial users, by expanding our sales force and improving technical support and after-sales services. Given the range of products we offer and the profile of our customers, we will continue to sell a significant proportion of our products through large-scale wholesalers and trading companies.

Generally large-scale wholesalers and trading companies provide very attractive wholesale pricing terms and excellent liquidity. Many of these trading companies are strong, efficient and economically viable and have developed extensive and efficient distribution systems. Although we will continue to use these distribution systems, we intend to increasingly use the trading companies as agents rather than distributors. An agency relationship should enable us to utilize a distributor's network while developing stronger direct relationships with the ultimate purchasers. Currently our products are still principally sold to trading companies and industrial users.



We use short-term contracts to sell most of our products. We did not experience significant write-offs or defaults on our accounts receivable or other trade accounts in 2005. We generally do not experience seasonal fluctuations in product sales.

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### **Product breakdown**

*Synthetic Fibers* In 2004, 4.0% of our synthetic fiber products were purchased by provincial and municipal government trading companies that act as intermediaries between us and end-users. No single customer accounted for more than 16.8% of our sales of synthetic fibers in 2004.

*Resins and Plastics* In 2004, approximately 5.3% of our resins and plastics sales were to provincial and municipal government trading companies and approximately 62.0% were sold to industrial users. No single customer accounted for more than 10.6% of our sales of resins and plastics in 2004.

*Intermediate Petrochemicals* We sell a variety of intermediate petrochemicals, few of which are sold in substantial quantities.

Shanghai Chlor-Alkali Chemical Co. Ltd. ( Chlor-Alkali ) is the principal outside consumer of our ethylene. In 2004, we sold 90,000 tons of ethylene to Chlor-Alkali, all of which was made outside of the State Plan and sold at market prices. We expect to sell 90,000 tons of ethylene to Chlor-Alkali in 2005.

*Petroleum Products* In 2004, our primary gasoline and diesel customers were wholesale distribution companies owned by local and provincial government entities in eastern China. We sold residual oil directly to industrial end-users for use as industrial fuel and as feedstock to produce high-margin petroleum products.

### **Product Pricing**

Most of our products other than petroleum products are permitted to be sold at market prices. However, among our major products, three types of petroleum products, gasoline, diesel and jet fuel, and some other products, remain subject to varying degrees of government pricing control and are, accordingly, sold at prices set by the Chinese government. In 2002, 2003 and 2004, approximately 60%, 59% and 57% of our net sales were from products subject to price controls. Price controls may apply to these products in various ways. In some cases, they are applied only to a portion of our sales of the controlled product or to only a portion or none of one of our competitor's output. We believe that the Chinese government will continue relaxing state control over the pricing of petrochemical products.

For products that are not subject to price controls, we set our prices with reference to prices in the major Chinese chemical commodities markets in Shanghai and other parts of China. We also monitor pricing developments in major international commodities markets, particularly in Southeast Asia. In most cases, we revise product prices each month, or more frequently during periods of price volatility. Due to our economies of scale, brand recognition and general high quality of products, we believe that we can continue to price our products competitively while maintaining overall profitability.

### **Competition**

We compete principally in the Chinese domestic market where 99% of our products were sold in 2004. In addition, the limited transportation infrastructure in China and the difficulties involved in transporting petrochemical products force companies to compete primarily on a regional basis. In 2004, 94% of our net sales were made to customers in Shanghai and its six nearby provinces.

Our Competitive Advantages

We believe our primary competitive advantages are quality, price, brand recognition, location and vertical integration. We have received many prizes and awards from both central and local government authorities for high product quality. Furthermore, our location on the outskirts of the densely populated and highly industrialized Shanghai area places us in close proximity to many of our customers.

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This location also gives us convenient access to ocean transport and inland waterways which results in a competitive advantage in terms of transportation cost and reliability and punctuality of product delivery. We believe this geographic advantage will be enhanced as China's accession into the WTO generates increasing demands for our products in eastern China.

We believe that our vertical integration represents a significant competitive advantage over non-integrated competitors in China, both in terms of reliability in delivery and price. For most downstream products, our vertical integration results in significant savings on transportation and storage costs which would be incurred by less vertically integrated facilities.

## The Domestic Competitive Environment

Prior to 1993, because distribution and pricing of our products were determined in accordance with the State Plan, we did not operate in a competitive environment. With the liberalization of control over pricing and product allocation by the Chinese government, competition in the domestic market has been gradually increasing.

## Foreign Competition and the World Trade Organization

China joined the WTO on December 11, 2001. As part of its membership commitments, China agreed to eliminate some tariff and non-tariff barriers to foreign competition in the domestic petrochemical industry that benefited us in the past. In particular, China has reduced tariffs on imported petrochemicals products that compete with ours to 2% to 12.9% from 5% to 17% with further reductions planned until they reach a range of between 0% and 6.5%, and

permits increasing levels of foreign investment in the domestic petrochemicals industry, allowing foreign investors to own 100% of a domestic petrochemicals company from December 11, 2004;

will gradually relax restrictions on the import of crude oil by non-state owned companies;

will grant foreign-owned companies the right to import petrochemical products; and

will permit foreign companies to distribute and market petroleum products in both retail and wholesale markets in China.

As a result of these measures, we will likely face increased competition from foreign companies and imports in the near future and longer term. Changes in crude oil import and distribution could potentially affect our current supply arrangements with Sinopec Corp.

Prior to its entry into the WTO, the Chinese government took early steps to reduce protection from import barriers. Tariffs have been gradually reduced beginning in 1997. Foreign imports are likely to reduce the prices for domestic petrochemical products and may reduce our net sales. Nevertheless, we believe that our products have been, and will continue generally to be, competitive with imports. These early steps and recent tariff reductions have exposed us to international competition early and should help us meet increased competition as China's WTO entry begins

to affect our markets.

In addition to tariff reductions, China is liberalizing the import of crude oil and the distribution of processed oil and other petrochemical products. Import and export of crude oil has historically been limited to designated state-owned companies. China agreed to allocate 7.2 million tons of crude oil to non-state traders in 2002 and to increase this amount by 15% each year for 10 years, at which time the growth rate will be reviewed by interested WTO member countries. Similarly, several categories of processed oil are also subject to state trading. China will allocate 4 million tons of processed oils to non-state traders and increase this amount by 15% annually for 10 years. Review of this amount by member countries will occur in 2004. In concurrent commitments, China has agreed that minority foreign-owned enterprises would receive trading rights by December 11, 2002, majority foreign-owned enterprises would receive trading rights by December 11, 2003 and wholly foreign-owned enterprises would receive trading rights by December 11, 2004. These changes could, in the long-term, open up alternative sources of crude oil that are not available to us today. We also expect that they will create additional foreign investment in China's petrochemical industry and additional competition for us.

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Overall, we think that China's WTO entry will create substantial amounts of new investment and business in China, with a corresponding increase in sales opportunities for us. Although we are confident that we may be able to capture additional sales, the net effect of China's accession to the WTO on our business and results of operations remains to be seen.

**Our Competitive Position**

In the following discussion, our internal consumption of resins and intermediate petrochemicals produced by integrated manufacturers in the production of downstream products are treated as sales.

***Synthetic Fibers***

In 2004, we had approximately a 2.67% share and imports had approximately a 10.01% share of total domestic polyester, acrylic and polypropylene consumption. We attribute the high level of imports to a variety of factors, including a shortage in the domestic supply and the importation of synthetic fibers into special economic zones in China, where tariffs are not imposed on imports processed for re-export.

The following table summarizes the competitive position of our principal synthetic fibers according to domestic sales in 2004.

<u>Product</u>	<u>Our share of domestic consumption</u>	<u>Our competitive ranking</u>	<u>Location of principal domestic competitor</u>	<u>Principal domestic competitor's share of consumption</u>	<u>Imports share of consumption</u>
Polyester staple fiber	2.16	4	Jiangsu	10.77	10.77
Acrylic	19.94	1	Jilin	7.01	41.08

Sources: Statistics provided to us by the Sinopec Group and the China National Council of Textiles. For reference only.

***Resins and Plastics***

In 2004, we had approximately a 5.74% share and imports had approximately a 31.28% share of total domestic resins and plastics consumption. The following table summarizes the competitive position of our principal resins and plastics products according to domestic sales in 2004.

<u>Product</u>	<u>Our share of domestic consumption</u>	<u>Our competitive ranking</u>	<u>Location of principal domestic competitor</u>	<u>Principal Domestic competitor's Share of</u>	<u>Imports share of consumption</u>
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				<u>consumption</u>	
Polyester chips	4.58	2	Jiangsu	7.71	2.20
PVA granules	14.51	4	Anhui	21.00	10.21
PE	6.24	2	Beijing	6.79	52.19
PP	6.00	1	Jiangsu	5.64	38.10

Sources: Statistics provided to us by Sinopec Group. For reference only.

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### ***Intermediate Petrochemicals***

In 2004, we were one of the largest sellers of intermediate petrochemicals in China and had a 7.25% share of the total domestic consumption. Imports had approximately a 37.89% share of domestic consumption. Ethylene, benzene and butadiene are our major intermediate petrochemical products. We are currently the largest ethylene producer in China.

### ***Petroleum Products***

In 2004, we had a 2.62% share of the total domestic petroleum products market while imports had a 6.61% share. Although we have one of the largest refining capabilities in China, we use most of our refining capacity to produce feedstock for our own downstream processing of petrochemical products.

The domestic markets for each of our major petroleum products are geographically concentrated because these markets tend to be highly localized with individual producers controlling a large share of the markets in their locality. In 2004, we sold approximately 99.97% of our petroleum products in Shanghai and its six nearby provinces.

### **Environmental Protection**

We are subject to national and local environmental protection regulations which currently impose a graduated schedule of fees for the discharge of waste substances, require the payment of fines for pollution and provide for the forced closure of any facility which fails to comply with orders requiring it to cease or cure certain environmentally damaging practices. We have established environmental protection systems to treat certain of our waste materials and to safeguard against accidents. Because of the nature of our business, however, we store and discharge into the environment a significant amount of waste substances. During 2004, we were assessed a total of RMB22.50 million (US\$2.72 million) in fees for discharges of waste substances. As of March 31, 2005, we had not been assessed any fines for environmental violations and there were no actions pending or, to our knowledge, threatened which would result in the assessment of such a fine.

We believe our environmental protection facilities and systems are adequate for the existing national and local environmental protection regulations. However, there can be no assurance that Chinese national or local authorities will not impose additional regulations which would require additional expenditures in respect of environmental matters in the future.

### **Insurance**

We currently maintain insurance coverage with Sinopec Group which, as of December 31, 2004, was approximately RMB 21.8 billion (US\$ 2.63 billion) on our property and facilities and approximately RMB 3.4 billion (US\$ 410.8 million) on our inventory. Transportation vehicles and products in transit are not insured by Sinopec Group. We maintain insurance policies for these assets with The People's Insurance Company of China. The Sinopec Group insurance coverage is compulsory and applies to all enterprises controlled by Sinopec Group, pursuant to guidelines of Sinopec Group which may not be legally enforceable against Sinopec Group. Thus, there is doubt under Chinese law as to whether



we could enforce insurance claims against Sinopec Group.

We do not carry any third party liability insurance to cover claims in respect of personal injury, property or environmental damage arising from accidents on our property or relating to our operations other than on our transportation vehicles. We have not had a third party liability claim filed against us during the last five years. Since business interruption insurance is not customary in China, we do not carry such insurance.

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### **Government Regulations**

Following the development of several major oil fields and a growth in demand for petroleum and petrochemical products in China in the early 1970 s, the Chinese government organized petroleum refining and petrochemical production and processing facilities into large complexes that would permit integrated production of petroleum products, intermediate petrochemicals, resins and plastics, and synthetic fibers.

Although the Chinese government is liberalizing its control over the petroleum and petrochemical industries in China, significant government regulations that limit the business strategies available to us remain. Central government agencies and their local or provincial level counterparts do not own or directly control our production facilities. However, they exercise significant control over the petrochemical industry in areas such as pricing, production quotas, quality standards, allocation of raw materials and finished products, allocation of foreign exchange and Renminbi loans for capital construction projects. The Chinese government s intentions with respect to the development objectives and policies for the petrochemical industry are stated as part of the Five Year Plans for National Economic and Social Development formulated every five years. These plans at both the national and Shanghai municipality level have identified the petrochemical industry as a pillar industry which may qualify companies in the petrochemical industry for preferential treatment by governmental agencies.

Historically, we were supervised by Sinopec, a ministry-level enterprise under the direct supervision of the State Council, China s highest administrative body. As a result of a governmental restructuring in 1998, we became subject to the administration of the State Bureau of Petroleum and Chemical Industry. After its functions were terminated in March 2001, we became subject to the administration of the State Economic and Trade Commission. The State Economic and Trade Commission was dissolved in March, 2003 and its function in directing the reform and management of state-owned enterprises were assumed by the State Assets Regulatory and Management Commission, its function in industry planning and policy making were assumed by NDRC, and its functions in administering domestic trade, coordinating and implementing import and export plans of critical industrial products and raw materials were assumed by the Ministry of Commerce. Since then, we have been subject to the industrial oversight of these three new governmental agencies at the national level.

As part of this restructuring, Sinopec was also restructured in July 1998. The succeeding entity, Sinopec Group, was authorized to conduct a petrochemical business and to control the exploration of crude oil and natural gas and crude oil refining, mainly in the southern and eastern regions of China. China Petroleum and Natural Gas Corporation, another major state-owned petrochemical company, was also restructured and renamed China National Petroleum Corporation to conduct the same type of business, mainly in the northern and western regions of China. On December 31, 1999, Sinopec Group completed a reorganization pursuant to which certain of its core oil and gas and chemical operations and businesses and related assets and liabilities were transferred into its subsidiary, Sinopec Corp, currently our controlling shareholder.

### ***C. Organizational Structure.***

#### **Our Subsidiaries**

Our significant subsidiaries are listed below. All of the subsidiaries named below are incorporated in China.

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<u>Subsidiary Name</u>	<u>Our ownership interest and voting power</u>
	(%)
Shanghai Petrochemical Investment Development Company Limited	100
SPC Marketing Development Corporation	100
China Jinshan Associated Trading Corporation	80
Shanghai Jinhua Industrial Company Limited	81.46
Shanghai Jindong Petrochemical Industrial Company Limited	60
Shanghai Golden Way Petrochemical Company Limited	75
Shanghai Jinchang Engineering Plastics Company Limited	50.38
Shanghai Golden-Phillips Petrochemical Company Limited	60
Zhejiang Jin Yong Acrylic Fiber Company Limited	75
Shanghai Petrochemical Enterprise Development Company Limited	100
Shanghai Golden Conti Petrochemical Company Limited	100

**Sinopec Corp**

We are a member of a group (defined as a parent and all its subsidiaries) for purposes of the disclosure rules of the Securities and Exchange Commission. The parent company of this group is Sinopec Corp, our controlling shareholder. Sinopec Corp is operated by separate management and from time to time uses its interest as a shareholder to direct our policies and management. We have extracted the following information regarding Sinopec Corp from its public filings:

Overview

Sinopec Corp is an integrated petroleum and petrochemical company with upstream, midstream and downstream operations. Based on the turnover in 2004, Sinopec Corp is the largest listed company in China and one of the largest petroleum and petrochemical companies in both China and Asia. Sinopec Corp is one of the largest refiners, distributors and marketers of gasoline, diesel, jet fuel and most other major refined products in China and Asia with principal markets in the eastern and southern regions of China. Sinopec Corp is also a producer and distributor of petrochemicals in China and additionally explores, develops and produces crude oil and natural gas principally to supply its refining and chemical operations.

Subsidiaries

Details of Sinopec Corp's principal subsidiaries are given in the table below. Except for Sinopec Kantons Holdings Limited, which is incorporated in Bermuda, all of the above principal subsidiaries are incorporated in China.

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<u>Name of company</u>	<u>Sinopec Corp's direct attributable equity interest</u>	<u>Principal activities</u>
	%	
Sinopec Beijing Yanhua Petrochemical Company Limited	70.01	Manufacturing of chemical products
Sinopec Shengli Oilfield Company Limited	100.00	Exploration and production of crude oil and natural gas
Sinopec Sales Company Limited	100.00	Marketing and distribution of refined petroleum products
China Petrochemical International Company Limited	100.00	Trading of crude oil and petrochemical products.
Sinopec Shanghai Petrochemical Company Limited	55.56	Manufacturing of synthetic fibers, resin and plastics, intermediate petrochemical products and petroleum products
Sinopec Yangzi Petrochemical Company Limited	84.98	Manufacturing of intermediate petrochemical products and petroleum products
Sinopec Qilu Petrochemical Company Limited	82.05	Manufacturing of intermediate petrochemical products and petroleum products
Sinopec Yizheng Chemical Fiber Company Limited	42.00	Production and sale of polyester chips and polyester fibers
Sinopec Zhenhai Refining and Chemical Company Limited	71.32	Manufacturing of intermediate petrochemical products and petroleum products
Sinopec Wuhan Phoenix Company Limited	40.72	Manufacturing of petrochemical products and petroleum products
Sinopec Shijiazhuang Refining-Chemical Company Limited	79.73	Manufacturing of intermediate petrochemical products and petroleum products
Sinopec Zhongyuan Petroleum Company Limited	70.85	Exploration and production of crude oil and natural gas
Sinopec Wuhan Petroleum Group Company Limited	46.25	Marketing and distribution of refined petroleum products
Sinopec Fujian Petrochemical Company Limited	50.00	Manufacturing of plastic, intermediate petrochemical products and petroleum products
Sinopec Kantons Holdings Limited	72.40	Trading of crude oil and petroleum products
Sinopec Shell (Jiangsu) Petroleum Marketing Company Limited	60.00	Marketing and distribution of refined petroleum products
BP Sinopec (Zhejiang) Petroleum Company Limited	60.00	Marketing and distribution of refined petroleum products

***D. Property, Plants and Equipment.*****Real Property**

Our corporate headquarters and production facilities, occupying an area of approximately 7.03 square kilometers, are located in Jinshanwei, approximately 75 kilometers from downtown Shanghai. The total gross floor area of all our production and other facilities is approximately 2 million square meters. We own all of the buildings and facilities located at the site. We have the right to use the land upon which our buildings and facilities are located for a term of 50 years beginning in 1993 without the payment of any rent or usage fees other than land use taxes. We also have the right to transfer our land use rights to third parties without any payment to the Chinese government, so long as the use of the land remains the same as when the land use right was granted to us and the terms of the land use right we received will be applicable to any transferee.

**Plants and Facilities**

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The following charts set forth the Rated Capacities of our principal production units. The actual production capacity of a production unit can exceed Rated Capacity and may be further increased without increasing the Rated Capacity through technical improvements or expansion of the unit. The utilization rate of a production unit is based upon Rated Capacity rather than actual production capacity and may vary with technical enhancements, changes in production management and scheduling of maintenance.

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The following table sets forth the Rated Capacities and weighted average utilization rates of our principal production units for petroleum products and intermediate petrochemicals in 2004:

<b>Production Unit (number of units)</b>	<b>Rated Capacity (tons)</b>	<b>Utilization Rate(%)</b>
Crude oil distillation units (2)	8,800,000	96.64
Hydrocracker (2)	3,000,000	75.66
Ethylene units (2)	850,000	104.89
Aromatics unit	235,000	89.46
PTA unit	280,000	108.82
EO/EG unit	225,000	91.61
Acrylonitrile unit	130,000	99.90
Acetaldehyde unit	42,000	105.32
Acetic acid unit	45,000	51.70
Cracking and catalyzing	1,000,000	96.75
Delayed Coling	1,000,000	104.84

Our two crude oil distillation units were designed and built in China. In 2004, the actual amount of crude oil we processed was approximately 9.11 million tons. Our hydrocracker uses technology from United Oil Products Corporation of the United States. Our first ethylene unit uses technology from Mitsubishi Petrochemical Corporation of Japan. The second ethylene unit uses technology from ABB Lummus Global Inc. of the United States. The aromatics unit uses technology from Universal Oil Products Corporation of the United States. The PTA unit uses technology from Mitsui Petrochemical Corporation of Japan. The EO/EG unit was constructed using technology from Scientific Design Corporation of the United States.

The following table sets forth the Rated Capacities and weighted average utilization rates of our principal production units for resins and plastics and synthetic fibers in 2004:

<b>Production Unit (number of units)</b>	<b>Rated Capacity (tons)</b>	<b>Utilization Rate(%)</b>
Polyester units (3)	550,000	98.76
Polyester staple units (2)	155,600	90.73
Polyester filament units (4)	66,900	52.40
Acrylic staple fiber units (3)	189,000	110.75
Acrylic top units (1)	29,500	115.32
Polyethylene units (3)	543,000	100.48
Polyethylene film blowing facilities (2)	42,000	32.93
PP units (3)	400,000	108.70
PP staple fiber unit	17,000	133.17
PVA unit	86,000	110.16

Our polyester units use technology from Kanebo Corporation of Japan and E.I. Dupont DeNemours & Co. Inc. ( Dupont ) of the United States. The polyester staple units use technology from Teijin of Japan and Jima of Germany as well as Chinese technology. The polyester filament units use technology from Murata Manufacturing Company Limited and Teijin Corporation of Japan, Barmag AG of Germany and Dupont. We produce polyethylene in three units, two LDPE units which use technology from Mitsubishi Petrochemical Corporation of Japan and BASF LDPE of Germany and one HDPE unit uses the Borstar bimodal polyethylene technology from Northern European Chemical Engineering Company.

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The acrylic fiber units were built domestically, based on a design of equipment which had been imported into China in the 1960s and that we substantially improved. In 1996, we acquired two additional acrylic fiber units which use technology from the Kawasaki Corporation of Japan. We produce PP in three identical units using technology from Himont Corporation of the United States. The PP staple fiber unit employs technology from FARE Company of Italy. The PVA unit uses technology acquired from Kuraray Corporation of Japan.

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### **Power Facilities**

Our electricity requirements are currently supplied by our own 275 MW oil-fired power plant, 225 MW coal-fired power plant and 100 MW coal-fired power plant and petroleum coke power plant. These power plants are designed to supply power sufficient for all of our facilities. We are connected to the East China electricity grid system, which provides a back-up source of power in case of a shortfall in our power supply. Our power gap is currently made up by East China Power Network.

### **Other Facilities**

We also have facilities to produce industrial water, steam, hydrogen, oxygen and nitrogen which we use in our production facilities.

### **Maintenance**

We conduct a regular maintenance program on all production equipment. Maintenance is performed by Sinopec Group, as the successor to Sinopec, under a services agreement we signed with Sinopec in March 1998. In addition, we employ approximately 4,010 engineers, technicians and other personnel who are employed by the various production units to perform day-to-day maintenance and repair.

### **Transportation-Related Fixtures**

Crude oil, our principal raw material, is transported by pipeline to the coast and then by oil tanker to the oil terminal wharf at Chenshan. Our products leave the factory by water, rail, road and pipeline. In 2004, approximately 50% of our products by sales volume were collected by customers from our premises, and we delivered the balance. Our major ethylene customer is supplied via a pipeline. Some of the products collected by customers were also transported using our facilities.

### **Wharfs**

We own two chemical wharfs at Jinshan with four berths of 3,000, 5,000, 10,000 and 25,000 tons. We also own a connecting pipeline capable of loading up to approximately 1.4 million tons of chemical products annually onto ocean-going barges and ships. In 2004, products representing 33% of total sales volume were shipped from the wharf. We also have a facility to load ships and barges which use the region's inland waterways. In 2004, products representing 15% of total sales volume were shipped from these facilities. We believe that we have a competitive advantage because a greater proportion of our products are shipped by water as opposed to rail and truck, which is subject to capacity constraints on China's rail and highway networks. Additionally, we own facilities for receiving crude oil and coal at docks that we own and transporting such materials by pipeline or conveyor to our production facilities.



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We own an oil terminal wharf at Chenshan, Zhapu, Pinghu County, Zhejiang Province, which is comprised of two berths, each of which is capable of handling 45,000 ton vessels. Two 25 kilometer pipelines connect this oil terminal wharf with our facilities.

**Table of Contents**Rail

We own a railroad loading depot with an annual capacity of 500,000 tons. The depot provides access via a spur line to the national Chinese railway system. In 2004, products representing 1% of total sales volume were transported from the factory by rail. Our ability to transport products by rail is limited because of China's overburdened railway system, the use of which remains strictly controlled and allocated by the Chinese government.

**Capital Expansion Program**

Our principal capital expansion projects for the near term are summarized in the table and further described below. In aggregate, we expect that total investment in the projects described will be approximately RMB2.7 billion (US\$ 326.2 million) in 2005. This amount will be funded internally and by bank loans. In 2002, 2003 and 2004, we invested RMB 2,404 million (US\$ 290.4 million), RMB 1,284.9 million (US\$ 155.2 million) and RMB2,206.0 million (US\$266.5 million) respectively, in capital expansion projects.

<u>Name of Project</u>	<u>Existing Rated Capacity (tons/year)</u>	<u>Added Rated Capacity (tons/year)</u>	<u>Percent Increase (%)</u>	<u>Expected Completion Date</u>	<u>Status</u>
<b>REFINING CAPACITY EXPANSION</b>					
No. 1 Distillation Unit Relocation and Renovation	2,800,000	5,200,000	185	2005	Under construction
<b>EXPANSION OF NEW AND EXISTING DOWNSTREAM PRODUCTION FACILITIES</b>					
380,000-ton EG Unit	N/A	380,000	N/A	2006	Under construction
12,000-ton/year Terylene Industrial Filament Expansion Project	N/A	12,000	N/A	2005	Under construction
400,000-ton/year PTA Unit Renovation	280,000	120,000	42	2005	Under construction
<b>OTHER PROJECTS</b>					
200MW Power Plant Expansion	325MW	2 <sup>nd</sup> phase 100 MW	30	2008	Preliminary development
Flue Gas Desulphurization ( FGD )	N/A	N/A	N/A	2006	Preliminary development
Material transportation line between our company and Secco	N/A	N/A	N/A	2005	Under construction

N/A not applicable.

Refining Capacity Expansion Plans

To meet the requirements of the planned ethylene expansion and to increase our capability to meet demand for higher-margin petroleum products, we are expanding and renovating our oil refining facilities. The principal projects are:

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Renovating our existing No. 1 atmosphere and vacuum distillation facility to increase the facility's Rated Capacity from 2.8 million tons to 8.0 million tons. This renovation was commenced in 2003 and is expected to be completed by the end of 2004 and commence production in 2005.

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The completion of the project will enable us to meet the production capacity for feedstock needed for ethylene expansion and to increase overall production volume of petroleum products.

### **Expansion of New and Existing Downstream Petrochemical Products**

As a fully integrated petrochemical complex, we produce a wide range of intermediate and downstream petrochemical products. We plan to further increase our production of higher-margin products by (i) adjusting our product mix, (ii) further processing existing products into higher-margin downstream products and (iii) adding new production capacity for higher-margin downstream products.

To increase production capacity for higher-margin products we:

will add a facility for producing ethylene glycol with 10,000 tons Rated Capacity to increase our production capacity of ethylene glycol. Construction will commence in 2005 and is expected to be completed in 2006.

We will implement the 12,000-ton/year Terylene Industrial Long Fiber Expansion Project and increase the output of higher-margin synthetic fibers, which is expected to be completed in 2005. To meet the demand for feedstock of downstream polyester, we will implement renovations on the 400,000-ton/year PTA unit, which is expected to be completed in several phases in 2005.

### **Other Projects**

In order to adjust our capital expansion projects, the development of a crude oil pier and depot on Cezi Island at Zhoushan, near Shanghai has been acquired by Sinopec Corp. Furthermore, the first phase of our 200MW coal-fired power plant expansion has been completed and commenced operation at the end of 2002. We plan to continue the construction of the second phase in our 100MW coal-fired power plant, which is expected to be completed in 2008. To control and reduce the volume of sulphur dioxide emission to protect the environment, we plan to implement an FGD project with a capacity of 1 million cubic meter of flue gas per hour.

In addition to the foregoing projects, ongoing technological improvements and other small scale capital expansion projects, we are exploring expansion opportunities through acquisitions and other business combinations. We believe that acquisitions will become an increasingly important component of our expansion strategy.

## **ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

### ***A. Operating Results.***

#### **General**

Our financial performance has been affected by factors arising from operating in a planned economy which are beyond our control. However, with China's WTO accession, the impact of these factors has gradually been decreasing.

In 2004, the world economy continued to improve. China's economy also continued its rapid growth. In 2004, the petrochemical industry experienced a relative peak period in this industrial business cycle. Accordingly, we experienced dramatic increases in the weighted average prices of most of our major products due to significant rises in the market prices for these products related to sharply rising crude oil prices and increased demand for our products. In addition, we continued to optimize our production and operation system, and maintained strict control of production costs (other than raw materials) while maintaining operation of key production facilities at a high level of capacity utilization. These factors contributed to a dramatic increase in our 2004 operating results as compared with 2003.

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You should read the following discussion and analysis in conjunction with our audited financial statements and our selected financial data, in each case, together with the accompanying notes included elsewhere in this annual report. Our audited financial statements have been prepared in accordance with IFRS. IFRS differs in a number of significant respects from US GAAP. Note 30 to our audited financial statements, included elsewhere in this annual report, contains information relating to the nature and effect of significant differences between IFRS and US GAAP as they relate to us and provides a reconciliation to US GAAP of our net income and shareholders' equity.

## **Critical Accounting Policies**

The following discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with IFRS. The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Our reported financial condition and results of operations are sensitive to accounting methods, assumptions and estimates that underlie the preparation of our financial statements. We based our assumptions and estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about matters that are not readily apparent from other sources. On an on-going basis, our management evaluates its estimates. Actual results may differ from those estimates as facts, circumstances and conditions change.

Our principal accounting policies are set forth in Note 2 to our consolidated financial statements. The selection of critical accounting policies, the judgments 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 our financial statements. To enhance our readers' understanding of our business activities, we have identified critical accounting policies. We believe the following critical accounting policies involve the most significant judgments and estimates used in the preparation of our financial statements.

