

SINOPEC SHANGHAI PETROCHEMICAL CO LTD

Form 20-F

May 20, 2009

Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 20-F**

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

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the fiscal year ended December 31, 2008**

**OR**

.. **TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**Date of event requiring this shell company report**

**OR**

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

The People's Republic of China

(Jurisdiction of incorporation or organization)

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

(Address of principal executive offices)

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The People's Republic of China

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(Name, Telephone, Email and/or Facsimile number and Address of Company Contact Person)

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

Title of each class	Name of each exchange on which registered
American Depositary Shares, each representing 100 Class H Ordinary Shares, par value RMB1.00 per Share	New York Stock Exchange
Class H Ordinary Shares, par value RMB1.00 per Share	The Stock Exchange of Hong Kong Limited

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

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(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, par value RMB1.00 per Share**

**4,870,000,000 Domestic Shares, par value RMB1.00 per Share**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes  No

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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP  International Financial Reporting Standards as issued by the International Accounting Standards Board  Other

If Other has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow. Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

**Table of Contents**

**Table of Contents**

<b><u>CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS</u></b>	<b>ii</b>
<b><u>EXCHANGE RATES</u></b>	<b>ii</b>
<b><u>CERTAIN TERMS AND CONVENTIONS</u></b>	<b>ii</b>
<b><u>PART I</u></b>	<b>1</b>
ITEM 1. <u>IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS.</u>	1
ITEM 2. <u>OFFER STATISTICS AND EXPECTED TIMETABLE.</u>	1
ITEM 3. <u>KEY INFORMATION.</u>	1
ITEM 4. <u>INFORMATION ON THE COMPANY.</u>	10
ITEM 4A. <u>UNRESOLVED STAFF COMMENTS.</u>	30
ITEM 5. <u>OPERATING AND FINANCIAL REVIEW AND PROSPECTS.</u>	30
ITEM 6. <u>DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES.</u>	44
ITEM 7. <u>MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS.</u>	53
ITEM 8. <u>FINANCIAL INFORMATION.</u>	56
ITEM 9. <u>THE OFFER AND LISTING.</u>	57
ITEM 10. <u>ADDITIONAL INFORMATION.</u>	58
ITEM 11. <u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.</u>	75
ITEM 12. <u>DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES.</u>	78
<b><u>PART II</u></b>	<b>78</b>
ITEM 13. <u>DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES</u>	78
ITEM 14. <u>MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS.</u>	78
ITEM 15. <u>CONTROLS AND PROCEDURES.</u>	78
ITEM 16A. <u>AUDIT COMMITTEE FINANCIAL EXPERT.</u>	80
ITEM 16B. <u>CODE OF ETHICS.</u>	80
ITEM 16C. <u>PRINCIPAL ACCOUNTANT FEES AND SERVICES.</u>	80
ITEM 16D. <u>EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES.</u>	80
ITEM 16E. <u>PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS.</u>	80
ITEM 16F. <u>CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT</u>	81
ITEM 16G. <u>CORPORATE GOVERNANCE.</u>	81
<b><u>PART III</u></b>	<b>85</b>
ITEM 17. <u>FINANCIAL STATEMENTS.</u>	85
ITEM 18. <u>FINANCIAL STATEMENTS.</u>	85
ITEM 19. <u>EXHIBITS.</u>	85

## **Table of Contents**

### **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 to update any forward-looking statements to reflect events and circumstances 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 the availability of crude oil supply channels and relevant prices, effects of the macroeconomic policy of The People's Republic of China and government control of currency conversion and the prices of refined oil products.

### **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 publish our financial statements in Renminbi. Unless otherwise indicated, all translations from Renminbi to US dollars have been made at a rate of RMB6.8225 to US\$1.00, the noon buying rate as certified for customs purposes by the Federal Reserve Bank of New York on December 31, 2008. We do not represent that Renminbi or US dollar amounts could be converted into US dollars or Renminbi, as the case may be, at any particular rate.

### **CERTAIN TERMS AND 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 on the Shanghai Stock Exchange by and between Chinese investors.

References to ADSs are references to our American Depositary Shares, which are listed and traded on the New York Stock Exchange. Each ADS represents 100 H Shares.

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.

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.

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

All references to tons are to metric tons.

Unless otherwise noted, references to sales volume are to sales to entities other than us or our divisions and subsidiaries.

**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 selected consolidated statements of income and cash flow data for each of the years ended December 31, 2006, 2007 and 2008 and our selected consolidated balance sheet data as of December 31, 2007 and 2008 are derived from our consolidated financial statements included in Item 17. Financial Statements. Our selected consolidated statements of income and cash flow data for the years ended December 31, 2004 and 2005 and our consolidated balance sheet data as of December 31, 2004, 2005 and 2006 are derived from our 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 ), as issued by the International Accounting Standards Board.

## Selected Consolidated Financial Data

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

	Years Ended December 31,				
	2004 (RMB)	2005 (RMB)	2006 (RMB)	2007 (RMB)	2008 (RMB)
<b>STATEMENTS OF INCOME DATA</b>					
Net sales:					
Synthetic fibers	4,751,773	4,763,993	4,711,667	4,328,742	3,662,023
Resins and plastics	12,085,967	13,958,329	15,753,304	15,878,803	14,850,284
Intermediate petrochemicals	5,896,580	6,555,953	6,775,721	9,372,658	10,271,840
Petroleum products	13,101,919	17,954,954	19,387,666	21,036,581	27,552,859
All others	2,827,820	1,956,985	3,289,765	3,637,905	2,992,765
Income/(loss) from operations	5,025,152	2,527,960	552,907	892,656	(7,817,264)
Earnings/(loss) before income tax	4,696,229	2,287,594	964,200	2,151,352	(8,014,438)
Net income/(loss) attributable to equity shareholders of the Company	3,971,103	1,850,449	844,407	1,634,080	(6,238,444)
Net income attributable to minority interests	88,065	70,845	66,555	49,056	36,717
Basic earnings/(loss) per share(a)	0.55	0.26	0.12	0.23	(0.87)
Basic earnings/(loss) per ADS(a)	55.15	25.70	11.73	22.70	(86.65)

- (a) 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 2008, 2007, 2006, 2005 and 2004, respectively. Earnings per ADS are calculated on the basis that one ADS is equivalent to 100 shares.

**Table of Contents**

	Years Ended December 31,				
	2004	2005	2006	2007	2008
	(RMB)	(RMB)	(RMB)	(RMB)	(RMB)
<b>CASH FLOW DATA</b>					
Net cash flow generated from/(used in) operating activities	4,589,711	3,943,578	1,696,615	1,441,998	(3,986,490)
Capital expenditures	2,205,957	1,142,927	2,008,779	2,134,123	1,511,072
Net proceeds from issuance of corporate bonds			2,977,800		
Proceeds from loans	5,214,936	9,836,199	13,939,126	17,605,887	32,528,758
Repayment of loans	6,981,696	11,393,941	15,910,127	16,166,938	27,377,610

**Table of Contents**

	Years Ended December 31,				
	2004 (RMB)	2005 (RMB)	2006 (RMB)	2007 (RMB)	2008 (RMB)
<b>BALANCE SHEET DATA</b>					
Current assets	8,615,910	7,507,554	7,563,106	8,936,764	6,511,351
Property, plant and equipment, net	15,206,325	14,651,167	13,359,862	14,977,237	13,272,899
Total assets	28,276,601	26,810,371	27,406,060	29,853,050	27,533,027
Short term debt(a)	5,000,305	3,926,742	4,270,337	4,091,969	9,372,725
Current liabilities	7,434,814	6,132,637	7,030,050	8,261,732	13,342,720
Long term debt (excluding current portion)	2,014,614	1,477,261	1,063,654	639,289	429,021
Total equity attributable to equity shareholders of the Company	18,416,989	18,829,987	18,976,343	20,648,038	13,496,933

(a) Including corporate bonds and 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
January 1, 1994-June 30, 1994	RMB0.04 (US\$0.0059)
July 1, 1994-December 31, 1994	RMB0.085 (US\$0.0125)
January 1, 1995-June 30, 1995	RMB0.04 (US\$0.0059)
July 1, 1995-December 31, 1995	RMB0.09 (US\$0.0132)
January 1, 1996-June 30, 1996	RMB0.04 (US\$0.0059)
July 1, 1996-December 31, 1996	RMB0.08 (US\$0.0117)
January 1, 1997-December 31, 1997	RMB0.06 (US\$0.0088)
January 1, 1998-December 31, 1998	RMB0.03 (US\$0.0044)
January 1, 1999-December 31, 1999	RMB0.05 (US\$0.0073)
January 1, 2000-December 31, 2000	RMB0.06 (US\$0.0088)
January 1, 2001-December 31, 2001	No dividend
January 1, 2002-December 31, 2002	RMB0.05 (US\$0.0073)
January 1, 2003-December 31, 2003	RMB0.08 (US\$0.0117)
January 1, 2004-December 31, 2004	RMB0.20 (US\$0.0293)
January 1, 2005-December 31, 2005	RMB0.10 (US\$0.0147)
January 1, 2006-December 31, 2006	RMB0.04 (US\$0.0059)
January 1, 2007-December 31, 2007	RMB0.09 (US\$0.0132)
January 1, 2008-December 31, 2008	No dividend

See also [Item 8.A. 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.D. Additional Information](#) [Exchange Controls](#).



**Table of Contents**

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

Period	Noon Buying Rates (RMB/US\$)			
	Period End	Average <sup>(1)</sup>	High	Low
2004	8.2765	8.2768	8.2774	8.2764
2005	8.0702	8.1828	8.2765	8.0702
2006	7.8041	7.9579	8.0702	7.8041
2007	7.2946	7.5806	7.8127	7.2946
2008	6.8225	6.9477	7.2946	6.7899
November 2008	6.8254	6.8281	6.8373	6.8220
December 2008	6.8225	6.8539	6.8842	6.8225
January 2009	6.8392	6.8360	6.8403	6.8225
February 2009	6.8395	6.8363	6.8470	6.8241
March 2009	6.8329	6.8360	6.8438	6.8240
April 2009	6.8180	6.8304	6.8347	6.8180

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.****The current global financial crisis may have further material adverse effects on our financial condition and operating results.**

The current global financial crisis has resulted in reduced demand and decreased prices for the petrochemical industry. Although China continued to experience steady and relatively fast growth in 2008, the momentum of its economic growth has weakened, with a substantial adverse impact on China's petrochemical industry. Beginning in the second half of 2008 in particular, production growth in China's petrochemical industry slowed significantly, market demand weakened, product prices fell sharply and corporate profitability decreased substantially. Our operating and financial performance in 2008 also suffered as a result. A sustained economic downturn may have further material adverse effects on our financial condition and operating results. Moreover, measures taken by the Chinese government, such as restrictions on workforce reduction, may limit our ability to adjust to a changing market environment and have an adverse impact on our financial performance.

**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 petrochemical products.**

Most of our revenues are attributable to petrochemical products, which have historically been cyclical and sensitive to the availability and price of raw materials 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 products have experienced alternating periods of tight supply, causing prices and margins to increase, followed by periods of capacity additions, finally resulting in oversupply and declining prices and margins. As tariffs and other import restrictions are reduced and the control of product pricing is relaxed in China, the markets for many of our products have become increasingly subject to the cyclicity of regional and global markets. For example, in 2008, abrupt changes occurred in the domestic demand for petrochemical products. In the first half of the year, the prices of petrochemical products continued to rise in conjunction with substantial rises in international oil prices. However, in the second half, there was a fall in both sales volume and prices of petrochemical products triggered by the global economic downturn. The sales volume and prices of our petrochemical products also declined, and may remain at the current levels for a sustained period of time, or even decline

further from such levels.

Historically, international prices of crude oil have fluctuated widely due to many factors beyond our control. For example, international crude oil prices increased significantly in the first half of 2008 but decreased significantly in the second half. After hitting successive record highs, crude oil prices began to fall rapidly, and hit a new, 3-year record low in December 2008. 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.

## **Table of Contents**

### **Some of our major products are subject to government price controls, and we are not able to pass on all cost increases from rising crude oil prices through higher product prices.**

We consume large amounts of crude oil to manufacture our products. We attempt to mitigate the effect of increased costs due to rising crude oil prices. However, our ability to pass on these increased costs to our customers is dependent on market conditions and government regulations, particularly government regulation with respect to the price of certain of our fuel products. In particular, gasoline, diesel and jet fuel, and liquefied petroleum gas are subject to government price controls. In 2006, 2007 and 2008, approximately 53.96%, 54.06% and 43.52% of our net sales were from such products subject to price control. Although we do receive subsidies from the Chinese government to, among other things, cover part of our losses resulting from such price controls, the amount of such subsidies vary substantially from year to year or even quarter to quarter and is difficult to predict. Although the Chinese government has adopted a new pricing mechanism for domestic refined oil products that indirectly links the prices of these products to international crude oil prices (see Item 4. Information on the Company B. Business Overview Product Pricing ), such pricing mechanism is still nontransparent. Moreover, the Chinese government controls the distribution of many petroleum products in China. For instance, some of our petroleum products are required to be sold to designated distributors (such as the subsidiaries of China Petroleum & Chemical Corporation). Because we cannot freely sell our fuel products to take advantage of opportunities for higher prices and because the formula for the new pricing mechanism set by the Chinese government is not transparent, in periods of high crude oil prices, we may not be able to fully cover increases in crude oil prices by increases in the sale prices of our products, which has had and will continue to have a material adverse effect on our financial condition, results of operations and cash flows.

### **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 2009 of approximately RMB2.2 billion (US\$332 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, 2009, we had aggregate outstanding indebtedness of approximately RMB8,558 billion (US\$1,254.38million). 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, 2008 and for the three-month period ended March 31, 2009.

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. If we fail to obtain sufficient funding for our operations or development plans, our business, results of operations and financial condition could be adversely affected.

### **We could face increased competition.**

Our principal market, Eastern China, which is comprised of Shanghai, Jiangsu, Zhejiang, Anhui and Jiangxi, 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. In particular, from 2008 to 2010, we expect that China's petrochemical market will reach a peak in newly built on stream capacity. The commencement of production by new plants will create a

capacity surplus and result in a structural oversupply in the petrochemical market in general. We believe this will have a substantial adverse impact on the production and sale of our major products. Moreover, Chinese private enterprises have gradually overcome technological and funding barriers to extend their business from the downstream processing sector to the upstream petrochemical field. These enterprises have advantages in many areas such as flexibility in operation costs, preferential policy treatment and regional presence, and may use these advantages to compete with us in markets for our products.

## **Table of Contents**

### **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 the supply of raw materials, product distribution and sales agency, project design and installment service. Our transactions with these companies are governed by a Mutual Product Supply and Sales Services Framework Agreement with Sinopec Corp and a Comprehensive Services Framework Agreement with Sinopec Group, the terms of which were negotiated on an arm's length basis, see Item 7. B. Related Party Transactions - Intercompany Service Agreement and Business-related Dealings. 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 the contracts between the parties 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 1, 2009, 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 may experience changes in its own business strategy and policies. Although we are not currently aware of any specific 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 and penalties for the discharge of waste substances;

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

the government to close or suspend 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 and operations require permits that are subject to renewal, modification and revocation. At present, 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. Chinese national or local authorities may also impose additional regulations or apply more rigorous enforcement of such regulations which would require additional expenditures on environmental matters.

### **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 fuel products;

setting the allocations and pricing of certain resources, products 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 may 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.

## **Table of Contents**

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 from 5% to 17% to 0% to 14%;

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

has gradually relaxed restrictions on the import of crude oil by non-state owned companies;

has granted foreign-owned companies the right to import petrochemical products; and

has permitted foreign-owned companies to distribute and market fuel products in both retail and wholesale markets in China. As a result of these measures, we face increased competition from foreign companies and imports. As a result of the impact of the global economic downturn, the global market for petrochemical products has contracted considerably and many overseas petrochemical companies, in particular those from neighboring areas, such as Japan, South Korea and the Middle East, have switched their focus to sales in China, which we believe, will further intensify competition in the Chinese domestic petrochemical market. In addition, tariff reductions 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.

### **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 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 may be unable to obtain the foreign currency which is necessary for our business.**

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:



## Table of Contents

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.

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 may be unable to obtain the foreign currency which is necessary for our business. In that case, our business may be materially adversely affected, and we may default on our obligations.

### **Changes in the PRC government's currency policy and fluctuations in the value of the Renminbi may adversely affect our business and operating results.**

The value of the Renminbi against the US dollar and other currencies may fluctuate and is affected by, among other things, changes in China's political and economic conditions. Historically, the People's Bank of China has set the conversion of Renminbi into foreign currencies, including US dollars. On July 21, 2005, the PRC government significantly changed its policy of pegging the value of the Renminbi to the US dollar by permitting the Renminbi to fluctuate within a certain band against a basket of certain foreign currencies. Since the adoption of this new policy, the value of the Renminbi against the US dollar has fluctuated daily, but overall has appreciated against the US dollar. In addition, the PRC government continues to receive significant international pressure to further liberalize its exchange rate policy and as a result may further change its currency policy.

A small portion of our cash and cash equivalents is denominated in foreign currencies, including the US dollar. Any increase in value of the Renminbi against other currencies, including the US dollar, may decrease the Renminbi value of our cash and cash equivalents that are denominated in foreign currencies. On the other hand, most of our revenues are denominated in Renminbi but a major part of our procurement of crude oil and certain equipment as well as certain debt repayments are denominated in foreign currencies. Any devaluation of the Renminbi in the future will increase our costs and jeopardize our profitability. Any devaluation of the Renminbi may also have an adverse impact on the value of dividends payable in foreign currencies by the Company for H shares and ADSs.

### **Changes in PRC tax laws may affect our business and operating results.**

In June 2007, the State Administration of Taxation issued a notice requesting local tax authorities to immediately cease the implementation of certain preferential tax treatment which was granted to nine joint stock enterprises approved by the State Council in 1993 to offer shares on the Hong Kong Stock Exchange on the basis that such treatment had expired. The notice further required that any difference in the past financial years between the enterprise income tax calculated based on the preferential tax rates that had expired and that calculated based on the applicable regular tax rates must be subject to the PRC Law on Tax Collection and Management.

We are one of the nine joint stock enterprises and had enjoyed a preferential enterprise income tax rate of 15%. In August 2007, we were notified by the Shanghai Municipal Office of the State Administration of Taxation that from 2007, our income tax rate would be adjusted from the original 15% to 33% with effect from 2007. We cannot guarantee that the relevant tax authorities will not request payment of the difference in the income taxes for the previous years. No provision has been made in the financial statements for this uncertainty because we believe it is

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not possible to reliably estimate the amount of the obligation, if any, which might exist. With the implementation of the Enterprise Income Tax Law of the PRC, effective January 1, 2008, our income tax rate has become 25%. In addition, our historical operating results may not be indicative of our operating results for future periods as a result of the expiration of the 15% tax rate of the Company.

## **Table of Contents**

### **The rejection of the proposed share reforms required of companies listed on the Shanghai Stock Exchange may adversely affect our market image and our ability to effectuate future transactions such as public offerings on the Shanghai Stock Exchange.**

Pursuant to regulations issued by the China Securities Regulatory Commission (the "CSRC"), we were required to gain shareholder approval for and implement certain share reforms in 2006. Under the share reform plans proposed by holders of our non-circulating A Shares in 2006 and 2007, respectively, all non-circulating A Shares would be converted into circulating A Shares and may be sold publicly on the Shanghai Stock Exchange subject to any applicable lock-up period under the condition that holders of our non-circulating A Shares transfer a portion of their A Shares to holders of our circulating A Shares. However, holders of our circulating A Shares rejected both share reform plans. No specific new proposals have yet been presented to implement the required share reforms. We are uncertain as to when such share reforms will be completed. On January 8, 2007, the Shanghai Stock Exchange began to impose stricter regulations on its listed companies that are required but unable to complete the share reforms, including stricter trading information disclosure requirements and greater restrictions on their ability to effectuate future public offerings. Since March 26, 2007, the Shanghai Stock Exchange has required us to make periodically public announcements regarding the status of our share reforms. In addition, the CSRC is expected to more strictly scrutinize any securities-related applications by publicly listed PRC companies that are required to but have failed to complete such share reforms, their major shareholders and ultimate beneficial owners. The rejection of the proposed share reforms by the holders of our circulating A Shares may adversely affect our market image and our ability to effectuate future transactions such as public offerings on the Shanghai Stock Exchange. The possibility that the CSRC and the Shanghai Stock Exchange will impose more restrictions cannot be eliminated.

### **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. Because these laws, regulations and legal requirements are relatively new and not all accessible to the public and because prior court decisions have little precedential value, 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.**

As most of our business is conducted in China, our operations are governed principally by the laws of China. Despite changes to the PRC Company Law, 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.

### **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 holders of our H shares or 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 such claim or dispute to arbitration with the China International Economic and Trade Arbitration Commission or to the Hong Kong International Arbitration Center. Our Articles of Association further provide that any arbitration decisions with respect to such disputes or claims shall be final and binding on all parties.

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## **Table of Contents**

### **We may be or become a passive foreign investment company, which could result in adverse U.S. federal income tax consequences to U.S. investors.**

We may be classified as a passive foreign investment company ( PFIC ) by the U.S. Internal Revenue Service for U.S. federal income tax purposes. Such characterization could result in adverse U.S. federal income tax consequences to you if you are a U.S. investor. For example, U.S. investors who owned our ADSs during any taxable year in which we were a PFIC generally are subject to increased U.S. tax liabilities and reporting requirements for that taxable year and all succeeding years, regardless of whether we actually continue to be a PFIC, although a shareholder election to terminate such deemed PFIC status may be available in certain circumstances. The same adverse U.S. federal income tax consequences will apply to U.S. investors who acquire our ADSs during the current taxable year or any subsequent taxable year if we are treated as a PFIC for that taxable year.

The determination of whether or not we are a PFIC is made on an annual basis and depends on the composition of our income and assets, from time to time. Specifically, we will be classified as a PFIC for U.S. tax purposes for a taxable year if either (a) 75% or more of our gross income for such taxable year is passive income, or (b) 50% or more of the average percentage of our assets during such taxable year either produce passive income or are held for the production of passive income. For such purposes, if we directly or indirectly own 25% or more of the shares of another corporation, we generally will be treated as if we (a) held directly a proportionate share of the other corporation's assets, and (b) received directly a proportionate share of the other corporation's income.

We do not believe that we are currently a PFIC. However, because the PFIC determination is highly fact intensive and made at the end of each taxable year, there can be no assurance that we will not be a PFIC for the current or any future taxable year or that the IRS will not challenge our determination concerning our PFIC status. For further discussion of the adverse U.S. federal income tax consequences of our possible classification as a PFIC, see Taxation below.

## **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, a 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.

Over the past thirty-six years, the Company built up an infrastructure system to support its production needs. The Company 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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## **Table of Contents**

### **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 assets and liabilities of the Complex were transferred either to us or to Sinopec Shanghai Jinshan Industrial Company ( *JI* ), a separate subsidiary of Sinopec. The Complex's non-core businesses and assets, such as housing, stores, schools, transportation and medical services were transferred to *JI*. The Complex's core business and assets was transferred to us. 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* ). On February 25, 2000, Sinopec Group transferred its interest in us to its subsidiary, Sinopec Corp. In 1997, *JI* was restructured and its subsidiaries were either transferred to Sinopec or Shanghai Jinshan District. Sinopec Group now provides community services to us that were formerly provided by *JI*.

Our H Shares were listed on the HKSE on July 26, 1993. Our 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 November 8, 1993, our A Shares were included in the Shanghai Securities Exchange Stock Index.

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

In the fourth quarter of 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 in order to manufacture and market ethylene, polyethylene, styrene, polystyrene, propylene, acrylonitrile, polypropylene, butadiene, aromatics and by-products; provide related after-sales services and technical advice with respect to such petrochemical products and by products; and engage in polymers application development. Secco completed construction in 2005. Secco's registered capital is US\$901,440,964 of which we were obligated to contribute an amount in Renminbi equivalent to US\$180,287,952 prior to the end of 2005. As of December 31, 2005, we had contributed such amount in full. For a description of capital expansion projects related to our facilities, 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 2008 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 2008 sales volumes, we are a leading Chinese producer of synthetic fibers and resins and plastic products. We believe that we are also a leading competitor in sales of petroleum products and intermediate petrochemicals in our regional markets.

**Table of Contents**

Our net sales by product category, as a percentage of total net sales in each of 2008, 2007 and 2006 are summarized as follows:

**Net Sales of RMB59,330 million (US\$8,696 million) in 2008**

Synthetic fibers	6.17%
Resins and plastics	25.03%
Intermediate petrochemicals	17.31%
Petroleum products	46.44%
All others	5.05%
Total	100.00%

**Net Sales of RMB54,255 million (US\$7,952.36 million) in 2007**

Synthetic fibers	7.98%
Resins and plastics	29.27%
Intermediate petrochemicals	17.28%
Petroleum products	38.77%
All others	6.70%
Total	100.00%

**Net Sales of RMB49,918 million (US\$7,316.67 million) in 2006**

Synthetic fibers	9.44%
Resins and plastics	31.56%
Intermediate petrochemicals	13.57%
Petroleum products	38.84%
All others	6.59%
Total	100.00%

We derive a substantial portion of our revenues from customers in Eastern China (principally Shanghai and its six neighboring 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 and exports, our net sales by product category as a percentage of total net sales for each of 2008, 2007 and 2006 are as follows:

**2008 Net Sales by Region (%)**

	Eastern China	Other parts of China	Exports
Synthetic fibers	80.84	17.12	2.04
Resins and plastics	86.06	13.94	0
Intermediate petrochemicals	84.88	13.79	1.33
Petroleum products	99.55	0.45	0
Total net sales	92.32	7.30	0.38

**2007 Net Sales by Region (%)**

	Eastern China	Other parts of China	Exports
Synthetic fibers	79.94	19.32	0.74
Resins and plastics	87.30	12.70	0.00

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Intermediate petrochemicals	89.12	9.86	1.02
Petroleum products	98.68	1.32	0.00
Total net sales	92.00	7.64	0.36

**2006 Net Sales by Region (%)**

	<b>Eastern China</b>	<b>Other parts of China</b>	<b>Exports</b>
Synthetic fibers	78.89	19.36	1.75
Resins and plastics	86.26	13.73	0.01
Intermediate petrochemicals	92.02	7.13	0.85
Petroleum products	99.65	0.35	0.00
Total net sales	92.70	6.83	0.47



## **Table of Contents**

### **Business Strategy**

In 2009, we will strive to cope with challenging conditions such as a decreased demand in the petrochemical market, a drop in product prices and intensifying market competition. We will implement initiatives to enhance our competitiveness in order to return to profitability.

For example, we will continue to work on constructing our structural adjustment projects and on technological advancement so as to enhance our competitiveness. We will strive to complete work on the comprehensive natural gas utilization renovation project to try to satisfy our planned requirements for receiving natural gas by September 2009. We will also continue to research and develop operative technology, application of new technology, products with high added-value, and increase the development of new plastic and chemical fiber products.

We will further reinforce internal control and management, improve business operation flows and enhance management efficiency. For example, we will continue to reinforce comprehensive budget controls; reduce non-production expenses; adjust our mix of inventories; and strive to lower relevant procurement, processing, and inventory financing costs for crude oil and other raw materials.

We will advance various training programs and further reinforce staff team building. For example, we will integrate corporate management resources, advance the centralized and specialized management of business operations such as quality control and assurance and analytical testing, and integrate auxiliary businesses with external investment businesses. We will further reinforce staff team building by extensively conducting cross-position, cross-department and cross-profession exchanges to increase the vitality of the staff. We will continue to enhance the training of professional technicians in the know-how and the skills needed to improve their vocational abilities.

We will reinforce management abilities to ensure safe, stable and efficient production operations. To do so, we will continue to improve our emergency response mechanism for environmental protection and strengthen the supervision and management of safety to prevent serious accidents or occupational diseases and hazards. We will also take measures to prevent corrosion and intensify the monitoring and routine maintenance of equipment and facilities.

We will also work on energy conservation in accordance with the relevant requirements of the Chinese government. For example, we will continue to improve the balance and optimization of our steam system, reducing the discharge of low-pressure steam. We will continue to improve the flare gas recovery project, enabling the recovery and utilization of flare gas and low added-value fuel to the maximum extent through use of our recovery system. We will continue to proceed with additional water conservation, emissions reduction and waste water recovery in oil refining and petrochemical production by further reducing the volume of water consumed by our projects. We will also proceed with a centralized supply of pure water to lower relevant costs.

### **Principal Products**

We produce four principal types of products with different specifications, including 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 2008 net sales by major product as a percentage of total net sales together with the typical uses of these products.

**Table of Contents**

<b>Product</b>	<b>% of net sales</b>	<b>Typical Use</b>
<b>SYNTHETIC FIBERS</b>		
Polyester staple fiber	1.02	Textiles and apparel
Acrylic staple fiber	3.98	Woven into fabrics or blended with other material fabrics to make fabric or acrylic top
Acrylic top	0.62	High bulk hand knitting yarn, blankets and fabrics
Others	0.55	
<b>Sub-total</b>	<b>6.17</b>	
<b>RESINS AND PLASTICS</b>		
Polyester chips	6.27	Polyester fibers, films and containers
PE pellets	10.06	Films, ground sheeting, wire and cable compound and other injection molding products such as housewares and toys
PP pellets	7.42	Extruded films or sheets, injection molded products such as housewares, toys and household electric appliance and automobile parts
PVA	0.91	PVA fibers, building coating materials and textile starch
Others	0.37	
<b>Sub-total</b>	<b>25.03</b>	
<b>INTERMEDIATE PETROCHEMICALS</b>		
Ethylene	1.18	Feedstock for Polyethylene, EG, PVC and other intermediate petrochemicals which can be further processed into resins and plastics and synthetic fiber.
Ethylene oxide	2.61	Intermediate for chemical and pharmaceutical industry, dyes, detergents and auxiliary agents
Benzene	2.70	Intermediate petrochemical products, styrene, plastics, explosives, dyes, detergents, epoxies and nylon
Butadiene	2.66	Synthetic rubber and plastics
Ethylene glycol	3.01	Fine chemicals
Others	5.15	
<b>Sub-total</b>	<b>17.31</b>	
<b>PETROLEUM PRODUCTS</b>		
Gasoline	6.83	Transportation fuels
Diesel	27.37	Agricultural fuels
Jet Fuel	6.05	Transportation fuels
Others	6.19	
<b>Sub-total</b>	<b>46.44</b>	
All others	5.05	
<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 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.

**Table of Contents**

## **Table of Contents**

Our refinery units refine crude oil into five basic components: (1) naphtha, (2) kerosene, (3) atmospheric gas oil ( AGO ), (4) VGO, and (5) residual oil. Naphtha and part of the AGO is fed to the ethylene units primarily to produce ethylene and propylene. The other part of the AGO is processed into diesel oil, and kerosene is fed to the jet fuel sweetening unit to produce jet fuel. Part of the VGO is further processed in a hydrocracking unit producing mainly light and heavy naphtha, liquefied petroleum gas ( LPG ), diesel oil, various aromatic hydrocarbon products and jet fuel. The other part of the VGO and 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) PE and (5) PVA. Each of these five products has its own production line or lines. We further process polyester and acrylonitrile 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.

*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 PE, two of which produce LDPE using the kettle type process, and the other unit produces all density PE products using the Borstar bimodal process.

*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 2008, crude oil accounted for approximately 71.47% 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 2008, we did not experience any significant problems in obtaining sufficient crude oil to meet our production needs.

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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. 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.

**Table of Contents**

We have received confirmation from Sinopec Corp that we will receive an allocation of 0.78 million tons of domestic offshore crude oil and 8.22 million tons of foreign crude oil in 2009. 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 offshore and foreign crude oil, for our anticipated annual needs. We anticipate fully utilizing our 2009 allocation of crude oil. We believe that the mix of crude oil feedstocks currently available is satisfactory for our 2009 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 2009 will depend on a variety of factors, including the amount of future allocations of domestic offshore 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 2009 production capacity and goals.

In 2008, our crude oil was sourced as follows:

Domestic offshore crude oil	5.41%
Foreign crude oil	94.59%
Total:	100.00%

As a result of a consistent decrease in the supply of domestic crude oil, we expect that we will continue to rely principally on foreign sources for our crude oil supply. However, 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.

Foreign and domestic offshore crude oil is supplied by tanker and pipeline to our oil terminal wharf and oil storage tank. See [Item 4.D. 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 at Chenshan wharf capable of storing approximately 300,000 cubic meters of crude oil, primarily to provide crude oil to our No. 2 atmosphere vacuum distillation facility. This crude oil storage can provide us with approximately a 20 day supply of crude oil. The crude oil for our No. 3 atmosphere vacuum distillation facility is mainly supplied from the Ningbo-Shanghai-Nanjing oil pipeline. Due to our ability to obtain crude oil from multiple sources, we are able to meet our normal requirements for crude oil.

*Pricing* The price of domestic offshore crude oil is controlled by China National Offshore Oil Corporation (CNOOC) and Sinopec Group based on government pricing policies and by reference to the price of the crude oil of the same quality in the international market, while imported crude oil is generally allocated to us at prevailing international market prices. The average cost of foreign and domestic offshore crude oil in 2008 was RMB5,340 (US\$782) per ton and RMB4,669 (US\$684.35) per ton, respectively. In 2008, we processed 8.739 million tons of foreign crude oil and 499,300 tons of domestic offshore crude oil.

Until March 2001 the Chinese government implemented a unified pricing system for crude oil. Each month, the National Development and Reform Commission (NDRC) would establish 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. Beginning 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.

Sinopec Corp will allocate crude oil to us in sources selected and quantities confirmed by the Company at market prices. 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.



## Table of Contents

### Coal

Most of the coal used for electricity generation is purchased through a unified system of procurement by Sinopec Corp, and the rest is purchased directly by us from mines. 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. Our cost of coal is primarily 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 2009 will be approximately 2.12 million tons. In 2008, we consumed approximately 2.12 million tons of coal, an increase from 2007 of approximately 0.278 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 2008, the total cost of these materials accounted for approximately 14.56% 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 fuel products is subject to government regulations. We are required to sell certain refined products to the subsidiaries of Sinopec Group or customers designated by Sinopec Group. Since the second half of 2005, Sinopec Group has executed reforms to its system of selling petrochemical products and implemented what it refers to as a Five Consolidations strategy featuring consolidated marketing strategy, consolidated promotion, consolidated logistics optimization, consolidated sales and consolidated branding. As a result, the sales of our major petrochemical products are now conducted in a consolidated manner by sales agents designated by Sinopec Group. However, we have the autonomy to decide on the distribution method of our other products in accordance with market conditions. The products we sold in 2008 that were subject to planned distribution by Sinopec Group, sales by agents and sales based on our own discretion accounted for 57.26%, 31.13% and 11.61%, respectively, of the total products we sold.

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. We believe that the transition to sales of major petrochemical products by agents designated by Sinopec Group will increase our distribution efficiency by allowing us to benefit from Sinopec Group's extensive and highly specialized sales network. It will also allow us to focus more of our resources on reducing production costs and enhancing our technical support.

We use long-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 2008. Though affected by the global economic downturn, in general we managed to keep a stable link between production and sales in 2008.

### Product breakdown

*Synthetic Fibers* In 2008, 7.22% 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 12.30% of our sales of synthetic fibers in 2008.

*Resins and Plastics* In 2008, approximately 5.15% of our resins and plastics sales were to provincial and municipal government trading companies and approximately 57.88% were sold to industrial users. No single customer accounted for more than 3.38% of our sales of resins and plastics in 2008.

*Intermediate Petrochemicals* We sell a variety of intermediate petrochemical products, none of which were sold in substantial quantities.



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Shanghai Chlor-Alkali Chemical Co. Ltd. ( Chlor-Alkali ) is the principal outside consumer of our ethylene. In 2008, we sold 76,600 tons of ethylene, representing 8.65% of our total 2008 production of such product, to Chlor-Alkali at prices mutually agreed upon by both parties. We have no plan to sell ethylene to Chlor-Alkali in 2009.

## **Table of Contents**

*Petroleum Products* In 2008, our primary gasoline and diesel customer was Sinopec Sales Company Eastern China Branch Company. We sold residual oil directly to industrial end-users for use as industrial fuel and as feedstock to produce light petroleum products.

### **Product Pricing**

Most of our products other than petroleum products are permitted to be sold at market prices. However, four types of petroleum products (gasoline, diesel and jet fuel, and liquefied petroleum gas) that we sell are subject to varying degrees of government pricing control and are, accordingly, sold at prices set by the Chinese government, which are often below our costs. In 2006, 2007 and 2008, approximately 53.96%, 54.06% and 43.52% of our net sales were from products subject to price controls. Price controls may apply to these products in various ways. Such pricing controls are sometimes applied exclusively to our products, exclusively to our competitors' products or sometimes applied to neither our products nor our competitors' products. The Chinese government plans to change the pricing mechanism for domestic refined oil to be indirectly aligned with international crude oil prices in a controlled manner through use of certain formula(s). However the pricing mechanism used in these formula(s) is not transparent.

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 high quality of products, we believe that we can continue to price our products competitively.

### **Competition**

We compete principally in the Chinese domestic market where 99.85% of our products were sold in 2008. 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 2008, 92.32% of our net sales were made to customers in Eastern China.

#### **Our Competitive Advantages**

We believe our primary competitive advantages are quality of product, pricing, brand recognition, geographic 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. 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 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. At the same time, Chinese private enterprises have gradually overcome technological and funding barriers to extend their business from the downstream processing sector to the upstream petrochemical field. These enterprises have advantages in many areas such as flexibility in operation costs, preferential policy treatment and regional presence, and may use these advantages to compete with us in markets for our products.

#### **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 certain 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 from between 5% to 17% to between 0% to 14% with further reductions planned until they reach a range of between 0% and 6.5%. In accordance with its WTO commitments, China has made the following changes:

foreign investors are now permitted to wholly-own domestic petrochemical companies;

restrictions on the import of crude oil by non-state owned companies are gradually relaxed;

foreign-owned companies are granted the right to import petrochemical products; and

foreign-owned companies are permitted to distribute and market petroleum products in both retail and wholesale markets in China.

## **Table of Contents**

As a result of these measures, we are facing increased competition from foreign companies and importation. Changes in crude oil importation 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 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 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 owned 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 limitation requiring trade through state owned traders. China will allocate 4.0 million tons of processed oils to non-state owned traders and increase this amount by 15% annually for 10 years.

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.

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.

Faced with the declining demand for petrochemical products as a result of the global economic downturn, many overseas petrochemical companies, in particular those from neighboring areas, such as Japan, South Korea and the Middle East, have switched their focus to sales in China, which we believe, will further intensify competition in the Chinese domestic petrochemical market.

## **Our Competitive Position**

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

### ***Synthetic Fibers***

In 2008, we had an approximate 1.36% share and imports had an approximate 2.34% share of total domestic polyester and acrylic 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.

**Table of Contents**

The following table summarizes the competitive position of our principal synthetic fibers according to domestic sales in 2008.

<b>Product</b>	<b>Our share of domestic consumption (%)</b>	<b>Our competitive ranking</b>	<b>Location of principal domestic competitor</b>	<b>Principal domestic competitor's share of consumption (%)</b>	<b>Imports share of consumption (%)</b>
Acrylic	25%	1	Ji Lin Province	23%	19.71%

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

**Table of Contents*****Resins and Plastics***

In 2008, we had an approximate 4.63% share and imports had an approximate 24.52% 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 2008.

<b>Product</b>	<b>Our share of domestic consumption (%)</b>	<b>Our competitive ranking</b>	<b>Location of principal domestic competitor</b>	<b>Principal Domestic competitors Share of consumption (%)</b>	<b>Imports share of consumption (%)</b>
Polyester chips	4.87%	20	Jiang Su Province	6%	2.55%
PE	4.81%	4	Guang Dong Province	11.9%	40.57%
PP	4.19%	3	Guang Dong Province	6.4%	28.03%

Sources: Statistics provided to us by Sinopec Group.

***Intermediate Petrochemicals***

In 2008, we were one of the largest sellers of intermediate petrochemicals in China and held an approximate 5.20% share of the total domestic consumption. Imports had an approximate 28.92% share of domestic consumption. Ethylene, benzene and butadiene are our major intermediate petrochemical products. In 2008, we were a major ethylene producer in China. The following table summarizes the competitive position of our principal intermediate petrochemicals according to domestic sales in 2008.

<b>Product</b>	<b>Our share of domestic consumption (%)</b>	<b>Our competitive ranking</b>	<b>Location of principal domestic competitor</b>	<b>Principal Domestic competitors Share of consumption (%)</b>	<b>Imports share of consumption (%)</b>
Ethylene glycol	5.94%	1	Jiang Su Province	4%	73.6%

***Petroleum Products***

In 2008, we had an approximate 2.15% share of the total domestic petroleum products market while imports had an approximate 7.35% 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 2008, we sold approximately 99.55% of our petroleum products in Eastern China.

**Investments**

We established Secco, a Sino-foreign equity joint venture, in late 2001 together with BP and Sinopec Corp, primarily to build and operate a 900,000 ton Rated Capacity ethylene petrochemical manufacturing facility. Secco completed construction and commenced its manufacturing operations in 2005. We own 20% of the equity interest of Secco.

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In 2008, Secco achieved a total sales revenue of RMB22.851 billion, representing a decrease of 5.65% from its sales revenue of RMB24.219 billion in 2007. Secco's net loss in 2008 was RMB0.49 billion, as compared to a net profit of RMB2.959 billion in 2007. The average price of the raw materials used by Secco increased by 9.52% in 2008 from that in 2007. To reduce the pressure resulting from the rising price of raw materials, Secco took a series of measures to control its costs, such as adjusting the mix of its production, improving the availability of its production equipment and further reducing its units' consumption of materials. The net loss in 2008 is mainly attributable to the combined effect of higher cost of raw materials during the first half of 2008 and the decrease in selling prices accompanying the absorption of the cost of the raw materials which had been purchased at higher prices during the second half of 2008.

## **Table of Contents**

### **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 that fails to comply with orders requiring it to cease or cure certain environmentally damaging practices. We have established environmental protection systems which consist of pollution control facilities 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 2008, we were assessed a total of RMB35.0 million (US\$5.1 million) in fees for discharges of waste substances. As of May 1, 2009, 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 that 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, 2008, was approximately RMB27.2 billion (US\$4.0 billion) on our property and facilities and approximately RMB2.2 billion (US\$0.3 billion) 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.

### **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.



**Table of Contents**

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, renamed China National Petroleum Corporation and authorized 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 to 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.

Subsidiary Name	Our ownership interest and voting power (%)
Shanghai Petrochemical Investment Development Company Limited	100.00
China Jinshan Associated Trading Corporation	67.33
Shanghai Jinchang Engineering Plastics Company Limited	50.38
Shanghai Golden Phillips Petrochemical Company Limited	60.00
Zhejiang Jin Yong Acrylic Fiber Company Limited	75.00
Shanghai Petrochemical Enterprise Development Company Limited	100.00
Shanghai Golden Conti Petrochemical Company Limited	100.00

**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 trading volume in 2008, Sinopec Corp is one of the largest publicly listed companies 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 and Sinopec (Hong Kong) Limited, which are incorporated in Bermuda and Hong Kong respectively, all of the below principal subsidiaries are incorporated in China.

**Table of Contents**

Name of company	Particulars of issued capital (millions)	Type of legal entity	Percentage of equity		Principal activities
			held by Sinopec Group (%)	held by Sinopec Group's subsidiary (%)	
China Petrochemical International Company Limited		Limited company	100.00		Trading of petrochemical products
Sinopec Sales Company Limited	RMB1,663	Limited company	100.00		Marketing and distribution of refined petroleum products
Sinopec Yangzi Petrochemical Company Limited	RMB1,700	Limited company	100.00		Manufacturing of intermediate petrochemical products and petroleum products
Sinopec Zhongyuan Petroleum Company Limited	RMB16,337	Limited company	100.00		Exploration and production of crude oil and natural gas
Sinopec Shengli Oil Field Dynamic Company Limited	RMB875	Limited company	100.00		Exploration and production of crude oil and distribution of petrochemical products
Sinopec Fujian Petrochemical Company Limited	RMB364	Limited company	100.00		Manufacturing of plastics, intermediate petrochemical products and petroleum products
	RMB2,253	Limited company	50.00		

**Table of Contents**

Name of company	Particulars of issued capital (millions)	Type of legal entity	Percentage of equity		Principal activities
			held by Sinopec Group (%)	held by Sinopec Group's subsidiary (%)	
Sinopec Shanghai Petrochemical Company Limited		Limited company	55.56		Manufacturing of synthetic fibers, resin and plastics, intermediate petrochemical products and petroleum products
Sinopec Kantons Holdings Limited	RMB7,200	Limited company		72.34	Trading of crude oil and petroleum products
Sinopec Wuhan Petroleum Group	HK\$104	Limited company	46.25		Marketing and distribution of refined petroleum products
Sinopec Yizheng Chemical Fiber Company Limited	RMB147	Limited company	42.00		Production and sale of polyester chips and polyester fibers
Sinopec Zhongyuan Petrochemical Company Limited	RMB4,000	Limited company	93.51		Manufacturing of chemical products
Sinopec Shell (Jiangsu) Petroleum Marketing Company Limited	RMB2,400	Limited company	60.00		Marketing and distribution of refined petroleum products
BP Sinopec (Zhejiang) Petroleum Company Limited	RMB830	Limited company	60.00		Marketing and distribution of refined petroleum products
Sinopec Qingdao Refining and Chemical Company Limited	RMB800	Limited company	85.00		Manufacturing of intermediate petrochemical products and petroleum products
China International United Petroleum and Chemical Company Limited	RMB3,040	Limited company	100.00		Trading of crude oil and petrochemical products
Sinopec Hainan Refining and Chemical Company Limited	RMB3,986	Limited company	75.00		Manufacturing of intermediate petrochemical products and petroleum products
Sinopec (Hong Kong) Limited	HK\$5,477	Limited company	100.00		Trading of crude oil and petrochemical products
Sinopec Senmei (Fujian) Petroleum Ltd.	RMB1,840	Limited company	55.00		Marketing and distribution of refined petroleum products

**Table of Contents****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**

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 such 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.

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 2008:

<b>Production Unit (number of units)</b>	<b>Rated Capacity (tons)</b>	<b>Utilization Rate (%)</b>
Crude oil distillation units (2)	14,000,000	63.75
Hydrocracker (2)	3,000,000	77.96
Ethylene units (2)	850,000	101.98
Aromatics unit	235,000	84.14
PTA unit	400,000	87.62
EO/EG unit (2)	525,000	102.84
Acrylonitrile unit	130,000	112.58
Acetaldehyde unit	42,000	73.43
Acetic acid unit	45,000	66.37
Cracking and catalyzing	1,000,000	99.46
Delayed Coking (2)	22,000,000	95.91

Our two crude oil distillation units were designed and built in China. In 2008, the actual amount of crude oil we processed was approximately 9.24 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 2008:

<b>Production Unit (number of units)</b>	<b>Rated Capacity (tons)</b>	<b>Utilization Rate (%)</b>
Polyester units (3)	550,000	99.33
Polyester staple units (2)	154,000	71.51
Polyester filament units (3)	45,000	39.14
Acrylic staple fiber units (4)	191,000	111.08
Acrylic top units (2)	32,000	103.81

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PE units (3)	408,000	100.56
PE film blowing facilities (2)	32,000	0.00
PP units (3)	400,000	102.73
PP staple fiber unit	17,000	0.00
Vinyl acetate unit (2)	102,000	116.57

## **Table of Contents**

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.

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.

## **Power Facilities**

Our electricity requirements are currently supplied by our own 425 megawatt coal-fired power plant and petroleum coke power plant. These power plants are designed to supply power needed by our facilities. We are connected to the East China electricity grid, which provides a back-up source of power in case of a shortfall in our power supply.

## **Other Facilities**

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

## **Maintenance**

We engage in production stoppages for facility maintenance and repairs and implement our routine monthly maintenance and repair plans according to the needs of our production facilities, our requirements for product quality, and our commitment to security and environmental protection. The technicians in our facility management department have responsibility for the daily management of maintenance and repair work. We also outsource facility maintenance and repair projects to qualified contractors.

## **Transportation-Related Fixtures**

Crude oil, our principal raw material, is transported by pipeline and oil tanker to a crude oil terminal wharf and storage tanks. Our products leave the factory by water, rail, road and pipeline. In 2008, approximately 65.96% 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 2008, products representing 23.04% 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 2008, products representing 11.78% 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.

We own an oil terminal wharf at Chenshan in 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.

## **Rail**

We own a railroad loading depot with an annual capacity of 50,000 tons. The depot provides access via a spur line to the national Chinese railway system. In 2008, products representing 2.99% 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 allocation of use of which remains strictly controlled 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 RMB2.2 billion in 2009. This amount will be funded internally and by bank loans.

**Table of Contents**

Name of Project	Rated Capacity (tons/year)	Start Date	Expected Completion Date	Status
<b>Refining Capacity Expansion</b>				
Transformation Project for Selective Hydrodesulphurization of FCC Gasoline	N/A	2009	2009	Basic design
Refinery Reconstruction Project	16,000,000	2010	2012	Feasibility study report submitted
<b>Expansion of New and Existing Downstream Production Facilities</b>				
150,000-ton C5 Segregation Unit	150,000	2008	2009	Under construction
600,000 ton Aromatics Unit	600,000	2007	2009	Under construction
No.1 Ethylene Unit, Relocation and Reconstruction	600,000	2010	2012	Pending government approval
<b>Other Projects</b>				
No. 3 and No. 4 Flue Gas Desulphurization ( FGD )	N/A	2008	2009	Under construction
Project of No. 2 Oxidation Unit Transformation for System Optimization, Energy Saving and Consumption Reduction	N/A	2009	2011	Feasibility study
Technological Transformation of No. 7 and 8 Berths of Chenshan Wharf	N/A	2009	2009	Feasibility study
Supporting Project for Connection of Natural Gas to the Plant	N/A	2009	2009	Feasibility Study

N/A not applicable.

In 2006, 2007 and 2008, we invested RMB2.009 billion, RMB2.134 billion, and RMB1.267 billion, respectively, in capital expansion projects. We have delayed the completion of some capital expansion projects in order to save costs and to respond to the changing demand for certain of our products following the recent global economic downturn. These projects include (1) the Transformation of the Selective Hydrodesulphurization of FCC, (2) the Refinery Reconstruction Project, (3) the Relocation and Reconstruction of the No. 1 Ethylene Unit, (4) the Transformation of the No. 2 Oxidation Unit, and (5) the Transformation of the No. 7 and 8 Berths of the Chenshan Wharf.

**Refining Capacity Expansion Plans**

With a view to accommodating the adjustment in our product mixes, processing the heavy and low-quality crude oil we purchase in order to control our cost, and enhancing the quality operations of oil refining facilities, we have implemented a transformation project for the selective hydrodesulphurization of FCC gasoline and other projects to ensure the gasoline delivered by the Company complies with the quality indices of China Stage III Standard and meets the market needs.

Currently preparation for a refinery reconstruction project, which will increase crude oil reprocessing capacity by 4 million ton/year, is under development. In September 2008, a new feasibility study report pertaining to the refinery reconstruction project was submitted to Sinopec Corp. It is planned that the project will commence construction in 2010 and be completed in 2012.

**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 take advantage of our strength in research, development and productions of C<sub>5</sub> chemical products, we plan to construct a 150,000-ton C<sub>5</sub> segregation unit. The construction of the project is anticipated to realize intermediate handover in May 2009 and be put into production in July 2009.



## **Table of Contents**

To meet the demands of national social and economic development and to upgrade out-of-date devices and realize production economies of scale, we have started to carry out reconstruction of the No. 1 ethylene unit by changing its location and constructing a new aromatics consolidation unit with a Rated Capacity of 600,000 tons per year. In July 2008, the No. 1 ethylene unit reconstruction project was approved by the National Reform and Development Commission. At present, the feasibility study report is being prepared and related technical preparations are being undertaken. Once the proposal for it has been granted approval, the project is expected to commence in 2010 and be completed in 2012. The new 600,000 ton/year unit began pile foundation construction in January 2008 and civil construction in April 2008, and is expected to realize intermediate handover in June 2009 and be put into production in the third quarter of 2009.

### **Other Projects**

To control and reduce the volume of carbon dioxide emission for protection of the environment and based on the FGD reconstruction projects conducted with respect to the No. 1 and No. 2 boilers, we plan to further implement an FGD reconstruction project with respect to the No. 3 and No. 4 boilers. We commenced pile foundation construction for the project in July 2008, civil construction in September 2008 and equipment installation in October 2008, and have completed intermediate handover of the project in March 2009.

The feasibility study for the No. 2 oxidation unit transformation project for the purpose of further energy saving, consumption reduction, cost cut and efficiency improvement, was approved by Sinopec Corp in September 2008, and entrusted basic design for the project is under way at present. The Company plans to start the procurement of long-cycle facilities in 2009 and civil construction at the end of 2009, and complete the project in 2011.

The feasibility study for the transformation of No. 7 and 8 berths of Chenshan Wharf was approved by Sinopec Corp in September 2008, and the basic design was submitted in December 2008 for approval. The Company plans to commence construction of the project in May 2009 and equipment installation in October 2009, and to put the transformed berths into use in December 2009.

To support gas supply from Sichuan to eastern China and the Company's optimization and comprehensive utilization of energy sources, the feasibility study report for the Company's comprehensive natural gas utilization project was submitted to Sinopec Corp in December 2008 for its examination and approval. The Company plans to commence civil construction for the project in the spring of 2009, start equipment and process line installation in June 2009, realize intermediate handover in September 2009, and put the project into use in October 2009.