## **Impairments**

If circumstances indicate that the net book value of an asset or an investment may not be recoverable, the asset may be considered impaired, and an impairment loss may be recognized in accordance with IAS 36 Impairment of Assets. We review the carrying amounts of long-lived assets periodically in order to assess whether the recoverable amounts have declined below the carrying amounts. We test these assets 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 the estimated recoverable amount. The amount of impairment loss is the difference between the carrying amount of the asset before the reduction and the estimated recoverable amount. The recoverable amount is the greater of the estimated net selling price and the value in use. It is difficult to precisely estimate selling prices because quoted market prices for our assets are often not readily available. In determining the value in use, we discount cash flows that we expect the asset to generate to their present value. Determining cash flows that we expect an asset to generate requires significant judgment in terms of projection of cash flows for future years and the assumption on the pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

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Under US GAAP, we are required to record an impairment to write down an asset that is considered impaired to its estimated fair value. Such fair value is generally determined using the discounted cash flow method, which is similar to that used for determining the assets' value in use under IFRS. Under US GAAP, an asset is considered impaired if its carrying value exceeds the estimated future undiscounted cash flows to be generated by that asset.

For the year ended December 31, 2004, RMB34 million of impairment losses were recognized for long-lived assets related to our synthetic fiber segment (for the year ended December 31, 2003: RMB25 million impairment losses recognized for long-lived assets of synthetic fiber segment; for the year ended December 31, 2002: nil) in our audited income statement.

**Depreciation**

Property, plant and equipment are depreciated on a straight-line basis over the estimated useful lives of the assets, after taking into account their estimated residual value. We review the estimated useful lives of the assets regularly in order to determine the amount of depreciation expense to be recorded during any reporting period. The useful lives are based on our historical experience with similar assets and taking into account anticipated technological changes. The depreciation expense for future periods is adjusted if there are significant changes from previous estimates. There have been no significant changes to the original estimates of useful lives or residual values in 2002, 2003 and 2004.

**Provision for Doubtful Debts**

We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make the required payments. Our provisions are based on the aging of the trade debtor balance, customer credit-worthiness, and historical write-off experience. If the financial condition of our customers were to deteriorate, the amount of actual write-offs might be higher than what we expected.

The following table summarizes the changes in allowances for doubtful debts for the years ended December 31, 2002, 2003 and 2004:

	<b>Years ended December 31,</b>		
	<b>2002</b>	<b>2003</b>	<b>2004</b>
As of January 1,	33,752	43,339	39,811
Provision for the year	17,041	33,644	22,814
Written-off	(7,454)	(37,172)	(17,434)
December 31,	<u>43,339</u>	<u>39,811</u>	<u>45,191</u>

**Recently Issued International Financial Reporting Standards**

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The International Accounting Standards Board ( IASB ) has issued a number of new and revised International Financial Reporting Standards and International Accounting Standards (collectively new IFRSs ) which are applicable to us for accounting periods beginning on or after January 1, 2005.



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We have not early adopted these new IFRSs in the financial statements for the year ended December 31, 2004. We have completed a preliminary assessment of the impact of these new IFRSs to the extent that they are applicable to us. The following is a brief summary of the key features of these new IFRSs and our preliminary assessments:

### *IFRS 2*

In February 2004, the IASB issued IFRS 2, *Share-based Payment*. IFRS 2 addresses the accounting for share-based payment transactions in financial statements and requires an entity to measure the employee service received and the liability incurred at the fair value of the instrument at the grant date, and re-measure the fair value of the liability at each balance sheet date until the final settlement of the liability. Currently, we do not expect the application of IFRS 2 will have a material impact on our consolidated financial position or consolidated results of operations.

### *IFRS 3*

In March 2004, the IASB issued IFRS 3, *Business Combinations* and replaced IAS 22 *Business Combinations* and related Interpretations. IFRS 3 requires all business combinations within its scope to be accounted for using the purchase method. IFRS 3 also requires positive goodwill to be tested for impairment annually and stated at cost less accumulated impairment losses, and negative goodwill be recognized immediately in the income statement on acquisition. In preparation of financial statements for the year ended December 31, 2004 and all previous years, goodwill arising on acquisition was recognized in the balance sheet as an asset and amortized on a straight-line basis over its estimated useful life of 10 years. Under the new IFRS 3, the goodwill reflected in the financial statements will no longer be amortized, but stated net of impairment losses at the balance sheet date. According to IFRS 3, the new IFRS shall be applied prospectively. As at December 31, 2004, the unamortized goodwill balance under IFRS amounted to RMB 22 million.

### *IFRS 5*

In March 2004, the IASB issued IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*. IFRS 5 requires that assets or disposal groups that are classified as held for sale are carried at the lower of carrying amount and fair value less costs to sell. IFRS 5 replaced IAS 35,

*Discontinued Operations* and classifies an operation as discontinued at the date the operation meets the criteria to be classified as held for sale or when the entity has disposed of the operation. We cannot determine the potential effects that application of IFRS 5 will have on our consolidated financial statements.

### *IAS 1*

In December 2003, the IASB issued IAS 1 (Revised 2003), *Presentation of Financial Statements* and replaced IAS 1 (Revised 1997). IAS 1 (Revised 2003) requires disclosure of an entity's judgments and assumptions on application of its accounting policies. Additionally, IAS 1 (Revised 2003) provides further guidance on classification of assets and liabilities. Currently, we do not expect the application of IAS 1 (Revised 2003) will have a material impact on our consolidated financial position or consolidated results of operations.

*IAS 2*

In December 2003, the IASB issued IAS 2 (Revised 2003), Inventories and replaced IAS 2 (Revised 1993) and a related Interpretation. IAS 2 (Revised 2003) eliminates the allowed alternative to measure inventories using the last-in, first-out ( LIFO ) method. Additionally, IAS 2 (Revised 2003) requires finance costs of inventories purchased with deferred settlement terms to be accounted for separately over the period of financing. Currently, we do not expect the application of IAS 2 (Revised 2003) will have a material impact on our consolidated financial position or consolidated results of operations.

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*IAS 8*

In December 2003, the IASB issued IAS 8 (Revised 2003), *Accounting Policies, Changes in Accounting Estimates and Errors* and replaced IAS 8. IAS 8 (Revised 2003) requires retrospective application of voluntary changes in accounting policies and retrospective restatement to correct prior period errors and eliminates the allowed alternative to include such adjustment in the current period income statement. IAS 8 (Revised 2003) requires, rather than encourages, disclosure of an impending change in accounting policy when an entity has yet to implement a new Standard or Interpretation that has been issued but not yet come into effect. Currently, we do not expect the application of IAS 8 (Revised 2003) will have a material impact on our consolidated financial position or consolidated results of operations.

*IAS 16*

In December 2003, the IASB issued IAS 16 (Revised 2003), *Property, Plant and Equipment* and replaced IAS 16 (Revised 1997) and related Interpretations. IAS 16 (Revised 2003) requires an entity to determine cost, useful life and depreciation charge separately for each significant part of an item of property, plant and equipment, and reverse the recognitions the carrying amount of a part of an item of property, plant and equipment if that part has been replaced. IAS 16 (Revised 2003) also requires an entity to include the costs of dismantlement, removal of restoration, the obligation for which an entity incurs as a consequence of installing the item in the cost of property, plant and equipment. Currently, we do not expect the application of IAS 16 (Revised 2003) will have a material impact on our consolidated financial position or consolidated results of operations.

*IAS 17*

In December 2003, the IASB issued IAS 17 (Revised 2003), *Leases* and replaced IAS 17 (Revised 1997). IAS 17 (Revised 2003) requires a lump sum lease of land and building to be split into a lease of land and a lease of building, in proportion to the relative fair values of the leasehold interests in the land and building elements of the lease, and account for the lease of land and lease of building separately by applying the classification criteria in the standard. Currently, we do not expect the application of IAS 17 (Revised 2003) will have a material impact on our consolidated financial position or consolidated results of operations.

*IAS 21*

In December 2003, the IASB issued IAS 21 (Revised 2003), *The Effects of Changes in Foreign Exchange Rates*, which replaced IAS 21 (revised 1993) and related Interpretation. IAS 21 (Revised 2003) requires each individual entity included in a reporting entity to determine its functional currency and measure its results and financial position in that currency and stipulates that an entity previously classified as an integral foreign operation will have the same functional currency as the reporting entity. Furthermore, IAS 21 (Revised 2003) disallows capitalizing exchange differences resulting from a severe devaluation or depreciation of a currency against which there is no means of hedging, and requires such differences be recognized in the income statement. Currently, we do not expect the application of IAS 21 (Revised 2003) will have a material impact on our consolidated financial position or consolidated results of operations.

*IAS 24*

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In December 2003, the IASB issued IAS 24 (Revised 2003), *Related Party Disclosures*, which replaced IAS 24 (reformatted 1994). IAS 24 (Revised 2003) expands the scope of related parties and removes the exemption of profit-oriented state controlled entities from disclosing transactions with other state-controlled entities. IAS 24 (Revised 2003) also requires additional disclosures, including the compensation of key management personnel. Currently, we do not expect the application of IAS 24 (Revised 2003) will have a material impact on our consolidated financial position or consolidated results of operations.

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### *IAS 27*

In December 2003, the IASB issued IAS 27 (Revised 2003), *Consolidated and Separate Financial Statements*, which replaced IAS 27 (Revised 2000) and a related Interpretation. IAS 27 (Revised 2003) modifies the conditions for exempting a parent from preparing consolidated financial statements and the conditions for excluding subsidiaries from consolidation. IAS 27 (Revised 2003) also requires minority interests to be presented within equity, separately from the parent shareholders' equity. In addition, IAS 27 (Revised 2003) prohibits the use of the equity method of accounting for investments in subsidiaries, jointly controlled entities and associates in a parent's separate financial statements. Currently, we do not expect the application of IAS 27 (Revised 2003) will have a material impact on our consolidated financial position or consolidated results of operations.

### *IAS 28*

In December 2003, the IASB issued IAS 28 (Revised 2003), *Investment in Associates*, which replaced IAS 28 (Revised 2000) and related Interpretations. IAS 28 (Revised 2003) clarifies its scope and the circumstances for which investments in associates must be accounted for using the equity method. Currently, we do not expect the application of IAS 28 (Revised 2003) will have a material impact on our consolidated financial position or consolidated results of operations.

### *IAS 32*

In December 2003, the IASB issued IAS 32 (Revised 2003), *Financial Instrument: Disclosure and Presentation*, which replaced IAS 32 (Revised 2000) and related Interpretations. IAS 32 (Revised 2003) clarifies the principle for classifying a financial instrument, and introduces additional disclosures. Currently, we do not expect the application of IAS 32 (Revised 2003) will have a material impact on our consolidated financial position or consolidated results of operations.

### *IAS 33*

In December 2003, the IASB issued IAS 33 (Revised 2003), *Earnings Per Share*, which replaced IAS 33 (Revised 1997) and a related Interpretation. IAS 33 (Revised 2003) provides guidance and illustrative examples on selected complex matters in respect of the calculation of earnings per share. Currently, we do not expect the application of IAS 33 (Revised 2003) will have a material impact on our consolidated financial position or consolidated results of operations.

### *IAS 36*

In December 2003, the IASB issued IAS 36 (Revised 2003), *Impairment of Assets*, which replaced IAS 36 (Revised 1998). IAS 36 (Revised 2004) requires that the recoverable amount of any intangible asset with an indefinite useful life or not yet available for use, and goodwill acquired in a business combination, be measured annually, rather than only when there is an indication that the asset may be impaired as required by IAS 36 (Revised 1998). In addition, IAS 36 (Revised 2004) clarifies the elements that should be reflected in the calculation of an

asset's value in use. Currently, we do not expect the application of IAS 36 (Revised 2004) will have a material impact on our consolidated financial position or consolidated results of operations.

**Table of Contents***IAS 38*

In March 2004, the IASB issued IAS 38 (Revised 2004), *Intangible Assets*, which replaced IAS 38 (Revised 1998). IAS 38 (Revised 2004) revises the definition of an intangible asset and provides further guidance on recognition of an intangible asset. IAS 38 (Revised 2004) also requires an entity to determine whether the useful life of an intangible asset is definite or indefinite and removes the rebuttable presumption that the useful life of an intangible asset does not exceed 20 years. Currently, we do not expect the application of IAS 38 (Revised 2004) will have a material impact on our consolidated financial position or consolidated results of operations.

*IAS 39*

In December 2003 and March 2004, the IASB issued IAS 39 (Revised 2003), *Financial Instruments: Recognition and Measurement* and Amendments to IAS 39 (March 2004), *Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk*, respectively. The revised IAS 39 amends its scope and clarifies the conditions for de-recognition of a financial asset. Additionally, the revised IAS 39 provides further guidance on determining fair value using valuation techniques and evaluating impairment of financial assets. Currently, we do not expect the application of IAS 39 (Revised 2003) will have a material impact on our consolidated financial position or consolidated results of operations.

**Summary**

The following table sets forth our sales volumes and net sales, net of sales taxes, for the years indicated, presented in accordance with IFRS:

	Years ended December 31,								
	2002			2003			2004		
	Net Sales			Net Sales			Net Sales		
Sales Volume ( 000 Tons)	(Millions of RMB)	% of Total	Sales Volume ( 000 Tons)	(Millions of RMB)	% of Total	Sales Volume ( 000 Tons)	(Millions of RMB)	% of Total	
Synthetic Fibers	363.5	3,374.3	15.5	395.4	4,092.6	14.1	384.4	4,751.8	12.3
Resins and Plastics	1,146.8	6,440.7	29.6	1,389.8	8,864.3	30.6	1,409.7	12,086.0	31.3
Intermediate Petrochemicals	786.3	2,555.0	11.8	1,021.8	3,851.3	13.3	1,075.8	5,896.6	15.3
Petroleum Products	4,100.2	7,991.2	36.8	4,650.4	10,329.1	35.7	4,828.9	13,101.9	33.9
Trading and Others		1,361.8	6.3		1,805.4	6.3		2,827.8	7.2
<b>Total</b>	<b>6,396.8</b>	<b>21,723.0</b>	<b>100.0</b>	<b>7,457.4</b>	<b>28,942.7</b>	<b>100.0</b>	<b>7,698.8</b>	<b>38,664.1</b>	<b>100.0</b>

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The following table sets forth a summary statement of income for the periods indicated:

	Years ended December 31,					
	2002		2003		2004	
	Millions of RMB	% of Operating revenues	Millions of RMB	% of Operating revenues	Millions of RMB	% of Operating revenues
<b>Synthetic fibres</b>						
Operating revenues	3,396.7	15.2	4,115.0	14.0	4,778.0	12.1
Operating expenses	(3,283.6)	(14.7)	(4,002.7)	(13.5)	(4,527.6)	(11.5)
Operating profit	113.1	0.5	112.3	0.5	250.4	0.6
<b>Resins and Plastics</b>						
Operating revenues	6,479.2	29.0	8,907.4	30.1	12,154.4	30.8
Operating expenses	(6,041.1)	(27.1)	(8,279.5)	(28.0)	(10,267.8)	(26.0)
Operating profit	438.1	2.0	627.9	2.1	1,886.6	4.8
<b>Intermediate Petrochemicals</b>						
Operating revenues	2,575.7	11.5	3,879.8	13.1	5,941.6	15.1
Operating expenses	(2,288.0)	(10.2)	(3,282.4)	(11.1)	(4,390.8)	(11.1)
Operating profit	287.7	1.3	597.4	2.0	1,550.8	3.9
<b>Petroleum products</b>						
Operating revenues	8,482.5	38.0	10,834.6	36.6	13,692.4	34.8
Operating expenses	(8,078.6)	(36.2)	(10,382.5)	(35.1)	(12,705.8)	(32.3)
Operating profit	403.9	1.8	452.1	1.5	986.6	2.5
<b>All others</b>						
Operating revenues	1,388.9	6.2	1,830.3	6.2	2,836.2	7.2
Operating expenses	(1,202.0)	(5.4)	(1,613.6)	(5.5)	(2,485.4)	(6.3)
Operating profit	186.9	0.8	216.7	0.7	350.8	0.9
<b>Total</b>						
Operating revenues	22,322.9	100.0	29,567.1	100.0	39,402.5	100.0
Operating expenses	(20,893.3)	(93.6)	(27,560.7)	(93.2)	(34,377.4)	(87.2)
Operating profit	1,429.6	6.4	2,006.4	6.8	5,025.2	12.8
Share of (losses)/ profits of associates	16.1	0.1	(24.0)	(0.1)	(36.9)	(0.1)
Net financing costs	(400.7)	(1.8)	(392.0)	(1.3)	(292.0)	(0.7)
Income before tax	1,045.0	4.7	1,590.4	5.4	4,696.3	11.9
Income tax	(84.5)	(0.4)	(145.1)	(0.5)	(637.1)	(1.6)
Income after tax	960.5	4.3	1,445.3	4.9	4,059.2	10.3
Minority interests	(44.2)	(0.2)	(43.6)	(0.1)	(88.1)	(0.2)



Net income	916.3	4.1	1,401.7	4.7	3,971.1	10.1
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### Results of Operations

#### Year Ended December 31, 2004 Compared with Year Ended December 31, 2003

##### *Net sales*

Total net sales increased by 33.6% to RMB38,664.1 million in 2004 compared with RMB28,942.7 million in 2003. In 2004, the price of our petrochemical products increased dramatically compared with 2003. The weighted average price of synthetic fibers, resins and plastics, intermediate petrochemicals and petroleum products for 2004 increased, resulting in the dramatic increase of our net sales compared with 2003.

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**Table of Contents***i) Synthetic fibers*

Net sales of synthetic fiber products increased by 16.1% to RMB4,751.8 million in 2004 compared with RMB4,092.6 million in 2003, due to a 19.4% increase in their weighted average prices compared with 2003, while the sales volume of synthetic fibers decreased by 2.8% compared with 2003 as a result of decrease in the sales volume of certain synthetic fiber products other than acrylic fiber and industrial fiber. Compared with 2003, the weighted average price of polyester fiber, polyester industrial fiber, acrylic fiber and acrylic top increased by 18.4%, 14.6%, 18.0% and 17.8%, respectively. Net sales of synthetic fiber products account for 12.3% of our total net sales in 2004, a decrease of 1.9% compared with 2003.

*ii) Resins and plastics*

Net sales of resins and plastics increased by 36.3% to RMB12,086.0 million in 2004 as compared with RMB8,864.3 million in 2003, which was attributable to a significant increase of 34.4% in the weighted average price of such products and a slight increase of 1.4% in sales volume. During this period, the average sales price of polyester pellet, PVA, polyethylene and polypropylene increased by 25.6%, 24.9%, 44.5% and 30.0%, respectively. The sales volume of polyester pellet, PVA and polyethylene increased by 9.9%, 5.0% and 1.5%, respectively, while the sales volume of polypropylene decreased slightly by 1.3%. Net sales of resins and plastics account for 31.3% of our total net sales in 2004, an increase of 0.6% compared with 2003.

*iii) Intermediate petrochemicals*

Net sales of intermediate petrochemicals increased by 53.1% to RMB5,896.6 million in 2004 as compared with RMB3,851.3 million in 2003, due to a significant increase of 45.4% in the weighted average price of such products and a 5.3% increase in sales volume compared with 2003. Among our intermediate petrochemical products, the weighted average price of ethylene, pure benzol, ethylene glycol, butadiene and ethylene oxide increased by 74.6%, 76.4%, 42.2%, 26.2% and 35.7%, respectively, while the sales volume of major products decreased slightly, except for pure benzol and ethylene glycol, the sales volume of which increased by 6.7% and 11.3%, respectively. Net sales of intermediate petrochemicals account for 15.3% of our total net sales in 2004, an increase of 1.9% compared with 2003.

*iv) Petroleum products*

Net sales of petroleum products increased by 26.8% to RMB13,101.9 million in 2004 as compared with RMB10,329.1 million in 2003, due to an increase of 21.2% in the weighted average price and 3.8% in sales volume of these products. The weighted average price of gasoline, diesel oil and jet fuel increased by 14.7%, 20.7% and 26.7%, respectively. The sales volume of gasoline and jet fuel decreased by 25.8% and 6.2%, respectively, while the sales volume of diesel oil increased by 13.4%. Net sales of petroleum products account for 33.9% of our total net sales in 2004, a decrease of 1.8% as compared with 2003.

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*v) Trading and other activities*

Revenues from trading and other activities increased by 56.6% to RMB2,827.8 million in 2004 compared with RMB1,805.3 million in 2003.

Operating profit increased from RMB2,006.4 million in 2003 to RMB5,025.2 million in 2004, representing an increase of 150.5%. Operating expenses increased by 24.7% to RMB34,377.4 million in 2004 compared with RMB27,560.7 million in 2003. Compared with 2003, the operating expenses of synthetic fibers, resins and plastics, intermediate petrochemicals and petroleum products increased by 13.1%, 24.0%, 33.8% and 22.4% to RMB4,527.6 million, RMB10,267.8 million, RMB4,390.8 million and RMB12,705.8 million, respectively, primarily due to a significant increase in the price of crude oil which is our major raw material, and the increase in the volume of certain raw materials we purchased to meet our requirements for production and operation. We have strengthened the production and operation and closely controlled the consumption of raw materials and energy in the production process. As a result, operating profit of the four major segments shows improvement as compared with 2003.

*(i) Synthetic fibers*

Operating expenses increased by RMB525 million, up by 13.1% as compared with 2003. The result was mainly due to the increase in the cost of PTA, a major raw material of the segment. The cost of PTA has increased by RMB414 million.

*(ii) Resins and plastic*

The increase in operating expenses was principally due to the increase in consumption of raw materials. We have completed certain improvement projects in 2004, such as the acrylonitrile improvement project, which increases the production capacity of resins and plastic products. The increase in purchase cost of raw materials also contributed to the increase in expenses. In particular, the weighted average cost of propylene increased by 60% during the year.

*(iii) Intermediate petrochemicals*

In 2004, the operating expenses increased by RMB1,909 million, representing 33.8% increase compared with 2003. This was mainly due to the increase in crude oil price which is the major raw material of ethylene, benzene and butadiene.

*(iv) Petroleum products*

Operating expenses increased by RMB2,323 million in 2004, up by 22.4% compared with 2003. The increase was principally due to the increase in price of crude oil. In 2004, the weighted average cost of crude oil was RMB2,306 per ton, representing an increase of 24% compared with 2003.

*(v) Trading and other activities*

The business activities of this segment mainly consist of trading of petrochemical products. The increase in operating expenses by RMB871 million was mainly driven by the general increase in price of petrochemical products during the year.

*Cost of sales*

Cost of sales increased by 25.9% to RMB33,223.6 million in 2004 compared with RMB26,396.2 million in 2003, and accounted for 85.9% of the net sales for 2004. This increase was primarily due to a significant increase in the price of crude oil which is our major raw material, and the increase in the volume of certain intermediate raw materials we purchased to meet our requirements for production and operation. In 2004, we strengthened the management of production and operation, and closely controlled the consumption of raw materials and energy in the production process. These efforts, however, could not completely offset the significant increase in cost of sales due to these factors.

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### *i) Crude Oil*

In 2004, the amount of crude oil we processed increased 5.8% to 9,109,400 tons (of which 602,500 tons were processed on a sub-contracted basis) compared with 8,610,000 tons in 2003 (of which 56,900 tons were processed on a sub-contracting). Excluding oil processed on a sub-contracted basis, the volume of imported oil, offshore oil and Shengli oil processed by us was 7,968,200 tons, 459,300 tons and 79,400 tons, respectively.

Total cost of crude oil processed by us in 2004 was RMB19,615.6 million, an increase of 24.4% as compared with RMB15,764.9 million in 2003, and accounted for 59.0% of the cost of sales. Reflecting substantial increases in the price of crude oil in the international market, the weighted average cost of crude oil for our Company was RMB2,305.85 per ton in 2004, representing an increase of 25.5% as compared to the prior year. The weighted average cost of imported oil, offshore oil and Shengli oil was RMB2,302, RMB2,472 and RMB1,702 per ton, respectively.

### *ii) Other expenses*

Expenses for other ancillary materials were RMB6,091.6 million in 2004, an increase of 54.6% as compared with RMB3,939.4 million in 2003 primarily due to an increase in the volume of intermediate petrochemicals, such as ethylene, ethylene glycol, propylene and polyvinyl alcohol, purchased during the year. Depreciation decreased slightly from RMB1,850.0 million in 2003 to RMB1,794.1 million in 2004. The decrease in depreciation was primarily due to the write-off or full depreciation of certain production equipment during 2004. Energy and power costs increased from RMB732.5 million in 2003 to RMB792.0 million in 2004 due to an increase in the price of coal and electricity. Labor and maintenance costs also increase from RMB1,090.7 million and RMB787.2 million in 2003 to RMB1,172.4 million and RMB920.5 million, respectively, in 2004.

### *Selling and administrative expenses*

Selling and administrative expenses were RMB408.1 million, a decrease of 8.2% compared with RMB444.7 million in 2003, primarily due to our continued efforts in internal optimization, and improved efficiency in operations and management. For example, we have negotiated with some of our customers to have them bear more of the transportation costs increased in shipping our products.

### *Operating income*

Operating income was RMB5,025.2 million, a significant increase of 150.5% as compared with RMB2,101.8 million in 2003, primarily due to the significant increase in net sales related to the increase in the weighted average price of our major products during the year, which offset the negative impact of a significant increase in the cost of crude oil.

### *Other operating income*

Other operating income was RMB277.0 million in 2004, an increase of 128.8% as compared with RMB121.1 million in 2003, primarily due to an increase in income from gain on disposal of property, plant and equipment, services and investments.

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### ***Other operating expenses***

Other operating expenses increased by 31.3% from RMB216.4 million in 2003 to RMB284.2 million in 2004, primarily due to the increase in employee reduction expenses by RMB48.4 million during the year.

### ***Net financing costs***

Our net financing costs were RMB292.0 million in 2004, a decrease of 25.5% as compared with RMB392.0 million in 2003, which was primarily due to an increase in the percentage of total borrowings represented by our lower interest rate foreign currency loans and a reduction in our total amount of borrowings in 2004.

### ***Profit before tax***

Our profit before tax was RMB4,696.2 million in 2004, an increase of 195.3% as compared with RM1,590.4 million in 2003.

### ***Income tax***

Our income tax increased by 339.1% to RMB637.1 million in 2004 compared with RMB145.1 million in 2003. This increase was primarily due to a substantial increase in gross profit. In 2004, we were entitled to a tax refund of RMB75.6 million in respect of the purchase of domestically manufactured equipment for technological improvement.

We continued to pay income tax at a preferential rate of 15% in 2004. This preferential rate was first applied to us under approval from the State tax authorities effective from January 1, 1993. According to the relevant tax regulations issued by the Ministry of Finance and the State Administration of Taxation, the first nine H-Share listed companies (including us) were permitted to pay income tax at a 15% tax rate in 1996 and 1997. From 1998 to 2004, the tax privilege was not revoked by the relevant government authorities. However, we cannot be sure whether the Ministry of Finance will maintain the 15% tax rate in 2005.

### ***Profit after tax***

Profit after tax was RMB4,059.2 million in 2004, a significant increase of 180.9% as compared with RMB1,445.3 million in 2003, mainly due to the significant increase in profit before tax.

Year Ended December 31, 2003 Compared with Year Ended December 31, 2002

*Net sales*

Net sales increased by 33.2% to RMB28,942.7 million in 2003 from RMB21,722.9 million in 2002. This increase was primarily attributable to the increase in both price and sales volume of most of our major products resulting from the rise in crude oil price and increase in market demand. The net sales of synthetic fibers, resins and plastics, intermediate petrochemicals and petroleum products for 2003 increased by 21.3%, 37.6%, 50.7% and 29.3%, respectively, as compared with 2002.



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### *i) Synthetic fibers*

Net sales of synthetic fibers increased by 21.3% to RMB4,092.6 million in 2003 from RMB3,374.3 million in 2002, due to a 11.5% increase in their weighted average price and a 8.8% increase in their sales volume. Sales of synthetic fibers as a portion of total sales decreased from 15.5% in 2002 to 14.1% in 2003 primarily because the increase in sales volume of synthetic fibers was less than the increase in sales volume of resins and plastics and intermediate petrochemicals. There was a significant increase in the production capacity of resins and plastics and intermediate petrochemicals as a result of the fourth phase of our production capacity expansion program, or the Phase IV Project, being completed in 2002 and achieving full production capacity in 2003.

### *ii) Resins and plastics*

Net sales of resins and plastics increased by 37.6% to RMB8,864.3 from RMB6,440.7 million in 2002, attributable to an increase of 13.6% in weighted average price and 21.2% in sales volume. Sales of resins and plastics as a portion of total sales slightly increased from 29.6% in 2002 to 30.6% in 2003 primarily because the increase in sales volume of resins and plastics was larger than the increase in sales volume of synthetic fibers and petroleum products. There was a significant increase in the production capacity of resins and plastics as a result of the Phase IV Project being completed in 2002 and achieving full production capacity in 2003.

### *iii) Intermediate petrochemicals*

Net sales of intermediate petrochemicals increased by 50.7% to RMB3,851.3 million in 2003 from RMB2,555.0 million in 2002, due to an increase of 16.0% in weighted average price and 30.0% in sales volume. Sales of products in this segment as a portion of total sales increased from 11.8% in 2002 to 13.3% in 2003 primarily because the increase in sales volume of intermediate petrochemicals was larger than the increase in sales volume of synthetic fibers and petroleum products. There was a significant increase in the production capacity of intermediate petrochemicals as a result of the Phase IV Projects being completed in 2002 and achieving full production capacity in 2003.

### *iv) Petroleum products*

Net sales of petroleum products increased by 29.3% to RMB10,329.1 million in 2003 from RMB7,991.2 million in 2002, due to an increase of 14.0% in weighted average price and 13.4% in sales volume. Sales of products in this segment as a proportion of total sales decreased slightly from 36.8% in 2002 to 35.7% in 2003 primarily because increase in sales volume of petroleum products was less than the increase in sales volume of resins and plastics and intermediate petrochemicals. There was a significant increase in the production capacity of resins and plastics and intermediate petrochemicals as a result of the Phase IV Projects being completed in 2002 and achieving full production capacity in 2003.

### *v) Trading and other activities*

Revenues from trading and other activities increased by 32.6% from RMB1,361.8 million in 2002 to RMB1,805.3 million in 2003 primarily due to an increase in trading revenues of ethylene glycol from RMB451.9 million in 2002 to RMB999.8 million in 2003.