### **ITEM 4A. UNRESOLVED STAFF COMMENTS.**

Not applicable.

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

#### **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.

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, as issued by the International Accounting Standards Board.

## **Table of Contents**

### **Critical Accounting Policies**

The following discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements. 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 2008. Our 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 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 for long-lived assets**

If circumstances indicate that the net book value of a long-lived asset may not be recoverable, the asset may be considered impaired, and an impairment loss may be recognized in accordance with International Accounting Standard No.36 Impairment of Assets. Long-lived assets are reviewed for impairment at the end of each reporting period or whenever events or changes in circumstance have indicated that their carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to recoverable amount. For goodwill, the recoverable amount is estimated annually. The recoverable amount is the greater of the net selling price and the value in use. It is difficult to precisely estimate selling prices because quoted market prices for our assets or cash-generating units are not readily available. In determining the value in use, expected cash flows generated by the asset or the cash-generating unit are discounted to their present value, which requires significant judgment relating to level of sale volume, selling price and amount of operating costs. We use all readily available information in determining an amount that is a reasonable approximation of recoverable amount, including estimates based on reasonable and supportable assumptions and projections of sale volume, selling price and amount of operating costs. During the years ended December 31, 2006, 2007 and 2008 we recognized impairment charges on property, plant and equipment of RMB50 million RMB200 million and RMB440 million respectively. During the year ended December 31, 2008 we also recognized a goodwill impairment charge of RMB22 million.

### **Depreciation**

Property, plant and equipment are depreciated on a straight-line basis over the estimated useful lives of the assets, after taking into account the estimated residual values. 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 were no significant changes in these estimates during the years ended December 31, 2006, 2007 and 2008.

### **Impairment for bad and doubtful debts**

We estimate impairment losses for bad and doubtful debts resulting from the inability of the customers to make the required payments. We base the estimates on the aging of the accounts receivable balance, customer credit-worthiness and historical write-off experience. If the financial condition of the customers were to deteriorate, actual write-offs would be higher than estimated. Impairment provisions for bad and doubtful debts were RMB9 million, RMB4 million and nil during the years ended December 31, 2006, 2007 and 2008, respectively.

### **Allowance for diminution in value of inventories**

Any excess of the cost over the net realizable value of each item of inventories is recognized as a provision for diminution in the value of inventories. Net realizable value represents the estimated selling price in the ordinary course of business, less the estimated costs of completion and the estimated costs necessary to make the sale. We base the estimates on all available information, including the current market prices of the finished goods and raw materials and historical operating costs. If the actual selling prices were to be lower or the costs of completion were to be higher than estimated, the actual allowance for diminution in value of inventories could be higher than estimated. Provisions for diminution in the value of inventories were RMB33 million, RMB36 million and RMB745 million during the years ended December 31, 2006, 2007 and 2008, respectively.



**Table of Contents****Summary**

The following table sets forth our sales volumes and net sales for the years indicated:

	For the years ended 31 December								
	2006			2007			2008		
	Sales Volume ( ' 000 tons)	Net Sales (Millions of RMB)	% of Total Net Sales	Sales Volume ( ' 000 tons)	Net Sales (Millions of RMB)	% of Total Net Sales	Sales Volume ( ' 000 tons)	Net Sales (Millions of RMB)	% of Total Net Sales
Synthetic Fibres	337.0	4,711.7	9.4	296.0	4,328.7	7.9	278.4	3,662.0	6.2
Resins and Plastics	1,558.9	15,753.3	31.6	1,549.0	15,878.8	29.3	1,462.6	14,850.3	25.0
Intermediate Petrochemicals	1,009.3	6,775.7	13.6	1,232.4	9,372.7	17.3	1,347.1	10,271.8	17.3
Petroleum Products	5,109.8	19,387.6	38.8	5,376.2	21,036.6	38.8	5,747.0	27,552.9	46.4
All others		3,289.8	6.6		3,637.9	6.7		2,992.8	5.1
Total	8,015.0	49,918.1	100.0	8,453.6	54,254.7	100.0	8,835.1	59,329.8	100.0

**Table of Contents**

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

	For the years ended 31 December					
	2006		2007		2008	
	Millions of RMB	% of Net sales	Millions of RMB	% of Net sales	Millions of RMB	% of Net sales
<b>Synthetic fibres</b>						
Net sales	4,711.7	9.4	4,328.7	7.9	3,662.0	6.2
Operating expenses	(4,515.4)	(9.0)	(4,410.8)	(8.1)	(5,313.5)	(9.0)
Operating profit/(loss)	196.3	0.4	(82.1)	(0.2)	(1,651.5)	(2.8)
<b>Resins and plastics</b>						
Net sales	15,753.3	31.6	15,878.8	29.3	14,850.3	25.0
Operating expenses	(14,591.2)	(29.3)	(15,222.3)	(28.1)	(17,027.0)	(28.7)
Operating profit/(loss)	1,162.1	2.3	656.5	1.2	(2,176.7)	(3.7)
<b>Intermediate petrochemicals</b>						
Net sales	6,775.7	13.6	9,372.7	17.3	10,271.8	17.3
Operating expenses	(6,095.3)	(12.2)	(8,558.9)	(15.8)	(10,314.5)	(17.4)
Operating profit/(loss)	680.4	1.4	813.8	1.5	(42.7)	(0.1)
<b>Petroleum Products</b>						
Net sales	19,387.6	38.8	21,036.6	38.8	27,552.9	46.4
Other income	282.1	0.6	93.9	0.2	2,312.2	3.9
Operating expenses	(21,367.4)	(42.8)	(21,774.7)	(40.2)	(33,811.0)	(57.0)
Operating profit/(loss)	(1,697.7)	(3.4)	(644.2)	(1.2)	(3,945.9)	(6.7)
<b>Others</b>						
Net sales	3,289.8	6.6	3,637.9	6.7	2,992.8	5.1
Operating expenses	(3,078.0)	(6.2)	(3,489.2)	(6.4)	(2,993.3)	(5.1)
Operating profit/(loss)	211.8	0.4	148.7	0.3	(0.5)	0.0
<b>Total</b>						
Net sales	49,918.1	100.0	54,254.7	100.0	59,329.8	100.0
Other income	282.1	0.6	93.9	0.2	2,312.2	3.9
Operating expenses	(49,647.3)	(99.5)	(53,455.9)	(98.6)	(69,459.3)	(117.1)
Income/(loss) from operation	552.9	1.1	892.7	1.6	(7,817.3)	(13.2)
Net financing costs	(165.4)	(0.3)	(177.9)	(0.3)	(330.4)	(0.6)
Investment income			770.7	1.4	131.8	0.2
Share of profits of associates and jointly controlled entities	576.7	1.2	665.9	1.2	1.5	0.0
Earnings/(loss) before income tax	964.2	1.9	2,151.4	4.0	(8,014.4)	(13.5)
Income tax	(53.2)	(0.1)	(468.3)	(0.9)	1,812.7	3.1
Net income/(loss)	911.0	1.8	1,683.1	3.1	(6,201.7)	(10.4)

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<b>Attributable to:</b>						
Equity shareholders of the Company	844.4	1.7	1,634.1	3.0	(6,238.4)	(10.5)
Minority interests	66.6	0.1	49.0	0.1	36.7	0.1
Net income/(loss)	911.0	1.8	1,683.1	3.1	(6,201.7)	(10.4)

- (1) Net sales revenue represents sales revenue of the respective product segments after tax. Operating expenses represent cost of sales, selling and administration expenses and other operating expenses/income, as allocated to respective product segments. Operating profit corresponds to the profit from operating allocated to respective product lines.

## **Table of Contents**

### **Results of Operations**

Year ended December 31, 2008 compared with year ended December 31, 2007.

#### **Net sales and other income**

Our total net sales increased by 9.35% to RMB59,329.8 million in 2008 compared to RMB54,254.7 million in 2007. In the first half of 2008, the prices of petrochemical products continued to rise in general as a result of a substantial rise in international oil prices. However, in the second half, there was a fall in both product sales volume and prices as a result of the slump in the petrochemicals market triggered by the global economic downturn. For the year ended December 31, 2008, the weighted average prices (excluding tax) of our synthetic fibres as well as resins and plastics decreased by 10.15% and 1.05%, respectively, from their levels in the previous year; the weighted average prices (excluding tax) of intermediate petrochemicals and petroleum products increased by 0.14% and 20.65% respectively, from their levels in the previous year.

##### *(i) Synthetic fibres*

The net sales of synthetic fibre products decreased to RMB3,662.0 million in 2008, representing a 15.40% decrease compared to RMB4,328.7 million in 2007. The weighted average price of synthetic fibres decreased by 10.15% as compared to 2007, and the profit margin of synthetic fibre products was substantially reduced as raw material costs of synthetic fibres remained at high levels. As such, sales volume of our synthetic fibres in 2008 decreased by 5.95% as compared to 2007 because the sales volumes of major synthetic fibre products decreased by varying extent in 2008.

Net sales of synthetic fibre products accounted for 6.20% of our total net sales in 2008, representing a decrease of 1.70 percentage points as compared to 2007.

##### *(ii) Resins and plastics*

The net sales of resins and plastics decreased to RMB14,850.3 million in 2008, representing a decrease of 6.48% compared to RMB15,878.8 million in 2007. Weighted average price of resins and plastics in 2008 decreased by 1.05% compared to 2007 and sales volume in 2008 decreased by 5.58% compared to 2007. Among our resins and plastics products, the sales volume of polyester chips for 2008 decreased by 11.14% and the average sales price decreased by 9.21%. The sales volumes of polyethylene and polypropylene for 2008 also decreased as compared to 2007.

Net sales of resins and plastics accounted for 25.00% of our total net sales in 2008, representing a decrease of 4.30 percentage points as compared to 2007.

##### *(iii) Intermediate petrochemicals*

The net sales of intermediate petrochemicals increased to RMB10,271.8 million in 2008, representing an increase of 9.59% compared to RMB9,372.7 million in 2007, with the weighted average price of intermediate petrochemicals increasing by 0.14% compared to 2007 and sales volume increasing by 9.31% as compared to 2007. Among our intermediate petrochemicals, the weighted average prices of ethylene, butadiene and ethylene oxide increased slightly compared to 2007.

The net sales of intermediate petrochemicals accounted for 17.3% of our total net sales in 2008, basically at par with 2007.

##### *(iv) Petroleum products*

The net sales of petroleum products increased to RMB27,552.9 million in 2008, representing an increase of 30.98% compared to RMB21,036.6 million in 2007, with an increase of 20.65% in the weighted average price as compared to 2007. The weighted average prices of gasoline and diesel oil increased by 20.68% and 19.70%, respectively as compared to 2007. Due to the price limits set by the Chinese government, the petroleum products segment reported a negative profit margin, while we increased sales volume of gasoline and diesel by 18% as compared to 2007 in compliance with government policies.

The net sales of petroleum products accounted for 46.40% of our total net sales in 2008, representing an increase of 7.6 percentage points as compared to 2007.





## **Table of Contents**

During the year ended December 31, 2008, we recognized a grant income of RMB2,312.2 million (2007: RMB93.9 million; 2006: RMB282.1 million). These grants were for compensation of losses incurred due to the distortion of the correlation of domestic refined petroleum product prices and the crude oil prices, and the measures taken by us to stabilize the supply in the PRC refined petroleum product market during the respective years. There are no unfilled conditions and other contingencies attached to the receipts of these grants. There is no assurance that we will continue to receive such grant in the future.

### *(v) Other activities*

Revenues from other activities decreased to RMB2,992.8 million in 2008, representing a decrease of 17.73% compared to RMB3,637.9 million in 2007. Such decrease in revenues was mainly attributed to a decrease in the trading volume of petrochemical products.

## **Operating Expenses**

Our operating expenses are comprised of cost of sales, selling and administrative expenses, other operating expenses and other operating income.

Our operating expenses increased by 29.90% to RMB69,459.3 million in 2008 compared to RMB53,455.9 million in 2007. The operating expenses of synthetic fibres, resins and plastics, intermediate petrochemicals, and petroleum products amounted to RMB5,313.5 million, RMB17,027.0 million, RMB10,314.5 million and RMB33,811.0 million, respectively, representing increases of 20.47%, 11.86%, 20.51% and 55.28%, respectively, as compared to 2007. The operating expenses of other activities amounted to RMB2,993.3 million, representing a decrease of 14.21% as compared to 2007.

### *(i) Synthetic fibres*

The operating expenses of synthetic fibres increased by RMB902.7 million compared to 2007, primarily due to an increase in the unit price of raw materials (such as ethylene) for producing synthetic fibres. For example, the price of ethylene increased from RMB8,785.0 per ton in 2007 to RMB9,496.2 per ton in 2008.

### *(ii) Resins and plastics*

The operating expenses of resins and plastics increased by RMB1,804.7 million as compared to 2007, primarily due to increased unit costs for raw materials such as ethylene.

### *(iii) Intermediate petrochemicals*

The operating expenses of intermediate petrochemicals increased by RMB1,755.6 million compared to 2007, which was mainly attributable to increase in sales of ethylene glycol, and the corresponding increases in costs and expenses of intermediate petrochemicals ultimately resulting from the increase in average unit cost of crude oil from RMB3,865.85 per ton in 2007 to RMB5,303.68 per ton during the year.

### *(iv) Petroleum products*

The operating expenses of petroleum products increased by RMB12,036.3 million compared to 2007, primarily due to the increase in crude oil prices (which is our major production raw material) which directly led to a significant increase in the operating expenses of petroleum products.

### *(v) Other activities*

The operating expenses of other activities decreased by RMB495.9 million compared to 2007, which was primarily attributable to reduced business volume.

## **Cost of sales**

Cost of sales increased to RMB68,556.4 million in 2008, representing an increase of 30.22% compared to RMB52,646.5 million in 2007, primarily due to significant increase in crude oil prices in 2008, which was our major raw material, and an increase in the purchase of other raw

materials. Cost of sales accounted for 115.60% of the net sales for 2008.

(i) *Crude Oil*

In 2008, we processed 9,238,300 tons of crude oil ( no imported crude oil was processed on a sub-contracting basis during the year), representing an increase of 299,900 tons compared to 8,938,400 tons in 2007 (of which 25,400 tons imported crude oil were processed on a sub-contracting basis). The volumes of imported crude oil and offshore crude oil processed by us were 8,739,000 tons and 499,300 tons, respectively.

## **Table of Contents**

The total cost of crude oil processed by us in 2008 amounted to RMB48,997.0 million, representing an increase of 42.20% compared to RMB34,456.3 million in 2007 and accounting for 71.47% of the total cost of sales. The weighted average cost of crude oil for us was RMB5,303.68 per ton, representing a significant increase of 37.19% as compared to 2007. The weighted averaged cost of imported crude oil and offshore crude oil were RMB5,339.95 per ton and RMB4,668.86 per ton, respectively.

### *(ii) Other expenses*

The expenses for other ancillary materials were RMB9,978.8 million in 2008, representing an immaterial decrease of 0.44% compared to RMB10,022.5 million in 2007.

### **Selling and administrative expenses**

Selling and administrative expenses amounted to RMB468.0 million, representing a decrease of 7.27% compared to RMB504.7 million in 2007 primarily due to a decrease in the our sales agency fees for sales operations during the reporting period.

### **Other operating expenses**

Other operating expenses increased from RMB521.3 million in 2007 to RMB580.0 million in 2008, representing an increase of 11.26%, primarily due to an increase of RMB240.7 million in our provision made for impairments of fixed assets in 2008 as compared to 2007. On the other hand, our employee reduction expenses during the reporting period decreased by RMB118.2 million as compared to 2007, and the loss on disposal of non-current assets decreased by RMB47.3 million as compared to 2007.

### **Other operating income**

Other operating income amounted to RMB145.2 million in 2008, a decrease of 32.96% compared to RMB216.6 million in 2007, which was primarily due to a decrease in income from the disposal of unlisted investments during the reporting period.

### **Income/ (loss) from operation**

We incurred an operating loss of RMB7,817.3 million in 2008, compared to an operating profit of RMB892.7 million in 2007. Two factors primarily contributed to the operating loss in 2008. We incurred losses in our petroleum products business in the first half of 2008 as a result of the substantial rise in world oil price and the government restriction on refined petroleum product prices. Then in the second half of 2008 the global economic downturn had a significant adverse impact on the petrochemicals market, and our operating results suffered as a result.

### **Net financing costs**

Our net financing costs were RMB330.4 million in 2008, representing an increase of 85.72% compared to RMB177.9 million in 2007, which consisted primarily of an increase of RMB297.8 million in our interest expense due to an increase of RMB5,280.8 million in our short-term borrowings. In addition, there was an increase of RMB145.3 million in our financial income as compared to 2007, which was mainly due to the increase of net gain in the fair value of derivative financial instruments amounting to RMB97.6 million and net foreign exchange gain amounting to RMB34.6 million.

### **Investment income**

Our investment income was RMB131.8 million in 2008, mainly due to income from the disposal of marketable securities.

### **Share of profits of associates and jointly controlled entities**

In 2008, our share of net profits from associates and jointly controlled entities was RMB1.5 million, a decrease of RMB664.4 million as compared to 2007, primarily due to the operating losses suffered by the 20% held investee, Secco. Our share of profits in Secco was RMB587.9 million in 2007, however, we had a share of losses in Secco of RMB98.7 million in 2008. The results of Secco's operations are discussed in

Item 4. Information on the Company Business Overview Investments.

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**Table of Contents****Income tax**

We had an income tax credit benefit of RMB1,812.7 million in 2008, compared to an income tax expense of RMB468.3 million in 2007. The income tax credit benefit in 2008 was primarily due to the fact that we recognized deferred income tax asset for tax losses generated in 2008 that we expect to be able to utilize to offset future taxable income. Based on the Company's financial data of previous years and forecast of the future operating results, the management believes it is probable that the Company will have sufficient taxable profit available in the foreseeable future to utilize the tax losses.

Following the implementation of the newly revised Enterprise Income Tax Law of the People's Republic of China with effect from January 1, 2008, the income tax rate of the Company was adjusted to 25%.

**Net Income/(loss)**

We incurred a net loss after tax of RMB6,201.7 million in 2008, compared to net income of RMB1,683.1 million in 2007.

**Year ended December 31, 2007 compared with year ended December 31, 2006.****Net sales and other income**

Total net sales increased by 8.69% to RMB54,254.7 million in 2007 as compared with RMB49,918.1 million in 2006. In 2007, demand for petrochemical products remained strong, driving product prices to rise. However, the pace for such increase in product prices has slowed down. The weighted average prices of synthetic fibres, resins and plastics, intermediate petrochemicals and petroleum products for 2007 increased to varying degrees as compared to 2006.

*(i) Synthetic fibres*

Net sales of synthetic fibre products decreased by 8.13% to RMB4,328.7 million in 2007 as compared with RMB4,711.7 million in 2006. Although the weighted average price of synthetic fibres increased by 4.58%, the profit margin of synthetic fibre products was substantially reduced as the raw material costs of synthetic fibres increased further. Sales volume of synthetic fibres decreased by 12.17% as compared to 2006 because the sales volume of certain major synthetic fibre products, except acrylic fibre, decreased by varying degrees. The decrease was in line with the decrease in demand for the export of textile products to foreign countries, as affected by the appreciation of Renminbi during 2007.

Net sales of synthetic fibre products accounted for 7.98% of our total net sales in 2007, a decrease of 1.46 percentage points as compared to 2006.

*(ii) Resins and plastics*

Net sales of resins and plastics increased by 0.80% to RMB15,878.8 million in 2007 as compared with RMB15,753.3 million in 2006. Weighted average price of resins and plastics increased by 1.45% as compared to 2006 and sales volume decreased by 0.64% as compared to 2006. Among our resins and plastics products for 2007, sales volume of polyester pellet increased by 9.41%, while the average sales price had decreased by 0.23%, and sales volume of polyethylene and polypropylene decreased by 9.06% and 2.38%, respectively, while the average sales prices had increased by 2.84% and 0.04%, respectively.

Net sales of resins and plastics accounted for 29.27% of our total net sales in 2007, a decrease of 2.29 percentage points as compared to 2006.

*(iii) Intermediate petrochemicals*

Net sales of intermediate petrochemicals increased substantially by 38.33% to RMB9,372.7 million in 2007 as compared with RMB6,775.7 million in 2006, with weighted average price of intermediate petrochemicals increasing by 13.28% and sales volume increasing by 22.10% as compared to 2006. Among our intermediate petrochemical products, the weighted average prices of our major products such as pure benzene, ethylene glycol and ethylene oxide increased by 20.97%, 34.37% and 13.18%, respectively, while the weighted average prices of ethylene and butadiene decreased by 1.52% and 17.21%, respectively. The sales volumes of pure benzene, ethylene glycol and ethylene oxide increased by 2.09%, 1,924.92% and 109.79%, respectively, except for ethylene and butadiene of which the sales volumes decreased.



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## **Table of Contents**

Net sales of intermediate petrochemicals accounted for 17.28% of our total net sales in 2007, a decrease of 3.71 percentage points as compared to 2006.

### *(iv) Petroleum products*

Net sales of petroleum products increased by 8.51% to RMB21,036.6 million in 2007 as compared with RMB19,387.6 million in 2006, with an increase of 3.13% in the weighted average price as compared to 2006. The weighted average prices of gasoline, diesel oil and jet fuel increased by 3.63%, 5.95% and 4.64%, respectively, but we reduced our sales volume of gasoline by 7.50% subject to the requirement of Sinopec Corp., in light of the negative profit margin of petroleum products as a result of the price control of petroleum products by the State, and our sales of volumes of diesel oil and jet fuel increased by 6.12% and 34.49%, respectively.

Net sales of petroleum products accounted for 38.77% of our total net sales in 2007, a decrease of 0.07 percentage point as compared to 2006.

During the year ended December 31, 2007, we recognized a grant income of RMB94 million (2006: RMB282 million; 2005: RMB633 million). These grants were for compensation of losses incurred due to the distortion of the correlation of domestic refined petroleum product prices and the crude oil prices, and the measures taken by the Group to stabilize the supply in the PRC refined petroleum product market during the respective year. There are no unfulfilled conditions and other contingencies attached to the receipts of these grants. There is no assurance that the Group will continue to receive such grant in the future.

### *(v) Other activities*

Revenues from other activities increased by 10.58% to RMB3,637.9 million in 2007 as compared with RMB3,289.8 million in 2006. Such increases in revenue were mainly attributed to increases in trading volume of our petrochemical products.

## **Operating Expenses**

Our operating expenses are comprised of cost of sales, selling and administrative expenses, other operating expenses and other operating income.

Operating expenses increased by 7.67% to RMB53,455.9 million in 2007 as compared with RMB49,647.3 million in 2006. The operating expenses of resins and plastics, intermediate petrochemicals, petroleum products, and other activities amounted to RMB15,222.3 million, RMB8,558.9 million, RMB21,774.7 million and RMB3,489.2 million, respectively, representing increases of 4.33%, 40.42%, 1.91% and 13.36%, respectively as compared to 2006, while the operating expenses of synthetic fibres amounted to RMB4,410.8 million, representing a decrease of 2.32% as compared to 2006.

### *(i) Synthetic fibres*

Operating expenses of synthetic fibres decreased by RMB104.6 million as compared to 2006, mainly due to a decrease in the sales volume of synthetic fibres.

### *(ii) Resins and plastics*

Operating expenses of resins and plastics increased by RMB631.1 million as compared to 2006, mainly due to increased costs for raw materials such as ethylene and propylene. Moreover, sales volume of polyester chips increased by more than 40,000 tons or 9.41% as compared to 2006, which also contributed to the increase in operating expenses of resins and plastics.

### *(iii) Intermediate petrochemicals*

Operating expenses of intermediate petrochemicals increased by RMB2,463.6 million as compared to 2006, due to significantly increased costs for intermediate raw materials such as naphtha as a result of substantially increased production and sales volumes of ethylene glycol.

### *(iv) Petroleum products*

Operating expenses of petroleum products increased by RMB407.3 million as compared to 2006, mainly due to the increase in crude oil price (which is a major production raw material for us), which has directly led to an increase in operating expenses of petroleum products.





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**Table of Contents***(v) Other activities*

Operating expenses of other activities increased by RMB411.2 million as compared to 2006, which was attributable to increased purchasing costs as a result of increased business volume.

**Cost of sales**

Cost of sales increased by 7.04% to RMB52,646.5 million in 2007, as compared with RMB49,182.2 million in 2006, primarily due to the increase in 2007 in crude oil price which is our major raw material. Cost of sales accounted for 97.04% of the net sales for 2007 and 98.53% for 2006. The gross margin increased from 2.01% in 2006 to 3.08% in 2007 because the average increase in crude oil price was less than the increase in selling price of our products.

*(i) Crude Oil*

In 2007, we processed 8,938,400 tons of crude oil (of which 25,400 tons were processed on a sub-contracting basis), an increase of 18,100 tons as compared with 8,920,300 tons in 2006 (110,000 tons of sub-contracting processing in 2006). The volumes of imported oil and offshore oil we processed were 8,635,700 tons and 302,700 tons, respectively.

The total cost of crude oil we processed in 2007 amounted to RMB34,456.3 million, an increase of 3.45% as compared with RMB33,307.6 million in 2006 and accounting for 65.45% of the total cost of sales. Our weighted average cost of crude oil was RMB3,865.85 per ton, representing an increase of 2.26% as compared to 2006. The weighted average cost of imported oil and offshore oil was RMB3,871 per ton and RMB3,721 per ton, respectively.

*(ii) Other expenses*

Expenses for other ancillary materials were RMB10,022.5 million in 2007, an increase of 26.84% as compared with RMB7,901.8 million in 2006, primarily due to a significant increase in the purchasing costs of intermediate petrochemicals such as propylene and acrylonitrile during 2007. Depreciation expenses decreased from RMB1,848.5 million in 2006 to RMB1,698.8 million in 2007. Energy and power costs increased to RMB1,190.2 million due to increases in coal prices and electricity tariffs in 2007. Compared to the same period of 2006, labor costs decreased slightly to RMB1,209.0 million during 2007, while maintenance costs increased to RMB1,023.8 million.

**Selling and administrative expenses**

Selling and administrative expenses amounted to RMB504.7 million, representing a decrease of 3.31% as compared with RMB522.0 million in the same period of the previous year due to the decrease in the cost of sales in transportation expenses and other miscellaneous expenses. The decrease in transportation expenses was because the Company no longer bears the transportation fee of selling polyester fiber chips to save the transportation cost. The decrease of other miscellaneous expenses was a result of the Company's cost-saving orientation.

**Other operating expenses**

Other operating expenses mainly include employee reduction expenses, loss on disposal of property, plant and equipment and impairment loss on property, plant and equipment. Other operating expenses increased by 116.76% from RMB240.5 million in 2006 to RMB521.3 million in 2007, primarily due to the increase of employee reduction expenses of RMB124.4 million as compared to 2006 due to an increase in the number of employee layoffs. In addition, the provision made for impairments of fixed assets during 2007 increased by RMB150.3 million from 2006, to 200.3 million in 2007.

**Other operating income**

Other operating income mainly includes income from unlisted investments, rental income from investment properties and gain on disposal of fixed assets. Other operating income was RMB216.6 million in 2007, due in part to the sale of equity interests in Guotai Junan Securities Co.,

Ltd. and Guotai Junan Asset Management Co. Ltd. to Ping An Trust, a PRC non-bank financial institution. Other operating income decreased by 27.17% as compared with RMB297.4 million in 2006, mainly due to an overall decrease in income from the disposal of property and equipment in 2007.

**Income from operation**

Operating profit was RMB892.7 million in 2007, representing a significant increase of 61.46% as compared with RMB552.9 million in 2006 primarily due to a significant improvement in our operating efficiency during the reporting period.

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## **Table of Contents**

### **Net financing costs**

Our net financing costs were RMB177.9 million in 2007, an increase of 7.56% as compared with RMB165.4 million in 2006, which was primarily due to the repayment of loans in an amount of US\$175.3 million in 2007. As a result of the appreciation of Renminbi against the US dollar, our foreign exchange gain in 2007 decreased by RMB45.31 million compared to 2006.

### **Share of profits of associates and jointly controlled entities**

In 2007, our share of net profits of associates and jointly controlled entities was RMB665.9 million, an increase of RMB89.2 million as compared to 2006, primarily due to the growth achieved by the 20% held investee, Secco. The Company's share in Secco's profit for 2006 was RMB545.2 million compared to the Company's share in Secco's net profit of RMB587.9 million for 2007. The results of Secco's operations are discussed in [Item 4. Information on the Company Business Overview Investments](#).

### **Income tax**

Our income tax increased to RMB468.3 million in 2007, a significant increase compared to RMB53.2 million in 2006. Such increase was primarily due to the substantial increase in profit before taxation and an adjustment in our income tax rate. Our effective tax rate was 21.8% in 2007 compared to 5.5% in 2006. The increase in our effective tax rate is primarily due to an increase in our income tax rate from 15% in 2006 to 33% in 2007.

### **Net Income**

Net income was RMB1,683.1 million in 2007, an increase of 84.75% as compared with RMB911.0 million in 2006.

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

Our approach in managing liquidity is to ensure, as far as possible, that we will always have sufficient liquidity to meet our liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to our reputation. We prepare monthly cash flow budget to ensure that we will always have sufficient liquidity to meet our financial obligations as they become due. We arrange and negotiate financing with financial institutions and maintain a certain level of standby credit facilities to reduce liquidity risk.

At December 31, 2008, our current liabilities exceeded our current assets by RMB6,831.4 million. In 2009, our liquidity will be primarily dependent on our ability to maintain adequate cash inflow from operations, the renewal of our short-term bank loans and on our ability to obtain adequate external financing, including the issuance of short-term corporate bonds, to support our working capital and meet our debt obligations when they become due. At December 31, 2008, we had standby credit facilities with several PRC financial institutions which allow us to borrow up to RMB9,600.0 million on an unsecured basis, at a weighted average interest rate of 5.30%. At December 31, 2008, our outstanding borrowings under these facilities were RMB6,933.4 million and were included in short-term bank loans. We believe our sources of liquidity are sufficient for our present requirements.

### *Net cash flows provided by (used in) operating activities*

In 2008, there was a significant increase in the costs of crude oil which could not be passed along to customers, which along with the negative impact of the global economic downturn, led to a decrease in net cash flows from operating activities. Our net cash outflows from operating activities amounted to RMB3,986.5 million in 2008, representing a decrease in cash inflows of RMB5,428.5 million compared to net cash inflows of RMB1,442.0 million in 2007. Net cash outflows from profit before tax (net of depreciation) amounted to RMB6,382.5 million in 2008, representing a decrease of RMB10,236.2 million of cash inflows compared to net cash inflows of RMB3,853.7 million in 2007. An increased inventories balance before provision at the end of 2008 led to an increase in cash outflows of RMB38.9 million in 2008 (as compared to an increase in cash outflows of RMB1,067.0 million in 2007). Changes in the year-end amounts of accounts payable, other payable and bills payable led to an increase in cash outflows of RMB786.9 million in 2008 (as compared to a decrease in cash outflows of RMB643.3 million in 2007). Decreases in the year-end balances of debtors, bills receivable and deposits led to a decrease in cash outflow of RMB1,122.0 million in 2008 (as compared with a decrease in cash inflows of RMB387.7 million in 2007 as a result of an increase in such year-end balances). In addition, our income tax payment decreased significantly as we incurred losses during the reporting period. In 2008, income tax payment led to a cash outflow of RMB60.7 million (as compared to RMB674.5 million of a cash outflow in 2007).



## **Table of Contents**

### *Net cash used in investing activities*

Net cash outflow for investing activities increased from RMB511.2 million in 2007 to RMB707.5 million in 2008, mainly representing a decrease in proceeds from disposal of other investments.

### *Cash flows from financing activities*

Net cash from financing activities increased from an outflow of RMB930.1 million in 2007 to an inflow of RMB4,429.2 million in 2008 mainly representing an increase in proceeds from loans.

### *Borrowings*

Our total borrowings in 2008 amounted to RMB9,801.7 million, representing an increase of RMB5,070.5 million. In particular, short-term bank loans increased by RMB5,165.3million, the current portion of long-term bank loans (repayable within one year) increased by RMB115.5 million and long-term loans decreased by RMB210.3 million. The increase in short-term bank loans was necessary to meet working capital requirements triggered by the recent global economic downturn.

We managed to maintain an asset-to-liability ratio at a safe level by enhancing controls over both liabilities (including borrowings) and financing risks. We generally do not experience any seasonality in borrowings. Due to the nature of our capital expenditures plan, long-term bank loans can be arranged in advance of expenditures while short-term borrowings are used to meet operational needs. The terms of our existing borrowings do not restrict our ability to pay dividends on our shares.

### *Liability-to-asset ratio*

Our liability-to-asset ratio was 50.02% as of December 31, 2008 compared to 29.82% as of December 31, 2007. The ratio is calculated using this formula: total liabilities/total assets.

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

We maintain a number of technology research and development units, including the Petrochemical Research Institute, the Polyester Fiber Research Institute, the Acrylic Fibre Research Institute and the Environmental Protection Research Institute. These units are charged with various research and development tasks with respect to new technology, new products, new production processes and equipment and environmental protection. Our research and development expenditures in 2006, 2007 and 2008 were RMB51.6 million, RMB53.5 million and RMB47.3 million, respectively, representing approximately 0.1% of the total sales for those years.

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

## **Table of Contents**

### **D. Trend Information**

The world is experiencing a significant economic downturn. Although China continued to experience steady and relatively fast growth in 2008, its economic growth has also slowed substantially.

Although international oil prices may remain volatile in 2009, we expect the overall level of international oil prices to remain lower than the level seen in 2008. The global petrochemical industry is expected to undergo a restructuring given the pressures of both decelerating economic growth and a downward industry cycle, compounded by the continuous increase in the on-stream availability of plants due to a gradual release of new production capacities created by investments made during the peak period. The growth of China's petrochemical industry will slow significantly, due to the impact of the global economic downturn. Moreover, there exist a number of adverse effects such as contracting demand in the domestic petrochemical industry; capacity surplus due to concurrent commencements of operations of new plants; an influx of a large number of overseas products; and obstructions to export of domestic petrochemical downstream products caused by market related factors. All these factors have had a significant adverse impact on the domestic petrochemical industry in general and our Company in particular.

On the other hand, the domestic petrochemical industry also has seen a substantial fall in the costs of crude oil and raw materials as a result of the global economic downturn, leading to a substantial decrease in costs. In addition, the Chinese government has adopted a number of economic stimulus measures in response to the economic slowdown, which may have a positive effect on our Company. Upon implementation of a reform program for the petroleum product tax regime, the prices of domestic petroleum products will be indirectly aligned with international crude oil prices in a controlled manner. This is a favorable change from the previous government regulation that caused losses at oil refining enterprises.

### **E. Off-balance Sheet Arrangements**

As of December 31, 2008, our contingent liabilities amounted to RMB25.7 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, 2007 were RMB30.7 million. Our guarantees issued to banks in favor of associated companies and other unlisted investments are limited to the respective share in equity interest held by us. Please refer to Note 26(b) to our consolidated financial statements included in Item 17. Financial Statements for more detailed information on our guarantees and commitments.

**Table of Contents****F. Contractual Obligations and Commercial Commitments**

The following table sets forth our obligations to make future payments under contracts effective as of December 31, 2008.

	Total (RMB 000)	As of December 31, 2008 Payment due by period			
		Less than 1 year (RMB 000)	1-3 years (RMB 000)	4-5 years (RMB 000)	More than 5 y ears (RMB 000)
<b>Contractual obligations</b>					
Short-term loan	8,838,204	8,838,204			
Long-term loan	963,542	534,521	229,021	200,000	
Total contractual obligations	9,801,746	9,372,725	229,021	200,000	
<b>Estimated future interest payments</b>					
Fixed rate	271,834	212,364	6,820	52,650	
Variable rate	178,738	178,738			
<b>Total estimated future interest payments</b>	450,572	391,102	6,820	52,650	
<b>Other commercial commitments</b>					
Capital commitments (note)	2,541,237	2,200,000	341,237		
Total commercial commitments	2,541,237	2,200,000	341,237		

Note: Capital commitments refer to commitments for purchase of property, plant and equipment and investment.

**G. Other Information****Employees**

Our staff costs for 2008 were RMB1,161.0 million.

As at December 31, 2008, we had 17,597 employees in total, among whom there were 9,795 production staff, 6,447 sales representatives, financial personnel and other personnel and 1,355 administrative staff. 38.39% of our employees had tertiary qualifications or above. We are responsible for the retirement insurance of 12,559 individuals.

**Table of Contents****Capital Expenditures**

In 2008, our capital expenditures amounted to RMB1,511.1 million, representing a decrease of 29.19% as compared to RMB2,134.1 million in capital expenditures in 2007. Major projects include the following:

<b>Project</b>	<b>Total project investment RMB million</b>	<b>Project progress as at December 31, 2008</b>
600,000-ton/year PX aromatics complex	3,013.2	Under construction
Ancillary project for the first tank area along Jinjiahu oil pipeline	71.4	Completed
150,000-ton/year C5 segregation plant	292.1	Under construction
<b>Total</b>	<b>3,376.7</b>	

Our capital expenditure for 2009 is estimated at approximately RMB2,200 million.

**Purchase, Sale and Investment**

Except as disclosed in this report, during the year 2008, we engaged in no material purchase or sale of our subsidiaries or associated companies or any other material investments.

**Pledge of Assets**

As of December 31, 2008, we have not pledged any of our property or equipment.

**ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES.****A. Directors and Senior Management.**

The following table sets forth certain information concerning our directors, executive officers and members of our supervisory committee ( Supervisory Committee ). The current term for our directors, executive officers and members of our Supervisory Committee is three years, which term will end in June 2011.

<b>Name</b>	<b>Age</b>	<b>Position</b>
<u>Directors</u> Rong Guangdao	53	Chairman of the Board of Directors and President
Du Chongjun	54	Vice Chairman of the Board of Directors and Vice President
Han Zhihao	57	Director and Chief Financial Officer



**Table of Contents**

Li Honggen	52 Director and Vice President
Shi Wei	49 Director and Vice President
Dai Jinbao	52 Director
Lei Dianwu	46 External Director
Xiang Hanyin	54 External Director
Chen Xinyuan	44 Independent Director and Director of the Audit Committee
Sun Chiping	50 Independent Director
Jiang Zhiquan	58 Independent Director
Zhou Yunnong	66 Independent Director and Director of the Remuneration and Appraisal Committee
<b><u>Other Executive Officers</u></b>	
Zhang Jianping	46 Vice President
Tang Chengjian	53 Vice President
Zhang Jingming	51 Secretary of the Company
<b><u>Supervisory Committee</u></b>	
Gao Jinping	42 Chairman of the Supervisory Committee
Zhang Chenghua	53 Supervisor
Wang Yanjun	48 Supervisor
Zhai Yalin	44 External Supervisor
Wu Xiaoqi	52 External Supervisor
Liu Xiangdong	57 Independent Supervisor
Yin Yongli	69 Independent Supervisor
<b>Directors</b>	

**Rong Guangdao**, 53, is Chairman, President and Deputy Secretary of the Communist Party Committee of the Company. Mr. Rong joined the Shanghai Petrochemical Complex (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, and in June 1995 he was elected Director of the Company. In October 2003, Mr. Rong was appointed President of the Company. In May 2004, Mr. Rong was elected Chairman of the China Jinshan Associated Trading Corporation. From June 2004 to June 2005, Mr. Rong served as Vice Chairman of the Company. In April 2005, Mr. Rong was elected as Deputy Secretary of the Communist Party Committee. In June 2005, Mr. Rong was elected as Chairman of the Company. In November 2006, Mr. Rong was appointed Director and Vice Chairman of Shanghai Secco Petrochemical Company Limited (Shanghai Secco). In August 2008, he was appointed Director and Chairman of Shanghai Chemical Industrial Park Development Company Limited. Mr. Rong has rich experience in management of large-scale petrochemical enterprise operations. 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 by professional title.

**Du Chongjun**, 54, is Secretary of the Communist Party Committee, Vice Chairman and Vice President of the Company. He joined the Complex in 1974 and has held various positions, including General Manager, Deputy Secretary and Secretary of the Communist Party Committee of the Acrylic Fibre Plant of the Complex, General Manager and Secretary of the Communist Party Committee of Shanghai Jinyang Acrylic Fibre Plant and General Manager of the Acrylic Fibre Division of the Company. In May 1999 he was appointed Deputy Secretary of the Communist Party Committee and Secretary of the Communist Party Discipline Supervisory Committee. From June 1999 to June 2004 he was Chairman of the Supervisory Committee of the Company. In October 2003 he was appointed Secretary of the Communist Party Committee of the Company. In June 2004, Mr. Du was appointed Vice Chairman of the Company. In June 2005, Mr. Du was appointed Vice President of the Company. Mr. Du has extensive experience in large-scale enterprise operation, management and internal supervision. Mr. Du graduated, majoring in enterprise management, from East China Institute of Chemical Technology in 1986. In 1999 Mr. Du graduated, majoring in computer application management, from Shanghai Second Polytechnic University. He is a senior economist by professional title.



## **Table of Contents**

**Han Zhihao**, 57, is Executive Director and Chief Financial Officer of the Company. Mr. Han joined the Complex in 1976 and has 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 the Company. In September 1998, he was appointed Chief Accountant of the Company. In October 2003, he was appointed Chief Financial Officer of the Company. In June 2004, he was elected Director of the Company. Mr. Han has rich experience in corporate finance and financial management. He graduated from Shanghai University of Finance and Economics majoring in financing and accounting in 1990. In 2002, he obtained an MBA from East China University of Science and Technology University of Canberra in Australia. Mr. Han is a senior accountant by professional title.

**Li Honggen**, 52, is Executive Director and Vice President of the Company. Mr. Li joined the Complex in 1973 and has held various positions including Deputy Director of No. 1 Chemical Plant of the Complex, Deputy Director and Director of the Ethylene Plant of the Company and Deputy Manager and Manager of the Refining and Chemical Division of the Company. From August 2000 to December 2003, he served as Vice President of Shanghai Chemical Industrial Park Development Company Limited. From August 2002 to January 2006, he served as Vice President of Shanghai Secco. In March 2006, he was appointed Vice President of the Company. In June 2006, he was appointed Director of the Company. In August 2008, he was concurrently appointed Director of Shanghai Chemical Industrial Park Development Company Limited. Mr. Li graduated from East China Institute of Chemical Technology majoring in engineering management and completed a post-graduate course majoring in engineering management at East China University of Science and Technology in 1998. He is an engineer by professional title.

**Shi Wei**, 49, is Executive Director and Vice President of the Company. Mr. Shi joined the Complex in 1982 and has held various positions including Assistant to the Manager, Deputy Manager of the Refining and Chemical Division of the Company, Manager of the Environmental Department, Secretary of the Communist Party Committee of the Refining and Chemical Division of the Company and then Manager of the division. In October 2003, Mr. Shi was appointed Vice President of the Company. In June 2005, he was appointed Director of the Company. In 1982, Mr. Shi graduated from East China University of Science and Technology majoring in oil refining engineering and obtained a bachelor's degree in engineering. Mr. Shi completed post-graduate studies in Business Management at East China University of Science and Technology in 1998. Mr. Shi is a senior engineer by professional title.

**Dai Jinbao**, 52, is Executive Director of the Company, Secretary of the Communist Party Committee and Deputy Manager, of the Company's Refining and Chemical Division and Chairman of the Labor Union. Mr. Dai joined the Complex in November 1973 and has held various positions including Deputy Director of No. 1 Chemical Plant of the Company, Director of No.1 Ethylene Complex of the Refining and Chemical Division of the Company, Chairman of the Labor Union of the Company's Refining and Chemical Division, Deputy Secretary of the Communist Party Committee and Chairman of the Labor Union of the Company's Refining and Chemical Division. In June 2006, he was appointed Director of the Company. In June 2008, he was appointed Secretary of the Communist Party Committee of the Company's Olefin Division and Deputy Manager of the division. Mr. Dai graduated from the Shanghai Second Polytechnic University majoring in business management. He is an intermediate technician by professional title.

## **External Directors**

**Lei Dianwu**, 46, is Director of Development and Planning Division of Sinopec Corp. In June 2005, Mr. Lei was elected External Director of the Company. Mr. Lei has held various positions including Deputy Director of Planning Division of Yangzi Petrochemical Company, Director of the Preparation Office of the Joint Venture of Yangzi Petrochemical Company, Vice President and Manager of production division of Yangzi BASF Styrene Company Limited. He acted as Deputy Manager and Deputy Director of the Joint Venture Office at Yangzi Petrochemical Company, Director of Project Development Department in China Dong Lian Petrochemical Limited Liabilities Company ( ), Deputy General Manager of Yangzi Petrochemical Limited Liabilities Company and Deputy Director of Development and Planning Division of Sinopec Corp. In March 2001, he assumed the current position of Director of Development and Planning Division of Sinopec Corp. Mr. Lei has rich experience in enterprise planning and investment development management. Mr. Lei graduated from the East China Petroleum Institute with a major in basic organic chemicals and obtained a bachelor's degree in engineering. He is a senior engineer by professional title.

**Xiang Hanyin**, 54, is Deputy Director of Chemical Division of Sinopec Corp. In June 2005, Mr. Xiang was elected External Director of the Company. Mr. Xiang commenced work in February 1982 and was Deputy Director of the Chemical Plant of Yizheng Chemical Fibre Company and Director of Chemical Plant of Yizheng Chemical Fibre Co., Ltd. In February 2000, he assumed the current position of Deputy Director of the Chemical Division of Sinopec Corp. Mr. Xiang has rich experience in the management of chemical enterprises. Mr. Xiang graduated from Nanjing Chemical College with a major in basic organic chemicals and a bachelor's degree in engineering in 1982. In 2000, he completed post-graduate studies in enterprise management at Nanjing University. He is a senior engineer by professional title.

## **Table of Contents**

### **Independent Directors**

**Chen Xinyuan**, 44, is currently Dean, Professor and Tutor to doctoral students of the College of Accounting, Shanghai University of Finance and Economics, and was elected as an Independent Director of the Company in June 2003. Between June 2000 and June 2003 he was an Independent Supervisor of the Company. After graduation from the Accounting Faculty, Hangzhou College of Commerce in July 1985, Mr. Chen undertook post-graduate studies at the Accounting Faculty of Shanghai University of Finance and Economics and continued 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 an expert in financial reporting and accounting, given his experience in the academic aspects of accounting and notable achievements in accounting research. He is also experienced in business management.

**Sun Chiping**, 50, is President and Secretary of the Communist Party Committee of the Industrial and Commercial Bank of China ( ICBC ), Shanghai Branch. In June 2005, Mr. Sun was elected Independent Director of the Company. Mr. Sun started to be involved in the finance industry in March 1979 and has held various positions including accountant, team leader and Deputy Director of the People's Bank of China, Shanghai Branch, sub-branch in both Huang Pu and Jing'an Districts. He joined the ICBC, Shanghai Branch, operating division and was Deputy Secretary of the Communist Party Committee and Secretary of the Communist Party Discipline Supervisory Committee. He also acted as Deputy Director, President and Deputy Secretary of the Communist Party Committee of ICBC, Shanghai Branch, Rep. Office (Sub-branch) in Xu Hui District, General Manager of the International Business Division of ICBC, Shanghai Branch, Assistant to the President of the ICBC, Shanghai Branch and concurrently General Manager of International Business Division of ICBC, Shanghai Branch and Deputy President of ICBC, Shanghai Branch. In November 2000, he became Deputy President, President and Secretary of the Communist Party Committee of ICBC, Guangdong Branch. In August 2002, he assumed the current position as President of ICBC, Shanghai Branch and Secretary of the Communist Party Committee. Mr. Sun graduated from Shanghai University of Finance and Economics with a major in Finance. He studied for a master's degree at Shanghai University of Finance and Economics and the Shanghai-Hong Kong Management School jointly organized by University of Hong Kong and Fudan University and obtained a Master in Economics and an MBA. Mr. Sun has been engaged in the management of banking business for many years and has extensive experience in finance practice. He is a senior economist by professional title.

**Jiang Zhiquan**, 58, is Secretary of the Communist Party Committee and Chairman of Shanghai Construction Group General Company. In June 2005, Mr. Jiang was elected Independent Director of the Company. Mr. Jiang started work in December 1968, and has held various positions including a cadre and Deputy Director of Shanghai Construction and Industry Bureau, Manager of the Fourth Construction Company of Shanghai, Deputy Secretary of the Communist Party Committee of the Shanghai Construction Engineering Administration Bureau, Deputy Secretary of the Communist Party Committee, Vice Chairman and General Manager of the Shanghai Construction Group. In March 2001, he assumed the current positions as Secretary of the Communist Party Committee and Chairman of Shanghai Construction Group General Company. Mr. Jiang is experienced in operational decision making and large-scale enterprise management. Mr. Jiang graduated from the Shanghai-Hong Kong Management School jointly run by the University of Hong Kong and Fudan University in July 2000 and obtained an MBA. He is a senior economist by professional title.

**Zhou Yunnong**, 66, has been an Independent Director of the Company since June 2005. He joined the Complex in October 1972 and has held various positions including Deputy President of the Complex, Deputy Director of the Human Resource Department of China Petrochemical Corporation, Deputy Secretary of Communist Party Committee of the Complex, Vice President of the Company, Secretary of the Communist Party Committee of Sinopec Jinshan Industrial Company and the Governor of Jinshan District of Shanghai. From November 1999 to April 2002 he was a Senior Advisor to Shanghai Jinshan District. From June 2003 to June 2005, Mr. Zhou was an Independent Supervisor of the Company. Mr. Zhou has extensive experience in business management and public administration management. Mr. Zhou graduated from East China Normal University in August 1964, majoring in radio. He is a senior engineer by professional title.

### **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 interests of the Company, its shareholders and employees and in compliance with 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 of seven members, two of whom are employee representatives and five of whom are external supervisors, including two independent supervisors.

**Table of Contents**

**Gao Jinping**, 42, is Chairman of the Supervisory Committee, Deputy Secretary of the Communist Party Committee, Secretary of the Communist Party Discipline Supervisory Committee of the Company and Chairman of the Labor Union of the Company. Mr. Gao joined the Complex in 1990 and has held various positions including Deputy Secretary of the Communist Youth League of the Company, Deputy Secretary of the Communist Party Committee of the Experimental Plant and Chemical Division of the Company and Director of the Propaganda Division of the Company. In May 2003, Mr. Gao was appointed Deputy Secretary of the Communist Party Committee of the Company and Chairman of the Labor Union of the Company. From June 2004 to June 2006, Mr. Gao served as Director of the Company. In April 2006, Mr. Gao was appointed Secretary of the Communist Party Discipline Supervisory Committee of the Company. In June 2006, Mr. Gao was appointed Supervisor and Chairman of the Supervisory Committee of the 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 studies in business administration in the aspect of industrial economics at Shanghai Academy of Social Sciences. He has senior professional title.

**Zhang Chenghua**, 53, is a Supervisor, Deputy Secretary of the Communist Party Discipline Supervisory Committee, Director of Supervisory Office, Director of Supervisory Committee Office and Director of the Communist Party Committee Office of the Company. Mr. Zhang joined the Complex in 1974 and worked in the Thermal Power Plant of the Complex as Deputy Secretary of the Communist Party Committee, Deputy Secretary of the Communist Party Committee cum Chairman of Labor Union of the Thermal Power Plant of the Complex. In March 2002, Mr. Zhang was appointed Deputy Secretary of the Communist Party Discipline Supervisory Committee and Director of Supervisory Division of the Company. In April 2002, Mr. Zhang was appointed Director of Supervisory Committee Office of the Company. In June 2002, Mr. Zhang was appointed Supervisor of the Company. In April 2004, Mr. Zhang was appointed Director of the Communist Party Committee Office. Mr. Zhang graduated, majoring in party administrative management, from Shanghai Party Institute in January 1999. In 2001, he completed his post-graduate studies in business administration in the aspect of industrial economics at Shanghai Academy of Social Sciences. He has senior professional title.

**Wang Yanjun**, 48, is a Supervisor and Vice Chairwoman of the Labor Union of the Company. Ms. Wang joined the Complex in July 1982 and has held various positions including Chairwoman of the Labor Union of the Plastics Plant of the Company, Chairwoman of the Labor Union of Plastics Division of the Company, Chairwoman of the Labor Union of Chemical Division of the Company, Deputy Secretary of the Communist Party Committee, Secretary of Communist Party Discipline Supervisory Committee of the Communist Party Committee and Chairwoman of the Labor Union of Chemical Division of the Company. In January 2005, Ms. Wang was appointed Vice Chairwoman of the Labor Union of the Company. In June 2005, Ms. Wang was appointed Supervisor of the Company. Ms. Wang graduated from East China University of Science and Technology majoring in basic organic chemistry in July 1982. In 2001, she completed her post-graduate studies in business administration in the aspect of industrial economics at Shanghai Academy of Social Sciences. She has senior professional technical qualifications.

**External Supervisors**

**Zhai Yalin**, 44, is Deputy Director of the Auditing Bureau of China Petrochemical Corporation and Deputy Director of Auditing Department of Sinopec Corp and has served as External Supervisors of the Company since June 2008. Mr. Zhai began his career in 1986 and had been successively Deputy Head of the Head Office and Director of the Auditing Department of Qianguo Refinery, Deputy Director of the General Office of Sinopec Huaxia Auditing Company and Deputy Manager of the Sinopec Huaxia Auditing Company, Deputy Director of the General Administrative Office of the Auditing Bureau of China Petrochemical Corporation, Director of the General Administrative Office of the Auditing Bureau of China Petrochemical Corporation, and Director of the General Administrative Office of the Auditing Bureau of China Petrochemical Corporation (Auditing Department of Sinopec Corp.). Since December 2001, Mr. Zhai has been holding concurrently the posts of Deputy Director of the Auditing Bureau of China Petrochemical Corporation and Deputy Director of Auditing Department of Sinopec Corp. Mr. Zhai graduated from Jilin Siping Normal College in 1986 and is a senior economist.