Our operating profit margin (the result of profit from operations divided by turnover) was 6.8% and 6.4% in 2003 and 2002, respectively. The increase of our operating profit margin in 2003 was primarily due to an increase in the net sales of our chemical and plastics products which are of a higher profit margin compared to our other products.

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### *Cost of sales*

Cost of sales increased by 33.0% from RMB19,853.9 million in 2002 to RMB26,396.2 million in 2003, primarily due to a significant increase in the sales volume of most of our major products. Cost of sales as a proportion of net sales slightly decreased from 91.4% in 2002 to 91.2% in 2003.

#### *i) Crude oil*

Processed crude oil volumes increased by 15.9% from 7.43 million tons in 2002 to 8.61 million tons in 2003. The weighted average cost of crude oil used to produce our own products per ton increased by 19.6% from RMB1,540.7 in 2002 to RMB1,843.2 in 2003. Total costs of crude oil used to produce our own products increased by 37.8% from RMB11,444.8 million in 2002 to RMB15,764.9 in 2003, accounting for 59.7% of the total costs of sales in 2003.

Due to the shortage of supply in domestic onshore crude oil, we have continuously increased our usage of imported crude oil to leverage the advantage of our coastal location. In 2003, we processed 6.71 million tons, 0.48 million tons, 0.04 million tons and 1.38 million tons, respectively, of imported crude oil, domestic offshore oil, domestic onshore oil from Daqing oilfield and domestic onshore oil from Shengli oilfield, at which the average processing costs are RMB1,876 per ton, RMB1,793 per ton, RMB1,744 per ton and RMB1,703 per ton, respectively.

#### *ii) Other expenses*

Expenses for other ancillary materials increased by 28.3% from RMB3,071.6 million in 2002 to RMB3,939.4 million in 2003. Depreciation increased by 16.7% from RMB1,585.8 million in 2002 to RMB1,850.0 million in 2003. The increase of depreciation was primarily due to an increase in amount of fixed assets resulting from completion of certain capital expenditure projects including, among others, Phase IV Projects.

### *Selling and administrative expenses*

Selling and administrative expenses increased by 5.6% from RMB421.2 million in 2002 to RMB444.7 million in 2003 primarily due to an increase in transportation costs as a result of the increase in the sales volume of our major products in 2003.

### *Operating profit*

Operating profit increased by 45.2% from RMB1,447.8 million in 2002 to RMB2,101.8 million in 2003 because net sales increased to a larger extent than cost of sales and selling and administrative expenses.

***Other operating income***

Other operating income decreased to RMB121.1 million in 2003 from RMB136.6 million in 2002.

***Other operating expenses***

Other operating expenses increased by 39.8% from RMB154.8 million in 2002 to RMB216.4 million in 2003 primarily due to the incurring of employee reduction expenses of RMB64.1 million incurred in 2003.

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### ***Net financing costs***

Net financing costs slightly decreased from RMB400.7 million in 2002 to RMB 392.0 million in 2003 primarily due to lower interest expenses resulting from an increase in the foreign currency borrowings which generally bear a lower interest rate than Renminbi borrowings. The decrease was effectively offset by an increase in interest expenses resulting from the cessation of capitalization of interest expenses incurred for the financing of Phase IV Projects.

### ***Profit before tax***

Profit before tax increased by 52.2% from RMB1,045.0 million in 2002 to RMB1,590.4 in 2003 primarily because increase in operating profit more than offset decrease in other operating income and increase in other operating expenses.

### ***Income tax***

Income tax increased by 71.7% to RMB145.1 million in 2003 from RMB84.5 million in 2002. This increase was primarily due to a substantial increase in profit before tax. We continued to pay income tax at a preferential rate of 15% in 2003. During 2003, we received a tax refund of RMB92.2 million (2002: RMB66.4 million) in respect of the purchase of domestically manufactured equipment for technological improvement which partially offset the increase in income tax.

### ***Profit after tax***

Profit after tax increased by 50.5% from RMB960.5 million in 2002 to RMB1,445.3 million in 2003 primarily due to a significant increase in profit before tax.

### ***B. Liquidity and Capital Resources.***

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

### ***Capital Resources***

#### ***Cash flows provided from operating activities***

Net cash flow provided from operating activities was RMB4,589.7 million in 2004, an increase of RMB2,312.8 million as compared with RMB2,277 million in 2003. Due to the significant increase in the net sales of our major products in 2004, profit before tax net of depreciation was RMB6,490.3 million in 2004, an increase of RMB 3,049.9 million compared with RMB3,440.4 million in 2003. In order to meet the market demand of our product in 2004, we expanded our production and operations, and as a result, the working capital required for the operation our business increased. In particular, an increase in inventories led to an increase in operating cash outflow by RMB 223.5 million in 2004 (as compared with an increase in operating cash outflow of RMB120.6 million in 2003). Change in accounts payable and other payables led to an increase in operating cash outflow by RMB 376.9 million in 2004 (as compared with cash outflow of RMB478.8 million in 2003). Increase in debtors, bills receivable and deposits led to a decrease in operating cash inflow by RMB515 million in 2004 (as compared with a decrease in operating cash inflow of RMB346.0 million in 2003). In addition, our income tax payments increased significantly due to a significant increase in profit during the reporting period. In 2004, income tax payments led to an increase in operating cash outflow of RMB550.9 million (as compared with RMB78.1 million cash outflow in 2003).

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### *Net cash used in investing activities*

Net cash outflow for investing activities increased from RMB 1,578.6 million in 2003 to RMB2,340.6 million in 2004, mainly represented cash outflow for capital expenditures of RMB2,206.0 million.

### *Cash flows used in financing activities*

Net cash outflow for financing activities increased from RMB 518.7 million in 2003 to RMB2,400.0 million in 2004, mainly represented the net repayment of loans of RMB1,766.8 million and the payment of dividends of RMB576 million.

### *Borrowings*

Our borrowings in 2004 was RMB7,014.9 million, a decrease of RMB1,766.7 million compared with RMB8,781.6 million in 2003, of which short-term borrowings were RMB5,000.3 million, a decrease of RMB574.4 million compared with RMB5,574.7 million in 2003. Short-term borrowings were primarily used to meet our needs for working capital for the production and operation process, and all carried floating interest rates and were denominated in Renminbi. Long-term borrowings were RMB2,014.6 million in 2004, a decrease of RMB1,192.2 million as compared with RMB3,206.8 million in 2003. Most of our long-term borrowings are used for capital expansion projects.

We closely monitor the level of bank borrowings and the corresponding financing risks. We generally do 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*

Our debt-equity ratio was 27.6% in 2004 compared to 36.9% in 2003. The ratio is computed as follows: (total short-term loans + total long-term loans) / (total short-term loans + total long-term loans + shareholders' equity).

### ***C. Research and Development, Patents and Licenses, etc.***

We maintain a range of technology development units, including Petrochemical Research Institute, Fiber Research Institute and Technology Development Company, for research and development with respect to new technology, new products, production processes and equipment, downstream processing of petrochemical products, oil refining, chemical machinery, chemical technology, catalysts and environmental protection. Our research and development expenditures in 2002, 2003 and 2004 were RMB84.0 million, RMB101.2 million and RMB74.7 million, respectively, representing approximately 0.4%, 0.3% and 0.2% of our total sales, respectively, in those years.





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We are not, in any material aspect, dependent on any patents, licenses, industrial, commercial or financial contracts or new production processes.

**D. Trend Information**

We believe that the ongoing global as well as domestic economic growth is set to provide the petrochemical industry with sound opportunities. According to the recent trends in the petrochemical market, the positive economic environment is expected to provide a stimulus for rapid growth in the demand for petrochemical products in 2005. Prices of major chemical products are generally rising, in tandem with the growth cycle of the petrochemical market. However, prices of domestic petrochemical products will also be subject to increased uncertainties and risks, such as the abolition of import quota for petroleum products for state-owned trading companies, continuous import tax reductions for certain types of petrochemical products and changes in state policies regarding export rebates that affect petroleum products. As for market competition, we believe that major international players are preparing to enter the Chinese market amid industry restructuring on a global basis. Apart from posing direct competition against us in petroleum and petrochemical products, these international companies are characterized by large-scale investments across different sectors, full vertical integration and streamlined organization. Domestic companies are expected to face intense competition from their international counterparts as the China market becomes increasingly internationalized. In terms of our production operation, our production capacity will remain by and large the same, but the completion and operation of the Ningbo-Shanghai-Nanjing oil pipeline will bring about fundamental changes in the crude oil supply for us and lower transportation costs.

**E. Off-balance Sheet Arrangements**

As of December 31, 2004, our contingent liabilities amounted to RMB101.9 million in respect of guarantees issued to banks in favor of our associated companies and other unlisted investments, while such contingent liabilities as of December 31, 2003 were RMB129.1 million. Our guarantees issued to banks in favor of associated companies, other unlisted investments and subsidiaries are limited to the respective share in equity interest held by us. Please refer to Note 25 to our consolidated financial statements included in [Item 18. Financial Statement](#) for more detailed information on our guarantees and commitments.

**F. Contractual Obligations and Commercial Commitments**

The following table sets forth our obligations to make future payments under contracts effective as of December 31, 2004.

	As of December 31, 2004				
	Payment due by period				
	Total	Less than 1 year	1-3 years	4-5 years	More than 5 years
	(RMB 000)	(RMB 000)	(RMB 000)	(RMB 000)	(RMB 000)
<b>Contractual obligations</b>					
Short-term debt	3,742,727	3,742,727			
Long-term debt	3,272,192	1,257,578	1,886,758	62,297	65,559

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Total contractual obligations	7,014,919	5,000,305	1,886,758	62,297	65,559
<b>Other commercial commitments</b>					
Capital commitment (note)	2,443,668	2,443,668			
Total commercial commitments	2,443,668	2,443,668			

Note: Capital commitment refers to commitment for purchase of property, plant and equipment and investment.

**Table of Contents****G. Other Information****Employees**

As at December 31, 2004, the number of our employees was 28,451.

Our staff costs for the year were RMB1,172.4 million.

**Foreign Exchange Risks**

Since we purchase our major raw materials (crude oil) through Sinopec Corp from overseas, and also export a portion of our petroleum products directly through Sinopec Corp, a change in exchange rates will indirectly affect the prices of our raw materials and products which will have a discernible impact on our profitability. In addition, as discussed above, since a small part of our debts are denominated in foreign currencies, a change in the relevant exchange rates will affect the level of our financial expense which will also have an impact on our profitability.

**Capital Expenditures**

In 2004, our capital expenditures amounted to RMB2,206.0 million, representing an increase of RMB921.1 million as compared with RMB1,284.9 million in 2003. The expenditures in 2004 were for the following projects:

Project	Amount	Progress
	RMB 000	
Renovation of No. 1 atmosphere and vacuum distillation facility	392,900	in progress
400,000 tons/year PTA unit renovation	246,000	in progress
150,000 tons/year polyester renovation	150,000	completed
12,000 tons/year terylene filament	198,000	in progress
Material supply pipeline between Shanghai Petrochemical and SECCO	180,000	in progress
Shanghai Petrochemical south-north key pipeline expansion	181,700	in progress
<b>Total</b>	<b>1,348,600</b>	

The estimated capital expenditure for 2005 is RMB2,700 million, mainly for the completion of the aforesaid projects, and also the 380,000 ton per year glycol project, unit for adding hydrogen in diesel oil, renovation to the oil refining process and other technological renovation projects.

**Ethylene Joint Venture**

Late in 2001, we established Secco, a Sino-foreign equity joint venture together with BP and Sinopec Corp. We own 20%, while BP and Sinopec Corp own 50% and 30%, of the equity interest of Secco, respectively. Secco's total registered capital is US\$901,440,964, of which we will provide the Renminbi equivalent amount of US\$180,287,952. As of December 31, 2004, we paid approximately RMB1,200.5 million of the above sum. All of our contribution will be made in 2005.

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We plan to fund our capital expenditures from operating cash income and available bank loans.

### ***Purchase, Sale and Investment***

Except as disclosed in this report, during the year 2004, there was no material purchase or sale of our subsidiaries or associated companies or any other material investments.

### ***Pledge of Assets***

At December 31, 2004, no property and equipment was pledged by us (2003: RMB414.3 million).

### ***U.S. GAAP Reconciliation***

The financial statements have been prepared in accordance with IFRS. IFRS vary in certain significant respects from U.S. GAAP. Information relating to the nature and effect of such differences is presented in Item 18. Financial Statements - Consolidated Financial Statements - Note 30.

## **ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES.**

### ***A. Directors and Senior Management.***

#### ***Changes of Directors, Supervisors and Executive Officers***

We convened the Supervisory Committee on March 25, 2004, during which the Chairman of the Supervisory Committee, Mr. Du Chong Jun, resigned from his post of the Chairman and supervisor, and Mr. Dai Shuming was nominated as a candidate for the Supervisor of the Supervisory Committee. At the meeting of the Board of Directors held on March 26, 2004, Mr. Xu Kaicheng, Mr. Feng Jianping, Mr. Jiang Baoxing and Mr. Li Weichang resigned from their posts as directors due to change of work, and Mr. Du Chongjun, Mr. Han Zhihao, Mr. Wu Haijun and Mr. Gao Jinping were nominated to replace them. On the meeting of the Board of Directors held on April 27, 2004, Mr. Feng Jianping resigned from the post of Vice President due to a change in work. The 2003 Annual Shareholders Meeting, which was held on June 18 2004, approved the resignations of Mr. Xu Kaicheng, Mr. Feng Jianping, Mr. Jiang Baoxing and Mr. Li Weichang from the board of directors, approved the nomination of Mr. Du Chongjun, Mr. Han Zhihao, Mr. Wu Haijun and Mr. Gao Jinping to fill the vacancies on the board, approved Mr. Du Chongjun's resignation from the post of the Supervisory Committee, and approved that Mr. Dai Shuming to fill the vacancy. At the meeting of the board of directors held on June 18, 2004, Mr. Rong Guangdao and Mr. Du Chongjun were elected as Vice Chairmen of the Board of Directors, and Mr. Du Chongjun, Mr. Han Zhihao, Mr. Wu Haijun and Mr. Gao Jinping were elected as Executive Directors. At the meeting of the Supervisory Committee held on June 18, 2004, Mr. Dai Shuming was elected as the Chairman of the Supervisory Committee pursuant to a unanimous votes. At the meeting of the board of directors held on July 2, 2004, Mr. Zhang Jianpin and Mr. Tang Chengjian were

engaged as Vice Presidents based on nominations of Mr. Rong Guangdao.

The following table sets forth certain information concerning our directors, executive officers and members of our supervisory committee ( Supervisory Committee ). Except for Du Chongjun, Han Zhihao, Wu Haijun and Gao Jinping, who were elected on June 18, 2004, all were elected on June 18, 2002. Each will serve a term of three years or until the election of their respective successors.

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<u>Name</u>	<u>Age</u>	<u>Position</u>
<u>Directors</u>		
Lu Yiping	59	Chairman of the Board of Directors
Rong Guangdao	49	Vice Chairman and President
Du Chongjun	50	Vice Chairman of the Board of Directors
Han Zhihao	53	Director and Chief Financial Officer
Wu Haijun	42	Director and President
Gao Jinping	38	Director
Liu Wenlong	64	External Director
Zhang Baojian	60	External Director
Chen Xinyuan	40	Independent Director
Gu Chuanxun	69	Independent Director
Wang Xingyu	60	Independent Director
Wang Yongshou	64	Independent Director
<u>Other Executive Officers</u>		
Shi Wei	45	Vice President
Zhang Jianping	42	Vice President
Yin Jihai	47	Vice President
Tang Chengjian	49	Vice President
Zhang Zhiliang	51	Vice President
Zhang Jingming	47	Secretary of the Company
<u>Supervisory Committee</u>		
Dai Shuming	49	Chairman of the Supervisory Committee
Zhang Chenghua	49	Supervisor
Zhu Weiyuan	56	Supervisor
Zhang Jianjun	53	External Supervisor
Lü Xiangyang	53	External Supervisor
Liu Xiangdong	53	Independent Supervisor
Zhou Yunnong	63	Independent Supervisor

**Directors**

*Lu Yiping*, 59, is our Chairman of the Board. Mr. Lu joined the Complex in 1974 and has held various positions, including Deputy Director and Director of the Acrylic Fiber Plant of the Complex. In April 1994 he was appointed Vice President responsible for sales and marketing, and in June 1995 he was appointed a Director of the Company. He was appointed Vice Chairman & President in October 1997, and was appointed Chairman of the Board and President in May 1999. In October 2003, he became the Chairman of our Board and stepped down from the position of President. Since January 2000, he has also been the Chairman of the Board of Shanghai Chemical Industrial Zone Development Co., Ltd. In addition, since July 2003 he has been the Chairman of the Board of Shanghai Secco Petroleum Chemical Co., Ltd. Mr. Lu has many years of experience in the management of large-scale petrochemical companies. From October 1993 to April 1994, Mr. Lu was a Deputy General Manager of JI. Between 1968 and 1974 Mr. Lu worked at the Shanghai No. 16 Yarn-dyed Fabric Mill. In 1967, Mr. Lu graduated from the Textile Engineering Department of the Shanghai Textile Technical College. He is a senior engineer.

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*Rong Guangdao*, 49, is the Vice Chairman and President of the Company. Mr. Rong joined the Complex in 1973 and has held various positions, including Deputy Director of the No.1 Chemical Plant and Deputy Director and Director of the Ethylene Plant. In April 1994 he was appointed Vice President of the Company, responsible for production and planning, and in June 1995 he was elected as a Director of our Company. In October 2003, Mr. Rong was appointed the President of the Company. In May 2004, Mr. Rong was elected the Chairman of the China Jinshan Associated Trading Corporation. In June 2004, Mr. Rong was elected as Vice Chairman of the Board of Directors of our Company. Mr. Rong has many years of experience in organizing and directing large scale petrochemical production and human resource development. In 1985, Mr. Rong graduated from the Automated Instrument Department of the Shanghai Petrochemical College for Workers and Staff Members. In 1997, he obtained an MBA from China Europe International Business School. He is a senior engineer.

*Du Chongjun*, 50, is the Secretary of the Communist Party Committee and the Vice Chairman of the Company. He joined the Complex in 1974 and has held various positions, including General Manager, Secretary and Deputy Secretary of the Communist Party Committee of the Acrylic Fibre Plant of the Complex, General Manager and the Secretary of the Communist Party Committee of Shanghai Jinyang Acrylic Fibre Plant and General Manager of the Acrylic Business Division of our company. In May 1999 he became the Deputy Secretary of the Communist Party Committee and the Secretary of the Communist Party Discipline Supervisory Committee. From June 1999 to June 2004, he was the Chairman of the Supervisory Committee of the Company. In October 2003, he was appointed the Secretary of the Communist Party Committee. In June 2004, Mr. Du was appointed the Vice Chairman of the Board of Directors of the Company. Mr. Du has extensive experience in large scale enterprise operation, management and internal supervision. Mr. Du graduated in enterprise management from East China Institute of Chemical Technology in 1986. In 1999, Mr. Du graduated in computer application management from Shanghai Second Polytechnic University. He is a senior economist.

*Han Zhihao*, 53, is Executive Director and Chief Financial Officer of the Company. Mr. Han joined the Complex in 1976 and was held various positions including Deputy Director of the Vehicle Transportation Department, Deputy Director and Director of the Finance Department of the Complex, Director of the Finance Department and Deputy Chief Accountant of our Company. In 1998, he became Chief Accountant of our Company. In October 2003, he became our Chief Financial Officer. In June 2004, he was elected one of our Directors. He graduated from Shanghai University of Finance and Economics with a major in financing and accounting (self studies) in 1990. He obtained an MBA from East China University of Science and Technology - University of Canberra in Australia in 2002. Mr. Han is a senior accountant.

*Wu Haijun*, 42, is Executive Director and Vice President of the Company. Mr. Wu joined the Complex in 1984 and held various positions including Deputy Director and Director of No.2 Chemical Plant and Manager of Petrochemical Business Department of our company. In May 1999, he was appointed as Vice President of our company. In June 2004, he was elected as Director of the Company. Mr. Wu graduated from the Chemical Engineering Department of Eastern China Petrochemical Institute in 1984 with a bachelor's degree in chemical engineering. In 1997, he obtained an MBA from China Europe International Business School. He is a senior engineer.

*Gao Jinping*, 38, is Executive Director, Deputy Secretary of the Communist Party Committee and Chairman of the Trade Union of the Company. Mr. Gao joined the Complex in 1990 and was held various positions including Deputy Secretary of the Communist Youth League, Deputy Secretary of the Communist Party Committee of the Experimental Plant and Petrochemical Business Department of the Company and the Director of the Propaganda Division of our company. In May 2003, Mr. Gao was appointed as Deputy Secretary of the Communist Party Committee and Chairman of the Trade Union of the Company. In June 2004, Mr. Gao was elected as Director of the Board of Directors of our company. Mr. Gao graduated from the Food Processing Faculty of Shanghai Aquatic Products University with a major in cooling and cold storage technology and obtained a bachelor's degree in engineering in July 1990. In 2001, he completed his post-graduate industrial economics studies at Shanghai Academy of Social Sciences. He has a senior professional technical qualification.



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### **External Directors**

*Liu Wenlong, 64*, was appointed a Director of the Company in June 1999. Mr. Liu has held various positions, including Director of the Designing Office, Deputy Director of the Liaison Office and Deputy Chief Engineer of Nanjing Refinery. In April 1983 Mr. Liu began to serve as Vice President of Jinling Petrochemical Company, in August 1985 he began to serve as the Director of the Planning and Finance Division of Sinopec, in June 1988 began to serve as the Director of the Planning Division of Sinopec. Mr. Liu has acted as the Chief Economist of Sinopec since November 1992 and has concurrently held the position of the Director of the Planning Department of Sinopec Corp. and Sinopec Group since November 1996. As of April 1998, Mr. Liu has concurrently held the position of the Director of the Development and Planning Department of Sinopec Group. Since February 2000, he has been to the Assistant to the President and Chief Economist of Sinopec Group and Chief Economist of Sinopec Corp. Mr. Wu retired in March 2004. Mr. Liu has long been engaged in the management of petrochemical enterprises and he is familiar with planning, designing and management of petrochemical enterprises. Mr. Liu has a wealth of experience in enterprise planning and investment management. He is a qualified senior engineer with a master's degree.

*Zhang Baojian, 60*, was appointed our Director in June 1999. Mr. Zhang has successively held various positions, including Deputy Director and Director and Chief Accountant of the Finance Department of the Yueyang Petrochemical Complex. In April 1989, he began to serve as Chief Accountant of the Finance Department of Sinopec Group. In 1990, he became Deputy Director of the Finance Department of Sinopec and in October 1995, became Director of the Finance Department of Sinopec and the Chairman of Sinopec Finance Company Limited. From December 2001, Mr. Zhang became Deputy Chief Accountant and Director of Financial Planning Department of Sinopec Group, and a Director of Sinopec Corp and Chairman of Sinopec Finance Co., Ltd. He retired in October 2004. Mr. Zhang has long been engaged in financial management in petrochemical firms and groups. He is experienced in financial management. He is a senior accountant at the professor level. Mr. Zhang has a bachelor's degree.

### **Independent Directors**

*Chen Xinyuan, 40*, currently the Dean, Professor and tutor to doctoral students of the College of Accounting, Shanghai University of Finance and Economics, was elected Independent Director of our company in June 2003. Between June 2000 and June 2003, he was an Independent Supervisor of our company. After graduation from the Accounting Faculty, Hangzhou College of Commerce in July 1985, Mr. Chen undertook graduate studies at the Accounting Faculty of Shanghai University of Finance and Economics and stayed on as a lecturer. He commenced his doctoral studies in accounting while teaching and received his doctorate in June 1994. He has been a tutor to doctoral students since December 1998. Mr. Chen has also studied in West Germany for one year. He is very familiar with financial accounting, given his experience in the academic aspects of accounting and notable achievements in accounting research. He is also experienced in business management.

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*Gu Chuanxun, 69*, is an independent director of the Company. Mr. Gu has held senior positions with respect to production technologies, operation and management in Shanghai Tianyuan Petrochemical Factory and the Complex. He was appointed Director of Production Administration Office of the Complex in 1978, and had been Vice President of the Complex since 1979 and President since 1983. Mr. Gu was elected Vice Mayor of Shanghai Municipality in 1988. After the expiration of his term of office as the Vice Mayor, he has been serving as the Chairman of Changjiang Economic Joint Development Company ( Changfa Group ) which was jointly established by Shanghai, Nanjing, Wuhan and Chongqing. He graduated from Huadong Petrochemical Institute in 1961 specializing in petrochemical machinery. Mr. Gu is a qualified senior engineer.

*Wang Xingyu, 60*, is a professor and the former President of East China University of Science and Technology and was appointed our Independent Director in June 1999. Mr. Wang graduated from the Department of Mathematics of Fudan University in 1967 and received a Master's degree in control theory from East China Normal University in 1982 and a Doctor's degree in industrial automation from East China Institute of Chemical Technology in 1984. Mr. Wang specializes in the fields of automation, control optimization and intelligent controls. He has published numerous books and papers in these fields and is influential both in China and abroad.

*Wang Yongshou, 64*, is the Vice President of Shanghai Jinshan Industrial Investment Development Co., Ltd as from setup of our company. He was appointed our Director in June 1993. In 1997 he became the President of Shanghai Jinshan Industrial Investment Development Company. He became our Independent Director in June 2002, and now acts as the Senior Economic Consultant of Shanghai Jinshan Industrial Investment Development Co., Ltd. Mr. Wang joined the Complex in 1974 and he had been the Deputy Director and Director of the Plastics Plant of the Complex and became the Complex's chief economist in 1990. Mr. Wang had been the Deputy General Manager of JI since our establishment. Mr. Wang has extensive experience in plastics production management. Mr. Wang graduated from Zhejiang Petrochemical Institute in 1965 specializing in organic chemistry. Mr. Wang is a qualified senior engineer.

## **Supervisory Committee**

The Company has a Supervisory Committee whose primary duty is to supervise senior management of the Company that includes the Board of Directors, managers and senior officers. The function of the Supervisory Committee is to ensure that senior management of the Company act in the interest of the Company, its shareholders and employees and does not perform acts which violate PRC law. The Supervisory Committee reports to the shareholders in the general meeting. The Articles of Association provide the Supervisory Committee with the right to investigate the business and the financial affairs of the Company and to convene shareholder's meetings from time to time. The Supervisory Committee currently comprises seven members, two of whom are employee representatives and five of whom are external supervisors, including two independent supervisors.

*Dai Shuming, 49*, is a Deputy Secretary of the Communist Party Committee and the Secretary of the Communist Party Discipline Supervisory Committee and the Chairman of the Supervisory Committee. He joined the Complex in 1973 and has successively held various positions, including Vice Director of the Communist Party Committee Office of the Complex, Vice Director and Director of the Communist Party Committee Office and Director of President's Office of Shanghai Petrochemical. In October 2003, he was appointed as Deputy Secretary of the Communist Party Committee and the Secretary of the Communist Party Discipline Supervisory Committee of the Company. From June 2004, he became the Chairman of the Supervisory Committee of our company. Mr. Dai graduated from Social Science Faculty, East China Chemical Institute in July 1986, specialized in politics, and obtained a Bachelor Degree in Communist Party political management from the municipal Communist Party's school in 1998. He finished postgraduate study of industrial economy in Shanghai Social Science Academy in 2001. Mr. Dai has a senior professional title.

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*Zhang Chenghua, 49*, is a Deputy Secretary of the Communist Party Discipline Supervisory Committee and the Director of the Supervision Office. He joined the Complex in 1974 and held various positions, including a Deputy Secretary of the Communist Party Committee and the Secretary of the Communist Party Discipline Supervisory Committee, as well as Chairman of the Trade Union of the Thermoelectricity Plant of the Complex (subsequently known as the Thermoelectricity Plant of Shanghai Petrochemical Company Limited). Mr. Zhang has rich experience in management of enterprises and trade unions. In January 1999, Mr. Zhang graduated from Shanghai Municipal Communist Party School specialized in Communist Party political management. He also finished postgraduate study of industrial economy in Shanghai Social Science Academy in June 2001. He is a qualified engineer.

*Zhu Weiyan, 56*, is a Vice Chairman of our Trade Union. He graduated in January 1977 from the Physics Department of Fudan University in Shanghai specializing in cryogenic superconductors. He also graduated from the Shanghai No. 2 Industry University specializing in management. Before joining the Complex in 1979, he was a teacher. Mr. Zhu had worked at the Research Institution and the Human Resource Department of the Complex. He has held various positions, including the Chairman of the Trade Union and the Director of the Propaganda Division. Mr. Zhu has rich experience in the operation of trade unions. Mr. Zhu holds the title of senior engineer.

## **External Supervisors**

*Zhang Jianjun, 53*, is currently Deputy Director of the Supervision Bureau of Sinopec Group and Deputy Director of Supervision Department of Sinopec Corp. She was appointed our external supervisor in June 2000. After she graduated from Tianjin University in September 1975 specializing in catalyst studies, Ms. Zhang joined Beijing Petrochemical Complex where she worked with a catalyst research team for 5 years. Ms. Zhang had held various positions, including Deputy Secretary of the Disciplinary Committee, Deputy Director and Deputy Party Secretary of the Research Institute and Director of the Supervisory Office of Yanshan Petrochemical Company Limited and Party Secretary of the Research Institute of Yanshan Petrochemical Company Limited. In February 2002 he began to hold the current office. Ms. Zhang has accumulated a wealth of experience in the management of petrochemical companies, having held various positions in senior management. Ms. Zhang has a senior professional title.

*Lü Xiangyang, 53*, is a Vice Director of the Auditing Bureau of Sinopec Group and was appointed our Supervisor in June 2002. He joined Qianguo Oil Refinery in 1970 and had held various positions there, including Deputy Director and Director of the Financial Department. He has served as the Deputy Director of the Production Auditing Division of the Auditing Department of Sinopec since 1992 and served as the Deputy Director of the Auditing Bureau of Sinopec and Sinopec Group since 1997. Mr. Lü had also held positions as the Director of Production Auditing Department and Deputy Manager of Sinopec Huxia Auditing Company. He has rich experience in management in the fields of finance and auditing. He graduated in 1985 from the Xi'an College of Petroleum Industry and has the title of accountant.