**Wu Xiaoqi**, 52, is Secretary of the Communist Party Committee of Sinopec Yunnan Oil Products Company, Deputy General Manager of said company, and has been an External Supervisor of the Company since June 2008. Mr. Wu began his career in 1971 and had been successively Deputy Office Head Class Disciplinary Monitor of the Supervisory Bureau of China Petrochemical Corporation's Disciplinary Division, Deputy Head (Deputy Director) and Head (Director) of the Office of the Supervisory Bureau of China Petrochemical Corporation's Disciplinary Division, and Director of Section 1 of Supervisory Bureau of China Petrochemical Corporation's Disciplinary Division. From June 2004 to April 2005, he served as a Deputy Bureau Director Class Disciplinary Inspector of Supervisory Bureau of China Petrochemical Corporation and a Deputy Bureau Director Class Supervisory Inspector of Supervisory Department of Sinopec Corp. From April 2005 to December 2008, Mr. Wu was Deputy Director of Supervisory Bureau of China Petrochemical Corporation and Deputy Director of Supervisory Department of Sinopec Corp. Since December 2008, he has served as Secretary of the Communist Party Committee, and Deputy General Manager of Sinopec Yunnan Oil Products Company. Mr. Wu graduated from Shijiazhuang Army Command Academy and has a senior professional title.



**Table of Contents****Independent Supervisors**

**Liu Xiangdong**, 57, is President of Zhengda International Finance Corporation. He was elected as an Independent Supervisor of the Company in June 2000. Mr. Liu has held various positions including Planning and Credit Officer and Deputy Head and Head of the Credit Division of banks. He has also been Deputy Director and Director of the Planning Department of the Industrial and Commercial Bank of China, Shanghai Branch, Chief Economist and Director of the Planning Division of the Industrial and Commercial Bank of China, Shanghai Branch. He has been Deputy Director of the Industrial and Commercial Bank of China, Shanghai Branch since October 1997. He was appointed General Manager of Investment Division of the Industrial and Commercial Bank of China in June 2002. Mr. Liu has been working in the banking sector for many years and has abundant experience in business management practices. He holds a master's degree in economics and is a senior economist.

**Yin Yongli**, 69, is Chairman of the Management Committee of Tianhua Certified Public Accountants. From June 2005, he has served as Independent Supervisor of the Company. Mr. Yin has held various positions including Deputy Chief and Chief of Finance section of Shandong Shengli Refinery, Deputy Chief Accountant of Qiliu Petrochemical Company, Chief Accountant of Planning and Financing Department of China Petrochemical Corporation and Chief Accountant and Deputy Director of Financing Department of China Petrochemical Corporation and Director of Shihua Auditing Firm. In September 2001, he was Chairman of China Rights on Certified Public Accountants. Since June 2004, Mr. Yin has been appointed Chairman of Huazheng Certified Public Accountants. Since June 2005, Mr. Yin has been Chairman of the Management Committee of Tianhua Certified Public Accountants. Mr. Yin has engaged in financing and auditing for many years and has rich experience in financing management and enterprise auditing. Mr. Yin graduated from Shandong Institute of Finance and Economics in 1964. Mr. Yin is a professional accountant and is a certified accountant.

**Senior Management**

**Zhang Jianping**, 46, is a Vice President of the Company. He joined the Complex in 1987, and successively held the positions of Deputy Chief Engineer of the Aromatics Plant of the Refining and Chemical Division, Deputy Director of the Plastic Plant, Deputy Manager of Plastics Division of the Company, Director of the Petrochemical Research Institute, Director of the Production Division of the Company, Assistant to President of the Company and Director of the Production Division. In July 2004, he was appointed Vice President of our Company. Mr. Zhang graduated in 1984 from East China Institute of Chemical Technology specializing in Petroleum Refinery and received a Master's Degree in Petroleum Processing from the same institute in 1987. He is a qualified senior engineer.

**Tang Chengjian**, 53, 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 of the Thermal Power Plant of the Complex, Director of Thermal Power Plant of the General Thermal Power Unit of the Company, Deputy Director and Director of the Company's General Thermal Power Unit. He was appointed the Vice President of our Company in July 2004. Mr. Tang graduated in 1974 from Shanghai Power Technology School with a specialization in power plant steam turbines and graduated from Shanghai Power College in power plant and power systems in 1986. In 1991, he graduated from Shanghai No. 2 Industry University majoring in project management; he earned an MBA from the China Europe International Business School in 2001. He is a qualified engineer.

**Zhang Jingming**, 51, is the Secretary of the Board of Directors and General Legal Counsel. Mr. Zhang joined the Complex in 1978 and has held various positions including Project Manager and Deputy Director of the International Department, Securities Affairs Representative in Hong Kong and Deputy Director of the Board Secretariat. In June 1999, Mr. Zhang was concurrently appointed as Secretary to the Board of Directors and Director of the Board Secretariat. In June 2001, Mr. Zhang was appointed Director of Strategy Research Department of the Company. In January 2005, Mr. Zhang was appointed General Counsel of the Company. In 1987, Mr. Zhang graduated from the Shanghai International Studies University majoring in English. During the period from 1992 to 1993, he was enrolled in graduate courses for the fourth Sino-British joint MBA program at Northwestern Polytechnic University and later on, Mr. Zhang earned an MBA degree from the University of Hull in the United Kingdom in July 1995. In 2002, Mr. Zhang completed his graduate courses in international economic law at East China University of Political Science and Law. He is a senior economist by professional title.

**B. Compensation.**

The aggregate amount of cash compensation we paid to our directors, supervisors and executive officers during the year ended December 31, 2008 was approximately RMB4.828 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 Supervisory Committee or the executive officers upon termination of their relationship with us.





**Table of Contents**

The following table sets forth the compensation on an individual basis for our directors, supervisors and executive officers who received compensation from us in 2008.

<b>Name</b>	<b>Position with the Company</b>	<b>Remuneration in 2008 (RMB 000) (before tax)</b>
Rong Guangdao	Chairman of the Board of Directors and President	481
Du Chongjun	Vice Chairman of the Board of Directors and Vice President	481
Han Zhihao	Director and Chief Financial Officer	408
Li Honggen	Director and Vice President	408
Shi Wei	Director and Vice President	412
Dai Jinbao	Director	215
Lei Dianwu	External Director	0
Xiang Hanyin	External Director	0
Chen Xinyuan	Independent Director	115
Sun Chiping	Independent Director	115
Jiang Zhiquan	Independent Director	115
Zhou Yunnong	Independent Director	115
Gao Jinping	Chairman of the Supervisory Committee	407
Zhang Chenghua	Supervisor	220
Wang Yanjun	Supervisor	217
Zhai Yalin	External Supervisor	0
Wu Xiaoqi	External Supervisor	0
Liu Xiangdong	Independent Supervisor	0
Yin Yongli	Independent Supervisor	0
Zhang Jianping	Vice President	404
Tang Chengjian	Vice President	408
Zhang Jingming	Company Secretary and Corporate Counsel	291

**C. Board Practices.****Board of Directors**

Our board of directors consists of twelve members. Our directors are elected at meetings of our shareholders, and, unless they resign at an earlier date, are deceased or removed, will serve three-year terms. The directors shall be eligible for reelection upon expiry of their terms of office, however, the combined tenure of an independent director may not exceed a total of six years. The term of our current board of directors will expire in 2011. None of our directors have entered into any service contracts with us or any of our subsidiaries providing for benefits upon termination of appointment or employment (with the exception of compensation required by Chinese labor law).

**Supervisory Committee**

The Supervisory Committee is responsible for ensuring that our directors and senior officers act in the interests of our company or those of our shareholders or employees and that they do not abuse their positions and powers. The Supervisory Committee has no power to overturn the decisions or actions of our directors or officers and may only recommend that they correct any acts that are harmful to our interests or the interests of our shareholders or employees. The Supervisory Committee is currently composed of seven members appointed for a three year term. The term of the current members will expire in June 2011. Supervisory Committee members have 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 Practices 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. The current members are Chen Xinyuan, Zhou Yunnong and Sun Chiping according to the Resolutions of the First Meeting of the Sixth Session of the Board of Directors. 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 their directorships which will expire in 2011.

Remuneration Committee

We formed a remuneration committee on December 25, 2001 which consists of three directors. The current members are Dai Jinbao, Jiang Zhiquan and Zhou Yunnong. The key responsibility of the Remuneration Committee is to formulate and review the remuneration policy and plan for the directors and executive officers, formulate the standards for evaluation of the directors and executive officers and conduct such evaluations.

**Table of Contents****Summary Corporate Governance Differences**

There are significant differences between our corporate governance practices and those of U.S. issuers listed on the New York Stock Exchange. Pursuant to Section 303A.11 of the NYSE listing Manual, we have disclosed certain of these differences on our website at [www.spc.com.cn/enspc/spc/newsroomlook.php?Did=1650&cid=69dD1ev=5](http://www.spc.com.cn/enspc/spc/newsroomlook.php?Did=1650&cid=69dD1ev=5) and in Item 16F Corporate Governance.

***D. Employees.***

As of December 31, 2008, we had 17,597 employees.

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,		
	2006	2007	2008
Management	1,580	1,533	1,355
Engineers, technicians and factory personnel	14,163	11,067	9,795
Accounting, marketing and other	7,179	6,652	6,447
Total	22,922	19,252	17,597

Approximately 38.39% of our work force are graduates with an associate degree or higher. In addition, we offer our employees opportunities for education and training based upon our development and the individual performance of each employee.

A system of labor contracts has been adopted in our company. 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, 2008, almost all of the work force was employed pursuant to labor contracts which specify the employee's position, responsibilities, remuneration and grounds for termination. The contracts generally have short terms of one to five years and may be renewed with the agreement of both parties. The remaining personnel are employed for an indefinite term.

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 2008, we paid RMB1,161 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. The Company is responsible for the retirement insurance of 12,559 employees.

We do not carry worker's 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 worker's compensation arrangements over time.



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

The following table shows the ownership interests of our Directors, Supervisors and senior officers in our shares as of March 1, 2009. All shares indicated are A shares and are directly owned by 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 affiliates had any other beneficial interest in our issued share capital as of March 1, 2009.

<b>Name</b>	<b>Position</b>	<b>Shares held at March 1, 2009</b>
Rong Guangdao	Chairman and President	3,600
Du Chongjun	Vice Chairman and Vice President	1,000
Han Zhihao	Director and Chief Financial Officer	0
Li Honggen	Director and Vice President	0
Shi Wei	Director and Vice President	0
Dai Jinbao	Director	0
Lei Dianwu	External Director	0
Xiang Hanyin	External Director	0
Sun Chiping	Independent Director	0
Jiang Zhiquan	Independent Director	0
Zhou Yunnong	Independent Director	0
Chen Xinyuan	Independent Director	0
Gao Jinping	Chairman of Supervisory Committee	0
Zhang Chenghua	Supervisor	0
Wang Yanjun	Supervisor	0
Zhai Yalin	External Supervisor	0
Wu Xiaoqi	External Supervisor	0
Liu Xiangdong	Independent Supervisor	0
Yin Yongli	Independent Supervisor	0
Zhang Jianping	Vice President	0
Tang Chengjian	Vice President	0
Zhang Jingming	Company Secretary	0

**Table of Contents**

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 March 1, 2009 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.

Title of Class	Identity of Person or Group	Number of Shares Held	Percent of Total Share Capital
Domestic Shares	China Petroleum & Chemical Corporation <sup>(1)</sup>	4,000,000,000	55.56%
H Shares	HKSCC nominees Ltd.	2,300,260,101	31.95%
A Shares	Directors and Officers	4,600	less than 1%

(1). This company is controlled by China Petrochemical Corporation which is itself controlled by the Chinese government. As of April 1, 2009, a total of 2,330,000,000 H Shares were outstanding. As of April 1, 2009, a total of 2,494,532 ADSs, representing the equivalent of 249,453,200 H Shares, were outstanding and held by 113 holders of record. A total of 720,000,000 A Shares were outstanding on April 1, 2009.

To the best of our knowledge, except as disclosed above, 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 and 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 primarily include procurement of crude oil and certain raw materials, sale of our petroleum products and some of our petrochemical products, sale of our petrochemical products as our exclusive sale agent, and provision of related services to us.

**Table of Contents**

We entered into a Mutual Product Supply and Sales Services Framework Agreement with Sinopec Corp and a Comprehensive Services Framework Agreement with Sinopec Group upon approval and authorization by the 2007 Extraordinary General Meeting held on December 13, 2007. During the reporting period, pursuant to the Mutual Product Supply and Sales Service Framework Agreement, we purchased raw materials from, and sell petroleum products and petrochemicals as well as lease properties to, Sinopec Corp and its associates, and Sinopec Corp and its associates act as sales agents for our petrochemical products. Under the Comprehensive Services Framework Agreement, we accept construction and installation, engineering design, insurance agency and financial services relating to the petrochemical industry provided by Sinopec Corp and its associates. The directors, including each of the independent non-executive directors confirm that these continuing connected transactions were conducted in accordance with the terms of the Product Supply and Sales Services Framework Agreement and the Comprehensive Services Framework Agreements throughout 2008. The transaction amounts of the relevant connected transactions did not exceed the caps in relation to the continuing connected transactions approved at the 2007 Extraordinary General Meeting held on December 13, 2007.

The purchases by us of crude oil and related materials from, and sales of petroleum products by us to, Sinopec Corp and its associates were conducted in accordance with the State's relevant policy and applicable State tariffs or State guidance prices. As long as the State does not lift its control over purchases of crude oil, sales of petroleum products and pricing thereof, such connected transactions will continue to occur. We sell petrochemicals to Sinopec Corp and its associates and Sinopec Corp and its associates act as agents for the sale of petrochemicals in order to reduce our inventories, expand their trading, distribution and sales networks and improve our bargaining power with our customers. We lease part of the properties to Sinopec Corp and its associates. We accept construction and installation, engineering design, insurance agency and financial services relating to the petrochemical industry from Sinopec Group and its associates in order to secure steady and reliable services at reasonable prices.

**Table of Contents**

Type of transactions	Related parties	Amount	Unit:
			RMB 000 Percentage of total amount of the type of transaction (%)
Income from sale of products and services	Sinopec East China Company	24,682,129	40.98
	Other related parties	5,226,157	8.68
Purchases	Sinopec Transport and Storage Company	28,986,447	48.72
	Other related parties	14,356,008	24.13
Installation fees	Sinopec and its subsidiaries	114,878	76.73
Transportation costs	Sinopec Transport and Storage Company	300,948	72.57
This includes an amount of RMB27,871,756,040 for the connected transactions in respect of the sale of products or the provision of labor services to the controlling shareholder and its subsidiaries by the listed company during 2008.			

**Other related party transactions**

We transferred to Sinopec Corp. a 81.97% equity interest owned by our wholly owned subsidiary Shanghai Petrochemical Investment Development Company Limited in Shanghai Jin Hua Industrial Company Limited for a consideration of RMB61,600,400. The relevant transfer agreement was entered into on February 8, 2006. The transaction generated a gain of RMB24,307,946 in 2006. The pricing principle was determined on the basis of a valuation report prepared by a qualified asset valuation company independent of the Company and Sinopec Corp. and upon arm's length negotiations between the parties. On the asset disposal date, the book value of the assets was RMB37,292,454, while the appraised value of the assets was RMB53,600,422 as at March 31, 2005.

We entered into equity transfer agreements with Sinopec Finance Co., Ltd to transfer our respective equity interests in China Everbright Bank and Bank of Shanghai to Sinopec Finance Co., Ltd. The considerations for the China Everbright Bank transfer and Bank of Shanghai transfer were RMB66,993,800 and RMB14,729,600, respectively. The relevant transfer agreements were entered into on December 7, 2006. As at the asset appraisal date, the book value of the equity interests held by the respective parties in China Everbright Bank and Bank of Shanghai totaled RMB55,449,641. The increase in the fair value of those equity interests of RMB26,228,500 as a result of the above transaction was recognized in the reserve, net of deferred tax, in 2006. The transaction prices were determined by way of a bidding process on the China Beijing Equity Exchange. The transfer of equity interest in China Everbright Bank was completed in April 2007. The transfer of equity interest in Bank of Shanghai was completed in July 2007.

We signed an agreement on December 30, 2005 to transfer our 2% equity interest in Sinopec Finance to Sinopec Corp for a purchase price of RMB82,000,000. In accordance with the payment terms of the agreement, we were paid the consideration on February 28, 2006.

We paid an amount of RMB164,763,000 to Sinopec Corp and its subsidiary which consisted of equipment pre-payments and progress payments for the 380,000 tons per year glycol project and the long-cycle facility of the 3,300,000 tons per year diesel hydrogenization project. Both facilities were delivered in the first half of the year in 2006.

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.



## **Table of Contents**

### **Equity joint venture**

Late in 2001, we established Secco, a Sino-foreign equity joint venture, together with BP and Sinopec Corp. We own a 20% interest in Secco, while BP and Sinopec Corp own 50% and 30% interests in 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; provide related after-sales services and technical advice with respect to such petrochemical products and by products; and engage in polymers application development. Secco completed construction in 2005. Secco's total registered capital is US\$901,440,964, of which we provided the Renminbi equivalent of US\$180,287,952.

### **HKSE connected transactions rules**

We are required by HKSE listing rules to obtain advance shareholder approval for certain transactions with related parties such as Sinopec Group, Sinopec Corp, or its associates. We comply with such HKSE listing rules by obtaining advance shareholder approval at least every three years for the renewal of our framework agreements (e.g. the Mutual Product Supply and Sales Services Framework Agreement and the Comprehensive Services Framework Agreement) with Sinopec Group and Sinopec Corp for setting maximum aggregated annual values spent on the supply of products and services under these agreements. The independent non-executive directors will need to confirm each year, upon reviewing our continuing connected transaction, that these transactions are conducted in the ordinary and usual course of our business, on normal commercial terms and in accordance with the terms of these agreements.

### ***C. Interests of Experts and Counsel.***

Not applicable.

## **ITEM 8. FINANCIAL INFORMATION.**

### ***A. Consolidated Statements and Other Financial Information.***

Please see [Item 17. Financial Statements](#) for our audited consolidated financial statements filed as part of this annual report.

Please see [Item 17. Financial Statements](#) for the separate financial statements and notes for Shanghai Secco Petrochemical Co., Ltd., which are being filed pursuant to Rule 3-09 of Regulation S-X.

## **Table of Contents**

### **Export Sales**

In 2008, export sales accounted for RMB225.4 million (US\$33.0million) or 0.38% 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 of up to 50% of our distributable profits. Shareholders receive dividends in proportion to their shareholdings.

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 in respect of our H shares be paid in Renminbi. If we record no profit for the year, we may not distribute dividends in such 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 and Item 3. Key Information Selected Financial Data Dividends.

### ***B. Significant Changes.***

No significant change has occurred since 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, ADSs and A Shares for the periods indicated.

**Table of Contents**

	Price per H Share (HK\$)		Price per ADS (US\$)		Price per A Share (RMB)	
	High	Low	High	Low	High	Low
2004	4.07	1.86	53.90	24.30	8.15	4.37
2005	3.58	2.25	45.20	29.55	5.07	3.11
2006	5.00	2.97	64.60	38.60	7.18	4.03
2007	7.38	3.26	102.77	31.37	22.49	6.05
2008	5.00	2.97	64.60	38.60	7.18	4.03
2007						
First Quarter	4.42	3.49	54.90	44.55	9.65	6.05
Second Quarter	6.18	3.99	75.95	51.50	15.77	8.70
Third Quarter	6.54	3.26	84.50	46.10	20.42	10.55
Fourth Quarter	7.38	4.20	102.77	54.74	22.49	14.48
2008						
First Quarter	4.88	2.37	61.88	31.37	13.64	9.21
Second Quarter	3.50	2.63	44.71	33.93	9.68	6.41
Third Quarter	2.80	1.60	34.99	20.15	7.02	4.59
Fourth Quarter	2.25	1.10	28.99	14.50	5.87	3.58
2009						
First Quarter	2.22	1.61	28.72	20.75	6.66	5.06
Most Recent Six Months						
November 2008	1.84	1.29	24.06	16.59	4.85	3.58
December 2008	2.25	1.58	28.99	19.77	5.87	4.56
January 2009	2.22	1.73	28.72	21.81	5.63	5.06
February 2009	2.07	1.75	27.08	22.24	6.50	5.36
March 2009	2.16	1.61	27.28	20.75	6.66	5.33
April 2009	2.93	1.94	38.00	27.26	8.32	6.27

***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 a depository 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 on July 26, 1993 and subsequent listings on the HKSE and NYSE, there was no market for our H Shares or the ADSs. Public trading in our A Shares commenced on November 8, 1993.

***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.

## **Table of Contents**

We are a joint stock limited company established in accordance with the Company Law and certain other laws and regulations of the PRC. We are registered with the Shanghai Administration of Industry and Commerce with business license number 310000000021453. Our Articles of Association provide, at article 12, that our purpose is:

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

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.

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.

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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 ordinances, rules and regulations applicable to companies listed on the HKSE, the Securities and Futures Ordinance and the 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.

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**Table of Contents**

**Enforceability of Shareholders' Rights**

There has not been any public disclosure in relation to the enforcement by holders of H shares of their rights under the charter 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.

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 certain 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 practices that occurred before the handover of Hong Kong to China. This 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.

## **Table of Contents**

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

all relevant transfer fees and stamp duties are 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;

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.

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**



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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 or two-thirds of the number specified in our Articles of Association;

if the number of directors is less than five, the 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 requests.

## **Table of Contents**

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 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;

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:

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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.

## **Table of Contents**

Shareholders are entitled to attend and vote at meetings either in person or by proxy. Proxy authorization forms must be in writing and deposited at our company's principal offices, or at such other place specified in the notice of shareholders meeting not less than 24 hours before the time that such meeting will be held or the time appointed for passing upon the relevant resolutions. If a proxy authorization form is signed by a third party on behalf of the relevant shareholder, then such proxy authorization form must be accompanied by the signature authorization letter or other such document authorizing such third party to sign on behalf of the shareholder.

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;

significant acquisition or disposal of material assets or provision of guarantees conducted within the period of one year with a value exceeding 30% of our latest audited total assets;

share incentive schemes; 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. Our directors are not required to hold any shares in us, and there is no age limit requirement for the retirement or non-retirement of our directors.

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

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.

## **Table of Contents**

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 multiplied by 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 members 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;

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.

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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;

**Table of Contents**

significant acquisitions 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;

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 is responsible for supervising our directors and senior officers and preventing them from abusing their positions and powers or infringing upon the rights and interests of our company or those of our shareholders and employees. The Supervisory Committee has no power over the decisions or actions of our directors or officers to correct any acts that are 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 the meetings of our board of directors;

inspect our financial affairs;

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

## **Table of Contents**

require our directors, general manager or other senior officers to correct any act harmful to our interests and those of our shareholders and employees;

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 company's behalf;

conduct investigation into any identified irregularities in our operations, and where necessary, to engage accountants, legal advisers or other professionals to assist in the investigation; 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 one-half 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.

## **Obligation of Shareholders**

Shareholders are not obligated 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 ADSs will also not be obligated 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**

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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;

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).

## **Table of Contents**

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.***

We have not entered into any material contracts other than in the ordinary course of business and other than those described in Item 4. Information on the Company or elsewhere in this annual report on Form 20-F.

### ***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.

The Renminbi currently is not a freely convertible currency. The State Administration of Foreign Exchange (SAFE), under supervision of the People's Bank of China (PBOC) controls the conversion of Renminbi into foreign currency. Although PRC governmental policies were introduced in 1996 to reduce restrictions on the convertibility of Renminbi into foreign currency for current account items, conversion of Renminbi into foreign exchange for capital items, such as foreign direct investment, loans or securities, requires the approval of SAFE and other relevant authorities. These limitations could affect our ability to obtain foreign exchange through debt or equity financing, or to obtain foreign exchange for capital expenditures.

On July 21, 2005, the Chinese government changed its policy of pegging the Renminbi to the U.S. dollar. Under the new policy, the Renminbi is permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies. Since the adoption of this new policy, the value of the Renminbi has fluctuated daily within a narrow band, but overall has appreciated against the US dollar. Nevertheless, the PRC government continues to receive significant international pressure to further liberalize its currency policy which could result in a further and more significant appreciation in the value of the Renminbi against the US dollar.

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While the impact of the foregoing developments is 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. The HK dollar is currently linked to and trades within a narrow band against the US dollar at a rate that does not deviate significantly from HK\$7.80 = US\$1.00. The Hong Kong government has stated its intention to maintain such link, although there can be no guarantee that such link will be maintained.

**Table of Contents*****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, as amended on December 29, 2007 (the Individual Income Tax Law) dividends paid by Chinese companies to foreign individuals 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 to foreign individuals, 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) 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.

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

***For a Corporation***

According to the Enterprise Income Tax Law of the People's Republic of China (Enterprise Income Tax Law) and its implementation rules, effective January 1, 2008, dividends by Chinese resident enterprises to non-resident enterprises are ordinarily subject to a Chinese withholding tax levied at a flat rate of 10%. For purposes of the Enterprise Income Tax Law, a Chinese resident enterprise is an enterprise which is either (i) set up in China in accordance with PRC laws or (ii) set up in accordance with the laws of a foreign country (region) but whose actual administrative headquarters is in China. For purposes of the Enterprise Income Tax Law, a non-resident enterprise is an enterprise which is set up in accordance with the laws of a foreign country (region) and whose actual administrative headquarters is located outside China but which has either (i) set up a legal presence in China or (ii) has income originating from China despite not having formally set up a legal presence in China. The State Administration of Taxation issued a *Circular on Issues Relating to the Withholding of Enterprise Income Tax for Dividends Distributed by Resident Enterprises in China to Non-resident Enterprises Holding H-shares of the Enterprises* (Guo Shui Huan [2008] No. 897)(Circular No. 897) on November 6, 2008, which further clarifies that Chinese resident enterprises should, in distributing dividends for 2008 or any year hereafter to non-resident enterprises holding H-shares of the Chinese resident enterprise, withhold enterprise income tax for such dividends at a tax rate of 10%. After receiving dividends, non-resident enterprises holding H-shares of any Chinese resident enterprise can, on their own or through an agent, file an application to the relevant taxation authorities for such dividends to be covered by any applicable tax treaty (or other arrangement). The relevant taxation authorities should, upon reviewing and verifying the application and supporting materials to be correct, refund the difference between the tax levied and the tax payable calculated at a tax rate specified by the applicable tax treaty (or other arrangement).