## **Independent Supervisors**

*Zhou Yunmang* is the former Governor of Shanghai Jinshan District, and is a Member of the Leaders Group of Shanghai Chemical and Industrial Park. He is currently the Senior Advisor of Jinshan Industrial Investment and Development Company. In August 1964, Mr. Zhou graduated from Huadong Normal University majoring in radio. He joined the Complex in October 1972, and was appointed the Vice President of the Complex in August 1984. From June 1989 to August 1991, Mr. Zhou was the Deputy Director of the Human Resource Department of Sinopec. In August 1991, Mr. Zhou became the Deputy Secretary of Communist Party Committee of the Complex, and was appointed the Vice President of the Complex in March 1992. From July 1993 to April 1994, Mr. Zhou was our Vice President in charge of administration and human resources. In April 1994, Mr. Zhou was appointed the Secretary of the Communist Party Committee of JI, and he was the Governor to Jinshan District of Shanghai from May 1997 to November 1999. Mr. Zhou has the title of senior engineer and he has rich experience in business management.



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*Liu Xiangdong, 53*, is currently the President of Zhengda International Finance Corporation. He was appointed our independent supervisor in June 2000. Mr. Liu has held the positions of planning and credit officer and deputy head and head of the credit division of several banks. He has also been Deputy Chief and Chief of the Planning Department of the Industrial and Commercial Bank of China, Shanghai Branch. He became Chief Economist and concurrently the Director of the Planning Division of the Industrial and Commercial Bank of China, Shanghai Branch in August 1996. He has been Deputy Director of the Industrial and Commercial Bank of China, Shanghai Branch since October 1997, and began to serve as General Manager of the Investment Bank Division of the Industrial and Commercial Bank of China from June 2002. Mr. Liu is a veteran in the banking sector with extensive experience in management and other practical aspects of the business. He holds a master's degree in economics and the title of senior economist.

## **Senior Management**

*Zhang Zhiliang, 51*, is a Vice President of the Company. Mr. Zhang joined the complex in 1977 and has held various positions, including Deputy Director and Director of the No. 1 Petrochemical Plant of our company and Deputy Manager and Manager of our Refining and Chemical Division. Mr. Zhang was appointed Vice President of our company in April 1997. He served as Director of the Company from June 1997 to June 2003. In November 2002, Mr. Zhang became the leader of management team of Shanghai Secco IPMT project, responsible for construction of the project. Mr. Zhang graduated from Fudan University in 1977 majoring in polymer chemistry. He is a qualified senior engineer.

*Yin Jihai, 47*, is a Vice President of our Company. Mr. Yin joined the Complex in 1984 and has held various positions, including Assistant to the General Manager and the Deputy General Manager and the General Manager of the Sales Company. Mr. Yin became the Director of the Market Division of the Company in 1999. He was appointed the Vice President of the Company in December 2001. In May 2004, He began to concurrently serve as Vice Chairman of China Jinshan Joint Trade Co., Ltd. and Hong Kong Jinrun Petrochemical Co., Ltd. Mr. Yin graduated from Shanghai University of Finance and Economics specializing in trade and economics in 1984. He obtained a master degree from the China Europe International Business School in 2001. He is a qualified engineer.

*Shi Wei, 45*, is a Vice President of the Company. Mr. Shi joined the complex in 1982 and was appointed Assistant to the Manager of the Refining and Chemical Division in May 1996, Deputy Manager of Refining and Chemical Division in October 1997, Manager of the Environment Protection Division of the Company in March 1999, Secretary of the Communist Party Committee of the Refining and Chemical Division in April 2001, Manager of the Refining and Chemical Division in July 2002, and Vice President of the Company in October 2003. Mr. Shi graduated from the Eastern China Petrochemical Institute specializing in oil refinery engineering in 1982, and completed the postgraduate course on business administration in Eastern China University of Science and Technology in 1998. He is a qualified senior engineer.

*Zhang Jianping, 42*, is a Vice President of the company. He joined the Complex in 1987, and successively held the positions of Vice Chief Engineer of Oil Refining Chemical Department Arene Factory, Vice Director of the Plastic Factory, Deputy Manager of Plastics Department of Shanghai Petrochemical, Director of the Chemical Institute, Director of Production Department of Shanghai Petrochemical. In February 2002, he became the assistant to the President of our company and Director of Production Department. In July 2004, he was appointed Vice President of our company. Mr. Zhang graduated from East China Chemical Institute specializing in Petroleum Refinery and received a Master's Degree in Petroleum Processing from the same school in 1987. He is a qualified senior engineer.

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*Tang Chengjian*, 49, is a Vice President of our company. He joined the Complex in 1974, and successively held the positions of Deputy Secretary of Communist Party Committee, Trade Union Director, Deputy Director and Director of Thermal Power Factory at the Complex. He was appointed the Vice President of our company in July 2004. Mr. Tang graduated from Shanghai Power Technology School specialized in power plant steam turbine, received a graduate diploma from Shanghai Power College in power plant and power system, and received a bachelor degree from Shanghai No. 2 Industry University in project management and a MBA from China Europe International Industrial and Commercial Institute in 2001. He is a qualified engineer.

*Zhang Jingming*, 47, is the Secretary of the Board, General Legal Counsel, the Director of the Secretariat Office to our Board of Directors and Director of Strategy Research Office of our company. Mr. Zhang joined the Complex in 1978. Mr. Zhang has held various positions including Project Manager and Deputy Director of the International Department and our representative in Hong Kong. Mr. Zhang is fluent in English with special expertise in interpretation and translation of petrochemical engineering documents. Mr. Zhang participated in the technology exchange, agreement negotiation, project construction and technical trainings of the Complex's Phase II & III projects. He is experienced in communication with foreigners and introduction of enterprise to others. In 1995, Mr. Zhang received an MBA from the University of Hull in the UK. He is a qualified senior economist.

### ***B. Compensation.***

The aggregate amount of cash compensation we paid to our directors, supervisors and executive officers during the year ended December 31, 2004 was approximately RMB3.14 million (US\$0.4 million). In addition, directors and supervisors who are also officers or employees receive certain other benefits-in-kind, such as subsidized or free health care services, housing and transportation, which large Chinese enterprises customarily provide to their employees. No benefits are payable to members of the board or the execution officers upon termination of their relationship with us.

In 2004, the aggregate emoluments of the three of our highest paid directors were RMB759,000 (US\$91,700), and the aggregate emoluments of the three of our highest paid executive officers were RMB 610,000 (US\$73,700). In 2004, our independent directors received allowance in the amount of RMB 240,000. Other directors and supervisors that did not receive any emoluments or allowance from us are: Liu Wenlong, Zhang Baojian, Chen Xinyuan, Zhang Jianjun, Lü Xiangyang, Zhou Yunnong and Liu Xiangdong. In 2004, the number of directors, supervisors or executive officer that received emoluments between RMB100,000 (US\$12,082) and RMB200,000 (US\$24,165) and between RMB200,000 (US\$24,165) and RMB 300,000 (US\$36,247) are 8 and 9, respectively.

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### *C. Board Practices.*

#### Board of Directors

Except for Mr. Du Chongjun, Han Zhihao, Wu Haijun and Gao Jinping who were appointed on June 18, 2004, all of our current directors were elected on June 18, 2002 and each will serve a term of three years or until the election of their respective successors. None of our directors or supervisors have entered into any service contract with us or any of our subsidiaries providing for benefits upon termination of employment.

#### Supervisory Committee

The Supervisory Committee are to supervise our directors and our senior officers and prevent them from abusing their positions and powers or infringing our rights and interests or those of our shareholders or employees. The Supervisory Committee has no power over the decisions or actions of our directors or officers except to compel them to correct any act harmful to our interests. The Supervisory Committee is currently composed of seven members appointed for a three year term. It has the right to attend meetings of our board of directors, inspect our financial affairs and perform other supervisory functions.

#### Audit Committee

Pursuant to Paragraph 14 of the Code of Best Practice set out in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Ltd, we formed an audit committee on June 15, 1999 which consists of three directors, Chen Xinyuan, Wang Xingyu and Wang Yongshou. The principal duty of the audit committee is to review and supervise our financial reporting process and internal controls. The members of the audit committee will hold office for the same term as directors.

#### Remuneration Committee

We formed a remuneration committee on December 25, 2001 which consists of three directors, Gu Chuanxun, Wang Yongshou and Rong Guangdao. The operating rules for the remuneration committee are still in the process of formulation.

### *D. Employees.*

As of December 31, 2004, we had 28,451 employees.

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The following table shows the approximate number of employees we had at the end of our last three years by the principal business function they performed:

	December 31,		
	2004	2003	2002
Management	2,395	2,751	2,962
Engineers, technicians and factory personnel	20,343	22,423	23,293
Accounting, marketing and other	5,713	5,834	5,234
Total	28,451	31,008	31,489

Approximately 22% of our work force graduated from university or technical colleges. In addition, we offered our employees opportunities for education and training based upon our development and actual performance of the employees.



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We have completed implementing a system of labor contracts. The contract system imposes discipline, provides incentives to adopt better work habits and gives us greater management control over our work force. We believe that by linking remuneration to productivity the contract system has also improved employee morale. As of December 31, 2004, almost all of the work force was employed under labor contracts which specify the employee's position, responsibilities, remuneration and grounds for termination. The contracts generally have terms of five years and may be renewed with the agreement of both parties. The personnel who have worked in SPC for over ten years may enter into labor contracts with an indefinite term. Since 2000, we have reduced our workforce by over 10,000.

We have a trade union that protects employees' rights, aims to assist in the fulfillment of our economic objectives, encourages employee participation in management decisions and assists in mediating disputes between us and union members. We have not been subject to any strikes or other labor disturbances which have interfered with our operations, and we believe that our relations with our employees are good.

Total remuneration of our employees includes salary and bonuses. Employees also receive certain benefits in terms of housing, education and health services that we subsidize, and other miscellaneous subsidies. In 2004, we paid RMB 1,172 million in employment costs.

In compliance with Shanghai regulations, we and our employees participate in a defined contribution government pension scheme under which all employees upon retirement are entitled to receive pensions. Pursuant to government regulations, we established a supplementary defined contribution retirement scheme for all employees in 1995. This scheme provides for a supplementary pension funded by voluntary payments by employees that are matched by payments we make. Each year's level of matching payments is based upon our profitability and the employee's performance and attitude. The supplementary pension is intended to provide a further incentive to employees.

In 1996, government directives required us to provide to eligible employees the opportunity to purchase housing that we had previously provided to them through JI. As of December 31, 1996, eligible employees, for a minor amount of consideration, had acquired 80.0% of our staff dormitories, the rights to which had previously been held in part by us and in part by JI. The net book value of the rights we previously held represents the original cost of the rights, which were established through arm's length negotiations between us and JI, minus depreciation. We determined to write-off the value of these rights acquired by our employees, resulting in 1996 in an operating expense in the amount of RMB160.7 million (US\$19.4 million) charged to our consolidated statements of income. After the write-off, the balance of the housing which had not been acquired by eligible employees had a net book value of approximately RMB48.0 million (US\$5.8 million). In 1999 we incurred similar charges of RMB155 million (US\$18.7 million). The housing reform policy ceased in 2000 pursuant to government directives.

We do not carry workers' compensation or other similar insurance. However, all employees (both contract and non-contract employees) who are unable to work due to illness or disability, whether or not such illness or disability is job-related, will continue, based on seniority, to receive most or all of their base salary and certain subsidies (but not bonuses) throughout the period of their absence, subject to certain time limitations. Employees who are unable to work due to job-related illnesses or disabilities will receive certain additional compensation from us. The compensation varies depending on the severity of the illness or disability. Structural changes being implemented by the Chinese and Shanghai governments and our own implementation of joint stock limited company accounting and financial principles may result in certain adjustments of the funding, management and payment methods for these types of workers' compensation arrangements over time.

**Table of Contents*****E. Share Ownership.***

The following table shows the interests of our Directors, Supervisors and senior officers in our shares as of December 31, 2004 and the net change since January 1, 2003. All shares indicated were A shares and represented the personal interests of the relevant persons. In each case, they represent less than 1% of the outstanding A shares. No change in shareholdings occurred. Except as disclosed below, none of the Directors, Supervisors or senior officers or their associates had any beneficial interest in our issued share capital in 2004.

Name	Position	Shares held at December 31, 2004
Lu Yiping	Chairman	3,600
Rong Guangdao	Vice Chairman and President	3,600
Du Chongjun	Vice Chairman	1,000
Han Zhihao	Director and Chief Financial Officer	0
Wu Haijun	Director and Vice President	1,500
Gao Jinping	Director	0
Liu Wenlong	External Director	0
Zhang Baojian	External Director	0
Wang Yongshou	Independent Director	3,600
Gu Chuanxun	Independent Director	0
Wang Xingyu	Independent Director	0
Chen Xinyuan	Independent Director	0
Dai Shuming	Chairman of Supervisory Committee	0
Zhang Chenghua	Supervisor	0
Zhu Weiyan	Supervisor	0
Zhang Jianjun	External Supervisor	0
Lü Xiangyang	External Supervisor	0
Liu Xiangdong	Independent Supervisor	0
Zhou Yunnong	Independent Supervisor	0
Zhang Zhiliang	Vice President	3,600
Yin Jihai	Vice President	0
Shi Wei	Vice President	0
Zhang Jianping	Vice President	0
Tang Chengjian	Vice President	0
Zhang Jingming	Company Secretary	0

We have no employee share purchase plan, share option plan or other arrangement to involve employees in our share capital.

**ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS.*****A. Major Shareholders.***

Sinopec Corp owns 55.56% of our share capital and is able to exercise all the rights of a controlling shareholder, including the election of directors and voting on amendments to our Articles of Association.

The table below sets forth information regarding ownership of our capital stock as of May 31, 2005 by (i) all persons who we know own more than five percent of our capital stock and (ii) our officers and directors as a group. We are not aware that any such shareholder had voting rights different from those of our other shareholders.

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<u>Title of Class</u>	<u>Identity of Person or Group</u>	<u>Number of Shares Held</u>	<u>Percent of Total Share Capital</u>
Domestic Shares	China Petroleum & Chemical Corporation <sup>(1)</sup>	4,000,000,000	55.56%
H Shares	HKSCC nominees Ltd.	1,916,102,857	26.61%
A Shares	Directors and Officers	14,800	less than 1%

1. This company is controlled by China Petrochemical corporation which is itself controlled by the Chinese government.

There have been no changes in our major shareholders or significant changes in the amount of shares such shareholders hold during 2002, 2003 and 2004.

As of May 31, 2005, a total of 2,330,000,000 H Shares were outstanding. As of May 31, 2005, a total of 1,739,205 ADSs, representing the equivalent of 173,920,500 H Shares, were outstanding and held by 119 holders of record. A total of 720,000,000 A Shares were also outstanding on May 31, 2005.

To the best of our knowledge, we are not directly or indirectly controlled by another corporation, any foreign government, or any other natural or legal person, severally or jointly.

We are not aware of any arrangement that may at a subsequent date result in a change of control of our company.

***B. Related Party Transactions.*****Intercompany service agreements**

Prior to its dissolution, JI provided machinery maintenance, transportation, medical care, technical training and other services to us, and we provided public utility services, such as water, electricity and steam, to JI. Following the dissolution of JI in August 1997 and the transfer of its subsidiaries to Sinopec, the services agreement between us and JI was terminated. In March 1998, we entered into a new services agreement with Sinopec to replace the terminated services agreement. The new services agreement contains the same terms and conditions as those contained in the previous services agreement and the services are to be provided either at market prices or prices set by governmental authorities. Those services are currently provided by Sinopec Group. See Item 4A. Information on the Company History.

In August 1997, we entered into a three-year agreement (the Agreement) with Sinopec for the management of six subsidiaries (the Subsidiaries) formerly held under and managed by JI and which provided services and products to us as required by the previous services agreement between us and JI. Following the dissolution of JI in August 1997, the Subsidiaries became subsidiaries of Sinopec and are now directly controlled by Sinopec Group. Under the Agreement, we have agreed to manage the production, operation and labor and employment matters of the Subsidiaries. We estimate the total management fee we receive, which is calculated on a cost basis, to be approximately RMB500,000 (US\$60,406) to RMB600,000 (US\$72,487) each year. We deduct these fees from the amounts payable to the Subsidiaries for their provision of services and products to us pursuant to the new services agreement referred to above.

Business-related dealings

We have entered into transactions with each of Sinopec Corp, Sinopec Group and its predecessor, Sinopec, JI and their respective affiliated entities, all of which are our affiliates, and will continue to enter into transactions with each of Sinopec Corp, Sinopec Group and their affiliated entities. Transactions with Sinopec Corp and its affiliated entities include the allocation of crude oil and certain raw materials, the exclusive sale of our acrylic fibers production, and the sale of certain of our products pursuant to the State Plan.

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### ***Ethylene Joint Venture***

Late in 2001, we established Secco, a Sino-foreign equity joint venture, together with BP and Sinopec Corp. We own 20%, while BP and Sinopec Corp own 50% and 30%, respectively. Secco was established to build and operate a 900,000 tons rated capacity ethylene petrochemical manufacturing facility, to manufacture and market ethylene, polyethylene, styrene, polystyrene, propylene, acrylonitrile, polypropylene, butadiene, aromatics and by-products, to provide related after-sales services and technical advice with respect to such petrochemical products and by products, and to engage in polymers application development. Secco is expected to complete construction in 2005. Secco's total registered capital is US\$901,440,964, of which we will provide the Renminbi equivalent of US\$180,287,952. As of December 31, 2004, we paid approximately RMB 1,200.5 million of the above sum. All of our contribution will be made before construction is completed in 2005.

### ***HKSE Connected Transactions Waivers***

The HKSE has granted two waivers from HKSE requirements that would require us to seek advance shareholder approval for transactions with related parties.

*Transactions under the State Plan* Transactions entered into pursuant to the State Plan are exempt, provided that we disclose them to shareholders in our next annual report filed in Hong Kong ( HK Annual Report ).

*Transactions with Sinopec Corp* The HKSE has confirmed that transactions with Sinopec Corp or its associates which were previously carried out with Sinopec and its associates and were covered by the waivers, continue to be exempt following the reorganization of Sinopec on the basis that there is no change in our ultimate controlling shareholder, provided that we satisfy the following conditions (such transactions will include transactions with Sinopec Group since Sinopec Group is the controlling company of Sinopec Corp):

we disclose details of the transactions to shareholders in our next HK Annual Report,

our independent non-executive directors certify in our next HK Annual Report that the transactions have been entered into (1) in the ordinary course of business of the relevant companies, (2) on normal commercial terms or on terms that are fair and reasonable so far as our shareholders are concerned and (3) the transactions have been entered into either in accordance with the terms of the agreement governing them or, where there is no such agreement, on terms no less favorable than terms available to third parties,

we provide a copy of the HKSE's waivers letter to our auditors and draw their attention to the requirements, and

our auditors review the transactions each year.

If, however, disclosure of any such transactions is necessary to enable investors to appraise our position or to avoid the establishment of a false market in our shares or if such transactions may have any material effect on the trading of our shares on the HKSE, we are required to disclose the relevant transaction to the HKSE as soon as practicable. The expression "ordinary course of business" will be determined in the context of the actual business of the relevant company and the expression "normal commercial terms" will be applied by reference to transactions of a similar nature and to be made by similar entities within China or, in the absence of available comparison, by reference to our history and pattern of

dealings. Please also see Note 27 to our consolidated financial statements included in [Item 18. Financial Statements](#).

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Other related party transactions

He Fei, a non-executive Director prior to June 18, 2002, is a partner of Haiwen & Partners, our legal advisor on Chinese laws, which has received and will continue to receive legal fees in connection with their representation of us.

*C. Interests of Experts and Counsel.*

Not applicable.

**ITEM 8. FINANCIAL INFORMATION.**

*A. Consolidated Statements and Other Financial Information.*

**Consolidated Financial Statements.**

Please see Item 18. Financial Statements.

**Other Financial Information**

Export Sales

In 2004, export sales accounted for RMB94 million (US\$11.4 million) or 0.24% of our total net sales.

Litigation

Neither we nor any of our subsidiaries is a party to, nor is any of our or their property the subject of, any legal or arbitration proceedings which may have significant effects on our financial position or profitability. We are not aware of any litigation or arbitration proceedings in which any of our directors, any member of our senior management or any of our affiliates is an adverse party or has a material adverse interest.



Dividend Policy

Our board of directors may propose dividend distributions subject to the approval of the shareholders. The Articles of Association also provide that, unless the shareholders otherwise resolve, our board of directors is authorized in advance to distribute interim dividends each year up to 50% of our distributable profits. Shareholders receive dividends proportional to their shareholding.

The Articles of Association require that cash dividends and other distributions in respect of H shares be declared in Renminbi and paid by us in Hong Kong dollars while cash dividends and other distributions of the domestic shares shall be paid in Renminbi. If we record no profit for the year, we may not distribute dividends for the year.

We expect to continue to pay dividends, although there can be no assurance as to the particular amounts that might be paid from year to year. Payment of future dividends will depend upon our revenue, financial condition, future earnings and other factors. See Item 5. Operating and Financial Review and Prospects. See also Item 3. Key Information - Selected Financial Data - Dividends.

**Table of Contents****B. Significant Changes.**

No significant change has occurred after the date of the financial statements included in this Annual Report.

**ITEM 9. THE OFFER AND LISTING.****A. Offer and Listing Details**

Set forth below is certain market information relating to our H Shares and ADSs for the periods indicated.

	<u>Price per H Share</u>		<u>Price per ADS</u>	
	<u>(HK\$)</u>		<u>(US\$)</u>	
	<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>
2000	1.50	0.67	18.56	9.00
2001	1.35	0.52	17.15	7.00
2002	1.28	0.69	15.61	8.74
2003	3.45	1.70	46.26	14.35
2004	4.07	1.86	53.90	24.30
2003				
First Quarter	1.46	1.10	18.98	14.35
Second Quarter	1.69	1.08	20.94	14.55
Third Quarter	1.93	1.44	24.99	18.73
Fourth Quarter	3.45	1.63	46.26	21.50
2004				
First Quarter	3.92	2.90	50.70	37.41
Second Quarter	4.07	1.86	53.90	24.30
Third Quarter	3.10	2.30	39.10	30.28
Fourth Quarter	3.12	2.60	40.08	34.12
Most Recent Six Months				
December, 2004	2.92	2.60	37.40	34.12
January, 2005	2.92	2.60	37.50	34.01
February, 2005	3.45	2.80	44.10	36.75
March, 2005	3.58	3.12	45.20	40.25
April, 2005	3.22	2.80	41.60	36.20
May, 2005	3.00	2.53	39.05	33.45

**B. Plan of Distribution**

Not applicable.

***C. Markets***

The principal trading market for our H Shares is the HKSE. The ADSs, each representing 100 H Shares, have been issued by The Bank of New York as depositary under a Deposit Agreement with us and are listed on the NYSE under the symbol `SHI`. We have also listed our A Shares on the Shanghai Securities Exchange. Prior to our initial public offering and subsequent listings on the HKSE and NYSE on July 26, 1993, there was no market for our H Shares or the ADSs. Public trading in our A Shares commenced on November 8, 1993.

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***D. Selling Shareholders***

Not applicable.

***E. Dilution***

Not applicable.

***F. Expenses of the Issue***

Not applicable.

**ITEM 10. ADDITIONAL INFORMATION.**

***A. Share Capital***

Not applicable.

***B. Memorandum and Articles of Association.***

The following is a summary based upon provisions of our Articles of Association as currently in effect, the Company Law of the People's Republic of China (1993) and other selected laws and regulations applicable to us. You should refer to the text of the Articles of Association and to the texts of applicable laws and regulations for further information.

Our total registered capital is 7,200,000,000 ordinary shares, of which 4,870,000,000 are domestic shares and 2,330,000,000 H shares. Our Articles of Association provide, at article 12, that our purpose is:

to build and operate a diversified industrial companies which will be one of the world's leading petrochemical companies;

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to promote the development of the petrochemical industry in China through the production of a broad variety of outstanding products; and

to practice advanced, scientific management and apply flexible business principles, and to develop overseas markets for our products so that we and our shareholders receive reasonable economic benefits.

Our scope of business is limited to matters approved by Chinese authorities. Article 13 provides that our primary business scope includes:

refining crude oil, a wide range of petroleum products, petrochemical products, basic organic chemicals, synthetic fibers and monomers, plastic products, polyester fibers and yarns, raw materials for knitting and textile products and finished products; and

production and operation of industrial fuels, production and operation of other by-products and refining and processing of platinum metals.

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Our secondary scope of operation includes: electricity generation, supply of heat, supply of liquefied petroleum gas, water treatment, railways, ocean and inland water transport, warehousing, real estate, technical consultation, import and export, research and all other activities incidental and consistent with our primary and secondary operation and business scope. We may adjust these subject to approval by governmental authorities.

The following discussion primarily concerns our shares and the rights of our shareholders. Holders of our ADSs will not be treated as our shareholders and will be required to surrender their ADSs for cancellation and withdrawal from the depository facility in which the H shares are held in order to exercise shareholder rights in respect of H shares.

Domestic shares and overseas-listed foreign invested H shares are both ordinary shares in our share capital. Domestic shares are shares we issue to domestic Chinese investors for subscription in Renminbi, while H shares are shares we issue for subscription in other currencies to investors from Hong Kong, Macau, Taiwan and outside of China.

### **Sources of Shareholders' Rights**

China's legal system is based on written statutes and is a system in which decided legal cases have little precedent value. China's legal system is similar to civil law systems in this regard. In 1979, China began the process of developing its legal system by undertaking to promulgate a comprehensive system of laws. In December 1993, the Standing Committee of the 8th National People's Congress adopted the Chinese Company Law. Although the Chinese Company Law is expected to serve as the core of a body of regulatory measures, which will impose a uniform standard of corporate behavior on companies and their directors and shareholders, only a limited portion of this body of regulatory measures has so far been promulgated.

Currently, the primary sources of shareholder rights are the Articles of Association, the Chinese Company Law and the HKSE listing rules, which, among other things, impose standards of conduct, fairness and disclosure on us, our directors and our controlling shareholder. To facilitate the offering and listing of shares of Chinese companies overseas, and to regulate the behavior of companies whose shares are listed overseas, the State Council Securities Committee and the State Commission for Restructuring the Economic System issued the Mandatory Provisions for articles of association of Companies Listing Overseas on August 27, 1994. These provisions have been incorporated into our Articles of Association and any amendment to those provisions will only become effective after approval by the companies approval department of local government authorized by the State Economic and Trade Commission and the China Securities Regulatory Commission.

In addition, upon the listing of and for so long as the H shares are listed on the HKSE, we will be subject to those relevant ordinance, rules and regulations applicable to companies listed on the HKSE, the Securities (Disclosure of Interests) Ordinance and the Hong Kong Codes on Takeovers and Mergers and Share Repurchases.

Unless otherwise specified, all rights, obligations and protections discussed below derive from our Articles of Association and/or the Chinese Company Law.

### **Enforceability of Shareholders' Rights**

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There has not been any public disclosure in relation to the enforcement by holders of H shares of their rights under constitutive documents of joint stock limited companies or the Chinese Company Law or in the application or interpretation of the Chinese or Hong Kong regulatory provisions applicable to Chinese joint stock limited companies.

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In most states of the United States, shareholders may sue a corporation derivatively. A derivative suit involves the commencement by a shareholder of a corporate cause of action against persons who have allegedly wronged the corporation, where the corporation itself has failed to enforce the claims directly. This would include suits against corporate officers, directors, or controlling shareholders. This type of action is brought based upon a primary right of the corporation, but is asserted by a shareholder on behalf of the corporation. Because the right to sue derivatively is not available under Chinese law, our shareholders may have to rely on other means to enforce the rights of shareholders, such as through administrative proceedings.

Our Articles of Association provide that all differences or claims

between a holder of H shares and us;

between a holder of H shares and any of our directors, supervisors, manager or other senior officers; or

between a holder of H shares and a holder of domestic shares,

involving any right or obligation provided in the Articles of Association, the Chinese Company Law or any other relevant law or administrative regulation which concerns our affairs must, with some exceptions, be referred to arbitration at either the China International Economic and Trade Arbitration Commission in China or the Hong Kong International Arbitration Center. Our Articles of Association also provide that the arbitration will be final and conclusive. On June 21, 1999, an arrangement was made between Hong Kong and China for the summary mutual enforcement of each other's arbitration awards in a manner consistent with the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards and pre-handover practice. This new arrangement was approved by the Supreme Court of China and the Hong Kong Legislative Council, and became effective on February 1, 2000.

All of our directors and officers reside outside the United States (principally in China) and substantially all of our assets and of those persons are located outside the United States. Therefore, you may not be able to effect service of process within the United States against any of those persons. In addition, China does not have treaties providing for the reciprocal recognition and enforcement of judgments of courts within the United States or most other countries that are members of the Organization for Economic Cooperation and Development. This means that administrative actions brought by regulatory authorities such as the Securities and Exchange Commission, and other actions which result in foreign court judgments could only be enforced in China if the judgments or rulings do not violate the basic principles of the law of China or the sovereignty, security and social public interest of the society of China, as determined by a People's Court of China which has jurisdiction for recognition and enforcement of judgments. We have been advised by our Chinese counsel, Haiwen & Partners, that there is doubt as to the enforceability in China of any actions to enforce judgments of United States courts arising out of or based on the ownership of our H shares or ADSs, including judgments arising out of or based on the civil liability provisions of United States federal or state securities laws.

## **Restrictions on Transferability and the Share Register**

All fully paid up H shares will be freely transferable in accordance with the Articles of Association unless otherwise prescribed by law and/or administrative regulations. Under current laws and regulations, H shares may be traded only among investors who are not Chinese persons, and may not be sold to Chinese investors. Consequences under Chinese law of a purported transfer of H shares to Chinese investors are unclear.





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As provided in our Articles of Association, we may refuse to register a transfer of H shares without providing any reason unless:

any relevant transfer fee and stamp duty is paid;

the instrument of transfer is accompanied by the share certificates to which it relates and any other evidence reasonably required by our board to prove the transferor's right to make the transfer;

there are no more than four joint holders as transferees; and

the H shares are free from any lien of ours.