**Capital Gains Tax**

According to the Individual Income Tax Law, the Enterprise Income Tax Law, and their respective implementing regulations, capital gains recognized by foreign individuals 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 and foreign corporations, with respect to their sale of Overseas Shares and B Shares are temporarily exempt from Chinese tax. As discussed above, the relevant tax authority has thus far not sought to collect Chinese tax on capital gains recognized by foreign individuals 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 New Enterprise Income Tax Law, and their respective implementing regulations, subject to reduction by an applicable income tax treaty.

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## Table of Contents

### 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 paid to individuals and corporations that qualify for treaty benefits. However, this treaty does not offer reduced tax rates for capital gains.

### Stamp Tax

While no express exemption exists for the imposition of Chinese stamp tax on transfers of Overseas Shares pursuant to the Provisional Regulations of the People's Republic of China Concerning Stamp Tax effective on July 1, 1989, we are not aware of any circumstance under which Chinese stamp tax has actually been imposed on the transfer of Overseas Shares.

### Estate or Gift Tax

China does not currently impose any estate or gift tax.

## **U.S. Taxation**

The following is a summary of the material U.S. federal income tax consequences of the ownership and disposition of H Shares or ADSs. The following discussion is not exhaustive of all possible tax considerations. This summary is based upon the Internal Revenue Code of 1986, as amended (the Code), regulations promulgated under the Code by the U.S. Treasury Department (including proposed and temporary regulations), rulings, current administrative interpretations and official pronouncements of the Internal Revenue Service (the IRS), and judicial decisions, all as currently in effect and all of which are subject to differing interpretations or to change, possibly with retroactive effect. Such change could materially and adversely affect the tax consequences described below. No assurance can be given that the IRS will not assert, or that a court will not sustain, a position contrary to any of the tax consequences described below.

This discussion does not address state, local, or foreign tax consequences of the ownership and disposition of H Shares or ADSs. (See PRC Taxation above).

This summary is for general information only and does not address all aspects of the U.S. federal income taxation that may be important to a particular holder in light of its investment or tax circumstances or to holders subject to special tax rules, such as: banks; financial institutions; insurance companies; dealers in stocks, securities, or currencies; traders in securities that elect to use a mark-to-market method of accounting for their securities holdings; tax-exempt organizations; real estate investment trusts; regulated investment companies; qualified retirement plans, individual retirement accounts, and other tax-deferred accounts; expatriates of the United States; persons subject to the alternative minimum tax; persons holding H Shares or ADSs as part of a straddle, hedge, conversion transaction, or other integrated transaction; persons who acquired H Shares or ADSs pursuant to the exercise of any employee stock option or otherwise as compensation for services; persons actually or constructively holding 10% or more of our voting stock; and U.S. Holders (as defined below) whose functional currency is other than the U.S. dollar.

**This discussion is not a comprehensive description of all of the U.S. federal tax consequences that may be relevant with respect to the ownership and disposition of H Shares or ADSs. We urge you to consult your own tax advisor regarding your particular circumstances and the U.S. federal income and estate tax consequences to you of owning and disposing of H Shares or ADSs, as well as any tax consequences arising under the laws of any state, local, or foreign or other tax jurisdiction and the possible effects of changes in U.S. federal or other tax laws.**

This summary is directed solely to persons who hold their H Shares or ADSs as capital assets within the meaning of Section 1221 of the Code, which generally means as property held for investment. For purposes of this discussion, the term U.S. Holder means a beneficial owner of H Shares or ADSs that is any of the following:

a citizen or resident of the United States or someone treated as a U.S. citizen or resident for U.S. federal income tax purposes;

a corporation (or other entity taxable as a corporation for U.S. federal income tax purposes) created or organized in or under the laws of the United States, any state thereof, or the District of Columbia;



an estate, the income of which is subject to U.S. federal income taxation regardless of its source;

a trust if a U.S. court can exercise primary supervision over the trust's administration and one or more U.S. persons have the authority to control all substantial decisions of the trust; or

a trust in existence on August 20, 1996 that has a valid election in effect under applicable Treasury Regulations to be treated as a U.S. person.

The term "Non-U.S. Holder" means a beneficial owner of H Shares or ADSs that is not a U.S. Holder. As described in "Taxation of Non-U.S. Holders" below, the tax consequences to a Non-U.S. Holder may differ substantially from the tax consequences to a U.S. Holder.

## **Table of Contents**

If a partnership (including for this purpose any entity treated as a partnership for U.S. federal income tax purposes) is a beneficial owner of H Shares or ADSs, the U.S. federal income tax consequences to a partner in the partnership will generally depend on the status of the partner and the activities of the partnership. A holder of H Shares or ADSs that is a partnership and the partners in such partnership should consult their own tax advisors regarding the U.S. federal income tax consequences of the ownership and disposition of H Shares or ADSs.

### **ADSs**

As it relates to the ADSs, this discussion is based in part upon the representations of the depository and the assumption that each obligation in the deposit agreement and any related agreement will be performed in accordance with its terms.

Generally, a holder of ADSs will be treated as the owner of the underlying H Shares represented by those ADSs for U.S. federal income tax purposes. Accordingly, no gain or loss will be recognized if the holder exchanges ADSs for the underlying H Shares represented by those ADSs. The holder's adjusted tax basis in the H Shares will be the same as the adjusted tax basis of the ADSs surrendered in exchange therefor, and the holding period for the H Shares will include the holding period for the surrendered ADSs.

### **TAXATION OF U.S. HOLDERS**

The discussion in *Distributions on H Shares or ADSs* and *Dispositions of H Shares or ADSs* below assumes that we will not be treated as a passive foreign investment company ( PFIC ) for U.S. federal income tax purposes. For a discussion of the rules that apply if we are treated as a PFIC, see the discussion in *Passive Foreign Investment Company* below.

#### **Distributions on H Shares or ADSs**

*General.* Subject to the discussion in *Passive Foreign Investment Company* below, if you actually or constructively receive a distribution on H Shares or ADSs, you must include the distribution in gross income as a taxable dividend on the date of your (or in the case of ADSs, the depository's) receipt of the distribution, but only to the extent of our current or accumulated earnings and profits, as calculated under U.S. federal income tax principles. Such amount must be included without reduction for any foreign taxes withheld. Dividends paid by us will not be eligible for the dividends received deduction allowed to corporations with respect to dividends received from certain domestic corporations. Dividends paid by us may or may not be eligible for preferential rates applicable to qualified dividend income, as described below.

To the extent a distribution exceeds our current and accumulated earnings and profits, it will be treated first as a non-taxable return of capital to the extent of your adjusted tax basis in the H Shares or ADSs, and thereafter as capital gain. Preferential tax rates for long-term capital gain may be applicable to non-corporate U.S. Holders.

We do not intend to calculate our earnings and profits under U.S. federal income tax principles. Therefore, you should expect that a distribution will generally be reported as a dividend even if that distribution would otherwise be treated as a non-taxable return of capital or as capital gain under the rules described above.

*Qualified Dividend Income.* With respect to non-corporate U.S. Holders (i.e., individuals, trusts, and estates), for taxable years beginning before January 1, 2011, dividends that are treated as qualified dividend income ( QDI ) are taxable at a maximum tax rate of 15%. Among other requirements, dividends generally will be treated as QDI if either (i) our H Shares or ADSs are readily tradable on an established securities market in the United States, or (ii) we are eligible for the benefits of a comprehensive income tax treaty with the United States which includes an information exchange program and which is determined to be satisfactory by the U.S. Treasury. It is expected that our ADSs will be readily tradable as a result of being listed on the New York Stock Exchange.

In addition, for dividends to be treated as QDI, we must not be a PFIC (as discussed below) for either the taxable year in which the dividend was paid or the preceding taxable year. We do not believe that we were a PFIC for the preceding taxable year or will be a PFIC for the current taxable year. However, please see the discussion under *Passive Foreign Investment Company* below. Additionally, in order to qualify for QDI treatment, you generally must have held the H Shares or ADSs for more than 60 days during the 121-day period beginning 60 days prior to the ex-dividend date. However, your holding period will be reduced for any period during which the risk of loss is diminished.

Moreover, a dividend will not be treated as QDI to the extent you are under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property. Since the QDI rules are complex, you should consult your own tax advisor regarding the availability of the preferential tax rates for dividends paid on H Shares or ADSs.

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*Foreign Currency Distributions.* A dividend paid in foreign currency (e.g., Hong Kong dollars or Chinese Renminbi) must be included in your income as a U.S. dollar amount based on the exchange rate in effect on the date such dividend is received, regardless of whether the payment is in fact converted to U.S. dollars. If the dividend is converted to U.S. dollars on the date of receipt, you generally will not recognize a foreign currency gain or loss. However, if you convert the foreign currency to U.S. dollars on a later date, you must include in income any gain or loss resulting from any exchange rate fluctuations. The gain or loss will be equal to the

**Table of Contents**

difference between (i) the U.S. dollar value of the amount you included in income when the dividend was received and (ii) the amount that you receive on the conversion of the foreign currency to U.S. dollars. Such gain or loss will generally be ordinary income or loss and U.S. source for U.S. foreign tax credit purposes.

*In-Kind Distributions.* Distributions to you of new H Shares or ADSs or rights to subscribe for new H Shares or ADSs that are received as part of a pro rata distribution to all of our shareholders will not be subject to U.S. federal income tax. The adjusted tax basis of the new H Shares or ADSs or rights so received will be determined by allocating your adjusted tax basis in the old H Shares or ADSs between the old H Shares or ADSs and the new H Shares or ADSs or rights received, based on their relative fair market values on the date of distribution. However, in the case of a distribution of rights to subscribe for H Shares or ADSs, the adjusted tax basis of the rights will be zero if the fair market value of the rights is less than 15% of the fair market value of the old H Shares or ADSs on the date of distribution and you do not make an election to determine the adjusted tax basis of the rights by allocation as described above. Your holding period for the new H Shares or ADSs or rights will generally include the holding period for the old H Shares or ADSs on which the distribution was made.

*Foreign Tax Credits.* Subject to certain conditions and limitations, any foreign taxes paid on or withheld from distributions from us and not refundable to you may be credited against your U.S. federal income tax liability or, alternatively, may be deducted from your taxable income. This election is made on a year-by-year basis and applies to all foreign taxes paid by you or withheld from you that year. No Chinese withholding tax currently is imposed on dividends on the H Shares and ADSs, although Chinese withholding taxes could be imposed in the future.

Distributions will constitute foreign source income for foreign tax credit limitation purposes. The foreign tax credit limitation is calculated separately with respect to specific classes of income. For this purpose, distributions characterized as dividends distributed by us will generally constitute passive category income or, in the case of certain U.S. Holders, general category income. Special limitations may apply if a dividend is treated as QDI (as defined above).

Special rules may apply to electing individuals whose foreign source income during the taxable year consists entirely of qualified passive income and whose creditable foreign taxes paid or accrued during the taxable year do not exceed \$300 (\$600 in the case of a joint return).

Since the rules governing foreign tax credits are complex, you should consult your own tax advisor regarding the availability of foreign tax credits in your particular circumstances.

The U.S. Treasury has expressed concerns that parties to whom ADSs are pre-released may be taking actions that are inconsistent with the claiming of foreign tax credits by U.S. Holders of ADSs. Such actions would also be inconsistent with the claiming of the preferential tax rates applicable to QDI, as defined above. Accordingly, the creditability of any foreign taxes and the availability of such preferential tax rates could be affected by future actions that may be taken by the U.S. Treasury or parties to whom ADSs are pre-released.

**Dispositions of H Shares or ADSs**

Subject to the discussion in *Passive Foreign Investment Company* below, you generally will recognize taxable gain or loss realized on the sale or other taxable disposition of H Shares or ADSs equal to the difference between the U.S. dollar value of (i) the amount realized on the disposition (i.e., the amount of cash plus the fair market value of any property received), and (ii) your adjusted tax basis in the H Shares or ADSs. Such gain or loss will be a capital gain or loss.

If you have held the H Shares or ADSs for more than one year at the time of disposition, such capital gain or loss will be long-term capital gain or loss. Preferential tax rates for long-term capital gain (currently, with a maximum rate of 15% for taxable years beginning before January 1, 2011) will apply to non-corporate U.S. Holders. If you have held the H Shares or ADSs for one year or less, such capital gain or loss will be short-term capital gain or loss taxable as ordinary income at your marginal income tax rate. The deductibility of capital losses is subject to limitations.

Generally, any gain or loss recognized will not give rise to foreign source income for U.S. foreign tax credit purposes.

You should consult your own tax advisor regarding the U.S. federal income tax consequences if you receive currency other than U.S. dollars upon the disposition of H Shares or ADSs.

**Passive Foreign Investment Company**

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We generally will be a PFIC under Section 1297 of the Code if, for a taxable year, either (a) 75% or more of our gross income for such taxable year is passive income (the income test ) or (b) 50% or more of the average percentage, generally determined by fair market value, of our assets during such taxable year either produce passive income or are held for the production of passive income (the asset test ). Passive income includes, for example, dividends, interest, certain rents and royalties, certain gains from the sale of stock and securities, and certain gains from commodities transactions.

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**Table of Contents**

Certain look through rules apply for purposes of the income and asset tests described above. If we own, directly or indirectly, 25% or more of the total value of the outstanding shares of another corporation, we generally will be treated as if we (a) held directly a proportionate share of the other corporation's assets, and (b) received directly a proportionate share of the other corporation's income. In addition, passive income does not include any interest, dividends, rents, or royalties that are received or accrued by us from a related person (as defined in Section 954(d)(3) of the Code), to the extent such items are properly allocable to income of such related person that is not passive income.

Under the income and asset tests, whether or not we are a PFIC will be determined annually based upon the composition of our income and the composition and valuation of our assets, all of which are subject to change. In determining that we are not a PFIC, we are relying on our projected revenues and projected capital expenditures. If our actual revenues and capital expenditures do not match our projections, we may become a PFIC. For example, if we do not spend enough of the cash (a passive asset) we raise from any financing transactions we may undertake, the relative percentage of our passive assets will increase. In addition, our determination is based on a current valuation of our assets. We believe our valuation approach is reasonable. However, it is possible that the IRS will challenge the valuation of our assets, which may result in our being a PFIC.

We do not believe that we are currently a PFIC. However, because the PFIC determination is highly fact intensive and made at the end of each taxable year, there can be no assurance that we will not be a PFIC for the current or any future taxable year or that the IRS will not challenge our determination concerning our PFIC status.

*Default PFIC Rules under Section 1291 of the Code.* If we are treated as a PFIC with respect to a U.S. Holder, the U.S. federal income tax consequences to a U.S. Holder of the ownership and disposition of H Shares or ADSs will depend on whether such U.S. Holder makes an election to treat us as a qualified electing fund ( QEF ) under Section 1295 of the Code (a QEF Election ) or a mark-to-market election under Section 1296 of the Code (a Mark-to-Market Election ). A U.S. Holder owning H Shares or ADSs while we were or are a PFIC that has not made either a QEF Election or a Mark-to-Market Election will be referred to in this summary as a Non-Electing U.S. Holder.

If you are a Non-Electing U.S. Holder, you will be subject to the default tax rules of Section 1291 of the Code with respect to:

any excess distribution paid on H Shares or ADSs, which means the excess (if any) of the total distributions received by you during the current taxable year over 125% of the average distributions received by you during the three preceding taxable years (or during the portion of your holding period for the H Shares or ADSs prior to the current taxable year, if shorter); and

any gain recognized on the sale or other taxable disposition (including a pledge) of H Shares or ADSs.

Under these default tax rules:

any excess distribution or gain will be allocated ratably over your holding period for the H Shares or ADSs;

the amount allocated to the current taxable year and any period prior to the first day of the first taxable year in which we were a PFIC will be treated as ordinary income in the current taxable year;

the amount allocated to each of the other years will be treated as ordinary income and taxed at the highest applicable tax rate in effect for that year; and

the resulting tax liability from any such prior years will be subject to the interest charge applicable to underpayments of tax.

In addition, notwithstanding any election you may make, dividends that you receive from us will not be eligible for the preferential tax rates applicable to QDI (as discussed above in Distributions on H Shares or ADSs ) if we are a PFIC either in the taxable year of the distribution or the preceding taxable year, but will instead be taxable at rates applicable to ordinary income.

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Special rules for Non-Electing U.S. Holders will apply to determine U.S. foreign tax credits with respect to foreign taxes imposed on distributions on H Shares or ADSs.

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## **Table of Contents**

If we are a PFIC for any taxable year during which you hold H Shares or ADSs, we will continue to be treated as a PFIC with respect to you for all succeeding years during which you hold H Shares or ADSs, regardless of whether we actually continue to be a PFIC. You may terminate this deemed PFIC status by electing to recognize gain (which will be taxed under the default tax rules of Section 1291 of the Code discussed above) as if your H Shares or ADSs had been sold on the last day of the last taxable year for which we were a PFIC.

If we are treated as a PFIC in any year with respect to you, you will be required to file an annual return on IRS Form 8621 regarding distributions received on H Shares or ADSs and any gain realized on the disposition of H Shares or ADSs.

*QEF Election.* If you own (or owned) H Shares or ADSs while we are (or were) a PFIC and make a QEF Election, you generally will not be subject to the default rules of Section 1291 of the Code discussed above. Instead, you will be subject to current U.S. federal income tax on your pro rata share of our ordinary earnings and net capital gain, regardless of whether such amounts are actually distributed to you by us. However, you can make a QEF Election only if we agree to furnish you annually with certain tax information, and we currently do not intend to prepare or provide such information.

*Mark-to-Market Election.* U.S. Holders may make a Mark-to-Market Election, but only if the H Shares or ADSs are marketable stock. The H Shares or ADSs will be marketable stock as long as they are regularly traded on a qualified exchange. Stock is considered regularly traded for any calendar year during which it is traded (other than in de minimis quantities) on at least 15 days during each calendar quarter. Qualified exchanges include (a) a national securities exchange that is registered with the Securities and Exchange Commission, (b) the national market system established pursuant to section 11A of the Securities and Exchange Act of 1934, and (c) a foreign securities exchange that is regulated or supervised by a governmental authority of the country in which the market is located, provided that (i) such foreign exchange has trading volume, listing, financial disclosure, surveillance, and other requirements and the laws of the country in which such foreign exchange is located, together with the rules of such foreign exchange, ensure that such requirements are actually enforced, and (ii) the rules of such foreign exchange effectively promote active trading of listed stocks.

Since the H Shares are listed on a foreign exchange (i.e., the Stock Exchange of Hong Kong Limited) and the IRS has yet to identify specific foreign exchanges that are qualified for this purpose, there can be no assurances that the H Shares will be marketable stock and will be regularly traded. As for the ADSs, they will be marketable stock as long as they remain listed on the New York Stock Exchange and are regularly traded. There can be no assurances, however, that the ADSs will be treated, or continue to be treated, as regularly traded.

If you own (or owned) H Shares or ADSs while we are (or were) a PFIC and make a Mark-to-Market Election, you generally will not be subject to the default rules of Section 1291 of the Code discussed above. Rather, you generally will be required to recognize ordinary income for any increase in the fair market value of the ADSs for each taxable year that we are a PFIC. You will also be allowed to deduct as an ordinary loss any decrease in the fair market value to the extent of net marked-to-market gain previously included in prior years. Your adjusted tax basis in the ADSs will be adjusted to reflect the amount included or deducted.

The Mark-to-Market Election will be effective for the taxable year for which the election is made and all subsequent taxable years, unless the ADSs cease to be marketable stock or the IRS consents to the revocation of the election. You should consult your own tax advisor regarding the availability of, and procedure for making, a Mark-to-Market Election.

Since the PFIC rules are complex, you should consult your own tax advisor regarding them and how they may affect the U.S. federal income tax consequences of the ownership and disposition of H Shares or ADSs.

## **Information Reporting and Backup Withholding**

Generally, information reporting requirements will apply to distributions on H Shares or ADSs or proceeds from the disposition of H Shares or ADSs paid within the United States (and, in certain cases, outside the United States) to a U.S. Holder unless such U.S. Holder is an exempt recipient, such as a corporation. Furthermore, backup withholding (currently at 28%) may apply to such amounts unless such U.S. Holder (i) is an exempt recipient that, if required, establishes its right to an exemption, or (ii) provides its taxpayer identification number, certifies that it is not currently subject to backup withholding, and complies with other applicable requirements.

A U.S. Holder may generally avoid backup withholding by furnishing a properly completed IRS Form W-9.



## **Table of Contents**

Backup withholding is not an additional tax. Rather, amounts withheld under the backup withholding rules may be credited against your U.S. federal income tax liability. Furthermore, you may obtain a refund of any excess amounts withheld by filing an appropriate claim for refund with the IRS and furnishing any required information in a timely manner.

### **TAXATION OF NON-U.S. HOLDERS**

#### **Distributions on H Shares or ADSs**

Subject to the discussion in *Information Reporting and Backup Withholding* below, as a Non-U.S. Holder, you generally will not be subject to U.S. federal income tax, including withholding tax, on distributions received on H Shares or ADSs, unless the distributions are effectively connected with your conduct of a trade or business in the United States (and, if an applicable income tax treaty so requires, attributable to a permanent establishment that you maintain in the United States).

If distributions are effectively connected with a U.S. trade or business (and, if applicable, attributable to a U.S. permanent establishment), you generally will be subject to tax on such distributions in the same manner as a U.S. Holder, as described in *Taxation of U.S. Holders Distributions on H Shares or ADSs* above. In addition, any such distributions received by a corporate Non-U.S. Holder may also, under certain circumstances, be subject to an additional *branch profits tax* at a 30% rate or such lower rate as may be specified by an applicable income tax treaty.

#### **Dispositions of H Shares or ADSs**

Subject to the discussion in *Information Reporting and Backup Withholding* below, as a Non-U.S. Holder, you generally will not be subject to U.S. federal income tax, including withholding tax, on any gain recognized on a sale or other taxable disposition of H Shares or ADSs, unless (i) the gain is effectively connected with your conduct of a trade or business in the United States (and, if an applicable income tax treaty so requires, attributable to a permanent establishment that you maintain in the United States), or (ii) you are an individual and are present in the United States for at least 183 days in the taxable year of the disposition, and certain other conditions are met.

If you meet the test in clause (i) above, you generally will be subject to tax on any gain that is effectively connected with your conduct of a trade or business in the United States in the same manner as a U.S. Holder, as described in *Taxation of U.S. Holders Dispositions of H Shares or ADSs* above. Effectively connected gain realized by a corporate Non-U.S. Holder may also, under certain circumstances, be subject to an additional *branch profits tax* at a 30% rate or such lower rate as may be specified by an applicable income tax treaty.

If you meet the test in clause (ii) above, you generally will be subject to tax at a 30% rate on the amount by which your U.S. source capital gain exceeds your U.S. source capital loss.

#### **Information Reporting and Backup Withholding**

Payments to Non-U.S. Holders of distributions on, or proceeds from the disposition of, H Shares or ADSs are generally exempt from information reporting and backup withholding. However, a Non-U.S. Holder may be required to establish that exemption by providing certification of non-U.S. status on an appropriate IRS Form W-8.

Backup withholding is not an additional tax. Rather, amounts withheld under the backup withholding rules may be credited against your U.S. federal income tax liability. Furthermore, you may obtain a refund of any excess amounts withheld by filing an appropriate claim for refund with the IRS and furnishing any required information in a timely manner.

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

Not applicable.

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

Not applicable.



## **Table of Contents**

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

We are subject to the periodic reporting and other informational requirements of the Securities Exchange Act of 1934, as amended, or the Exchange Act. Under the Exchange Act, we are required to file reports and other information with the Securities and Exchange Commission. Specifically, we are required to file annually a Form 20-F no later than six months after the close of each fiscal year, which is December 31 of each year. Copies of reports and other information, when so filed, may be inspected without charge and may be obtained at prescribed rates at the public reference facilities maintained by the Securities and Exchange Commission at Room 1024, Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549. You can request copies of these documents upon payment of a duplicating fee, by writing to the SEC. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference rooms. The SEC also maintains a Web site at [www.sec.gov](http://www.sec.gov) that contains reports, proxy and information statements, and other information regarding registrants that make electronic filings with the SEC using its EDGAR system. As a foreign private issuer, we are exempt from the rules under the Exchange Act prescribing the furnishing and content of quarterly reports and proxy statements, and officers, directors and principal shareholders are exempt from the reporting and short- swing profit recovery provisions contained in Section 16 of the Exchange Act.

### ***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 such activities in 2008 or 2007.

**Table of Contents**

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, 2008 and 2007.

	As of December 31, 2008					Total Recorded Amount	Fair Value
	2009	2010	2011	2012	2013		
	(RMB equivalent in thousands, except interest rates)						
Fixed rate bank and other loans							
In U.S. Dollars							
Average interest rate							
In RMB	5,230,000	100,000	100,000		200,000	5,630,000	5,635,091
Average interest rate <sup>(1)</sup>	5.08%	6.80%	5.10%		5.27%	5.12%	
Variable rate bank and other loans							
In U.S. Dollars	4,093,204					4,093,204	4,093,204
Average interest rate <sup>(1)</sup>	5.26%					5.26%	

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

	As of December 31, 2007					Total Recorded Amount	Fair Value
	2008	2009	2010	2011	2012		
	(RMB equivalent in thousands, except interest rates)						
Fixed rate bank and other loans							
In U.S. Dollars	9,097					9,097	8,641
Average interest rate	1.80%					1.80%	
In RMB	3,445,300	85,000	100,000			4,030,300	4,015,929
Average interest rate <sup>(1)</sup>	5.41%	6.88%	5.91%			5.60%	
Variable rate bank and other loans							
In U.S. Dollars	612,642					612,642	612,642
Average interest rate <sup>(1)</sup>	5.77%					5.77%	

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

**Exchange Rate Sensitivity**

We are also exposed to foreign currency exchange rate risk as a result of our foreign currency denominated short-term debt, long-term debt and, to a limited extent, cash and cash equivalents denominated in foreign currencies. In 2008, we entered into forward exchange contracts with notional amounts of USD 460.2 million to manage foreign currency exposure related to short-term and long-term debts denominated in US dollars. We had no program of foreign currency hedging activities and did not engage in any foreign currency hedging activities in 2007.

**Table of Contents**

The following table provides information, by maturity date, regarding our foreign currency exchange rate sensitive financial instruments, which consist of cash and cash equivalents, short-term and long-term debt obligations as of December 31, 2008 and 2007.