Additionally, no transfers of shares may be registered within the 30 days prior to a shareholders' general meeting or within five days before we decide on the distribution of dividends.

We are required to keep a register of our shareholders which shall be comprised of various parts, including one part which is to be maintained in Hong Kong in relation to H shares listed on the HKSE. Shareholders have the right to inspect the share register. For a reasonable fee, shareholders may copy any part of the share register, obtain background information regarding our directors, supervisors, manager and other senior officers, minutes of shareholder general meetings and reports regarding our share capital and any share repurchases in the prior year.

## **Dividends**

Our Articles of Association require the Company to distribute dividends annually in the second quarter of the year following that in which the Company made the profits from which the dividend is paid. The Articles of Association allow for distribution of dividends in the form of cash or shares. A distribution of shares, however, must be approved by special resolution of the shareholders.

Dividends may only be distributed, however, after allowance has been made for:

recovery of losses, if any;

allocations to the statutory common reserve fund;

allocations to the statutory public welfare fund;

payment of dividends on any preference shares we issue in the future; and

allocations to a discretionary common reserve fund.

The Articles of Association require us to appoint on behalf of the holders of H shares a receiving agent which is registered as a trust corporation under the Trustee Ordinance of Hong Kong to receive dividends we declare in respect of the H shares on behalf of the H shareholders. The Articles of Association require that cash dividends and other distributions in respect of H shares be declared in Renminbi and paid by us in Hong Kong dollars while cash dividends and other distributions of the domestic shares shall be paid in Renminbi.

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If we record no profit for the year, we may not normally distribute dividends for the year.

Dividend payments may be subject to Chinese withholding tax. See [Item 10. Additional Information](#) Taxation.

## **Voting Rights and Shareholders Meetings**

Our board of directors must convene a shareholders annual general meeting once every year within six months from the end of the preceding financial year. Our board must convene an extraordinary general meeting within two months of the occurrence of any one of the following events:

where the number of directors is less than 10, two-thirds of the number specified in our Articles of Association;

if the number of directors is less than five, a number stipulated in the Chinese Company Law;

where our unrecovered losses reach one-third of the total amount of our share capital;

where shareholder(s) holding 10% or more of our issued and outstanding voting shares request(s) in writing; or

whenever our board deems necessary or our Supervisory Committee so request.

Meetings of a special class of shareholders must be called in specified situations when the rights of the holders of that class of shares may be varied or abrogated, as discussed below. Resolutions proposed by our Supervisory Committee or shareholder(s) holding 5% or more of the total number of voting shares shall be included in the agenda for the relevant annual general meeting if they are matters which fall within the scope of the functions and powers of shareholders in general meeting.

All shareholders meetings must be convened by our board by notice given to shareholders by personal service, mail or announcement in the newspaper not less than 45 days before the meeting. Based on the written replies we receive 20 days before a shareholders meeting, we will calculate the number of voting shares represented by shareholders who have indicated that they intend to attend the meeting. We can convene the shareholders general meeting if the number of voting shares represented by those shareholders is more than one-half of our total voting shares, regardless of the number of shareholders who actually attend the meeting. Otherwise, we shall, within five days, inform the shareholders again of the motions to be considered and the date and venue of the meeting by way of public announcement. After the announcement is made, the shareholders meeting may be convened. Our accidental omission to give notice of a meeting to, or the non-receipt of notice of a meeting by, a shareholder will not invalidate the proceedings at that shareholders meeting. However, an extraordinary shareholders meeting cannot conduct any business not contained in the notice of meeting.

Shareholders at meetings have the power, among other things, to decide on our operational policies and investment plans, to approve or reject our proposed annual budget, approve or reject our profit distribution plans, an increase or decrease in share capital, the issuance of debentures, our merger or liquidation and any amendment to our Articles of Association. Shareholders also have the right to review any proposals by a

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shareholder owning 5% or more of our shares. In general, holders of H shares and domestic shares vote together as a single class at all meetings and on all matters. However, the rights of a class of shareholders may not be varied or abrogated, unless approved by both a special resolution of all shareholders at a general shareholders meeting and by a special resolution of shareholders of that class of shares at a separate meeting. Our Articles of Association specify, without limitation, that the following amendments would be deemed to be a variation or abrogation of the rights of a class of shareholders:

increasing or decreasing the number of shares of a class or of a class having voting or distribution rights or privileges equal or superior to that class;

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removing or reducing rights to receive dividends in a particular currency;

creating shares with voting or distribution rights superior to shares of that class;

restricting or adding restrictions to the transfer of ownership of shares of that class;

allotting and issuing rights to subscribe for, or to convert into, shares of that class or another class;

increasing the rights or privileges of any other class; or

modifying the provision of our Articles of Association that specifies which amendments would be deemed a variation or abrogation of the rights of a class of shareholder.

For votes on any of these matters, or any other matter that would vary or abrogate the rights of the domestic shares or H shares, the holders of domestic shares and H shares are deemed to be separate classes and vote separately. However, Interested Shareholders are not entitled to vote at class meetings. The meaning of Interested Shareholder depends on the proposal to be voted on at the class meeting:

If the proposal is for us to repurchase our shares either from all shareholders proportionately or by purchasing share on a stock exchange, an Interested Shareholder is our controlling shareholder;

If the proposal is for us to repurchase our shares from a shareholder by a private contract, an Interested Shareholder is the shareholder whose shares would be repurchased;

If the proposal is for our restructuring, an Interested Shareholder is any shareholder that has an interest in the restructuring different from the other shareholders of the class or who bears a burden under the proposed restructuring that is less than proportionate to his shareholdings of the class.

Our Articles of Association specifically provide that an issue of up to 20% of domestic and H shares would not be a variation or abrogation of the rights of domestic shareholders or H shareholders, therefore, separate approval of the domestic shareholders or H Shareholders would not be required.

Each share is entitled to one vote on all matters submitted to a vote of our shareholders at all shareholders meetings, except for meetings of a special class of shareholders where only holders of shares of the affected class are entitled to vote on the basis of one vote per share of the affected class.

Shareholders are entitled to attend and vote at meetings either in person or by proxy. Proxies must be in writing and deposited at our residence, or any other place specified in the meeting notice, not less than 24 hours before the time for holding the meeting at which the proxy proposes to vote or the time appointed for the passing of the relevant resolution(s). When the instrument appointing a proxy is executed by the shareholder's attorney-in-fact, the proxy when deposited must be accompanied by a notarially certified copy of the relevant power of attorney or other authority under which the proxy was executed.



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Except for those actions discussed below, which require supermajority votes, or special resolutions, resolutions of the shareholders are passed by a simple majority of the voting shares held by shareholders who are present in person or by proxy. Special resolutions must be passed by more than two-thirds of the voting rights represented by shareholders who are present in person or by proxy.

The following decisions must be adopted by special resolution:

an increase or reduction of our share capital or the issue of shares of any class, warrants and other similar securities;

the issue of our debentures;

our division, merger, dissolution and liquidation;

amendments to our Articles of Association; and

any other matters considered by the shareholders in a general meeting and which they have resolved by way of an ordinary resolution to be material and should be adopted by special resolution.

All other actions taken by the shareholders, including the appointment and removal of our directors and independent auditors and the declaration of normal dividend payments, will be decided by an ordinary resolution of the shareholders.

Our listing agreement with the HKSE provides that we may not permit amendments to certain sections of our Articles of Association that are subject to the Mandatory Provisions. These sections include provisions relating to (i) varying the rights of existing classes of shares, (ii) voting rights, (iii) our ability to purchase our own shares, (iv) rights of minority shareholders and (v) procedures on liquidation. In addition, certain amendments to the Articles of Association require the approval and assent of Chinese authorities.

## **Board of Directors**

Our Articles of Association authorize up to 19 directors. Directors are elected by shareholders at a general meeting for a three year term from among candidates nominated by the board of directors or by shareholders holding 5% or more of our shares. Because our directors do not serve staggered terms, the entire board of directors will stand for election, and could be replaced, every three years.

In addition to obligations imposed by laws, administrative regulations or the listing rules of the stock exchanges on which our shares are listed, the Articles of Association place on each of our directors, supervisors, manager and any other senior officers a duty to each shareholder, in the exercise of our functions and powers entrusted to them:



not to cause us to exceed the scope of business stipulated in our business license;

to act honestly in what he considers our best interests;

not to expropriate our assets in any way, including (without limitation) usurpation of opportunities which may benefit us; and

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not to expropriate the individual rights of shareholders, including (without limitation) rights to distributions and voting rights, except according to a restructuring which has been submitted to the shareholders for their approval in accordance with the Articles of Association.

Our Articles of Association further place on each of our directors, supervisors, manager and other senior officers:

a duty, in the exercise of their powers and discharge of their duties, to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances;

a fiduciary obligation, in the discharge of his duties, not to place himself or herself in a position where his or her interests may conflict with his or her duty to us; and

a duty not to cause a person or an organization related or connected to him or her in specified relationships to do what they are prohibited from doing.

We pay all expenses that our directors incur for their services as directors. Directors also receive compensation for their services under service contracts that are negotiated by the supervisory committee and approved by the shareholders.

Subject to the stipulations of relevant laws and regulations, the shareholders in a general meeting may by ordinary resolution remove any director before the expiration of his term of office. Except for the restrictions placed on controlling shareholders, discussed below, our shareholders in general meeting have the power to relieve a director, supervisor, manager or senior officer from liability for specific breaches of duty.

Cumulative voting is required for election of our directors as long as more than 30% of our outstanding shares are held by a single shareholder. Cumulative voting allows shareholders to cast a number of votes for a candidate equal to the number of shares held times the number of directors being elected at the shareholders' meeting. If a shareholder attempts to cast more votes than he is entitled to under this system, all of the shareholder's votes will be invalid and will be deemed an abstention.

More than one third of our directors of board must be independent from our shareholders and not hold any office with us (each, "Independent Director"). At least one Independent Director must be an accounting professional and all Independent Directors must possess a basic knowledge of the operations of a listed company and be familiar with relevant laws and rules and have at least five years working experience in law, economics or other area required for the fulfillment of responsibilities as an Independent Director. Independent Directors may not serve for terms exceeding six years. In addition, there are specific persons who are disqualified from acting as Independent Director. These include:

immediate family of persons who work for us or our associated entities;

persons or their immediate family who hold one percent or more of our shares or are among our ten largest shareholders;

any persons that satisfied the foregoing conditions within the past one year;

persons providing financial, legal, consultation or other services to us or our associated entities;

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persons who already serve as Independent Director for five other listed companies; and

anyone designated by the China Securities Regulatory Commission.

If the resignation of an Independent Director would cause our Board of Directors to have less than one third Independent Directors, the resignation will only become effective after a new Independent Director has been appointed.

Our Board will be required to meet at least four times each year. Directors who miss two consecutive Board meetings without appointing an alternate director to attend on their behalf will be proposed for removal at the next shareholders' meeting, provided that Independent Directors may miss three consecutive meetings before being proposed for removal. Otherwise, Independent Directors cannot be removed without cause.

Directors may not vote on any matter in which he has a material interest, nor will he be counted for purposes of forming a quorum on such a matter.

Board resolutions are passed by a simple majority of the Directors except for the following matters which require the consent of more than two thirds of the Directors:

proposals for our financial policies;

the increase or reduction of our registered capital;

the issue of securities of any kind and their listing;

any repurchase of our shares;

significant acquisition or disposals;

our merger, division or dissolution; and

any amendment to our Articles of Association.

Our Board of Directors or Supervisory Committee may nominate candidates for our Board of Directors and Supervisory Committee. In addition, shareholders holding one percent or more of our shares have the right to nominate candidates for Independent Director or Independent Supervisor and shareholders holding five percent or more of our shares have the right to nominate other candidates for Director or Supervisor. For Director candidates, the nominator and candidate will be responsible for providing truthful and complete information about the candidate for disclosure. Candidates for Independent Director must publicly declare that there does not exist any relationship between himself and us that may influence his independent, objective judgment. The China Securities Regulatory Commission may veto any candidate for Independent Director.

Our Independent Directors must approve any connected transactions. Connected transactions are those defined by the HKSE and by Chinese rules and regulations, but would generally include transactions with any of the following:

any company that, directly or indirectly, controls us or is under common control with us;

any shareholders owning 5% or more of our shares;

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our directors, supervisors and other senior management;

any of our key technical personnel or key technology suppliers; and

any close relative or associate of any of the above.

Our independent directors can also propose to the Board of Directors the appointment or removal of our auditors, the convening of a Board meeting, independently appoint external auditors, solicit votes from shareholders and report circumstances directly to shareholders, Chinese securities regulatory authorities or other government departments. Two or more may request that the Board convene an extraordinary meeting of shareholders.

Our Independent Directors will have to express their opinion on specified matters to the Board or to the shareholders at a shareholders meeting, either by a single unanimous statement or individually. These matters are:

the nomination, removal and remuneration of directors or senior management;

any major loans or financial transactions with our shareholders or related enterprises and whether we have taken adequate steps to ensure repayment;

matters that the Independent Director believes may harm the rights and interests of minority shareholders; and

any other matter that they are required to opine on by applicable law or rules.

These opinions must be expressed as either, agree, qualified agreement, opposition or unable to form an opinion. All but agreement must also be accompanied by a supporting explanation. If public disclosure of the matter is required, we must also disclose the opinions of our Independent Directors.

Any Independent Director may engage independent institutions to provide independent opinions as the basis of their decision. We must arrange the engagement and bear any costs.

## **Supervisory Committee**

The Supervisory Committee exists to supervise our directors and our senior officers to prevent them from abusing their positions and powers or infringing our rights and interests or those of our shareholders or employees. The Supervisory Committee has no power over the decisions or actions of our directors or officers except to compel them to correct any act harmful to our interests. The Supervisory Committee is currently composed of seven members appointed for a three year term. It has the right to:

attend meetings of our board of directors;

inspect our financial affairs;

supervise our directors, general manager and other senior officers in order see whether they violate any laws, regulations or the Articles of Association in performing their duties;

require our directors, general manager or other senior officers to correct any act harmful to our interests;

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verify financial reports, accounting reports, business reports, profit distribution plans and other financial information proposed to be tabled at the shareholders' general meeting;

require the board of directors to convene an extraordinary general meeting of shareholders;

represent us in negotiations with directors or in initiating legal proceedings against a director on our behalf; and

any other matters authorized by the Articles of Association.

Our Supervisory Committee must include two employee representatives appointed by our employees. The remaining members are appointed by the shareholders in a general meeting, provided that our directors, general manager and senior officers are not eligible to serve as supervisors. The Supervisory Committee must meet at least once a year. Decisions of the Supervisory Committee must be made by a two-thirds vote. We will pay all reasonable expenses incurred by the Supervisory Committee in appointing professional advisors, such as lawyers, accountants or auditors.

### **Liquidation Rights**

In the event of our liquidation, payment of debts out of our remaining assets will be made in the order of priority prescribed by applicable laws and regulations. After payment of debts, we will distribute the remaining property to shareholders according to the class and proportion of their shareholdings. For this purpose, the H shares will rank equally with the domestic shares.

### **Liability of Shareholders**

Shareholders are not liable to make any further contributions to our share capital other than as agreed by the subscriber of the relevant shares on subscription. This provision means that holders of ADRs will also not be liable to make further contributions to our share capital.

### **Duration**

We are organized as a joint stock limited company of indefinite duration.

### **Increase in Share Capital**

The Articles of Association require that approval by a resolution of the shareholders be obtained prior to issuing new shares. New issues of shares must also be approved by the relevant Chinese authorities.



### **Reduction of Share Capital and Purchase by Us of Our Shares**

We may reduce our registered share capital only upon obtaining the approval of the shareholders and, when applicable, relevant Chinese authorities. Repurchases may be made either by way of a general offer to all shareholders in proportion to their shareholdings, by purchasing our shares on a stock exchange or by an off-market contract with individual shareholders.

### **Restrictions on Large or Controlling Shareholders**

Our Articles of Association provide that, in addition to any obligation imposed by laws and administrative regulations or required by the listing rules of the stock exchanges on which our shares are listed, a controlling shareholder cannot exercise voting rights in a manner prejudicial to the interests of the shareholders generally or of some part of the shareholders:

to relieve a director or supervisor from his or her duty to act honestly in our best interest;

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to approve the expropriation by a director or supervisor (for his or her own benefit or for the benefit of another person) of our assets in any way, including, without limitation, opportunities which may benefit us; or

to approve the expropriation by a director or supervisor (for his or her own benefit or for the benefit of another person) of the individual rights of other shareholders, including, without limitation, rights to distributions and voting rights (but not according to a restructuring of our company which has been submitted for approval by the shareholders in a general meeting in accordance with our Articles of Association).

A controlling shareholder, however, will not be precluded by our Articles of Association or any laws and administrative regulations or the listing rules of the stock exchanges on which our shares are listed from voting on these matters.

A controlling shareholder is defined by our Articles of Association as any person who, acting alone or together with others:

has the power to elect more than one-half of the board of directors;

has the power to exercise, or to control the exercise of, 30% or more of our voting rights;

holds 30% or more of our issued and outstanding shares; or

has *de facto* control of us in any other way.

## **Minutes, Accounts and Annual Report**

Our shareholders may inspect copies of the minutes of the shareholders' general meetings during our business hours free of charge. Shareholders are also entitled to receive copies of these minutes within seven days of receipt of the reasonable charges we may require.

Our fiscal year is the calendar year ending December 31. Each fiscal year, we must mail our financial report to shareholders not less than 21 days before the date of the shareholders' annual general meeting. These and any interim financial statements must be prepared in accordance with Chinese accounting standards and, for so long as H shares are listed on the HKSE, must also be prepared in accordance with or reconciled to either Hong Kong accounting standards or international accounting standards. The financial statements must be approved by an ordinary resolution of the shareholders at the annual general meeting.

Independent auditors are appointed each year by the shareholders at the annual meeting.

## ***C. Material Contracts.***

None.

***D. Exchange Controls.***

Our Articles of Association require that cash dividends on our H Shares be declared in Renminbi and paid in HK dollars. The Articles of Association further stipulate that such dividends must be converted to HK dollars at a rate equal to the average of the closing exchange rates for HK dollars as announced by the Chinese Foreign Exchange Trading Center for the calendar week preceding the date on which the dividends are declared.

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The Renminbi currently is not a freely convertible currency. The Chinese government imposes control over its foreign currency reserves in part through direct regulation of the conversion of Renminbi into foreign exchange, through control of foreign debts borrowed by domestic enterprises and through restrictions on foreign imports. The State Administration of Foreign Exchange (SAFE), under supervision of the People's Bank of China (PBOC), is responsible for matters relating to foreign exchange administration.

Foreign exchange transactions involving Renminbi must take place either through financial institutions authorized to undertake foreign exchange conversion transactions, such as Chinese state-owned or foreign banks. Access to foreign exchange, and the ability to remit foreign exchange abroad are regulated by Chinese government policies administered by the SAFE.

Effective January 1, 1994, a unitary, managed floating-rate system was introduced in China to replace the previous dual-track foreign exchange system consisting of two exchange rates. Under this system, the PBOC sets and publishes the PBOC Rate each day, with reference to the prior day's Renminbi-US dollar trading price on the national inter-bank foreign exchange market, called the China Foreign Exchange Trading System (CFETS). At present, certain State-designated banks, foreign banks and Chinese funded non-banking financial institutions, connected through a computer network, are the principal parties participating in the CFETS. The main function of the CFETS is to provide foreign exchange trading and settlement services among the participating members. Based on the PBOC Rate, each participating member sets its own exchange rate for the purpose of buying and selling foreign exchange from or to its customers. The CFETS is supervised and managed by the SAFE in accordance with PBOC policy.

As a result of the adoption of the unitary system, on January 1, 1994, the official exchange rate of approximately RMB5.8 to US\$1.00 was revalued to approximately RMB8.7 to US\$ 1.00. As part of the new system, the PBOC also publishes the Renminbi rate of exchange against other major currencies by reference to the price of the US dollar in international foreign exchange markets.

The Chinese government announced a policy in late December 1993 that, under the unitary system, the PBOC would try to balance the demand for and supply of foreign currencies in China and stabilize the Renminbi exchange rate mainly through macroeconomic measures, such as monetary policy and interest rates. Nonetheless, if necessary, government intervention is expected to be used to stabilize the PBOC Rate.

Domestic enterprises, which prior to 1994 had been permitted to retain a portion of their foreign currency earnings, are now required to sell all of their foreign currency earnings to State-designated banks at the rate used by the relevant CFETS member, which is based on the PBOC Rate, except for such items as the proceeds of foreign currency loans or the issuance of foreign currency-denominated bonds or shares. All international commercial loans borrowed by domestic enterprises have to be registered with the SAFE before the loans become effective. Under the new system, domestic enterprises and institutions are permitted to buy foreign exchange from State-designated banks at designated times upon presentation of appropriate documentation establishing the existence of import contracts or payment notes of overseas financial institutions. Such enterprises and institutions also are permitted under the new system to purchase foreign exchange for the import of certain products subject to quotas, import permits and registration controls. Domestic enterprises are permitted to apply to purchase foreign exchange for the payment of dividends that have been authorized as payable in foreign currency.

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Conversion and payment are to be effected on the basis of a written resolution on profit distribution passed by the enterprise's board of directors and evidence that the enterprise has paid all required Chinese taxes.

While the impact of the foregoing developments are not entirely clear, it appears that the trend in the Chinese government's foreign exchange policy is toward easier convertibility of the Renminbi.

The holders of the ADSs will receive the HK dollar dividend payments in US dollars at conversion rates related to market rates and subject to fees as set forth in our Deposit Agreement with The Bank of New York, as Depositary. Since October 17, 1983, the HK dollar has been linked to the US dollar at the rate of HK\$7.80 = US\$1.00, and the Hong Kong government has stated its intention to maintain the link at that rate, although there can be no guarantee that the link will be maintained.

### ***E. Taxation***

#### **PRC Taxation**

The following is a summary of those taxes, including withholding provisions, to which United States security holders are subject under existing Chinese laws and regulations. The summary is subject to changes in Chinese law, including changes that could have retroactive effect. The summary does not take into account or discuss the tax laws of any country other than China, nor does it take into account the individual circumstances of a security holder. This summary does not purport to be a complete technical analysis or an examination of all potential tax effects under such laws and regulations.

#### **Tax on Dividends**

##### ***For an Individual Investor***

According to the Individual Income Tax Law of the People's Republic of China of October 31, 1993, as amended (the Individual Income Tax Law) dividends paid by Chinese companies to foreign individuals not resident in China are ordinarily subject to Chinese withholding tax at a flat rate of 20%.

However, pursuant to the Notice Concerning the Taxation of Gains on Transfer and Dividends from Shares (Equities) Received by Foreign Investment Enterprises, Foreign Enterprises and Foreign Individuals (the Tax Notice), issued by the State Tax Bureau (now the State Administration of Taxation or SAT) on July 21, 1993, dividends paid by Chinese companies, with respect to their shares listed on an overseas stock exchange (Overseas Shares), such as H Shares (including H Shares represented by ADSs), or on domestically-listed foreign invested shares (B Shares), to foreign individuals not resident in China, are temporarily exempt from Chinese withholding tax. The Tax Notice remains in force and the relevant tax authority has thus far not collected withholding tax on dividends paid by Chinese companies, with respect to their Overseas Shares and B Shares, to foreign individuals not resident in China.

In the event that the Tax Notice is withdrawn, a 20% withholding tax may be imposed in accordance with the Individual Income Tax Law and the Rate Reduction Notice, subject to reduction by an applicable income tax treaty.

*For a Corporation*

According to the Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises of April 9, 1991, as amended (the Foreign Corporate Income Tax Law), dividends paid by Chinese companies to foreign corporations are ordinarily subject to Chinese withholding tax at a flat rate of 20%.

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However, pursuant to the Tax Notice, dividends paid by Chinese companies, with respect to their Overseas Shares and B Shares, to foreign corporations are temporarily exempt from Chinese withholding tax. Again, the Tax Notice remains in force and the relevant tax authority has thus far not collected withholding tax on dividends paid by Chinese companies, on their Overseas Shares and B Shares, to foreign corporations.

In the event that the Tax Notice is withdrawn, a 20% withholding tax may be imposed in accordance with the Foreign Corporate Income Tax Law and the Rate Reduction Notice, subject to reduction by an applicable income tax treaty.

## Capital Gains Tax

According to the Individual Income Tax Law, the Foreign Corporate Income Tax Law, their respective implementing regulations, and the Notice on Questions Relating to Reduced Income Tax on Foreign Enterprise Income in China from Interest, etc., issued by the State Council on November 18, 2000 (the Rate Reduction Notice), capital gains recognized by foreign individuals not resident in China and foreign corporations, with respect to their sale of equity shares of Chinese companies, are ordinarily subject to Chinese tax, purportedly in the form of withholding tax, at a flat rate of 20% and 10% respectively.

However, pursuant to the Tax Notice, capital gains recognized by foreign individuals not resident in China and foreign corporations, with respect to their sale of Overseas Shares and B Shares are temporarily exempt from Chinese tax. As discussed above, the Tax Notice remains in force and the relevant tax authority has thus far not sought to collect Chinese tax on capital gains recognized by foreign individuals not resident in China and foreign corporations with respect to their sale of Overseas Shares and B Shares.

In the event that the Tax Notice is withdrawn, Chinese tax, at a rate of 20% for individuals or 10% for corporations may be imposed in accordance with the Individual Income Tax Law, the Corporate Income Tax Law, their respective implementing regulations and the Rate Reduction Notice, subject to reduction by an applicable income tax treaty.

## Tax Treaties

China has an income tax treaty with the United States that currently limits the rate of Chinese withholding tax to 10% for dividends we pay to individuals and corporations that qualify for treaty protection. However, this treaty does not offer protection for capital gains. Since the Tax Notice remains in force to temporarily exempt dividends and capital gains from the Chinese taxes described above, this treaty is not relevant at this time.

## Stamp Tax

Chinese stamp tax is not applicable to the acquisition or disposition of shares in a Chinese company made outside of China pursuant to the Provisional Regulations of the People's Republic of China Concerning Stamp Tax effective on July 1, 1989.

Estate or Gift Tax

China does not currently impose any estate or gift tax.



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### **U.S. Taxation**

The following is a summary of United States federal income tax considerations that are relevant to US Holders (as defined below) who hold H shares or ADSs. This summary is based upon existing United States federal income tax law, which is subject to change, possibly with retroactive effect. This summary does not discuss all aspects of United States federal income taxation that may be important to particular US Holders in light of their individual investment circumstances, such as investors subject to special tax rules, including: financial institutions, insurance companies, broker-dealers, tax-exempt organizations, partnerships and other flow-through entities, and, except as described below, non-US Holders, or to persons that hold H shares or ADSs as part of a straddle, hedge, conversion, or constructive sale transaction for United States federal income tax purposes or that have a functional currency other than the United States dollar, all of whom may be subject to tax rules that differ significantly from those summarized below. In addition, this summary does not discuss any estate, gift, foreign, state, or local tax considerations. This summary assumes that US Holders hold their H shares or ADSs as capital assets (generally, property held for investment) under the United States Internal Revenue Code.

In general, for US federal income tax purposes and for purposes of the income tax treaty between China and the United States, beneficial owners of ADSs will be treated as the beneficial owners of the H shares represented by those ADSs. Accordingly, no gain or loss will be recognized upon the exchange of an ADS for the holder's proportionate interest in the H shares. A US Holder's tax basis in the withdrawn H shares will be the same as the tax basis in the ADSs surrendered therefore, and the holding period in the withdrawn H shares will include the period during which the holder held the surrendered ADSs.

For purposes of this summary, a US Holder is a beneficial owner of H shares or ADSs that is for United States federal income tax purposes:

An individual who is a citizen or resident of the United States;

A corporation or other entity treated as a corporation that is created in or organized under the laws of the United States or any State or political subdivision thereof;

An estate the income of which is includible in gross income for United States federal income tax purposes regardless of its source;

A trust the administration of which is subject to the primary supervision of a United States court and which has one or more United States persons who have the authority to control all substantial decisions of the trust;

A trust that was in existence on August 20, 1996, was treated as a United States person for United States federal income tax purposes on the previous day, and elected to continue to be so treated; or

A person otherwise subject to US federal income tax on its worldwide income.

The treatment of a partner of a partnership (or of an entity treated as a partnership for US federal income tax purposes) as a US Holder may depend upon the status of the partner as a US Holder (irrespective of the status of the partnership) and upon the nature and activities of the partnership. Partners of partnerships (or of entities treated as partnerships for US federal income tax purposes) holding H shares or ADSs should consult their tax advisors as to the tax consequences of purchasing, owning or disposing of such H shares or ADSs.

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A beneficial owner of H shares or ADSs that is not a US Holder is referred to herein as a Non-US Holder. Except as specifically addressed below, this discussion does not address any tax consequences to Non-US Holders of the ownership or disposition of the H shares or ADSs. Non-US Holders should consult their own tax advisors with respect to the tax consequences to them of owning and disposing of the H shares and ADSs.

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A foreign corporation will be treated as a passive foreign investment company (a PFIC), for United States federal income tax purposes, if 75% or more of its gross income consists of certain types of passive income or 50% or more of its assets are passive. We presently believe that we are not a PFIC and do not anticipate becoming a PFIC. This is, however, a factual determination made on an annual basis and is subject to change. The following discussion assumes that we will not be subject to treatment as a PFIC for United States federal income tax purposes.

### Taxation of Dividends

For US federal income tax purposes, the gross amount of a distribution in respect of H shares or ADSs owned by a US Holder, including any amounts of Chinese tax withheld on the distribution, will be treated as dividend income to such US Holder to the extent paid out of current or accumulated earnings and profits, as determined for US federal income tax purposes. That dividend income will not be eligible for the dividends received deduction generally allowed to corporations under Section 243 of the US Code. To the extent the distribution exceeds the US Holder's allocable share of current and accumulated earnings and profits, the excess will be applied first to reduce the US Holder's basis in his or her H shares or ADSs, and any remaining excess would constitute gain from the deemed sale or exchange of such H shares or ADSs. See Sale or Other Disposition of H shares or ADSs below.