	As of December 31, 2008						Total Recorded Amount	Fair Value
	2009	2010	2011	2012	2013	Thereafter		
(RMB equivalent in thousands, except interest rates)								
<b>On-balance sheet financial instruments</b>								
Cash and cash equivalents:								
In Hong Kong Dollars	11,912						11,912	11,912
In U.S. Dollars	318						318	318
In Euro								
In Japanese Yen								
In Swiss Frank	840						840	840
Other debtors								
Forward contracts receivable	97,644						97,644	97,644
Debt:								
Fixed rate bank and other loans in U.S. Dollars								
Average interest rate								
Variable rate bank and other loans in U.S. Dollars	4,093,204						4,093,204	4,093,204
Average interest rate <sup>(1)</sup>	5.26%						5.26%	
Interest free bank and other loans in U.S. Dollars	4,921	2,460	2,461				9,842	8,884

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

	As of December 31, 2007						Total Recorded Amount	Fair Value
	2008	2009	2010	2011	2012	Thereafter		
(RMB equivalent in thousands, except interest rates)								
<b>On-balance sheet financial instruments</b>								
Cash and cash equivalents:								
In Hong Kong Dollars	12,382						12,382	12,382
In U.S. Dollars	347						347	347
In Euro								
In Japanese Yen								
In Swiss Frank	841						841	841
Debt:								
Fixed rate bank and other loans in U.S. Dollars								
Average interest rate	1.80%						1.80%	
Variable rate bank and other loans in U.S. Dollars	612,642						612,642	612,642
Average interest rate <sup>(1)</sup>	5.77%						5.77%	
Interest free bank and other loans in U.S. Dollars	2,630	2,630	2,630	6,629			10,519	9,150

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

**Table of Contents**

**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.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) of the Securities Exchange Act of 1934) as of the end of the fiscal year covered by this annual report. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the fiscal year covered by this annual report, our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed in the reports we file under the Exchange Act is recorded, processed, summarized and reported as and when required.

***B. Management's report on internal control over financial reporting.***

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) of the Securities Exchange Act of 1934). The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with International Financial Reporting Standards.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of our internal control over financial reporting based upon the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission as of December 31, 2008. Based on that evaluation, our management has concluded that our internal control over financial reporting was effective as of December 31, 2008 based on these criteria.

## Edgar Filing: SINOPEC SHANGHAI PETROCHEMICAL CO LTD - Form 20-F

KPMG, an independent registered public accounting firm, has audited the consolidated financial statements included in this annual report on Form 20-F and, as part of the audit, has issued a report, included herein, on the effectiveness of our internal control over financial reporting.

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.

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**Table of Contents**

***C. Report of Independent Registered Public Accounting Firm.***

The Board of Directors and Shareholders of

Sinopec Shanghai Petrochemical Company Limited:

We have audited Sinopec Shanghai Petrochemical Company Limited and subsidiaries (the Group) s internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Group s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management s Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Group s internal control over financial reporting based on our audit.

We conducted our audit 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 effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Group maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Group as of December 31, 2007 and 2008, and the related consolidated statements of operations, equity and cash flows for each of the years in the three-year period ended December 31, 2008, and our report dated March 27, 2009 expressed an unqualified opinion on those consolidated financial statements.

**KPMG**

Hong Kong, China

March 27, 2009



**Table of Contents****D. Changes in internal control over financial reporting.**

For the year ended December 31, 2008, there have been no significant changes to our internal controls over financial reporting that have materially affected, or are reasonably likely to materially 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 2007 and 2008.

	<b>For the year ended December 31, (in thousands of RMB)</b>	
	<b>2007</b>	<b>2008</b>
Audit fees (1)	8,727	8,310
Audit-related fees (2)		
Tax fees (3)		
All other fees (4)		
<b>Total</b>	<b>8,727</b>	<b>8,310</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.**

We have not been granted an exemption from the applicable listing standards for the audit committee of our board of directors.

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

None.

**Table of Contents**

**ITEM 16F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT**

Not applicable.

**ITEM 16G. CORPORATE GOVERNANCE**

Set forth below is a summary of the significant differences between the corporate governance rules of the New York Stock Exchange and those of the People's Republic of China for listed companies:

		<b>The Company's Corporate Governance Practices</b>
<b>Director Independence</b>	<p style="text-align: center;"><b>NYSE Corporate Governance Rules</b></p> <p>A listed company must have a majority of independent directors on its board of directors. The board of directors needs to affirmatively determine that the director has no material relationship with the listed company (either directly or as a partner, shareholder or officer of an organization that has a relationship with the company). In addition, a director must meet certain standards to be deemed independent.</p>	<p><b>(which conform with the corporate governance rules for companies organized and listed in the People's Republic of China)</b></p> <p>It is required in China that any listed company must have independent directors and set forth specific requirements for the qualification and election of independent directors in compliance with PRC laws. For example, an independent director shall not hold any other position in the listed company other than being a director and shall not be influenced by the main shareholders or the controlling persons of the listed company, or by any other entities or persons with whom the listed company has a significant relationship.</p>
	<p>The non-management directors of each listed company must meet at regularly scheduled executive sessions without management.</p>	<p>The Company has complied with the relevant Chinese corporate governance rules and has implemented internal rules governing the independence and responsibilities of independent directors. The Company determines the independence of independent directors every year.</p> <p>No similar requirements.</p>
<b>Nominating/Corporate Governance Committee</b>	<p>Listed companies must have a nominating/corporate governance committee composed entirely of independent directors.</p> <p>The nominating/corporate governance committee must have a written charter that addresses the committee's purposes and responsibilities which, at minimum, must be to: search for eligible people for the board of directors, select and nominate directors for the next session of the shareholders' annual meeting, study and propose corporate governance guidelines, supervise the evaluation of the board of directors and</p>	<p>The board of directors can establish a nominating committee if the shareholders pass resolutions to establish such a committee. A majority of the directors on the committee shall be independent directors, who shall act as the convener. As of now, the Company has not set up a nominating committee.</p> <p>Relevant responsibilities of the nominating/corporate governance committee are similar to those stipulated by the NYSE rules, but the main responsibilities do not include the research and recommendation of corporate governance guidelines, the supervision of the evaluation of the board of directors and management, or the annual evaluation of the committee.</p>

management, and evaluate the performance of the committee every year.

**Table of Contents**

<b>Compensation Committee</b>	<p>Listed companies must have a compensation committee composed entirely of independent directors.</p> <p>The purposes and responsibilities of the compensation committee stated in its charter must include the following:</p> <p>(1) review and approve the corporate goals associated with CEO's compensation, evaluate the performance of the CEO in fulfilling these goals, and based on such evaluation determine and approve the CEO's compensation level;</p> <p>(2) make recommendations to the board with respect to non-CEO executive officer compensation, and incentive-compensation and equity-based plans that are subject to board approval;</p> <p>(3) produce a committee report on executive compensation as required by the SEC to be included in the annual proxy statement or annual report filed with the SEC.</p> <p>The charter must also include the requirement for an annual performance evaluation of the compensation committee.</p>	<p>The board of directors can establish a compensation and assessment committee if the shareholders pass resolutions to establish such a committee. A majority of the directors on the committee shall be independent directors, who shall act as the convener.</p> <p>The responsibilities of the compensation and assessment committee include:</p> <p>(1) review the standards for the evaluation of directors and management, evaluate directors and management and report the results of such evaluation to the board of directors;</p> <p>(2) review compensation policies and benefit plans for directors and executive officers.</p> <p>Unlike the NYSE rules, the PRC rules do not require the committee to produce a report on the executive compensation or make an annual performance evaluation of the committee. In addition, the compensation committee evaluates and reviews the compensation of directors as well as executive officers.</p> <p>The board of directors of the Company has established a compensation and performance evaluation committee composed mainly of independent directors who act as the convener, and the committee has established a written charter complying with the domestic corporate governance rules.</p>
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**Table of Contents**

**Audit Committee**

Listed companies must have an audit committee that satisfies the requirements of Rule 10A-3 of Securities Exchange Act of 1934 (the Exchange Act ). It must have a minimum of three members, and all audit committee members must satisfy the requirements for independence set forth in Section 303A.02 of NYSE Corporate Governance Rules as well as the requirements of Rule 10A-3b(1) of the Exchange Act.

The board of directors of a listed company can, through the resolution of the shareholders meeting, establish an audit committee composed entirely of directors, of which the independent directors are the majority and act as the convener, and, at minimum, one independent director is an accounting professional.

The written charter of the audit committee must specify that the purpose of the audit committee is to assist the board oversight of the integrity of financial statements, the company's compliance with legal and regulatory requirements, qualifications and independence of independent auditors, the performance of the listed company's internal audit function and the appointment and retention of independent auditors.

The purpose, authority and responsibilities of the audit committee are similar to those stipulated by the NYSE rules, but according to customary practices in China, the Company is not required to make an annual performance evaluation of the audit committee, and the audit committee is not required to prepare an audit report to be included in the Company's annual proxy statement. The board of directors of the Company has established an audit committee that satisfies Rule 10A-3 under the Securities Exchange Act of 1934, as amended, and relevant domestic requirements. The audit committee has a written charter.

The written charter must also require the audit committee to prepare an audit committee report as required by the SEC to be included in the listed company's annual proxy statement as well as an annual performance evaluation of the audit committee.

Each listed company must have an internal audit department.

China has a similar regulatory provision, and the Company has an internal audit department.

**Equity Compensation**

Shareholders must be given the opportunity to vote on equity compensation plans and material revisions thereto, except for employment incentive plans, certain awards and plans in the context of mergers and acquisitions.

The relevant regulations of China require the board of directors propose plans on the amount and types of director compensation for the shareholders meeting to approve. The compensation plan of executive officers shall be approved by the board and announced at the shareholders meeting and disclosed to the public upon the approval of the board of directors.

**Corporate Governance Guidelines**

Listed companies must adopt and disclose corporate governance guidelines involving director qualification standards, director compensation, director continuing education and annual performance evaluation of the board of directors.

The China Securities Regulatory Commission (the CSRC ) has issued the Corporate Governance Rules, prescribing detailed guidelines on directors of the listed companies, including director selection, the structure of the board of directors and director performance evaluation.

The Company has complied with the above mentioned rules.

**Table of Contents**

**Code of Ethics for**

Listed companies must adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers.

There is no such requirement for a code for ethics in China. As the directors and officers of the Company have all signed a Director Service Agreement, however, they are bound by their fiduciary duties to the Company. In addition, the directors and officers must perform their legal duties in accordance with the Company Law of the PRC, relevant requirements of CSRC and Mandatory Provisions to the Charter of Companies Listed Overseas.

**Directors, Officers and**

**Employees**

Each listed company CEO must certify to the NYSE each year that he or she is not aware of any violation by the company of NYSE corporate governance listing standards and he or she must promptly notify the NYSE on writing of any material non-compliance with any applicable provisions of Section 303A.

No similar requirements.

**Table of Contents**

**PART III**

**ITEM 17. FINANCIAL STATEMENTS.**

See pages F-1 to F-63.

Separate financial statements and notes thereto for Shanghai Secco Petrochemical Co., Ltd. are being filed pursuant to Rule 3-09 of Regulation S-X. See pages F-64 to F-107.

**ITEM 18. FINANCIAL STATEMENTS.**

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

**ITEM 19. EXHIBITS**

<b>No.</b>	<b>Exhibit</b>
1.1	Translation of the Articles of Association of Sinopec Shanghai Petrochemical Company Limited (incorporated by reference to Exhibit 1.1 of our annual report on Form 20-F/A (File No. 1-12158) filed with the Commission on August 20, 2008).
4.1	Translation of the Product Supply and Sales Services Framework Agreement dated as of October 19, 2007 between Sinopec Shanghai Petrochemical Company Limited and China Petroleum & Chemical Corporation (incorporated by reference to Exhibit 4.1 of our annual report on Form 20-F/A (File No. 1-12158) filed with the Commission on August 20, 2008).
4.2	Translation of the Comprehensive Services Framework Agreement dated as of October 19, 2007 between Sinopec Shanghai Petrochemical Company Limited and China Petroleum & Chemical Corporation (incorporated by reference to Exhibit 4.2 of our annual report on Form 20-F/A (File No. 1-12158) filed with the Commission on August 20, 2008).
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.



**Table of Contents**

**SIGNATURES**

The registrant hereby 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: May 19, 2009

/s/ Rong Guangdao  
Rong Guangdao, Chairman

**Table of Contents**

**SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED**

**Index**

**Years Ended December 31, 2006, 2007 and 2008**

**Consolidated Financial Statements of Sinopec Shanghai Petrochemical Company Limited**

	<b>Page</b>
<u>Report of Independent Registered Public Accounting Firm</u>	F-2
<u>Consolidated Balance Sheets</u> <u>December 31, 2007 and 2008</u>	F-3
<u>Consolidated Statements of Operations</u> <u>Years Ended December 31, 2006, 2007 and 2008</u>	F-4
<u>Consolidated Statements of Equity</u> <u>Years Ended December 31, 2006, 2007 and 2008</u>	F-5
<u>Consolidated Statements of Cash Flows</u> <u>Years Ended December 31, 2006, 2007 and 2008</u>	F-7
<u>Notes to Consolidated Financial Statements</u>	F-9
<u>Financial Statements of Shanghai Secco Petrochemical Company Limited (1)</u> <u>Years Ended December 31, 2006, 2007 and 2008 (Unaudited)</u>	F-63

- (1) The financial statements of Shanghai Secco Petrochemical Company Limited, an investee of Sinopec Shanghai Petrochemical Company Limited, are included in this Annual Report on Form 20-F of Sinopec Shanghai Petrochemical Company Limited to comply with Rule 3-09 of Regulation S-X of the U.S. Federal Securities Laws.

**Table of Contents**

**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, 2007 and 2008, and the related consolidated statements of operations, equity, and cash flows for each of the years in the three-year period ended December 31, 2008. 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, 2007 and 2008, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2008, in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Group s internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 27, 2009 expressed an unqualified opinion on the effectiveness of the Group s internal control over financial reporting.

**KPMG**

Hong Kong, China

March 27, 2009

**Table of Contents**

## SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED

## AND SUBSIDIARIES

## Consolidated Balance Sheets

As of December 31, 2007 and 2008

(Amounts in thousands)

	Note	December 31, 2007 Renminbi	2008 Renminbi
<u>Assets</u>			
Current assets:			
Cash and cash equivalents		893,165	627,685
Inventories	14	5,197,849	4,492,215
Amounts due from related companies	28	515,222	277,777
Trade debtors, net	15	212,257	89,086
Bills receivable		1,757,131	532,580
Other debtors and prepayments	16	262,918	484,475
Income tax recoverable		98,222	7,533
Total current assets		8,936,764	6,511,351
Non-current assets:			
Property, plant and equipment, net	17	14,977,237	13,272,899
Investment property	18	512,793	492,690
Construction in progress	19	962,313	1,854,154
Lease prepayments and other assets		649,337	604,163
Interest in associates and jointly controlled entities	20	3,068,135	2,545,978
Other investments	21	714,427	289,657
Deferred tax assets	11(b)	9,629	1,962,135
Goodwill	22	22,415	
Total non-current assets		20,916,286	21,021,676
Total assets		29,853,050	27,533,027
<u>Liabilities and Shareholders' Equity</u>			
Current liabilities:			
Loans and borrowings	23	4,091,969	9,372,725
Amounts due to related companies	28	904,870	1,752,647
Trade creditors		1,504,454	1,272,811
Bills payable		300,575	263,443
Accrued expenses and other creditors		1,442,284	679,415
Income tax payable		17,580	1,679
Total current liabilities		8,261,732	13,342,720
Non-current liabilities:			
Loans and borrowings	23	639,289	429,021

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Total non-current liabilities		639,289	429,021
Total liabilities		8,901,021	13,771,741
<b>Shareholders' equity:</b>			
Share capital	24	7,200,000	7,200,000
Share premium and reserves	25	13,448,038	6,296,933
Total equity attributable to equity shareholders of the Company		20,648,038	13,496,933
Minority interests		303,991	264,353
Total equity		20,952,029	13,761,286
Total liabilities and shareholders' equity		29,853,050	27,533,027

See accompanying notes to consolidated financial statements.

F-3

**Table of Contents**

## SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED

## AND SUBSIDIARIES

## Consolidated Statements of Operations

For the years ended December 31, 2006, 2007 and 2008

(Amounts in thousands, except per share data)

		Years ended December 31,		
	Note	2006 Renminbi	2007 Renminbi	2008 Renminbi
Sales		50,599,485	55,328,384	60,226,859
Less Sales taxes and surcharges		(681,362)	(1,073,695)	(897,088)
Net sales		49,918,123	54,254,689	59,329,771
Other income	4	282,142	93,900	2,312,227
Cost of sales	5	(49,182,232)	(52,646,516)	(68,556,447)
Gross profit/(loss)		1,018,033	1,702,073	(6,914,449)
Selling and administrative expenses		(521,990)	(504,712)	(467,987)
		496,043	1,197,361	(7,382,436)
Other operating income	6	297,394	216,553	145,191
Other operating expenses	7	(240,530)	(521,258)	(580,019)
Income/(loss) from operation		552,907	892,656	(7,817,264)
Financial income		137,997	82,280	227,533
Financial expenses		(303,386)	(260,206)	(557,971)
Net financing costs	9	(165,389)	(177,926)	(330,438)
Investment income	10		770,725	131,772
Share of profits of associates and jointly controlled entities		576,682	665,897	1,492
Earnings/(loss) before income tax		964,200	2,151,352	(8,014,438)
Income tax	11(a)	(53,238)	(468,216)	1,812,711
Net income/(loss)		910,962	1,683,136	(6,201,727)
Attributable to:				
Equity shareholders of the Company		844,407	1,634,080	(6,238,444)
Minority interests		66,555	49,056	36,717
Net income/(loss)		910,962	1,683,136	(6,201,727)
Basic earnings/(loss) per share	12	RMB 0.12	RMB 0.23	RMB (0.87)

Dividends attributable to the year	13(a)	288,000	648,000
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See accompanying notes to consolidated financial statements.

F-4

**Table of Contents**

## SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED

## AND SUBSIDIARIES

## Consolidated Statements of Equity

For the years ended December 31, 2006, 2007 and 2008

(Amounts in thousands)

	Note	Share capital Renminbi	Share premium Renminbi	Reserves Renminbi	Retained earnings Renminbi	Total equity attributable to equity shareholders of the Company Renminbi	Minority interests Renminbi	Total Renminbi
Balances at January 1, 2006		7,200,000	2,420,841	4,392,598	4,816,548	18,829,987	347,453	19,177,440
<b>Net income recognized directly in equity:</b>								
Unrealized gain for changes in fair values of available-for-sale securities, net of deferred tax				21,949		21,949		21,949
<i>Net income for the year recognized directly in equity</i>				21,949		21,949		21,949
<b>Profit attributable to shareholders</b>					844,407	844,407	66,555	910,962
<b>Total recognized income and expense</b>				21,949	844,407	866,356	66,555	932,911
Appropriation	25			73,685	(73,685)			
Dividends approved in respect of previous year	13(b)				(720,000)	(720,000)		(720,000)
Dividends paid to minority shareholders							(77,995)	(77,995)
Balances at December 31, 2006		7,200,000	2,420,841	4,488,232	4,867,270	18,976,343	336,013	19,312,356
Balances at January 1, 2007		7,200,000	2,420,841	4,488,232	4,867,270	18,976,343	336,013	19,312,356
<b>Net income recognized directly in equity:</b>								
Unrealized gains for changes in fair value of available-for-sale securities, net of deferred tax				842,002		842,002		842,002
<i>Net income for the year recognized directly in equity</i>				842,002		842,002		842,002
<b>Transfers from equity:</b>								
Transfer to profit or loss on disposal of available-for-sale securities, net of deferred tax				(516,387)		(516,387)		(516,387)
				(516,387)		(516,387)		(516,387)
<b>Profit attributable to shareholders</b>					1,634,080	1,634,080	49,056	1,683,136
<b>Total recognized income and expense</b>				325,615	1,634,080	1,959,695	49,056	2,008,751
Adjustment to statutory surplus reserve	25			(36,733)	36,733			



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Appropriation	25			192,434	(192,434)			
Dividends approved in respect of previous year	13(b)				(288,000)	(288,000)		(288,000)
Dividends paid to minority shareholders							(81,078)	(81,078)
Balances at December 31, 2007		7,200,000	2,420,841	4,969,548	6,057,649	20,648,038	303,991	20,952,029

F-5

**Table of Contents**

## SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED

## AND SUBSIDIARIES

## Consolidated Statements of Equity

For the years ended December 31, 2006, 2007 and 2008

(Amounts in thousands)

	Note	Share capital Renminbi	Share premium Renminbi	Reserves Renminbi	Retained earnings Renminbi	Total equity attributable to equity shareholders of the Company Renminbi	Minority interests Renminbi	Total Renminbi
Balances at January 1, 2008		7,200,000	2,420,841	4,969,548	6,057,649	20,648,038	303,991	20,952,029
<b>Net expense recognized directly in equity:</b>								
Unrealized loss for changes in fair value of available-for-sale securities, net of deferred tax				(165,832)		(165,832)		(165,832)
<i>Net expense for the year recognized directly in equity</i>				(165,832)		(165,832)		(165,832)
<b>Transfers from equity:</b>								
Transfer to profit or loss on disposal of available-for-sale securities, net of deferred tax				(98,829)		(98,829)		(98,829)
				(98,829)		(98,829)		(98,829)
<b>(Loss)/profit attributable to shareholders</b>					(6,238,444)	(6,238,444)	36,717	(6,201,727)
<b>Total recognized income and expense</b>				(264,661)	(6,238,444)	(6,503,105)	36,717	(6,466,388)
Appropriation	25							
Dividends approved in respect of previous year	13(b)				(648,000)	(648,000)		(648,000)
Dividends paid to minority shareholders							(76,355)	(76,355)
Balances at December 31, 2008		7,200,000	2,420,841	4,704,887	(828,795)	13,496,933	264,353	13,761,286

See accompanying notes to consolidated financial statements.

**Table of Contents**

## SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED

## AND SUBSIDIARIES

## Consolidated Statements of Cash Flows

For the years ended December 31, 2006, 2007 and 2008

(Amounts in thousands)

	Years ended December 31,		
	2006	2007	2008
	Renminbi	Renminbi	Renminbi
Net cash generated from/(used in) operating activities (a)	1,696,615	1,441,998	(3,986,490)
Cash flows from investing activities:			
Interest income received	56,827	46,421	59,472
Investment income received	47,596	393,062	546,333
Proceeds from disposal of property, plant and equipment	254,843	68,708	51,829
Proceeds from disposal of investments	351,178	1,114,701	153,997
Capital expenditure	(2,008,779)	(2,134,123)	(1,511,072)
Purchase of investments and addition of interests in associates	(54,206)		(8,039)
Net cash used in investing activities	(1,352,541)	(511,231)	(707,480)
Cash flows from financing activities:			
Net proceeds from issue of corporate bonds	2,977,800		
Proceeds from loans	13,936,126	17,605,887	32,528,758
Repayment of loans	(15,910,127)	(16,166,938)	(27,377,610)
Redemption of corporate bonds	(1,000,000)	(2,000,000)	
Dividends paid to equity shareholders of the Company	(720,000)	(288,000)	(645,551)
Dividends paid to minority shareholders	(77,995)	(81,078)	(76,355)
Net cash (used in)/generated from financing activities	(794,196)	(930,129)	4,429,242
Net (decrease)/increase in cash and cash equivalents	(450,122)	638	(264,728)
Cash and cash equivalents at beginning of year	1,347,237	894,650	893,165
Effect of foreign currency exchange rate changes	(2,465)	(2,123)	(752)
Cash and cash equivalents at end of year	894,650	893,165	627,685

See accompanying notes to consolidated financial statements.

**Table of Contents**

## SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED

## AND SUBSIDIARIES

## Notes to the Consolidated Statements of Cash Flows

For the years ended December 31, 2006, 2007 and 2008

(Amounts in thousands)

(a) Reconciliation of earnings/(loss) before income tax and minority interests to net cash generated from/(used in) operations

	Years ended December 31,		
	2006	2007	2008
	Renminbi	Renminbi	Renminbi
Earnings/(loss) before income tax	964,200	2,151,352	(8,014,438)
Interest income	(56,827)	(46,421)	(59,472)
Income from unlisted investments	(97,179)	(122,709)	(9,721)
Share of profits of associates and jointly controlled entities	(576,682)	(665,897)	(1,492)
Transfer from equity on disposal of available-for-sale securities		(770,725)	(131,772)
Interest expense	303,386	260,206	557,971
Depreciation for property, plant and equipment	1,810,990	1,687,435	1,618,478
Depreciation for investment property	12,678	14,879	13,440
Impairment losses for property, plant and equipment	50,000	200,295	440,946
Amortization of lease prepayments	29,400	16,972	16,759
Impairment loss of goodwill			22,415
Unrealized exchange gain	(78,841)	(16,535)	(70,993)
(Gain)/loss on disposal of property, plant and equipment	(19,569)	44,045	(13,166)
(Increase)/decrease in inventories	(48,278)	(1,034,593)	705,634
(Increase)/decrease in debtors, bills receivable and deposits	(585,256)	(387,688)	1,122,004
Increase/(decrease) in creditors, other creditors and bills payable	345,628	643,342	(786,918)
(Decrease)/increase in balances with related companies	(1,870)	485,161	1,159,222
Cash generated from/(used in) operations	2,051,780	2,459,119	(3,431,103)
Interest paid	(344,064)	(342,574)	(578,605)
Income tax paid	(63,386)	(674,547)	(60,699)
Income tax refund	52,285		83,917
Net cash generated from/(used in) operations	1,696,615	1,441,998	(3,986,490)

See accompanying notes to consolidated financial statements.

**Table of Contents**

SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED

AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(All Renminbi amounts in thousands, except per share data and except otherwise stated)

**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 fibres, 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, 2008, 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
China Jinshan Associated Trading Corporation	RMB 25,000	67.33		Import and export of petrochemical products and equipment
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 fibre products
Shanghai Petrochemical Enterprise Development Company Limited	RMB 455,000	100		Investment management
Shanghai Golden Conti Petrochemical Company Limited	RMB 545,776		100	Production of petrochemical products

None of the subsidiaries have issued any debt securities.

**Table of Contents**

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

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ( IFRS ) as issued by the International Accounting Standards Board ( IASB ), and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB.

The consolidated financial statements are prepared on the historical cost basis except for certain property, plant and equipment which are modified by the revaluation and the available-for-sale equity securities and derivative financial instruments which are stated at fair value. The accounting policies have been consistently applied by the Group.

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Key assumptions and estimation made by management in the application of IFRS that have significant effect on the financial statements and have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities in the next financial year are disclosed in note 30.

**Table of Contents**

**2. PRINCIPAL ACCOUNTING POLICIES**

(a) Basis of consolidation

(i) Subsidiaries and minority interests

The consolidated financial statements of the Group include the financial statements of the Company and all of its principal subsidiaries. Subsidiaries are entities controlled by the Group. Control exists when the Group has the power 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 are taken into account.

An investment in a subsidiary is consolidated into the consolidated financial statements from the date that control commences until the date that control ceases. Intra-group balances and transactions and any unrealized profits arising from intra-group transactions are eliminated in full in preparing the consolidated financial statements. Unrealized losses resulting from intra-group transactions are eliminated in the same way as unrealized gains but only to the extent that there is no evidence of impairment.