Dividends paid in Hong Kong dollars will be included in the income of a US Holder in a US dollar amount calculated by reference to the exchange rate in effect on the date of receipt thereof by the depository, in the case of ADSs, or by the US Holder, in the case of H shares held directly by such US Holder, regardless of whether the payment is in fact converted into US dollars. If the dividends paid in Hong Kong dollars are converted into US dollars on the date of receipt by the depository, in the case of ADSs, or by the US Holder, in the case of H shares held directly by such US Holder, US Holders generally should not be required to recognize foreign currency gain or loss in respect of the dividend income. In the case of dividends paid in Hong Kong dollars that are not converted into US dollars on the date of receipt, the amount of Hong Kong dollars received will have a tax basis equal to their US dollar value at the time of receipt, and any gain or loss realized upon a subsequent conversion or other disposition of the Hong Kong dollar amount will be treated as ordinary income or loss from sources within the United States.

Dividends received on H shares or ADSs will be treated, for US federal income tax purposes, as foreign source income. A US Holder may be eligible, subject to a number of complex limitations, to claim a foreign tax credit in respect of any Chinese withholding taxes imposed on such dividends. US Holders who do not elect to claim a foreign tax credit for foreign income tax withheld may instead claim a deduction, for United States federal income tax purposes, in respect of such withholdings, but only for a year in which the US Holder elects to do so for all creditable foreign income taxes. As discussed in Chinese Taxation - Tax on Dividends, no Chinese withholding tax currently is imposed in respect of dividends on the H shares and ADSs, although Chinese withholding taxes could be imposed in the future.

### Sale or Other Disposition of H shares or ADSs

A US Holder will recognize capital gain or loss upon the sale or other disposition of H shares or ADSs in an amount equal to the difference between the amount realized upon the disposition and the US Holder's adjusted tax basis in such H shares or ADSs, as each is determined in US dollars. Any capital gain or loss will be long-term if the H shares or ADSs have been held for more than one year and will generally be United States source gain or loss. The claim of a deduction in respect of a capital loss, for United States federal income tax purposes, may be subject to limitations.

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### **Backup Withholding**

Proceeds from the sale of, and dividends on, the ADSs or H shares paid within the United States or through certain US-related financial intermediaries are subject to information reporting and may be subject to backup withholding at the rate of 28% unless the US Holder (1) is a corporation or other exempt recipient or (2) provides a taxpayer identification number and certifies that no loss of exemption from backup withholding has occurred. Any amount withheld from a payment to a US Holder under the backup withholding rules will be allowable as a credit against such US Holder's US federal income tax liability, provided that the required information is furnished to the US Internal Revenue Service.

US Holders should consult their own tax advisor as to the application of the US federal information reporting and backup withholding requirements to them and their qualification, if any, for an exemption under these rules.

### **Non-US Holders**

An investment in H shares or ADSs by a Non-US Holder will not give rise to any US federal income tax consequences unless:

the dividends received or gain recognized on the sale of H shares or ADSs by such person is treated as effectively connected with the conduct of a trade or business by such person in the United States as determined under United States federal income tax law; or

in the case of gains recognized on a sale of H shares or ADSs by an individual, such individual is present in the United States for 183 days or more and certain other conditions are met.

In order to avoid backup withholding on dividend payments made in the United States, a Non-US Holder of the H shares or ADSs may be required to complete, and provide the payer with, an Internal Revenue Service Form W-8BEN, or other documentary evidence, certifying that such holder is an exempt foreign person.

This discussion, which does not address any aspects of US taxation other than US federal income taxation relevant to US Holders of Sinopec Shanghai Petrochemical Company Limited H shares or ADRs, is of a general nature only and is not intended to be and should not be constructed to be, legal or tax advice to any US Holder and no representation with respect to those tax consequences to any particular US Holder is made. DUE TO THE INDIVIDUAL NATURE OF TAX CONSEQUENCES, US HOLDERS ARE URGED TO CONSULT THEIR OWN TAX ADVISORS WITH RESPECT TO THE PARTICULAR TAX CONSEQUENCES TO THEM OF OWNING AND DISPOSING OF H SHARES AND ADSs, INCLUDING THE EFFECTS OF US FEDERAL, STATE, LOCAL, FOREIGN AND OTHER TAX CONSEQUENCES.

### ***F. Dividends and Paying Agents.***

Not applicable.

***G. Statement by Experts.***

Not applicable.

***H. Documents on Display.***

We are subject to the informational requirements of the Securities Exchange Act of 1934, as amended (the Exchange Act ). In accordance with these requirements, we file reports with and submit other information to the Securities and Exchange Commission. These materials, including this annual report and the exhibits hereto, may be inspected and copied at the Commission's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549 and at the Commission's regional office at The Woolworth Building, 233 Broadway, New York, NY 10279. Copies of the materials may be obtained from the Public Reference Room at prescribed rates. The public may obtain information on the operation of the Commission's Public Reference Room by calling the Commission in the United States at 1-800-SEC-0330. In addition, this information can be obtained from the web site of the Commission: <http://www.sec.gov>.

**Table of Contents****I. Subsidiary Information.**

Not applicable.

**ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.****Interest Rate Sensitivity**

We are subject to risk resulting from fluctuations in interest rates. Our debts are fixed and variable rate bank and other loans, with original maturities ranging from 1 to 13 years. Accordingly, fluctuations in interest rates can lead to significant fluctuations in the fair value of such debt instruments. We have no program of interest rate hedging activities and did not engage in any of such activities in 2004.

The following table provides information, by maturity date, regarding our interest rate sensitive financial instruments, which consist of fixed and variable rate short-term and long-term debt obligations, as of December 31, 2004 and 2003.

**As of December 31, 2004**

	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2009 Thereafter</b>	<b>Total Recorded Amount</b>	<b>Fair Value</b>
(RMB equivalent in thousands, except interest rates)								
<b>Fixed rate bank and other loans</b>								
In U.S. Dollars	14,899	14,899	14,899	7,737			52,434	48,048
Average interest rate	1.80%	1.80%	1.80%	1.80%			1.80%	
<b>Variable rate bank and other loans</b>								
In U.S. Dollars	2,735,227		416,402				3,151,629	3,151,629
Average interest rate <sup>(1)</sup>	3.61%		3.61%				3.61%	
In RMB	2,217,500	1,390,000	24,500				3,632,000	3,612,580
Average interest rate <sup>(1)</sup>	5.06%	5.20%	5.58%				5.11%	

**As of December 31, 2003**

	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2008 Thereafter</b>	<b>Total Recorded Amount</b>	<b>Fair Value</b>
(RMB equivalent in thousands, except interest rates)								
<b>Fixed rate bank and other loans</b>								
In U.S. Dollars	52,644	14,673	14,673	14,673	12,929		109,592	107,102
Average interest rate	4.74%	1.50%	1.50%	1.50%	1.50%		3.06%	

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In Japanese Yen	23,188				23,188	24,472
Average interest rate	5.70%				5.70%	
Variable rate bank and other loans						
In U.S. Dollars	3,226,740				3,226,740	3,226,740
Average interest rate <sup>(1)</sup>	1.81%				1.81%	
In RMB	2,189,100	1,760,000	1,220,000	24,500	5,193,600	5,193,600
Average interest rate <sup>(1)</sup>	4.97%	5.09%	5.24%	5.58%	5.07%	

(1) The average interest rates for variable rate bank and other loans are calculated based on the year end indices.

**Table of Contents****Exchange Rate Sensitivity**

We are also exposed to foreign exchange rate risk as a result of its foreign currency denominated long-term debt and, to a limited extent, cash and cash equivalents denominated in foreign currencies. We have no program of foreign currency hedging activities and engaged no foreign currency hedging activities in 2004 and 2003.

The following table provides information, by maturity date, regarding our foreign exchange rate sensitive financial instruments, which consist of cash and cash equivalents, short-term and long-term debt obligations as of December 31, 2004 and 2003.

As of December 31, 2004								
	2005	2006	2007	2008	2009	2009 Thereafter	Total Recorded Amount	Fair Value
(RMB equivalent in thousands, except interest rates)								
<b>On-balance sheet financial instruments</b>								
<b>Cash and cash equivalents:</b>								
In Hong Kong Dollars	39,656						39,656	39,656
In U.S. Dollars	118,173						118,173	118,173
In Swiss Francs	944						944	944
In Euro	1,181						1,181	1,181
In Japanese Yen	37						37	37
<b>Debt:</b>								
<b>Fixed rate bank and other loans</b>								
In U.S. Dollars	14,899	14,899	14,899	7,738			52,435	48,048
Average interest rate	1.80%	1.80%	1.80%	1.80%			1.80%	
<b>Variable rate bank and other loans</b>								
In U.S. Dollars	2,554,805		416,402				2,971,207	2,971,207
Average interest rate <sup>(1)</sup>	3.61%		3.61%				3.61%	
<b>Interest free bank and other loans</b>								
In U.S. Dollars	2,979	2,980	2,980	2,980	2,980	5,959	20,858	20,858
As of December 31, 2003								
	2004	2005	2006	2007	2008	2008 Thereafter	Total Recorded Amount	Fair Value
(RMB equivalent in thousands, except interest rates)								
<b>On-balance sheet financial instruments</b>								
<b>Cash and cash equivalents:</b>								
In Hong Kong Dollars	36,624						36,624	36,624
In U.S. Dollars	55,700						55,700	55,700
In Swiss Francs	861						861	861
<b>Debt:</b>								



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<b>Fixed rate bank and other loans</b>							
In U.S. Dollars	52,644	14,673	14,673	14,673	12,929	109,592	107,102
Average interest rate	4.74%	1.50%	1.50%	1.50%	1.50%	3.06%	
In Japanese Yen	23,188					23,188	24,472
Average interest rate	5.70%					5.70%	
<b>Variable rate bank and other loans</b>							
In U.S. Dollars	3,201,723					3,201,723	3,201,723
Average interest rate <sup>(1)</sup>	1.81%					1.81%	
<b>Interest free bank and other loans</b>							
In U.S. Dollars	4,137					4,137	4,137

(1) The average interest rates for variable rate bank and other loans are calculated based on the year end indices.

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**ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES.**

Not applicable.

**PART II**

**ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES.**

None.

**ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS.**

None.

**ITEM 15. CONTROLS AND PROCEDURES**

*A. Evaluation of disclosure controls and procedures.*

The term *disclosure controls and procedures* is defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act. These rules refer to the controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files under the Exchange Act is recorded, processed, summarized and reported within required time periods. This includes controls and procedures designed to ensure that information required to be disclosed is accumulated and communicated to our management, including our principal executive officer or officers and principal financial officer or officers, to allow timely decisions regarding required disclosure.

We maintain a written policy adopted by our board of directors that governs the collection, coordination and disclosure of information to our shareholders, the public and to governmental and other regulatory bodies. All such disclosures are coordinated by the Secretary and subject to execution by either the Chairman of the Board or, for disclosures by our Supervisory Board, the Chairman of the Supervisory Board. Under the policy, all material issues must be disclosed and our disclosures must be true, accurate, complete and timely without any false or misleading statements. Each of our departments and subsidiaries have their own supplemental policies which may be both written and unwritten.

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Our chief executive officer and our chief financial officer have evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report (the Evaluation Date ), and they have concluded that, as of the Evaluation Date, such controls and procedures were effective at ensuring that required information will be disclosed on a timely basis in our reports filed under the Exchange Act.

Subsequent to the date of the evaluation described above, we have not made any significant changes, including corrective actions with regard to significant deficiencies or material weaknesses, in our internal controls or in other factors that could significantly affect these controls.

Although we believe our existing disclosure controls and procedures are adequate to enable us to comply with our disclosure obligations, we do not expect that our disclosure controls and procedures or our other internal controls can prevent all error and all fraud or that our evaluation of these controls and procedures can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. The benefits of controls and procedures must be considered relative to their costs, and the design of any system of controls is based in part upon assumptions about the likelihood of future events. There can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls and procedures may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of these and other inherent limitations in controls and procedures, misstatements or omissions due to error or fraud may occur and not be detected. In part to mitigate this risk, we plan to further refine our controls and procedures in light of developing practice in this area and emerging standards and mandatory rules.

### ***B. Changes in internal controls.***

We maintain a system of internal accounting controls that are designed to provide reasonable assurance that our books and records accurately reflect our transactions and that our established policies and procedures are carefully followed. For the year ended December 31, 2004, there were no significant changes to our internal controls over financial reporting during the period covered by this annual report that has materially affected, or is reasonably likely to material affect, our internal control over financial reporting.

### **ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT**

We currently have an audit committee financial expert, Chen Xinyuan, serving on our audit committee and he is an independent director as defined in 17 CFR 240.10A-3.

### **ITEM 16B. CODE OF ETHICS**

We have not adopted a code of ethics as defined by the applicable U.S. securities regulations that applies to our principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions since it is not a customary practice for a PRC company to adopt such code of ethics.

### **ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The following table summarizes the fees charged by KPMG, our principal accountant, for certain services rendered to us during 2003 and 2004.

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	<b>For the year ended December 31,</b>	
	<b>(in thousands of US\$)</b>	
	<b>2003</b>	<b>2004</b>
Audit fees (1)	550	650
Audit-related fees (2)		
Tax fees (3)		
All other fees (4)		
<b>Total</b>	<b>550</b>	<b>650</b>

- (1) Audit fees means the aggregate fees billed in each of the fiscal years listed for professional services rendered by our principal auditors for the audit of our annual financial statements.
- (2) Audit-related fees means the aggregate fees billed in each of the fiscal years listed for assurance and related services rendered by our principal auditors for the audit of our financial information.
- (3) Tax fees means the aggregate fees billed in each of the fiscal years listed for professional services rendered by our principal auditors for tax compliance, tax advice and tax planning.
- (4) All other fees means the aggregate fees billed in each of the fiscal years listed for products and services provided by the our principal accountant, other than the services reported under audit fees, audit-related fees and tax fees.

**Audit Committee Pre-approval Policies and Procedures**

Our audit committee has adopted procedures which set forth the manner in which the committee will review and approve all audit and non-audit services to be provided by KPMG. The pre-approval procedures are as follows:

Any audit or non-audit service to be provided to us by the independent accountant must be (i) pre-approved by the audit committee; or (ii) pre-approved by one or several committee members designated by the committee and rectified by the audit committee.

**ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES.**

Not applicable.

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**ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS.**

None.

**PART III**

**ITEM 17. FINANCIAL STATEMENTS.**

We have elected to provide the financial statements and related information specified in Item 18 in lieu of the information called for by this Item 17.

**ITEM 18. FINANCIAL STATEMENTS.**

See pages F-1 to F-54 incorporated herein by reference.

**ITEM 19. EXHIBITS**

- 12.1 Certification of Chairman Required by Rule 13a-14(a)
- 12.2 Certification of Chief Financial Officer Required by Rule 13a-14(a)
- 13.1 Certification of Chairman Required by Rule 13a-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code
- 13.2 Certification of Chief Financial Officer Required by Rule 13a-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code

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**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Shareholders of

Sinopec Shanghai Petrochemical Company Limited:

We have audited the accompanying consolidated balance sheets of Sinopec Shanghai Petrochemical Company Limited and subsidiaries (the Group) as of December 31, 2003 and 2004, and the related consolidated statements of income, cash flows, and shareholders' equity for each of the years in the three-year period ended December 31, 2004, all expressed in Renminbi. These consolidated financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Sinopec Shanghai Petrochemical Company Limited and subsidiaries as of December 31, 2003 and 2004, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2004, in conformity with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

International Financial Reporting Standards vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature and effect of such differences is presented in Note 30 to the consolidated financial statements.

The accompanying consolidated financial statements as of and for the year ended December 31, 2004 have been translated into United States dollars solely for the convenience of the readers. We have audited the translation and, in our opinion, the consolidated financial statements expressed in Renminbi have been translated into United States dollars on the basis set forth in note 1 to the consolidated financial statements.

**KPMG**

Hong Kong, China

March 23, 2005





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## SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED

## AND SUBSIDIARIES

## Consolidated Balance Sheets

As of December 31, 2003 and 2004

(Amounts in thousands)

	Note	December 31,		
		2003 Renminbi	2004 Renminbi	2004 U.S. Dollars
<u>Assets</u>				
Current assets:				
Cash and cash equivalents		1,840,351	1,690,500	204,242
Time deposits with maturity over three months		165,885	4,000	483
Inventories	12	3,504,259	3,727,749	450,375
Amounts due from related companies	27	418,440	585,419	70,728
Trade debtors, net	13	472,117	395,353	47,765
Bills receivable		1,214,465	1,675,412	202,418
Other debtors and prepayments	14	406,521	535,222	64,664
Income tax recoverable		2,385	2,255	272
<b>Total current assets</b>		<b>8,024,423</b>	<b>8,615,910</b>	<b>1,040,947</b>
Non-current assets:				
Property, plant and equipment, net	15	16,020,104	15,206,325	1,837,178
Investment property	16		511,307	61,774
Construction in progress	17	385,373	807,477	97,557
Lease prepayments		540,882	526,956	63,665
Interests in associates	18	1,370,339	1,906,917	230,387
Investments	19	688,837	630,377	76,160
Deferred tax assets	9	35,660	48,917	5,910
Goodwill	20	35,863	22,415	2,708
<b>Total non-current assets</b>		<b>19,077,058</b>	<b>19,660,691</b>	<b>2,375,339</b>
<b>Total assets</b>		<b>27,101,481</b>	<b>28,276,601</b>	<b>3,416,286</b>
<u>Liabilities and Shareholders' Equity</u>				
Current liabilities:				
Bank loans	22	5,444,729	4,870,305	588,414
Loans from a related company	22	130,000	130,000	15,706

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Amounts due to related companies	27	780,222	639,445	77,256
Trade creditors		1,033,107	797,753	96,382
Bills payable		238,583	259,746	31,382
Accrued expenses and other creditors		776,449	663,635	80,178
Income tax payable		78,950	73,930	8,932
<b>Total current liabilities</b>		<b>8,482,040</b>	<b>7,434,814</b>	<b>898,250</b>
Non-current liabilities:				
Deferred income	21	49,467	37,100	4,482
Bank loans	22	3,206,848	2,014,614	243,399
<b>Total non-current liabilities</b>		<b>3,256,315</b>	<b>2,051,714</b>	<b>247,881</b>
<b>Total liabilities</b>		<b>11,738,355</b>	<b>9,486,528</b>	<b>1,146,131</b>
Minority interests		341,240	373,084	45,075
Shareholders' equity				
Share capital	23	7,200,000	7,200,000	869,880
Share premium and reserves	24	7,821,886	11,216,989	1,355,200
<b>Total shareholders' equity</b>		<b>15,021,886</b>	<b>18,416,989</b>	<b>2,225,080</b>
<b>Total liabilities and shareholders' equity</b>		<b>27,101,481</b>	<b>28,276,601</b>	<b>3,416,286</b>

See accompanying notes to consolidated financial statements.

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SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED  
AND SUBSIDIARIES

Consolidated Statements of Income

Years ended December 31, 2002, 2003 and 2004

(Amounts in thousands, except per share data)

	Note	Years ended December 31,			
		2002	2003	2004	2004
		Renminbi	Renminbi	Renminbi	U.S. Dollars
Sales	3	22,322,896	29,567,140	39,402,533	4,760,486
Less Business taxes and surcharges		(599,927)	(624,457)	(738,474)	(89,220)
<b>Net sales</b>		<b>21,722,969</b>	<b>28,942,683</b>	<b>38,664,059</b>	<b>4,671,266</b>
Cost of sales	4	(19,853,928)	(26,396,224)	(33,223,604)	(4,013,966)
		1,869,041	2,546,459	5,440,455	657,300
Selling and administrative expenses		(421,208)	(444,703)	(408,144)	(49,311)
		1,447,833	2,101,756	5,032,311	607,989
Other operating income	5	136,631	121,079	277,005	33,467
Other operating expenses	6	(154,835)	(216,432)	(284,164)	(34,332)
<b>Income from operations</b>		<b>1,429,629</b>	<b>2,006,403</b>	<b>5,025,152</b>	<b>607,124</b>
Share of profits/(losses) of associates		16,065	(24,017)	(36,915)	(4,460)
Net financing costs	8	(400,656)	(392,021)	(292,008)	(35,279)
<b>Income before income tax and minority interests</b>		<b>1,045,038</b>	<b>1,590,365</b>	<b>4,696,229</b>	<b>567,385</b>
Income tax	9	(84,494)	(145,065)	(637,061)	(76,968)
<b>Income before minority interests</b>		<b>960,544</b>	<b>1,445,300</b>	<b>4,059,168</b>	<b>490,417</b>
Minority interests		(44,179)	(43,610)	(88,065)	(10,640)

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Net income			916,365		1,401,690		3,971,103		479,777
Basic earnings per share	10	RMB	0.127	RMB	0.195	RMB	0.552	USD	0.067
Dividend attributable to the year	11		360,000		576,000		1,440,000		173,976

See accompanying notes to consolidated financial statements.

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## SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED

## AND SUBSIDIARIES

## Consolidated Statements of Cash Flows

For the years ended December 31, 2002, 2003 and 2004

(Amounts in thousands)

		Years ended December 31,			
		2002	2003	2004	2004
		Renminbi	Renminbi	Renminbi	U.S. Dollars
Cash generated from operations	(a)	2,348,821	2,796,993	5,591,615	675,561
Interest paid		(524,254)	(415,684)	(346,696)	(41,887)
Income tax paid		(50,344)	(147,352)	(673,214)	(81,336)
Income tax refund		24,097	43,000	18,006	2,175
<b>Net cash generated from operating activities</b>	<b>(a)</b>	<b>1,798,320</b>	<b>2,276,957</b>	<b>4,589,711</b>	<b>554,513</b>
<b>Cash flows from investing activities:</b>					
Interest income received		25,323	27,419	42,750	5,165
Investment income received		47,635	49,087	96,591	11,670
Capital expenditure		(2,404,293)	(1,284,868)	(2,205,957)	(266,516)
Proceeds from disposal of property, plant and equipment		23,764	40,985	112,949	13,646
Purchase of investments and addition of interests in associates		(269,430)	(388,894)	(650,285)	(78,565)
Sale of investments		42,516	59,437	101,461	12,258
Increase in time deposits		(84,095)	(191,285)	(63,333)	(7,652)
Maturity of time deposits		40,815	109,495	225,218	27,210
<b>Cash used in investing activities</b>		<b>(2,577,765)</b>	<b>(1,578,624)</b>	<b>(2,340,606)</b>	<b>(282,784)</b>
<b>Cash flows from financing activities:</b>					
Proceeds from loans		7,575,168	7,490,040	5,214,936	630,051
Repayment of loans		(6,551,874)	(7,619,254)	(6,981,696)	(843,506)
Dividends paid			(360,000)	(576,000)	(69,590)
Dividends paid to minority interests		(35,206)	(29,532)	(56,221)	(6,792)
<b>Cash (used in)/ provided from financing activities</b>		<b>988,088</b>	<b>(518,746)</b>	<b>(2,398,981)</b>	<b>(289,837)</b>
<b>Net (decrease)/ increase in cash and cash equivalents</b>		<b>208,643</b>	<b>179,587</b>	<b>(149,876)</b>	<b>(18,108)</b>
Cash and cash equivalents at beginning of year		1,446,678	1,660,531	1,840,351	222,345
Effect of foreign exchange rate changes		5,210	233	25	4

Cash and cash equivalents at end of year	1,660,531	1,840,351	1,690,500	204,241
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See accompanying notes to consolidated financial statements.

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SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED  
AND SUBSIDIARIES

Notes to the Consolidated Statements of Cash Flows

For the years ended December 31, 2002, 2003 and 2004

(Amounts in thousands)

(a) Reconciliation of income before income tax and minority interests to cash generated from operations

	Years ended December 31,			
	2002	2003	2004	2004
	Renminbi	Renminbi	Renminbi	U.S. Dollars
Income before income tax and minority interests	1,045,038	1,590,365	4,696,229	567,383
Interest income	(25,015)	(27,419)	(42,830)	(5,175)
Investment income	(36,505)	(18,059)	(62,800)	(7,587)
Share of losses/ (profits) of associates	(16,065)	24,017	36,915	4,460
Interest expense	421,747	415,935	325,033	39,269
Depreciation	1,585,823	1,850,013	1,794,120	216,760
Provision for impairment loss		24,600	34,345	4,149
Amortisation of lease prepayments	14,518	22,822	21,191	2,560
Amortization of goodwill	13,448	13,448	13,448	1,625
Amortization of deferred income	(14,822)	(12,367)	(12,367)	(1,494)
Unrealized exchange gain	(5,086)	884	77	9
Loss on disposal of property, plant and equipment	85,134	57,571	9,544	1,153
Movement in inventories	(503,822)	(120,589)	(223,490)	(27,001)
Movement in debtors, bills receivable and deposits	80,792	(345,974)	(514,956)	(62,215)
Movement in creditors, other creditors and bills payable	(200,269)	(478,758)	(376,854)	(45,530)
Movement in balances with parent companies and fellow subsidiaries	(96,095)	(199,496)	(105,990)	(12,805)
<b>Cash generated from operations</b>	<b>2,348,821</b>	<b>2,796,993</b>	<b>5,591,615</b>	<b>675,561</b>
Interest paid	(524,254)	(415,684)	(346,696)	(41,887)
Income tax paid	(50,344)	(147,352)	(673,214)	(81,336)
Income tax refund	24,097	43,000	18,006	2,175
<b>Net cash generated from operating activities</b>	<b>1,798,320</b>	<b>2,276,957</b>	<b>4,589,711</b>	<b>554,513</b>

See accompanying notes to consolidated financial statements.





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## SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED

## AND SUBSIDIARIES

## Consolidated Statements of Shareholders' Equity

Years ended December 31, 2002, 2003 and 2004

(Amounts in thousands)

		<u>Share capital</u>	<u>Share premium</u>	<u>Reserves</u>	<u>Retained earnings</u>	<u>Total shareholders equity</u>
	Note	Renminbi	Renminbi	Renminbi	Renminbi	Renminbi
Balances at December 31, 2001		7,200,000	2,420,841	2,798,512	644,478	13,063,831
Net income					916,365	916,365
Appropriation	24			181,794	(181,794)	
Balances at December 31, 2002		7,200,000	2,420,841	2,980,306	1,379,049	13,980,196
Net income					1,401,690	1,401,690
Appropriation	24			277,112	(277,112)	
Dividend	11				(360,000)	(360,000)
Balances at December 31, 2003		7,200,000	2,420,841	3,257,418	2,143,627	15,021,886
Net income					3,971,103	3,971,103
Appropriation	24			794,254	(794,254)	
Dividend	11				(576,000)	(576,000)
Balances at December 31, 2004		7,200,000	2,420,841	4,051,672	4,744,476	18,416,989
U.S. Dollars equivalent		869,880	292,478	489,510	573,212	2,225,080

See accompanying notes to consolidated financial statements.

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**1. ORGANIZATION, PRINCIPAL ACTIVITIES AND BASIS OF PREPARATION**

Sinopec Shanghai Petrochemical Company Limited ( the Company ), formerly Shanghai Petrochemical Company Limited, was established in the People s Republic of China ( the PRC or the State ) on June 29, 1993 as a joint stock limited company to hold the assets and liabilities of the production divisions and certain other units of the Shanghai Petrochemical Complex ( SPC ). SPC was established in 1972 and owned and managed the production divisions as well as the related housing, stores, schools, hotels, transportation, hospitals and other municipal services in the community of Jinshanwei.

The Company s former controlling shareholder, China Petrochemical Corporation ( CPC ) completed its reorganization on February 25, 2000 in which its interests in the Company were transferred to its subsidiary, China Petroleum & Chemical Corporation ( Sinopec Corp ). In connection with the reorganization, CPC transferred its 4,000,000,000 of the Company s state owned legal shares, which represented 55.56 per cent of the issued share capital of the Company, to Sinopec Corp. On October 12, 2000, the Company changed its name to Sinopec Shanghai Petrochemical Company Limited.

The principal activity of the Company and its subsidiaries (the Group ) is the processing of crude oil into petrochemical products for sale. The Group is one of the largest petrochemical enterprises in the PRC, with a highly integrated petrochemical complex which processes crude oil into a broad range of synthetic fibers, resins and plastics, intermediate petrochemicals and petroleum products. Substantially all of its products are sold in the PRC domestic market.

**Table of Contents****1. ORGANIZATION, PRINCIPAL ACTIVITIES AND BASIS OF PREPARATION** *(continued)*

At December 31, 2004, the following list contains the particulars of subsidiaries, all of which are limited companies established and operated in the PRC, which principally affected the results and assets of the Group.

Company	Registered Capital	Percentage of equity held by the Company	Percentage of equity held by subsidiaries	Principal activities
		%	%	
Shanghai Petrochemical Investment Development Company Limited	RMB 800,000	100		Investment management
SPC Marketing Development Corporation	RMB 25,000	100		Trading in petrochemical products
China Jinshan Associated Trading Corporation	RMB 25,000	80		Import and export of petrochemical products and equipment
Shanghai Jinhua Industrial Company Limited	RMB 25,500		81.46	Trading in petrochemical products
Shanghai Jindong Petrochemical Industrial Company Limited	RMB 40,000		60	Trading in petrochemical products

**Table of Contents****1. ORGANIZATION, PRINCIPAL ACTIVITIES AND BASIS OF PREPARATION** *(continued)*

<b>Company</b>	<b>Registered Capital</b>	<b>Percentage of equity held by the Company</b>	<b>Percentage of equity held by subsidiaries</b>	<b>Principal activities</b>
		%	%	
Shanghai Golden Way Petrochemical Company Limited	US\$ 3,460		75	Production of vinyl acetate products
Shanghai Jinchang Engineering Plastics Company Limited	US\$ 4,750		50.38	Production of polypropylene compound products
Shanghai Golden Phillips Petrochemical Company Limited	US\$ 50,000		60	Production of polypropylene products
Zhejiang Jin Yong Acrylic Fibre Company Limited	RMB 250,000	75		Production of acrylic fiber products
Shanghai Petrochemical Enterprise Development Company Limited	RMB 455,000	100		Investment management
Shanghai Golden Conti Petrochemical Company Limited	RMB 295,776		100	Production of petrochemical products

None of the subsidiaries has issued any debt securities.

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**1. ORGANIZATION, PRINCIPAL ACTIVITIES AND BASIS OF PREPARATION** *(continued)*

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ( IFRS ) promulgated by the International Accounting Standards Board ( IASB ), and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB. Significant differences between IFRS and accounting principles generally accepted in the United States ( U.S. GAAP ) and their effect on net income for each of the years in the three-year period ended December 31, 2004, and shareholders' equity as of December 31, 2003, and 2004, are set forth in Note 30.

The consolidated financial statements are prepared on the historical cost basis as modified by the revaluation of certain property, plant and equipment. The accounting policies have been consistently applied by the Group.

The IASB has issued a number of new and revised International Financial Reporting Standards and International Accounting Standards (collectively new IFRSs ) which are effective for accounting periods beginning on or after January 1, 2005. The Group has not early adopted these new IFRSs in the financial statements for the year ended December 31, 2004. The Group has already commenced an assessment of the impact of these new IFRSs but is not yet in a position to state whether these new IFRSs would have significant impact on its results of operations and financial position.

The financial information has been prepared in Renminbi ( RMB ), the national currency of the PRC. Solely for the convenience of the reader, the financial statements have been translated into United States dollars at the rate of U.S. \$1.00 = RMB 8.277 quoted by the People's Bank of China on December 31, 2004. No representation is made that the Renminbi amounts could have been, or could be, converted into United States dollars at that rate.

## **Table of Contents**

### **2. PRINCIPAL ACCOUNTING POLICIES**

(a) Basis of consolidation

(i) *Subsidiaries*

The consolidated financial statements of the Group include the financial statements of the Company and all of its principal subsidiaries. Subsidiaries are those enterprises controlled by the Company. Control exists when the company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The results of subsidiaries are included in the consolidated financial statements from the date that control effectively commences until the date that control effectively ceases. The share of results attributable to minority interests is deducted from or added to profit after tax.

(ii) *Associates*

Associates are those enterprises in which the Company or the Group has significant influence, but not control, over the financial and operating policies. The Company's financial statements and the Group's consolidated financial statements include the Company's and the Group's share of the total recognised gains and losses of the principal associates on an equity accounted basis respectively, from the date that significant influence commences until the date that significant influence ceases. When the Company's or the Group's share of losses exceeds the carrying amount of the associate, the carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Company or the Group has incurred legal or constructive obligations or made payment on behalf of an associate.

(iii) *Transactions eliminated on consolidation*

All material intercompany transactions and balances, and any unrealized gains arising from intercompany transactions, are eliminated on consolidation.

(iv) *Goodwill*

Goodwill arising on acquisition represents the excess of the cost of acquisition over the fair value of their net identifiable assets on acquisition. Goodwill is stated at cost less amortization and impairment losses (see Note 2(r)). Amortization is charged on a straight-line basis to the consolidated statements of income over its economic useful life.

Negative goodwill arising on acquisition represents the excess of the fair value of the net identifiable assets of subsidiaries acquired over the cost of acquisition. Negative goodwill is, where material, credited to deferred income which is recognized in the consolidated statements of income on a systematic basis.

**Table of Contents****2. PRINCIPAL ACCOUNTING POLICIES** *(continued)*

## (b) Property, plant and equipment

Property, plant and equipment are stated in the balance sheet at cost or valuation (see Note 15) less accumulated depreciation and impairment losses (see Note 2(r)). Revaluations are performed periodically to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.

*(i) Subsequent expenditure*

Expenditure incurred to replace a component of an item of property, plant and equipment that is accounted for separately, is capitalized with the carrying amount of the component being written off. Other subsequent expenditure is capitalized only when it increases the future economic benefits embodied in the item of property, plant and equipment. All other expenditure is recognized in the consolidated statements of income as an expense as incurred.

*(ii) Depreciation and amortization*

Depreciation is provided to write off the costs or valuation of property, plant and equipment over their estimated useful lives on a straight-line basis, after taking into account their estimated residual values, as follows:

Buildings	15 to 40 years
Plant, machinery, equipment and others	5 to 26 years

*(iii) Retirement or disposal*

Gains or losses arising from the retirement or disposal of property, plant and equipment are determined as the difference between the net disposal proceeds and the carrying amount of the asset and are recognized in the consolidated statements of income on the date of retirement or disposal.

## (c) Investment property

Investment property is property which is held either to earn rental income or for capital appreciation or for both.

Investment property is stated in the balance sheet at cost less accumulated depreciation. Depreciation is provided over its estimated useful lives on a straight-line basis, after taking into account their estimated residual values. Estimated useful life of investment property is 40 years.





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**2. PRINCIPAL ACCOUNTING POLICIES** *(continued)*

(d) Lease prepayments

Lease prepayments represent land use rights paid to the PRC's land bureau. Land use rights are carried at cost and amortized on a straight-line basis over the respective periods of the rights.

(e) Construction in progress

Construction in progress represents buildings, various plant and equipment under construction and pending installation, and is stated at cost less the government grants that compensate the Company for the cost of construction and impairment losses (see Note 2(r)). Cost comprises direct costs of construction as well as interest charges, and foreign exchange differences on related borrowed funds to the extent that they are regarded as an adjustment to interest charges, during the period of construction.

The construction in progress is transferred to property, plant and equipment when the asset is substantially ready for its intended use.

No depreciation is provided in respect of construction in progress.

(f) Interest in subsidiaries

In the Company's financial statements, interests in subsidiaries are accounted for using the equity method.

(g) Investments

Investments in unlisted equity securities are stated at cost less provision for impairment losses (see Note 2(r)). A provision is made where, in the opinion of management, the carrying amount of the investments exceeds its recoverable amount.

(h) Inventories

Inventories, other than spare parts and consumables, are carried at the lower of cost and net realizable value. Cost includes the cost of materials computed using the weighted average method and expenditure incurred in acquiring the inventories and bringing them to their existing location and condition. In the case of work in progress and finished goods, cost includes direct labor and an appropriate proportion of production overheads. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sales.



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**2. PRINCIPAL ACCOUNTING POLICIES** *(continued)*

(h) Inventories (continued)

When inventories are sold, the carrying amount of those inventories is recognized as an expense in the period in which the related revenue is recognized. The amount of any write-down of inventories to net realizable value and all losses of inventories are recognized as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realizable value, is recognized as a reduction in the amount of inventories recognized as an expense in the period in which the reversal occurs.

Spare parts and consumables are stated at cost less any provision for obsolescence.

(i) Trade and other receivables

Trade debtors are stated at cost less allowance for doubtful accounts. Allowance for doubtful accounts is provided based upon the evaluation of the recoverability of these accounts at the balance sheet date.

(j) Cash and cash equivalents

Cash equivalents consist of time deposits with financial institutions with an initial term of less than three months when purchased. Cash equivalents are stated at cost, which approximates fair value.

(k) Translation of foreign currencies

Transactions in foreign currencies are translated into Renminbi at the applicable exchange rates ruling at the transaction dates.

Monetary assets and liabilities denominated in foreign currencies are translated into Renminbi at rates quoted by the People's Bank of China at the balance sheet date. Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated into Renminbi at the foreign exchange rate ruling at the date of the transaction.

Foreign currency translation differences relating to funds borrowed to finance the construction of property, plant and equipment to the extent that they are regarded as an adjustment to interest costs are capitalized during the construction period. All other exchange differences are dealt with in the consolidated statements of income.

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**2. PRINCIPAL ACCOUNTING POLICIES** *(continued)*

(l) Revenue recognition

Revenue from the sale of goods is recognized in the consolidated statements of income when the significant risks and rewards of ownership have been transferred to the buyer. Revenue excludes value added tax and is after deduction of any trade discounts and returns. No revenue is recognized if there are significant uncertainties regarding recovery of the consideration due to the possible return of goods, or when the amount of revenue and the costs incurred or to be incurred in respect of the transaction cannot be measured reliably.

Revenue from the rendering of services is recognized in the consolidated statements of income upon performance of the services.

Dividend income is recognized when the shareholder's right to receive payment is established.

(m) Grants

Capital-based government grants consist of grants for the purchase of equipment used for technology improvements. Such grants are offset against the cost of asset to which the grant related and are recognised in the income statement on a systematic basis over the useful life of the asset.

(n) Net financing costs

Net financing costs comprise interest expense on borrowings, interest income on bank deposits, foreign exchange gains and losses and bank charges.

Interest income from bank deposits is accrued on a time-apportioned basis by reference to the principal outstanding and at the rate applicable.

All interest and other costs incurred in connection with borrowings are expensed as incurred as part of net financing costs, except to the extent that they are capitalized as being directly attributable to the acquisition, construction or production of an asset which necessarily takes a substantial period of time to get ready for its intended use or sale.

(o) Repairs and maintenance expenses

Repairs and maintenance expenses, including cost of major overhaul, are charged to the consolidated statements of income as and when they are incurred.



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**2. PRINCIPAL ACCOUNTING POLICIES** *(continued)*

(p) Research and development costs

Research and development costs comprise all costs that are directly attributable to research and development activities or that can be allocated on a reasonable basis to such activities. Because of the nature of the Group's research and development activities, no development costs satisfy the criteria for the recognition of such costs as an asset. Both research and development costs are therefore recognized as expenses in the year in which they are incurred.

(q) Retirement benefits

The contributions payable under the Group's retirement plans are charged to the consolidated statements of income according to the contribution determined by the plans. Further information is set out in Note 26.

(r) Impairment loss

The carrying amounts of the Group's 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 the recoverable amount. The recoverable amount is the greater of the net selling price and the value in use. In determining the value in use, expected future cash flows generated by the asset are discounted to their present value. The amount of the reduction is recognized as an expense in the consolidated statements of income.

The Group assesses at each balance sheet date whether there is any indication that an impairment loss recognized for an asset in prior years may no longer exist. An impairment loss is reversed if there has been a favorable change in the estimates used to determine the recoverable amount. A subsequent increase in the recoverable amount of an asset, when the circumstances and events that led to the write-down or write-off cease to exist, is recognized as income. The reversal is reduced by the amount that would have been recognized as depreciation had the write-down or write-off not occurred.

(s) Deferred income

Deferred income is amortized on a straight-line basis to the consolidated statements of income over 10 years.

(t) Dividends

Dividends are recognized as a liability in the period in which they are declared.

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**2. PRINCIPAL ACCOUNTING POLICIES** *(continued)*

(u) Income tax

Income tax on the consolidated statements of income comprises current and deferred tax.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes, except differences relating to goodwill not deductible for tax purposes and the initial recognition of assets or liabilities which affect neither accounting nor taxable income. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date. The effect on deferred tax of any changes in tax rates is charged to the consolidated statements of income.

A deferred tax asset is recognized only to the extent that it is probable that future taxable income will be available against which the assets can be utilized. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

(v) Provisions

A provision is recognized in the balance sheet when the Group has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligations.

(w) Related parties

For the purposes of these financial statements, parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control or common significant influence. Related parties may be individuals or other entities.

(x) Segment reporting

A segment is a distinguishable component of the Group that is engaged in providing products or services and is subject to risks and rewards that are different from those of other segments.

**Table of Contents****2. PRINCIPAL ACCOUNTING POLICIES** *(continued)*

(y) Estimates

The preparation of financial statements in accordance with IFRS and U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**3. SALES**

The Group's principal activity is the processing of crude oil into petrochemical products for sale and substantially all of its products are sold in the PRC domestic markets.

Sales represents the sales value of goods sold to customers, net of value added tax and is after deduction of any sales discounts and returns.

**4. COST OF SALES**

Cost of sales represents:

	Years ended December 31,		
	2002	2003	2004
Costs of raw materials			
-crude oil	11,277,494	15,848,188	19,461,243
-other ancillary materials	3,071,608	3,939,371	6,091,649
Depreciation	1,585,823	1,850,013	1,794,120
Repairs and maintenance	673,255	787,246	920,490
Research and development	83,952	101,223	74,663
Employer's pension costs			
-municipal retirement scheme costs	168,747	168,276	167,640
-supplementary retirement scheme costs	24,781	39,153	42,379
Staff costs	1,079,318	1,090,687	1,172,442
Amortization of lease prepayment	14,518	22,822	21,191
Others	1,874,432	2,549,245	3,477,787
	<u>19,853,928</u>	<u>26,396,224</u>	<u>33,223,604</u>

Cost of sales includes charges for specific services provided by Sinopec Corp group companies to the Group. Such amounts have not been a material portion of cost of sales.





**Table of Contents****5. OTHER OPERATING INCOME**

Other operating income represents:

	<b>Years ended December 31,</b>		
	<b>2002</b>	<b>2003</b>	<b>2004</b>
Income from rendering of services	63,739	74,040	130,298
Gain on disposal of property, plant and equipment			58,913
Income from joint ventures and other investments	36,505	18,059	62,800
Amortization of deferred income	14,822	12,367	12,367
Others	21,565	16,613	12,627
	<b>136,631</b>	<b>121,079</b>	<b>277,005</b>

**6. OTHER OPERATING EXPENSES**

Other operating expenses represent:

	<b>Years ended December 31,</b>		
	<b>2002</b>	<b>2003</b>	<b>2004</b>
Loss on disposal of property, plant and equipment	85,134	57,571	68,457
Employee reduction expenses (Note 7)		64,108	112,526
Amortization of goodwill	13,448	13,448	13,448
Impairment loss of property, plant and equipment (Note 15)		24,600	34,345
Donation	1,699	10,080	9,992
Others	54,554	46,625	45,396
	<b>154,835</b>	<b>216,432</b>	<b>284,164</b>

**Table of Contents****7. EMPLOYEE REDUCTION EXPENSES**

In accordance with the Group's voluntary employee reduction plan, the Group recorded employee reduction expenses of RMB 112,526 (2003: RMB 64,108; 2002: RMB Nil) during the year ended December 31, 2004 in respect of the voluntary resignation of approximately 1,500 employees (2003: 950; 2002: Nil).

**8. NET FINANCING COSTS**

Net financing costs represent:

	Years ended December 31,		
	2002	2003	2004
Interest expenses, net	421,747	415,935	325,033
Interest income	(25,015)	(27,419)	(42,830)
Foreign exchange losses, net	3,924	3,505	9,805
	<u>400,656</u>	<u>392,021</u>	<u>292,008</u>

Interest costs capitalized as a component of the cost of construction in progress amounted to RMB 101,753, RMB 14,095 and RMB 23,801 in 2002, 2003 and 2004 respectively. Interest costs have been capitalized at a rate of between 2.98% and 5.58% per annum (2003: 2.98%-5.31%; 2002: 4.18%-6.03%) for construction in progress.

**Table of Contents****9. TAXATION**

- (a) Taxation in the consolidated statements of income represents:

	Years ended December 31,		
	2002	2003	2004
Provision for PRC income tax for the year	155,874	249,285	725,897
Deferred tax	(4,975)	(12,053)	(13,257)
Tax refund (Note)	(66,405)	(92,167)	(75,579)
	84,494	145,065	637,061

Note:

Pursuant to the document Cai Shui Zi (1999) No. 290 issued by the Ministry of Finance and the State Administration of Taxation of the PRC on December 8, 1999, the Company is entitled to an income tax refund of RMB 75,579 (2003: RMB 92,167, 2002: RMB 66,405) during the year relating to the purchase of equipment produced in the PRC for technological improvements.

A reconciliation of the income tax calculated at the applicable tax rate with income tax expense is as follows:

	Years ended December 31,		
	2002	2003	2004
Income before income tax	1,045,038	1,590,365	4,696,229
Expected PRC taxation at statutory tax rate of 15%	156,756	238,555	704,435
Non-deductible expenses	2,706	3,437	9,888
Non-taxable earnings	(10,108)	(7,032)	(7,589)
Income tax refund	(66,405)	(92,167)	(75,579)
Differential tax rate on subsidiaries income	1,545	2,272	5,906
Income tax expense	84,494	145,065	637,061

The charge for income tax is calculated at the rate of 15% (2003: 15%; 2002: 15%) on the estimated assessable income of the year determined in accordance with relevant income tax rules and regulations. The Group did not carry out business overseas and therefore does not incur overseas income tax. The Company has not received notice from the Ministry of Finance that the 15% tax rate will be revoked in 2005. It is possible that the Company's tax rate will increase in the future. However, the Company continues to use the 15% tax rate in 2004.



**Table of Contents****9. TAXATION** (continued)

(b) Deferred taxation:

(i) Deferred tax assets and deferred tax liabilities are attributable to the items detailed in the tables below:

	Assets		Liabilities		Net balance	
	December 31,		December 31,		December 31,	
	2003	2004	2003	2004	2003	2004
<i>Current</i>						
Provisions	21,163	32,600			21,163	32,600
<i>Non-current</i>						
Provisions for impairment losses	3,690	8,842			3,690	8,842
Lease prepayments	20,453	19,928			20,453	19,928
Capitalization of borrowing costs			(9,646)	(12,453)	(9,646)	(12,453)
Deferred tax assets/(liabilities)	45,306	61,370	(9,646)	(12,453)	35,660	48,917

There is no other significant deferred tax asset or liability that has not been provided for in the financial statements.

(ii) Movement in the deferred tax assets and liabilities are as follows:

	Balance at January 1, 2002	Recognized	Balance at
		in consolidated statements of income	December 31, 2002
<i>Current</i>			
Provisions	8,796	6,375	15,171
<i>Non-current</i>			
Lease prepayments	21,503	(525)	20,978
Capitalization of borrowing costs	(7,843)	(875)	(8,718)
Net deferred tax assets	22,456	4,975	27,431

  

	Balance at January 1, 2003	Recognized	Balance at
		in consolidated statements of income	December 31, 2003

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<i>Current</i>			
Provisions	15,171	5,992	21,163
<i>Non-current</i>			
Provision for impairment losses		3,690	3,690
Lease prepayments	20,978	(525)	20,453
Capitalization of borrowing costs	(8,718)	(928)	(9,646)
	<u>27,431</u>	<u>8,229</u>	<u>35,660</u>
Net deferred tax assets	<u>27,431</u>	<u>8,229</u>	<u>35,660</u>

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**Table of Contents****9. TAXATION** (continued)

	Balance at January 1, 2004	Recognized in consolidated statements of income	Balance at December 31, 2004
<i>Current</i>			
Provisions	21,163	11,437	32,600
<i>Non-current</i>			
Provision for impairment losses	3,690	5,152	8,842
Lease prepayments	20,453	(525)	19,928
Capitalization of borrowing costs	(9,646)	(2,807)	(12,453)
<b>Net deferred tax assets</b>	<b>35,660</b>	<b>13,257</b>	<b>48,917</b>

**10. BASIC EARNINGS PER SHARE**

The calculation of basic earnings per share is based on the profit attributable to shareholders of RMB 3,971,103 (2003: RMB 1,401,690, 2002: RMB 916,365) and 7,200,000,000 (2003: 7,200,000,000; 2002: 7,200,000,000) shares in issue during the year.

The amount of diluted earnings per share is not presented as there were no dilutive potential ordinary shares in existence for each of the years in the three-year period ended December 31, 2004.

**11. DIVIDEND**

(a) Dividend attributable to the year:

	Years ended December 31,		
	2002	2003	2004
Final dividend proposed after the balance sheet date of RMB 0.20 per share (2003: RMB 0.08 per share, 2002: RMB 0.05 per share)	360,000	576,000	1,440,000

Pursuant to a resolution passed at the Directors' meeting on March 23, 2005, a final dividend of RMB 0.20 per share totaling RMB 1,440,000 (2003: RMB 576,000; 2002: RMB 360,000) was proposed for shareholders' approval at the Annual General Meeting. The final dividend proposed after the balance sheet date has not been recognized as a liability at the balance sheet date.





**Table of Contents****11. DIVIDEND** *(continued)*

- (b) Dividend attributable to the previous financial year, approved and paid during the year:

	<b>Years ended December 31,</b>		
	<b>2002</b>	<b>2003</b>	<b>2004</b>
Final dividend in respect of the previous financial year, approved and paid during the year, of RMB 0.08 per share (2003: RMB 0.05; 2002: RMB Nil)		360,000	576,000

**12. INVENTORIES**

Inventories comprise:

	<b>December 31,</b>	
	<b>2003</b>	<b>2004</b>
Raw materials	1,226,324	1,163,508
Work in progress	1,188,187	1,340,643
Finished goods	608,533	758,081
Spare parts and consumables	481,215	465,517
	<b>3,504,259</b>	<b>3,727,749</b>

At December 31, 2004, the Group had inventories carried at net realizable value with carrying amount of RMB 104,130. (2003: RMB 98,618).

**Table of Contents****13. TRADE DEBTORS**

Trade debtors comprise:

	<b>December 31,</b>	
	<b>2003</b>	<b>2004</b>
Trade debtors	511,928	440,635
Less: Allowance for doubtful debts	(39,811)	(45,282)
	<u>472,117</u>	<u>395,353</u>

Allowance for doubtful debts is analyzed as follows:

At January 1, 2002	33,752
Provision for the year	17,041
Written-off	(7,454)
	<u>43,339</u>
At December 31, 2002	43,339
Provision for the year	33,644
Written-off	(37,172)
	<u>39,811</u>
At December 31, 2003	39,811
Provision for the year	22,814
Written-off	(17,343)
	<u>45,282</u>
At December 31, 2004	<u>45,282</u>

**14. OTHER DEBTORS AND PREPAYMENTS**

Other debtors and prepayments comprise:

	<b>December 31,</b>	
	<b>2003</b>	<b>2004</b>
Purchase deposits	109,053	166,724
Prepayments in connection with construction work and equipment purchases	18,467	126,591
VAT receivable	40,594	
Sundry debtors	238,407	241,907

<u>406,521</u>	<u>535,222</u>
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**Table of Contents****15. PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment comprise:

	<b>Buildings</b>	<b>Plant and other fixed assets</b>	<b>Total</b>
<b>Cost or valuation:</b>			
At January 1, 2004	5,080,323	25,441,075	30,521,398
Additions	22,582	184,902	207,484
Transferred from construction in progress (Note 17)	268,295	692,752	961,047
Disposals	(47,027)	(454,790)	(501,817)
At December 31, 2004	5,324,173	25,863,939	31,188,112
<b>Accumulated depreciation:</b>			
At January 1, 2004	2,591,695	11,909,599	14,501,294
Charge for the year	224,480	1,568,604	1,793,084
Impairment loss		34,345	34,345
Written back on disposal	(11,924)	(335,012)	(346,936)
At December 31, 2004	2,804,251	13,177,536	15,981,787
<b>Net book value:</b>			
At December 31, 2004	2,519,922	12,686,403	15,206,325
At December 31, 2003	2,488,628	13,531,476	16,020,104

All of the Group's buildings are located in the PRC (including Hong Kong).

Buildings in Hong Kong with a net book value of RMB 36,500 (2003: RMB 37,684) were held under medium-term leases.

The Company was established in the PRC on June 29, 1993 as a joint stock limited company as part of the restructuring of Shanghai Petrochemical Complex ( SPC ). On the same date, the principal business undertakings of SPC together with the relevant assets and liabilities were taken over by the Company. As required by the relevant PRC rules and regulations, a valuation of the assets and liabilities injected into the Company was carried out as at January 1, 1993 by the State-owned Assets Administration Bureau and the injected assets and liabilities were reflected in the financial statements on this basis.

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**15. PROPERTY, PLANT AND EQUIPMENT** *(continued)*

In accordance with IAS 16, subsequent to this revaluation, which was based on depreciated replacement costs, property, plant and equipment are carried at revalued amount, being the fair value at the date of the revaluation less any subsequent accumulated depreciation and impairment losses. Revaluation is performed periodically to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date. Based on a revaluation performed as of February 2, 2005, which was based on depreciated replacement costs, the carrying value of property, plant and equipment did not differ materially from their fair value.

At December 31, 2004, no property, plant and equipment that were pledged by the Group (2003: RMB 414,342; 2002: RMB Nil).

**Table of Contents****16. INVESTMENT PROPERTY**

	<u>2003</u>	<u>2004</u>
<b>Cost:</b>		
At January 1, 2004		
Transferred from construction in progress (Note 17)		512,343
	<u>          </u>	<u>          </u>
At December 31, 2004		512,343
	<u>          </u>	<u>          </u>
<b>Accumulated depreciation:</b>		
At January 1, 2004		
Charge for the year		1,036
	<u>          </u>	<u>          </u>
At December 31, 2004		1,036
	<u>          </u>	<u>          </u>
<b>Net book value:</b>		
At December 31, 2004		511,307
	<u>          </u>	<u>          </u>
At December 31, 2003		
	<u>          </u>	<u>          </u>

Investment property represents certain floors of an office building rented out under the terms of operating leases.

The fair values of the investment property of the Group as at December 31, 2004 are estimated by the directors to be approximately RMB 565,214 (2003: RMB Nil) by reference to market conditions. The investment property has not been valued by an external independent valuer.

No rental income is received during the year as lease agreements for the investment property were formed with lessees subsequent to the year ended December 31, 2004.

**Table of Contents****17. CONSTRUCTION IN PROGRESS**

Construction in progress comprises costs incurred on property, plant and equipment not yet commissioned at December 31, 2004. The movement of construction in progress is as follows:

	<u>2003</u>	<u>2004</u>
At January 1	896,798	385,373
Additions	1,065,131	1,895,494
Transferred to property, plant and equipment (Note 15)	(1,576,556)	(961,047)
Transferred to investment property (Note 16)		(512,343)
	<u>385,373</u>	<u>807,477</u>



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**Table of Contents****18. INTERESTS IN ASSOCIATES**

	<b>December 31,</b>	
	<b>2003</b>	<b>2004</b>
Share of net assets	1,370,339	1,906,917

The above amount represents the share of net assets of the Company's interest in its associates.

**Table of Contents****18. INTERESTS IN ASSOCIATES** *(continued)*

The particulars of these associates, which are limited companies established and operating in the PRC, which principally affected the results or assets of the Group at December 31, 2004 are as follows:

Company	Registered		Percentage	Percentage	Principal activities
	Capital	Company	of equity held by the Company	of equity held by the subsidiaries	
			%	%	
Shanghai Jinsen Hydrocarbon Resins Company Limited	US\$ 14,695			40	Production of resins products
Shanghai Jinpu Plastics Packaging Material Company Limited	US\$ 20,204			50	Production of polypropylene film
Shanghai YaNan Electrical Appliances Company	RMB 5,420			44	Trading of electrical appliances
XinLian Special Sealings Company	RMB 5,000			33	Production of special sealing material
Shanghai Secco Petrochemical Company Limited	US\$ 901,441		20		Manufacturing and distribution of chemical products
Shanghai Chemical Industry Park Development Company Limited	RMB 2,372,439		38.26		Planning, development and operation of the Chemical Industry Park in Shanghai, PRC

**Table of Contents****19. INVESTMENTS**

Investments comprise:

	<b>December 31,</b>	
	<b>2003</b>	<b>2004</b>
Investments in joint ventures	380,751	353,433
Other unlisted investments	333,874	337,353
	<u>714,625</u>	<u>690,786</u>
Less provision	(25,788)	(60,409)
	<u>688,837</u>	<u>630,377</u>

The Group's other investments in joint ventures include non-controlling equity investments in various enterprises which are mainly engaged in manufacturing or trading activities related to the Group's operations. The Group's share of results attributable to these investments during the year ended December 31, 2004 is not material in relation to the profit of the Group for the said period.

**20. GOODWILL**

	<b>December 31,</b>	
	<b>2003</b>	<b>2004</b>
Goodwill through acquisition of subsidiaries	134,482	134,482
Less accumulated amortization	(98,619)	(112,067)
	<u>35,863</u>	<u>22,415</u>

On August 16, 1996, the Company acquired the entire equity interest in Shanghai Jinyang Acrylic Fibre Plant ( Jinyang ) for consideration of RMB 38,800 satisfied in cash. Goodwill of RMB 134,482 on acquisition has been recognised in the financial statements and was included in interests in subsidiaries. Such goodwill was amortised over 10 years which is the remaining economic useful life of the related plants of this subsidiary.

**Table of Contents****21. DEFERRED INCOME**

	Net assets obtained			
	Negative goodwill		(Note)	
	2003	2004	2003	2004
At 1 January	33,044	8,492	115,177	115,177
Disposal	(24,552)			
Amortization	(5,094)	(5,943)	(69,108)	(80,626)
At 31 December	3,398	2,549	46,069	34,551

Note:

In 1998, the Group obtained the assets, liabilities and employees of certain businesses and various other net assets from the community of Jinshanwei without monetary consideration. The value of net assets obtained amounted to RMB 115,177 and was recorded as deferred income in the consolidated financial statements. The deferred income is amortized to the consolidated statements of income on a straight-line basis over 10 years.

**22. DEBT**

Short-term debts represent:

	December 31,	
	2003	2004
Short-term bank loans	4,445,588	3,612,727
Current portion long-term bank loans	999,141	1,257,578
	5,444,729	4,870,305
Loans from a related company	130,000	130,000
	5,574,729	5,000,305

The Group's short-term bank loans are used primarily to finance working capital needs. At December 31, 2004, no bank loans were secured by the way of pledge of property, plant and equipment. (2003: RMB 75,000). The Group's weighted average short-term interest rates were 3.50% and 3.56% at December 31, 2003 and 2004, respectively.



**Table of Contents****22. DEBT** (continued)

The Group's long-term bank loans, which are for the addition of plant and equipment and working capital purposes, comprise:

	Interest rate at		December 31,	
	December 31, 2004	Interest Type	2003	2004
<b>Arranged by Central Treasury of the Company:</b>				
U.S. Dollar denominated:				
Payable semi-annually through 2004 (note (a))	7.10%	Fixed	17,954	
Due in 2007	2.24%	Floating		416,402
Payable semi-annually through 2008 (note (a))	1.80%	Fixed	71,621	52,434
Japanese Yen denominated:				
Payable semi-annually through 2004	5.70%	Fixed	23,188	
Renminbi denominated:				
Due in 2004	5.22% - 5.30%	Fixed	700,000	
Due in 2005	4.94% - 5.58%	Fixed	1,650,000	1,100,000
Due in 2006	4.94% - 5.30%	Fixed	1,220,000	1,220,000
Due in 2006	4.94%	Fixed		170,000
Other loans due in 2005	Interest free		15,000	15,000

**Table of Contents****22. DEBT** (continued)

	Interest rate at December 31, 2004	Interest type	December 31,	
			2003	2004
<b>Arranged by subsidiaries:</b>				
U.S. Dollar denominated:				
Payable semi-annually through 2004	1.70%	Floating	42,135	
Payable annually through 2011	Interest free		24,154	20,856
Renminbi denominated:				
Payable semi-annually through 2004	5.76%	Floating	68,100	
Payable semi-annually through 2004	Interest free		66,912	
Payable annually from 2001 through 2005	Interest free		14,800	7,400
Payable annually through 2010	Interest free		143,500	123,000
Payable annually through 2011	Interest free		14,125	12,600
Due in 2005 and thereafter	4.94% - 5.58%	Fixed	134,500	134,500
<b>Total long-term bank loans outstanding</b>			<b>4,205,989</b>	<b>3,272,192</b>
Less: Amounts due within one year			(999,141)	(1,257,578)
<b>Amounts due after one year</b>			<b>3,206,848</b>	<b>2,014,614</b>

(a) Guaranteed by China Petrochemical Corporation

The weighted average short-term interest rates for the Group and the Company were 3.56% (2003: 3.50%) at December 31, 2004.

The aggregate maturities of long-term loans subsequent to December 31, 2004 are as follows:

2005	1,257,578
2006	1,430,178
2007	456,580
2008	57,518
2009	25,280
Thereafter	45,058
	<b>3,272,192</b>

**Table of Contents****23. SHARE CAPITAL**

Share capital represents:

	<b>December 31,</b>	
	<b>2003</b>	<b>2004</b>
Registered, issued and paid up capital:		
4,870,000,000 A shares of RMB 1.00 each	4,870,000	4,870,000
2,330,000,000 H shares of RMB 1.00 each	2,330,000	2,330,000
	<u>7,200,000</u>	<u>7,200,000</u>

All the A and H shares rank pari passu in all respects.

**24. SHARE PREMIUM AND RESERVES**

Movements on reserves comprise:

	<b>2003</b>	<b>2004</b>
<b>Share premium (Note a)</b>		
Balance at January 1 and December 31	<u>2,420,841</u>	<u>2,420,841</u>
<b>Statutory surplus reserve (Note b)</b>		
Balance at January 1	922,108	1,060,664
Appropriation	138,556	397,127
Balance at December 31	<u>1,060,664</u>	<u>1,457,791</u>
<b>Statutory public welfare fund (Note c)</b>		
Balance at January 1	840,019	978,575
Appropriation	138,556	397,127
Balance at December 31	<u>978,575</u>	<u>1,375,702</u>
<b>General surplus reserve (Note d)</b>		
Balance at January 1 and December 31	<u>82,089</u>	<u>82,089</u>



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<b>Capital reserve fund (Note e)</b>		
Balance at January 1 and December 31	4,180	4,180
<b>Discretionary surplus reserve (Note f)</b>		
Balance at January 1 and December 31	1,280,514	1,280,514
<b>Excess over share capital (Note g)</b>		
Balance at January 1 and December 31	(148,604)	(148,604)
<b>Retained profits (Note h)</b>		
Balance at January 1 and December 31	2,143,627	4,744,476
	<b>7,821,886</b>	<b>11,216,989</b>

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**24. SHARE PREMIUM AND RESERVES** *(continued)*

Note a

The application of the share premium account is governed by Sections 178 and 179 of the PRC Company Law.

Note b

According to the Company's Articles of Association, the Company is required to transfer 10% of its profit after taxation, as determined under PRC Accounting Rules and Regulations, to a statutory surplus reserve until the reserve balance reaches 50% of the registered capital. The transfer to this reserve is made before distribution of a dividend to shareholders.

The statutory surplus reserve can be used to make good previous years' losses, if any, and may be converted into share capital by the issue of new shares to shareholders in proportion to their existing shareholdings or by increasing the par value of the shares currently held by them, provided that the balance after such issue is not less than 25% of the registered capital.

Note c

According to the Company's Articles of Association, the Company is required to transfer 5% to 10% of its profit after taxation, as determined under PRC Accounting Rules and Regulations, to the statutory public welfare fund. This fund can only be utilized on capital items for the collective benefits of the Company's employees such as the construction of dormitories, canteen and other staff welfare facilities. This fund is non-distributable other than in liquidation. The transfer to this reserve must be made before distribution of a dividend to shareholders. The Directors have resolved to transfer 10% (2003: 10%) of the current year's profit after taxation to the fund.

Note d

When the statutory public welfare fund is utilized, an amount equal to the lower of cost of the assets and the balance of the statutory public welfare fund is transferred from the statutory public welfare fund to the general surplus reserve. This reserve is non-distributable other than in liquidation. When the relevant assets are disposed of or written off, the original transfers from the statutory public welfare fund are reversed. In 2004, the Company did not utilize the statutory public welfare fund (2003: RMB Nil). As at December 31, 2004, the net book value of assets acquired utilizing the statutory public welfare fund was RMB 37,282 (2003: RMB 40,639).

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**24. SHARE PREMIUM AND RESERVES** *(continued)*

Note e

This reserve represents gifts or grants received from China Petrochemical Corporation, the ultimate parent company and which are required to be included in this reserve fund by PRC regulations.

Note f

The transfer to this reserve from the consolidated statements of income is subject to the approval by shareholders at general meetings. Its usage is similar to that of statutory surplus reserve.

Note g

Effective January 1, 2002, land use rights which are included in lease prepayments are carried at historical cost base. Accordingly, the surplus on the revaluation of land use rights net of deferred tax asset are reversed to shareholders' equity. Under PRC Accounting Rules and Regulations, land use rights are carried at revalued amounts.

Note h

According to the Company's Articles of Association, the reserve available for distribution is the lower of the amount determined under PRC Accounting Rules and Regulations and the amount determined under IFRS. As of December 31, 2004, the reserve available for distribution was RMB 4,649,907 (2003: RMB 2,048,896). Final dividend of RMB 1,440,000 (2003: RMB 576,000) in respect of the financial year 2004 was declared after the balance sheet date.

**25. COMMITMENTS AND CONTINGENCIES**

(a) *Capital commitments*

The Group had capital commitments outstanding at December 31, 2004 not provided for in the financial statements as follows:

<u>Property, plant and equipment</u>	
Contracted but not provided for	322,797

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Authorized by the Board but not contracted for	1,824,985
	<hr/>
	2,147,782
	<hr/>
<u>Investment</u>	
Contracted but not provided for	295,886
	<hr/>

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**25. COMMITMENTS AND CONTINGENCIES** *(continued)*

*(b) Management fee commitments*

At December 31, 2004, the Group had annual contractual obligation for management fee approximately to RMB 7,609.

*(c) Contingent liabilities*

At December 31, 2004, the Group was contingently liable with respect to guarantees issued to banks in favor of associates and joint ventures of RMB 101,886 (2003: RMB 129,098).

Guarantees issued to banks in favor of associates and joint ventures are given to the extent of the Company's respective interest in these entities. The Group monitors the conditions that are subject to the guarantees to identify whether it is probable that a loss has occurred, and recognize any such losses under guarantees when those losses are estimable. At December 31, 2003 and 2004, it is not probable that the Group will be required to make payments under the guarantees. Thus no liability has been accrued for a loss related to the Company's obligation under the guarantees arrangement.

**26. RETIREMENT SCHEMES**

As stipulated by the regulations of the PRC, the Group participates in a defined contribution retirement plan organized by the Shanghai Municipal Government for its staff. The Group is required to make contributions to the retirement plan at a rate of 22.5% of the salaries, bonuses and certain allowances of its staff. The contribution rate has been changed to 22% since August 2004. A member of the plan is entitled to a pension equal to a fixed proportion of the salary prevailing at his retirement date. The Group has no other material obligation for the payment of pension benefits associated with this plan beyond the annual contributions described above. In addition, pursuant to a document Lao Bu Fa (1995) No.464 dated December 29, 1995 issued by the Ministry of Labor of the PRC, the Company has set out a supplementary defined contribution retirement plan for the benefit of employees. Employees who have served the Company for five years or more may participate in this plan. The Company and participating employees make defined contributions to their pension savings accounting according to the plan. The assets of this plan are held separately from those of the Company in an independent fund administered by a committee consisting of representatives from the employees and the Company. In April 2003, the Company revised certain terms of the supplementary defined contribution retirement plan and increased the amounts of contributions. For the year ended December 31, 2004, the Company's contribution to this plan amounted to RMB 42,379 (2003: RMB 39,153).

**Table of Contents****27. RELATED PARTY TRANSACTIONS**

- (a) Most of the transactions undertaken by the Group during the year ended December 31, 2004 have been affected with such counterparties and on such terms as have been determined by China Petroleum & Chemical Corporation ( Sinopec Corp ), the immediate parent company, and other relevant PRC authorities.

Sinopec Corp negotiates and agrees the terms of crude oil supply with suppliers on a group basis, which is then allocated among its subsidiaries, including the Group, on a discretionary basis. During the year ended December 31, 2004, the value of crude oil purchased in accordance with Sinopec Corp's allocation was as follows:

	Years ended December 31,		
	2002	2003	2004
Purchases of crude oil	11,645,363	15,904,304	19,563,608

- (b) Other transactions between the Group and other related parties during the year ended December 31, 2004 were as follows:

	Years ended December 31,		
	2002	2003	2004
Sales of goods and service fee income	8,077,376	10,481,474	15,334,038
Purchases other than crude oil	267,228	757,053	961,919
Insurance premiums paid	78,104	85,460	97,332
Research and development expenses		25,000	
Net withdrawal from deposits in related party	257,045	(197,366)	(11,416)
Interest received and receivable	488	1,580	4,894
New loans obtained from a related party	530,000	130,000	130,000
Loans repaid to a related party	400,000	130,000	130,000
Interest paid and payable	5,111	6,774	6,643
Transportation fee	40,132	44,733	151,163
Construction and installation fees	579,476	297,525	199,676
Proceeds from sales of property, plant & Equipment			99,969

**Table of Contents****27. RELATED PARTY TRANSACTIONS** *(continued)*

(c) Deposits in related party

	December 31,	
	2003	2004
Deposits, with maturity within 3 months	263,854	252,438

(d) Loans with related party

	December 31,	
	2003	2004
Short-term loans	130,000	130,000

The Directors of the Company are of the opinion that the above transactions were entered into in the normal course of business and on normal commercial terms or in accordance with the agreements governing such transactions, and this has been confirmed by the non-executive Directors.

**28. OPERATING SEGMENT DATA**

Segment information is presented in respect of the Group's business segments. The format of which is based on the Group's management and internal reporting structure. In view of the fact that the Company and its subsidiaries operate mainly in the PRC, no geographical segment information is presented.

The Group evaluates performance based on operating profit before income tax and non-operating income and expenses. Certain administrative expenses are allocated based on the percentage of sales.

Inter-segment transfer pricing is based on cost plus an appropriate margin, as specified by Group policy.

Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items mainly comprise income-earning assets and revenue, interest-bearing loans, borrowings and expenses, and corporate assets and expenses.

Segment capital expenditure is the total cost incurred during the year to acquire segment assets that are expected to be used for more than one period.

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**28. OPERATING SEGMENT DATA** *(continued)*

The Group principally operates in four operating segments: synthetic fibers, resins and plastics, intermediate petrochemicals and petroleum products. All of the Group's products are produced through intermediate steps from the principal raw material of crude oil. The specific products of each segment are as follows:

- (a) The synthetic fibers segment produces primarily polyester and acrylic fibers primarily used in the textile and apparel industries.
- (b) The resins and plastics segment produces primarily polyester chips, low density polyethylene resins and films, polypropylene resins and PVA granules. The polyester chips are used in the processing of polyester fibers and construction coating materials and containers. Low density polyethylene resins and plastics are used in cable jacketing, sheeting, the manufacture of moulded products, such as housewares and toys and for agricultural and packaging uses. Polypropylene resins are used in the manufacturing of extruded films or sheets and injection moulded products such as housewares, toys and household electric appliance and automobile parts.
- (c) The intermediate petrochemicals segment primarily produces ethylene and benzene. Most of the intermediate petrochemicals produced by the Group are used by the Group as raw materials in the production of other petrochemicals, resins, plastics and synthetic fibers. A portion of the intermediate petrochemicals as well as certain by-products of the production process are sold to outside customers.
- (d) The Group's petroleum products segment has crude oil distillation facilities used to produce vacuum and atmospheric gas oils used as feedstocks of the Group's downstream processing facilities. Residual oil and low octane gasoline fuels are produced primarily as a co-product of the crude oil distillation process. A proportion of the residual oil is further processed into qualified refined gasoline and diesel oil. In addition, the Group produces a variety of other transportation, industrial and household heating fuels, such as diesel oils, jet fuels, heavy oils and liquefied petroleum gases.

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**28. OPERATING SEGMENT DATA** *(continued)*

- (e) All other operating segment represents the operating segments which do not meet the quantitative threshold for determining reportable segments. These include trading, consumer products and services and a variety of other commercial activities, which are not allocated to the above four operating segments.

Most of the Group's sales and concentrations of credit risk (see Note 29(b)) are with affiliates of Sinopec Corp or other state-owned enterprises. Export sales accounted for approximately, 4.8 %, 5.0% and 0.2% of total sales in 2002, 2003 and 2004 respectively.

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Reportable information on the Group's operating segments is as follows:

**28. OPERATING SEGMENT DATA (continued)**

	Years ended December 31,		
	2002	2003	2004
<b>Sales</b>			
<b>Manufactured Products</b>			
Synthetic Fibers			
External sales	3,396,652	4,114,966	4,777,981
Intersegment sales		707	63
<b>Total</b>	<b>3,396,652</b>	<b>4,115,673</b>	<b>4,778,044</b>
Resins and Plastics			
External sales	6,479,166	8,907,410	12,154,361
Intersegment sales	24,948	25,850	19,952
<b>Total</b>	<b>6,504,114</b>	<b>8,933,260</b>	<b>12,174,313</b>
Intermediate Petrochemicals			
External sales	2,575,668	3,879,846	5,941,589
Intersegment sales	5,655,309	8,288,481	9,753,690
<b>Total</b>	<b>8,230,977</b>	<b>12,168,327</b>	<b>15,695,279</b>
Petroleum Products			
External sales	8,482,497	10,834,580	13,692,352
Intersegment sales	603,473	800,070	846,488
<b>Total</b>	<b>9,085,970</b>	<b>11,634,650</b>	<b>14,538,840</b>
<b>All others</b>			
External sales	1,388,913	1,830,338	2,836,250
Intersegment sales	3,190,159	3,520,710	3,452,657
<b>Total</b>	<b>4,579,072</b>	<b>5,351,048</b>	<b>6,288,907</b>
Eliminations of intersegment sales	(9,473,889)	(12,635,818)	(14,072,850)
<b>Consolidated sales</b>	<b>22,322,896</b>	<b>29,567,140</b>	<b>39,402,533</b>

External sales include sales to other Sinopec Corp group companies.

**Table of Contents****28. OPERATING SEGMENT DATA** *(continued)*

	Years ended December 31,		
	2002	2003	2004
<b>Profit from operations</b>			
Synthetic Fibers	113,095	112,316	250,419
Resins and Plastics	438,030	627,870	1,886,537
Intermediate Petrochemicals	287,660	597,411	1,550,796
Petroleum Products	403,903	452,077	986,578
All others	186,941	216,729	350,822
<b>Profit from operations</b>	<b>1,429,629</b>	<b>2,006,403</b>	<b>5,025,152</b>
<b>Share of loss of associates</b>	16,065	(24,017)	(36,915)
<b>Net financing costs</b>	(400,656)	(392,021)	(292,008)
	(384,591)	(416,038)	(328,923)
<b>Profit from ordinary activities before taxation</b>	1,045,038	1,590,365	4,696,229
<b>Income tax</b>	(84,494)	(145,065)	(637,061)
<b>Income before minority interests</b>	960,544	1,445,300	4,059,168
<b>Minority interests</b>	(44,179)	(43,610)	(88,065)
<b>Net income</b>	<b>916,365</b>	<b>1,401,690</b>	<b>3,971,103</b>

**Table of Contents****28. OPERATING SEGMENT DATA (continued)**

	December 31,		
	2002	2003	2004
<b>Assets</b>			
<b>Segment assets</b>			
Synthetic Fibers	2,872,995	3,034,919	3,168,259
Resins and Plastics	4,426,040	4,138,796	3,981,270
Intermediate Petrochemicals	5,903,756	6,090,790	5,647,630
Petroleum Products	7,063,384	7,383,556	8,075,376
All others	2,216,993	2,338,076	2,589,245
<b>Total segment assets</b>	<b>22,483,168</b>	<b>22,986,137</b>	<b>23,461,780</b>
<b>Interests in associates</b>	<b>1,044,217</b>	<b>1,370,339</b>	<b>1,906,917</b>
<b>Unallocated:</b>			
(including Cash and cash equivalents, Deposits, Income tax recoverable, Investments, Deferred tax assets and Goodwill)	2,558,534	2,768,981	2,907,904
<b>Consolidated assets</b>	<b>26,085,919</b>	<b>27,125,457</b>	<b>28,276,601</b>
<b>Liabilities</b>			
<b>Segment liabilities</b>			
Synthetic Fibers	463,353	393,708	286,338
Resins and Plastics	883,852	852,185	728,239
Intermediate Petrochemicals	351,358	371,081	355,975
Petroleum Products	1,157,136	1,036,311	820,301
All others	189,468	175,076	169,726
<b>Total segment liabilities</b>	<b>3,045,167</b>	<b>2,828,361</b>	<b>2,360,579</b>
<b>Unallocated:</b>			
(including Loans, Income tax payable and Deferred income)	8,693,785	8,933,970	7,499,033
<b>Consolidated liabilities</b>	<b>11,738,952</b>	<b>11,762,331</b>	<b>9,859,612</b>

**Table of Contents****28. OPERATING SEGMENT DATA** *(continued)*

	Years ended December 31,		
	2002	2003	2004
<b>Depreciation and amortization</b>			
Synthetic Fibers	217,979	261,810	250,930
Resins and Plastics	344,525	359,380	356,097
Intermediate Petrochemicals	520,426	648,628	630,467
Petroleum Products	346,040	409,152	399,200
All others	171,371	193,865	177,581
<b>Segment depreciation and amortization</b>	<b>1,600,341</b>	<b>1,872,835</b>	<b>1,814,275</b>
<b>Unallocated:</b>			1,036
<b>Consolidated depreciation and amortization</b>	<b>1,600,341</b>	<b>1,872,835</b>	<b>1,815,311</b>

	Years ended December 31,		
	2002	2003	2004
<b>Impairment losses</b>			
Synthetic Fibers		24,600	34,345
Resins and Plastics			
Intermediate Petrochemicals			
Petroleum Products			
All others			
<b>Consolidated depreciation</b>		<b>24,600</b>	<b>34,345</b>

	Years ended December 31,		
	2002	2003	2004
<b>Total capital expenditures for segment long-lived assets</b>			
Synthetic Fibers	470,066	123,335	555,441
Resins and Plastics	79,487	121,630	124,768
Intermediate Petrochemicals	989,103	746,555	378,542
Petroleum Products	666,423	188,019	469,080
All others	199,214	105,329	165,783
<b>Total segment capital expenditures</b>	<b>2,404,293</b>	<b>1,284,868</b>	<b>1,693,614</b>
<b>Unallocated:</b>			512,343

<b>Consolidated capital expenditures for segment long-lived assets</b>	2,404,293	1,284,868	2,205,957
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**29. FINANCIAL INSTRUMENTS**

Financial assets of the Group include cash and cash equivalents, deposits with financial institutions, investments, trade debtors, bills receivable, deposits, other debtors and prepayments and amounts due from related companies. Financial liabilities of the Group include bank loans, trade creditors, bills payable, accrued expenses and other creditors and amounts due to related companies. The Group does not hold or issue financial instruments for trading purposes. The Group had no positions in derivative contracts that are designated and qualified as hedging instruments at December 31, 2003 and 2004.

(a) Interest rate risk

The interest rates and terms of repayment of loans of the Group are disclosed in Note 22.

(b) Credit risk

The Group's financial instruments do not represent a concentration of credit risk because the Group deals with a variety of major financial institutions with good credit ratings, and its trade debtors are spread among a number of major industries and customers.

(c) Foreign currency risk

The Group has foreign currency risk as certain loans and cash and cash equivalents are denominated in foreign currencies, principally U.S. dollars and Hong Kong dollars. Depreciation or appreciation of Renminbi against foreign currencies will affect the Group's financial position and results of operations.

(d) Fair value

Fair value estimates are made at a specific point in time and based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.



**Table of Contents****29. FINANCIAL INSTRUMENTS** *(continued)*

The following table presents the carrying amounts and fair values of the Group's long-term bank loans at December 31, 2003 and 2004:

	2003		2004	
	Carrying amount	Fair value	Carrying amount	Fair value
<b>Liabilities</b>				
Long-term bank loans	4,205,989	4,204,084	3,272,192	3,218,533

Long-term bank loans – the fair values are estimated based on applying a discounted cash flow using current market interest rates for similar financial instruments.

Investments are unquoted interests, primarily equity interests in joint ventures. There is no quoted market price for such interest and securities in the PRC, and accordingly a reasonable estimate of fair value could not be made without incurring excessive costs. Further details pertinent to the valuation of these interests are disclosed in Note 19.

The fair values of cash, trade debtors, bills receivable, deposits, other debtors, trade creditors, other creditors and amounts due to/from related companies are not materially different from their carrying amounts.

Time deposits and short-term bank loans – the carrying value is estimated to approximate fair value based on the nature or short-term maturity of these instruments.

Fair value estimates are made at a specific point in time and based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

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**30. SIGNIFICANT DIFFERENCES BETWEEN IFRS AND ACCOUNTING PRINCIPLES GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA ( U.S. GAAP )**

The Group's accounting policies conform with IFRS which differ in certain significant respects from US GAAP. Information relating to the nature and effect of such differences are set out below.

(a) Foreign exchange gains and losses

Under IFRS, foreign exchange differences on funds borrowed for construction are capitalized as property, plant and equipment to the extent that they are regarded as an adjustment to interest costs during the construction period. In the years ended December 31, 2002, 2003 and 2004, no foreign exchange differences were capitalized to property, plant and equipment. Under U.S. GAAP, all foreign exchange gains and losses on foreign currency debt are included in current earnings. In 2002, 2003 and 2004, the U.S. GAAP adjustments represent the effect of amortization of amounts previously capitalized. Accordingly, the balances of cost and accumulated depreciation of property, plant and equipment under IFRS were higher than the balances under US GAAP by RMB 365,258,000 and RMB 365,258,000 respectively (December 31, 2003: RMB 365,258,000 and RMB 362,785,000 respectively.)

(b) Capitalization of property, plant and equipment

In years prior of those presented herein, certain adjustments arose between IFRS and the U.S. GAAP with regard to the capitalization of interest and pre-production results under IFRS, that were reversed and expensed under U.S. GAAP. For the years presented herein, no adjustments related to the capitalization of construction costs, including capitalized interest, are necessary. Accordingly, the U.S. GAAP adjustments for 2002, 2003 and 2004 represent the amortization effect of such originating adjustments described above.

(c) Revaluation of property, plant and equipment

In the years prior to those presented herein, the property, plant and equipment of the Company were revalued to reflect the then current fair value resulting in a revaluation surplus recorded in the Company's financial statements. Additional depreciation charges have been taken in the years ended December 31, 2002, 2003 and 2004 on the revaluation surplus of RMB1,576,330.

Under U.S. GAAP, property, plant and equipment are stated at historical cost less accumulated depreciation. However, as a result of the tax deductibility of the revaluation, a deferred tax asset related to the reversal of the revaluation surplus is created under U.S. GAAP with a corresponding increase in shareholders' equity.

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**30. SIGNIFICANT DIFFERENCES BETWEEN IFRS AND U.S. GAAP** *(continued)*

- (d) Capitalized interest on investment in associates

Under IFRS, investment accounted for by the equity method is not considered a qualifying asset for which interest is capitalized. Under U.S. GAAP, an investment accounted for by the equity method while the investee has activities in progress necessary to commence its planned principal operations, provided that the investee's activities include the use of funds to acquire qualifying assets for its operations, is a qualifying asset for which interest is capitalized.

- (e) Goodwill and negative goodwill amortization

Under IFRS, goodwill and negative goodwill are amortized on a systematic basis over their useful lives.

Under U.S. GAAP, with reference to Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" (SFAS No. 142), goodwill is no longer amortized beginning January 1, 2002, the date that SFAS No. 142 was adopted. Instead, goodwill will be reviewed for impairment upon adoption of SFAS No. 142 and annually thereafter. In addition, under U.S. GAAP, negative goodwill that existed at the date of adoption of SFAS No. 142 was written off effective January 1, 2002 as a cumulative effect of a change in accounting principle. Accordingly, the goodwill balance as at December 31, 2004 under IFRS was lower than the balance under US GAAP by RMB 40,344,000 (December 31, 2003: RMB 26,896,000). At December 31, 2004, the negative goodwill balance included in deferred income under IFRS amounted to RMB 2,549,000 (December 31, 2003: RMB 3,398,000) as opposed to a nil balance under US GAAP as at both December 31, 2003 and 2004.

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**30. SIGNIFICANT DIFFERENCES BETWEEN IFRS AND U.S. GAAP (continued)**

(f) Basic earnings per share

The calculation of basic earnings per share is based on the net profit under U.S. GAAP of RMB 4,146,065 (2003: RMB 1,568,439; 2002: RMB 1,124,623) and the number of shares in issue during the year of 7,200,000,000 (2003: 7,200,000,000; 2002: 7,200,000,000). Basic earnings per ADS is calculated on the basis that one ADS is equivalent to 100 shares.

The amount of diluted earnings per share is not presented as there were no dilutive potential ordinary shares in existence for both years.

(g) Recently issued accounting standards

**SFAS No. 123R**

In December 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-based payment*. SFAS No. 123R addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for equity instruments of the enterprise or liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. SFAS No. 123R requires an entity to recognize the grant-date fair-value of stock options and other equity-based compensation issued to employees in the income statement. The revised statement generally requires that an entity account for those transactions using the fair-value-based method, and eliminates an entity's ability to account for share-based compensation transactions using the intrinsic value method of accounting, which was permitted under Statement 123, as originally issued. For the Group, SFAS No. 123R is effective for fiscal years beginning after June 15, 2005. Currently, the Group does not expect the application of this statement will have a material impact on its consolidated financial statements.

**SFAS No. 151**

In November 2004, the FASB issued SFAS No. 151, *Inventory costs*. SFAS No. 151 clarifies accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). The statement requires that those items be recognized as current period charges. Additionally, SFAS No. 151 requires that allocation of fixed production overheads to the costs of conversion based on normal capacity of the production facilities. For the Group, SFAS No. 151 is effective for fiscal years beginning after June 15, 2005. Currently, the Group does not expect the application of this statement will have a material impact on its consolidated financial statements.

**Table of Contents****30. SIGNIFICANT DIFFERENCES BETWEEN IFRS AND U.S. GAAP (continued)**

The effect on the profit attributable to shareholders of significant differences between IFRS and U.S. GAAP is as follows:

		<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2004</u>
	Note	RMB	RMB	RMB	US dollar
Net income under IFRS		916,365	1,401,690	3,971,103	479,776
U.S. GAAP adjustments:					
Foreign exchange gains and losses	(a)	37,054	37,054	2,473	299
Capitalization of property, plant and equipment	(b)	21,703	21,703	21,707	2,623
Depreciation charge on revalued property, plant and equipment	(c)	129,995	129,995	129,995	15,705
Capitalized interest on investment in associates	(d)	20,996	7,045	36,841	4,451
Goodwill amortization	(e)	13,448	13,448	13,448	1,625
Negative goodwill amortization	(e)	(3,304)	(13,126)	(849)	(103)
Cumulative effect of adopting SFAS No. 142	(e)	19,828			
Deferred tax effect of the above adjustments		(31,462)	(29,370)	(28,653)	(3,462)
Net income under U.S. GAAP		<u>1,124,623</u>	<u>1,568,439</u>	<u>4,146,065</u>	<u>500,914</u>
Basic earnings per share under U.S. GAAP	(f)	RMB 0.156	RMB 0.218	RMB 0.576	US\$ 0.696
Basic earnings per ADS under U.S. GAAP	(f)	RMB 15.620	RMB 21.784	RMB 57.584	US\$ 6.960

**Table of Contents****30. SIGNIFICANT DIFFERENCES BETWEEN IFRS AND U.S. GAAP** (continued)

The effect on shareholders' equity of significant differences between IFRS and U.S. GAAP is as follows:

	Note	At December 31,		
		2003	2004	2004
		RMB	RMB	US dollar
Shareholders' equity under IFRS, as previously report		15,021,886	18,416,989	2,225,080
U.S. GAAP adjustments:				
Foreign exchange gains and losses	(a)	(2,473)		
Capitalization of property, plant and equipment	(b)	(21,707)		
Revaluation of property, plant and equipment	(c)	(193,516)	(63,521)	(7,675)
Capitalized interest on investment in associates	(d)	52,359	89,200	10,777
Goodwill and negative goodwill	(e)	26,896	40,344	4,874
Negative goodwill	(e)	3,398	2,549	308
Deferred tax effect of the above adjustments		24,801	(3,852)	(465)
Shareholders' equity under U.S. GAAP		14,911,644	18,481,709	2,232,899

The Deferred tax effect of the above adjustments as of December 31, 2002, 2003 and 2004 and for the years then ended is based on the 15% tax rate applicable to the Company through 2004. The Company has not received notice from the Ministry of Finance that the 15% tax rate will continue to be applicable to the Company in 2005. As such, it is possible that the Company's tax rate will increase in 2005.

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**SIGNATURES**

The registrant certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

**SINOPEC SHANGHAI PETROCHEMICAL COMPANY  
LIMITED**

Date: June 27, 2005

/s/ Lu Yiping

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Lu Yiping, Chairman

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**Exhibit Index**

<b>No.</b>	<b>Exhibit</b>
12.1	Certification of Chairman Required by Rule 13a-14(a)
12.2	Certification of Chief Financial Officer Required by Rule 13a-14(a)
13.1	Certification of Chairman Required by Rule 13a-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code
13.2	Certification of Chief Financial Officer Required by Rule 13a-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code