Minority interests represent the portion of the net assets of subsidiaries attributable to equity interests that are not owned by the Company, whether directly or indirectly through subsidiaries, and in respect of which the Group has not agreed any additional terms with the holders of those interests which would result in the Group as a whole having a contractual obligation in respect of those interests that meets the definition of a financial liability. Minority interests are presented in the consolidated balance sheet within equity, separately from equity attributable to the equity shareholders of the Company. Minority interests in the results of the Group are presented on the face of the consolidated income statement as an allocation of the total profit or loss for the year between minority interests and the equity shareholders of the Company.



**Table of Contents**

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

(a) Basis of consolidation *(continued)*

(ii) Associates and jointly controlled entities

An associate is an entity in which the Group or the Company has significant influence, but not control or joint control, over its management, including participation in the financial and operating policy decisions.

A jointly controlled entity is an entity which operates under a contractual arrangement between the Group or Company and other parties, where the contractual arrangement establishes that the Group or Company and one or more of the other parties share joint control over the economic activity of the entity.

An investment in an associate or a jointly controlled entity is accounted for in the consolidated financial statements under the equity method and is initially recorded at cost and adjusted thereafter for the post acquisition change in the Group's share of the associate's or the jointly controlled entity's net assets.

When the Group's share of losses exceeds its interest in the associate or the jointly controlled entity, the Group's interest is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate or the jointly controlled entity.

Unrealized profits and losses resulting from transactions between the Group and its associates and jointly controlled entities are eliminated to the extent of the Group's interest in the associate or jointly controlled entity, except where unrealized losses provide evidence of an impairment of the asset transferred, in which case they are recognized immediately in the profit or loss.

(b) Goodwill

Goodwill represents the excess of the cost of a business combination or an investment in an associate or a jointly controlled entity over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is allocated to cash-generating units and is tested annually for impairment (see note 2(u)). In respect of associates or jointly controlled entities, the carrying amount of goodwill is included in the carrying amount of the interest in the associate or jointly controlled entities.

Any excess of the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of a business combination or an investment in an associate or a jointly controlled entity is recognized immediately in profit or loss.

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

## (c) Other investments in equity securities

The Group's policies for investments in equity securities, other than investments in associates and jointly controlled entities, are as follows:

Investments in available-for-sale equity securities are carried at fair value with any change in fair value recognized directly in equity. When these investments are derecognized or impaired, the cumulative gain or loss previously recognized directly in equity is recognized as investment income in profit or loss. Investments in equity securities, that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are recognized in the balance sheet at cost less impairment losses (see note 2(u)).

## (d) Property, plant and equipment

Property, plant and equipment are stated in the balance sheet at cost or valuation (see note 17) less accumulated depreciation and impairment losses (see note 2(u)). Revaluations are performed with sufficient regularity to ensure that the carrying amount of these assets does not differ materially from that which would be determined using fair value at balance sheet date.

The cost of self-constructed assets includes the cost of materials, direct labor, the initial estimate, where relevant, of the costs of dismantling and removing the items and restoring the site on which they are located, and an appropriate proportion of production overheads and borrowing costs.

Gains or losses arising from the retirement or disposal of items of property, plant and equipment are determined as the difference between the net disposal proceeds and the carrying amount of the items and are recognized as other operating income or expenses in profit or loss on the date of retirement or disposal.

Depreciation is calculated to write off the costs/revalued amount 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 and machinery	10 to 20 years
Vehicles and other equipment	5 to 26 years

Where parts of an item of property, plant and equipment have different useful lives, the cost or valuation of the item is allocated on a reasonable basis between the parts and each part is depreciated separately. Both the useful life of an asset and its residual value are reviewed annually.

## (e) Investment property

Investment properties are properties which are owned or held under a leasehold interest either to earn rental income and/or for capital appreciation.

Investment properties are stated in the balance sheet at cost less accumulated depreciation and impairment losses (see note 2(u)). Depreciation is provided over their estimated useful lives on a straight-line basis, after taking into account their estimated residual values. Estimated useful life of the investment property is 40 years.

**Table of Contents**

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

(f) Lease prepayments and other assets

Lease prepayments and other assets represent prepayments for land use rights and catalysts used in production. They are carried at cost less accumulated amortization and impairment losses (see note 2(u)). Lease prepayments and other assets are charged to cost of sales on a straight-line basis over the respective periods of the rights and the estimated useful lives of the catalysts.

(g) Construction in progress

Construction in progress represents buildings, various plant and equipment under construction and pending installation, and is stated at cost less government grants that compensate the Company for the cost of construction, and impairment losses (see note 2(u)). 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.

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.

(h) Inventories

Inventories, other than spare parts and consumables, are carried at the lower of cost and net realizable value. Cost is calculated using the weighted average cost formula and comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. 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 sale.

When inventories are sold, the carrying amount of the 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 cost of sales in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories 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.

**Table of Contents**

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

(i) Trade receivables, bills and other receivables

Trade receivables, bills and other receivables are initially recognized at fair value and thereafter stated at amortized cost less allowance for impairment of doubtful debts (see note 2(u)), except where the receivables are interest-free loans made to related parties without any fixed repayment terms or the effect of discounting would be immaterial. In such cases, the receivables are stated at cost less allowance for impairment of doubtful debts.

Trade receivables, bills and other receivables are derecognized if the Group's contractual rights to the cash flows from these financial assets expire or if the Group transfers these financial assets to another party without retaining control or substantially all risks and rewards of the assets.

(j) Derivative financial instruments

Derivative financial instruments are recognized initially at fair value. At each balance sheet date the fair value is remeasured. The gain or loss on remeasurement of derivative financial instruments to fair value, except where the derivatives qualify for cash flow hedge accounting or hedge the net investment in a foreign operation, is recognized in profit or loss.

(k) Interest-bearing borrowings

Interest-bearing borrowings are recognized initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortized cost with any difference between the amount initially recognized and redemption value being recognized in profit or loss over the period of the borrowings, together with any interest and fees payable, using the effective interest method.

**Table of Contents**

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

(l) Trade and other payables

Trade and other payables are initially recognized at fair value and thereafter stated at amortized cost unless the effect of discounting would be immaterial, in which case they are stated at cost.

(m) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and on hand and time deposits with banks and other financial institutions with an initial term of less than three months at acquisition. Cash equivalents are stated at cost, which approximates fair value.

(n) Translation of foreign currencies

Foreign currency transactions during the year 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 gains and losses are recognized as net financial costs in profit or loss.

**Table of Contents**

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

(o) Revenue recognition

Revenues associated with the sale of petroleum and chemical products are recognized in profit or loss 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 services rendered is recognized in profit or loss upon performance of the services.

Dividend income is recognized as other operating income in profit or loss on the date the shareholder's right to receive payments is established.

Gains or losses arising from the disposal of unlisted investments are determined as the difference between the net disposal proceeds and the carrying amount of the investment and are recognized as other operating income or expenses in profit or loss on the date of disposal.

Rental income from investment property is recognized as other operating income in profit or loss on a straight-line basis over the term of the lease.

(p) Government grants

Government grants are recognized in the balance sheet initially when there is reasonable assurance that they will be received and that the Group will comply with the conditions attaching to them. Grants that compensate the Group for expenses incurred are recognized as revenue in profit or loss on a systematic basis in the same periods in which the expenses are incurred. Grants that compensate the Group for the cost of an asset are deducted in arriving at the carrying amount of the asset and consequently are recognized in profit or loss over the useful life of the asset.

(q) Net financing costs

Net financing costs comprise interest payable on borrowings calculated using the effective interest rate method, interest income on bank deposits, gains and losses in fair value change of derivative financial instruments, foreign exchange gains and losses and bank charges.

Interest income from bank deposits is recognized in profit or loss as it accrues using the effective interest method.

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 or construction of an asset which necessarily takes a substantial period of time to get ready for its intended use or sale.

**Table of Contents**

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

(r) Repairs and maintenance expenses

Repairs and maintenance expenses are charged to cost of sales in the profit or loss as and when they are incurred.

(s) 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 cost of sales in the period in which they are incurred.

(t) Employee benefits

The contributions payable under the Group's retirement plans are charged to the profit or loss on an accrual basis according to the contribution determined by the plans. Further information is set out in note 27.

Termination benefits, recorded as employee reduction expenses in the profit or loss, are recognized when, and only when, the Group demonstrably commits itself to terminate employment or to provide benefits as a result of voluntary redundancy by having a detailed formal plan which is without realistic possibility of withdrawal.

(u) Impairment loss

- (i) Impairment of trade accounts receivable, bills and other receivables and investments in equity securities other than investments in associates and jointly controlled entities (see note 2(u) (ii)), that do not have a quoted market price in an active market are accounted as follows:

Trade accounts receivable, bills and other receivables and investments in equity securities other than investments in associates and jointly controlled entities, that do not have a quoted market price in an active market are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, an impairment loss is determined and recognized as cost of sales or other operating expenses. The impairment loss is measured as the difference between the asset's carrying amount and the estimated future cash flows, discounted at the current market rate of return for a similar asset where the effect of discounting is material. Impairment losses for trade accounts receivable, bills and other receivables are reversed if in a subsequent period the amount of the impairment loss decreases. Impairment losses for investments in equity securities are not reversed.

**Table of Contents**

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

(u) Impairment loss *(continued)*

(ii) Impairment of other long-lived assets is accounted as follows:

The carrying amounts of other long-lived assets, including property, plant and equipment, construction in progress, lease prepayment, other assets and investments in associates and jointly controlled entities, are reviewed at each balance sheet date to identify indications that the asset may be impaired. 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. For goodwill, the recoverable amount is estimated at each balance sheet date.

The recoverable amount is the greater of the fair value less costs to sell 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 using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

The amount of the reduction is recognized as other operating expenses in profit or loss unless the asset is carried at revalued amount for which an impairment loss is recognized directly against any related revaluation reserve to the extent that the impairment loss does not exceed the amount held in the revaluation reserve for that same asset. Impairment losses recognized in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit and then, to reduce the carrying amount of the other assets in the unit on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

Management assesses at each balance sheet date whether there is any indication that an impairment loss recognized for an asset, except in the case of goodwill, 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 unless the asset is carried at revalued amount. Reversal of an impairment loss on a revalued asset is credited to the revaluation reserve except for impairment loss which was previously recognized as an expense in the income statement; a reversal of such impairment loss is recognized as an income. The reversal is reduced by the amount that would have been recognized as depreciation had the write-down or write-off not occurred. An impairment loss in respect of goodwill is not reversed.



**Table of Contents**

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

(v) Dividends payable

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

(w) Income tax

Income tax expense comprises current and deferred tax. Income tax expense is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

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 or credited to the profit or loss, except for the effect of a change in tax rate on the carrying amount of deferred tax assets and liabilities which were previously charged or credited directly to equity upon initial recognition, in such case the effect of a change in tax rate is also charged or credited to equity.

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.

## **Table of Contents**

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

#### (x) Provisions and contingent liabilities

Provisions are recognized for liabilities of uncertain timing or amount when the Group has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditure expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

#### (y) Related parties

Parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control or jointly 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 (being members of key management personnel, significant shareholders and/or their close family members) or other entities and include entities which are under the significant influence of related parties of the Group where those parties are individuals, and post-employment benefit plans which are for the benefit of employees of the Group or of any entity that is a related party of the Group.

#### (z) 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.

Management evaluates performance based on operating profits 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.

**Table of Contents**

**3 CHANGES IN ACCOUNTING POLICIES**

The IASB has issued a number of new Interpretations and an amendment to IFRS that are first effective for the current accounting period of the Group. However, none of these developments are relevant to the Group's operations.

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period (see note 32).

**4. OTHER INCOME**

During the year ended December 31, 2008, the Group recognized grant income of RMB2,312,227 (2007: RMB93,900; 2006: RMB282,142). These grants were mainly for compensation of losses incurred due to the distortion of the correlation of domestic refined petroleum product prices and the crude oil prices, and the measures taken by the Group to stabilize the supply in the PRC refined petroleum product market during the respective year. There are no unfilled conditions and other contingencies attached to the receipts of these grants. There is no assurance that the Group will continue to receive such grants in the future.

**Table of Contents****5. COST OF SALES**

Cost of sales represents:

	Years ended December 31,		
	2006	2007	2008
Costs of raw materials			
-crude oil	33,307,637	34,456,334	48,996,902
-other ancillary materials	7,901,778	10,022,551	9,978,791
Depreciation	1,806,444	1,681,874	1,616,596
Repairs and maintenance	874,461	1,023,794	988,393
Research and development	51,610	53,548	47,303
Employer's pension costs			
-municipal retirement scheme costs	207,071	197,191	199,135
-supplementary retirement scheme costs	61,692	55,048	54,862
Staff costs	1,210,266	1,209,035	1,160,658
Amortization of lease prepayments	29,400	16,972	16,759
Others	3,731,873	3,930,169	5,497,048
	49,182,232	52,646,516	68,556,447

**Table of Contents****6. OTHER OPERATING INCOME**

Other operating income represents:

	Years ended December 31,		
	2006	2007	2008
Income from rendering of services	35,068	36,282	34,842
Gain on disposal of property, plant and equipment	83,386	7,745	17,618
Rental income from investment property	42,643	40,021	48,869
Amortization of deferred income	23,033		
Income from unlisted investments	97,179	122,709	9,721
Others	16,085	9,796	34,141
	297,394	216,553	145,191

**7. OTHER OPERATING EXPENSES**

Other operating expenses represent:

	Years ended December 31,		
	2006	2007	2008
Loss on disposal of property, plant and equipment	63,817	51,790	4,452
Employee reduction expenses (note 8)	83,603	208,013	89,844
Impairment loss on property, plant and equipment (note (i) and 17)	50,000	200,295	440,946
Impairment loss on goodwill			22,415
Donations	380	14,250	2,000
Others	42,730	46,910	20,362
	240,530	521,258	580,019

- (i) Impairment loss recognized on property, plant and equipment, primarily relating to certain assets of synthetic fibres segment, was RMB417,936 for the year ended December 31, 2008 (2007: RMB181,681; 2006: RMB50,000). The impairment loss relates to certain synthetic fibres facilities. The carrying values of these facilities were written down to their recoverable amounts that were primarily determined based on the asset held for use model using the present value of estimated future cash flows of the production facilities. The primary factor resulting in the impairment losses on property, plant and equipment was due to the expected reduction in production volume caused by the adverse changes in the business environment.

**Table of Contents****8. EMPLOYEE REDUCTION EXPENSES**

In accordance with the Group's voluntary employee reduction plan, the Group recognized employee reduction expenses of RMB89,844 during the year ended December 31, 2008 (2007: RMB208,013; 2006: RMB83,603) payable in cash in respect of the voluntary resignation of approximately 947 employees (2,622 employees in 2007 and 1,280 employees in 2006).

**9. NET FINANCING COSTS**

Net financing costs represent:

	Years ended December 31,		
	2006	2007	2008
Interest income	(56,827)	(46,421)	(59,472)
Net foreign exchange gain	(81,170)	(35,859)	(70,417)
Net gain in fair value change of derivative financial instruments			(97,644)
Financial income	(137,997)	(82,280)	(227,533)
Interest on loans and borrowings	367,716	329,643	585,142
Less: borrowing costs capitalized as construction in progress	(64,330)	(69,437)	(27,171)
Financial expenses	303,386	260,206	557,971
Net financing costs	165,389	177,926	330,438

Interest costs have been capitalized at a rate of 5.10%-7.47% per annum (2007: 5.27%-7.47%; 2006: 5.18%-5.85%) for construction in progress.

**10. INVESTMENT INCOME**

Investment income represents the gain on disposal of available-for-sale securities transferred from equity of RMB131,772 during the year ended December 31, 2008 (2007: 770,725; 2006: nil).

**Table of Contents****11. TAXATION**

(a) Taxation in the consolidated statement of operations represents:

	Years ended December 31,		
	2006	2007	2008
Current tax			
-Provision for income tax for the year	71,183	557,078	34,919
-(Over)/under-provision in respect of prior years	(6,911)	2,439	16,655
Deferred taxation	(11,034)	(91,301)	(1,864,285)
<b>Total income tax expense/(benefit)</b>	<b>53,238</b>	<b>468,216</b>	<b>(1,812,711)</b>

A reconciliation of the expected income tax expense/(benefit) calculated at the applicable tax rate with the actual income tax expense/(benefit) is as follows:

	Years ended December 31,		
	2006	2007	2008
Earnings/(loss) before income tax	964,200	2,151,352	(8,014,438)
Expected PRC income tax expense/(benefit) at the statutory tax rate of 25% (2007: 33%; 2006: 15%)	144,630	709,946	(2,003,610)
Tax effect of non-deductible expenses	7,361	47,056	29,348
Tax effect of non-taxable income	(5,414)	(32,201)	(1,276)
(Over)/under-provision in prior years	(6,911)	2,439	16,655
Effect of change in tax rate on deferred tax assets and liabilities		(23,083)	
Tax effect of share of profits recognized under the equity method	(86,503)	(219,746)	(373)
Tax effect of unused tax losses not recognized	9,688	22,621	49,488
Tax effect of unrecognized deferred tax assets			97,057
Tax effect of differential tax rate on subsidiaries income	(9,613)	(38,816)	
<b>Actual tax expense/(benefit)</b>	<b>53,238</b>	<b>468,216</b>	<b>(1,812,711)</b>

The charge for PRC income tax is calculated at the standard rate of 25% (2007: 33%; 2006: 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 taxes.

**Table of Contents****11. 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, 2007	2008	December 31, 2007	2008	December 31, 2007	2008
Current						
Provisions	40,075	203,974			40,075	203,974
Forward exchange contracts				(24,411)		(24,411)
Non-current						
Provisions for impairment losses	77,310	98,156			77,310	98,156
Lease prepayments	30,592	29,717			30,592	29,717
Capitalization of borrowing costs			(32,070)	(29,196)	(32,070)	(29,196)
Fair value of available-for-sale securities			(115,855)	(27,634)	(115,855)	(27,634)
Tax losses carry forward		1,701,453				1,701,453
Others	11,822	10,946	(2,245)	(870)	9,577	10,076
Deferred tax assets/(liabilities)	159,799	2,044,246	(150,170)	(82,111)	9,629	1,962,135

As at December 31, 2008, a subsidiary of the Company did not recognize the tax value of losses carried forward for PRC income tax purpose, because it was not probable that the related tax benefit will be realized. The total deductible losses available to offset its future PRC taxation income are RMB310,396, if any. The deductible losses carried forward of RMB14,539, RMB29,357, RMB68,548 and RMB197,952 expire in 2010, 2011, 2012 and 2013 respectively.



**Table of Contents****11. TAXATION** *(continued)*(b) Deferred taxation *(continued)*:

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

	Balance at January 1, 2006	Recognized in consolidated statements of operations	Recognized in reserve	Balance at December 31, 2006
<b>Current</b>				
Provisions	11,396	745		12,141
<b>Non-current</b>				
Provision for impairment losses	8,842	7,500		16,342
Lease prepayments	19,403	(523)		18,880
Capitalization of borrowing costs	(16,492)	(4,307)		(20,799)
Fair value of available-for-sale securities			(3,873)	(3,873)
Others		7,619		7,619
<b>Net deferred tax assets</b>	<b>23,149</b>	<b>11,034</b>	<b>(3,873)</b>	<b>30,310</b>

	Balance at January 1, 2007	Recognized in consolidated statements of operations	Recognized in reserve	Balance at December 31, 2007
<b>Current</b>				
Provisions	12,141	27,934		40,075
<b>Non-current</b>				
Provision for impairment losses	16,342	60,968		77,310
Lease prepayments	18,880	11,712		30,592
Capitalization of borrowing costs	(20,799)	(11,271)		(32,070)
Fair value of available-for-sale securities	(3,873)		(111,982)	(115,855)
Others	7,619	1,958		9,577
<b>Net deferred tax assets</b>	<b>30,310</b>	<b>91,301</b>	<b>(111,982)</b>	<b>9,629</b>

	Balance at January 1, 2008	Recognized in consolidated statements of operations	Recognized in reserve	Balance at December 31, 2008
<b>Current</b>				
Provisions	40,075	163,899		203,974
Forward exchange contracts		(24,411)		(24,411)
<b>Non-current</b>				
Provision for impairment losses	77,310	20,846		98,156
Lease prepayments	30,592	(875)		29,717
Capitalization of borrowing costs	(32,070)	2,874		(29,196)
Fair value of available-for-sale securities	(115,855)		88,221	(27,634)
Tax losses carry forward		1,701,453		1,701,453
Others	9,577	499		10,076
<b>Net deferred tax assets</b>	<b>9,629</b>	<b>1,864,285</b>	<b>88,221</b>	<b>1,962,135</b>



**Table of Contents****12. BASIC (LOSS)/EARNINGS PER SHARE**

The calculation of basic (loss)/earnings per share is based on the loss attributable to equity shareholders of the Company of RMB6,238,444 (2007: profit of RMB1,634,080; 2006: profit of RMB844,407) and 7,200,000,000 (2007: 7,200,000,000; 2006: 7,200,000,000) shares in outstanding during the year.

The amount of diluted (loss)/earnings per share is not presented as there were no dilutive potential ordinary shares in existence for either year.

**13. DIVIDENDS**

- (a) Dividends attributable to the year:

	Years ended December 31,		
	2006	2007	2008
Final dividend proposed after the balance sheet date of RMB nil (2007: RMB 0.09; 2006: 0.04) per share	288,000	648,000	

Pursuant to a resolution passed at the directors meeting on April 7, 2008, a final dividend of RMB0.09 per share totalling RMB648,000 was approved by shareholders at the Annual General Meeting (2006: RMB288,000). No final dividend was proposed after the balance sheet date in respect of the year ended December 31, 2008.

- (b) Dividends attributable to the previous financial year, approved and paid during the year:

	Years ended December 31,		
	2006	2007	2008
Final dividend in respect of the previous financial year, approved and paid during the year, of RMB 0.09 per share (2007: RMB 0.04 per share; 2006: RMB 0.01 per share)	720,000	288,000	648,000

**Table of Contents****14. INVENTORIES**

Inventories in the balance sheet comprise:

	<b>December 31,</b>	
	<b>2007</b>	<b>2008</b>
Raw materials	1,669,945	2,018,250
Work in progress	1,871,324	1,158,924
Finished goods	986,782	590,640
Spare parts and consumables	669,798	724,401
	5,197,849	4,492,215

At December 31, 2008, the Group had inventories carried at net realizable value with carrying amount of RMB3,728,692 (2007: RMB626,212).

Allowance for diminution in value of inventories is analyzed as follows:

At January 1, 2006	50,070
Provision for the year	33,407
Write-off	(42,122)
At December 31, 2006	41,355
Provision for the year	35,753
Write-off	(3,316)
At December 31, 2007	73,792
Provision for the year	744,578
Write-off	
At December 31, 2008	818,370

**Table of Contents****15. TRADE DEBTORS, NET**

Trade debtors comprise:

	<b>December 31,</b>	
	<b>2007</b>	<b>2008</b>
Trade debtors	236,848	107,697
Less: Impairment losses for bad and doubtful debts	(24,591)	(18,611)
	212,257	89,086

Impairment losses for bad and doubtful debts are analyzed as follows:

At January 1, 2006	25,845
Provision for the year	8,513
Written-off	(3,447)
At December 31, 2006	30,911
Provision for the year	3,687
Written-off	(10,007)
At December 31, 2007	24,591
Provision for the year	
Written-off	(5,980)
At December 31, 2008	18,611

**16. OTHER DEBTORS AND PREPAYMENTS**

Other debtors and prepayments comprise:

	<b>December 31</b>	
	<b>2007</b>	<b>2008</b>
Purchase deposits	47,939	45,632
Forward contracts receivable		97,644
Sundry debtors	214,979	341,199
	262,918	484,475

**Table of Contents****17. PROPERTY, PLANT AND EQUIPMENT, NET**

Property, plant and equipment comprise:

	Buildings	Plant and Machinery	Vehicles and other equipment	Total
<b><i>Cost or valuation:</i></b>				
At January 1, 2007	5,623,540	20,126,275	6,413,715	32,163,530
Additions	27,041	113,096	32,641	172,778
Transferred from construction in progress (note 19)	113,445	3,067,434	352,398	3,533,277
Disposals	(97,443)	(361,942)	(175,575)	(634,960)
At December 31, 2007	5,666,583	22,944,863	6,623,179	35,234,625
At January 1, 2008	5,666,583	22,944,863	6,623,179	35,234,625
Additions	7,414	66,961	30,150	104,525
Transferred from construction in progress (note 19)	11,084	180,739	97,241	289,064
Disposals	(19,324)	(67,545)	(42,406)	(129,275)
At December 31, 2008	5,665,757	23,125,018	6,708,164	35,498,939
<b><i>Accumulated depreciation and impairment losses:</i></b>				
At January 1, 2007	3,081,867	11,811,818	3,909,983	18,803,668
Charge for the year	184,765	1,144,257	358,413	1,687,435
Impairment loss	48,335	151,838	122	200,295
Written back on disposals	(33,524)	(288,053)	(112,433)	(434,010)
At December 31, 2007	3,281,443	12,819,860	4,156,085	20,257,388
At January 1, 2008	3,281,443	12,819,860	4,156,085	20,257,388
Charge for the year	161,275	1,141,925	315,278	1,618,478
Impairment loss	3,281	403,748	33,917	440,946
Written back on disposals	(6,181)	(47,868)	(36,723)	(90,772)
At December 31, 2008	3,439,818	14,317,665	4,468,557	22,226,040
<b><i>Net book value:</i></b>				
At December 31, 2008	2,225,939	8,807,353	2,239,607	13,272,899
At December 31, 2007	2,385,140	10,125,003	2,467,094	14,977,237

**Table of Contents**

**17. PROPERTY, PLANT AND EQUIPMENT, NET** *(continued)*

All of the Group's buildings are located in the PRC (including Hong Kong).

Buildings in Hong Kong with a net book value of RMB31,759 (2007: RMB32,944) 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 to be 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.

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 5, 2005, which was based on depreciated replacement costs, the carrying value of property, plant and equipment did not differ materially from their fair value.

**Table of Contents****18. INVESTMENT PROPERTY, NET**

	2007	2008
<b>Cost:</b>		
At January 1	528,465	554,233
Additions	25,768	
Disposals		(7,395)
At December 31	554,233	546,838
<b>Accumulated depreciation:</b>		
At January 1	26,561	41,440
Charge for the year	14,879	13,440
Written back on disposal		(732)
At December 31	41,440	54,148
<b>Net book value:</b>		
At December 31	512,793	492,690

Investment property represents certain floors of an office building rented out under the terms of operating leases.

The fair value of the investment property of the Group as at December 31, 2008 was estimated by the directors to be approximately RMB729,739 by reference to market values of like properties in the relevant regions (2007: RMB715,779). The investment property has not been valued by an external independent valuer.

Rental income of RMB48,869 was received by the Group during the year ended December 31, 2008 (2007: RMB40,021).

**19. CONSTRUCTION IN PROGRESS**

Construction in progress comprises costs incurred on property, plant and equipment not yet commissioned. The movement of construction in progress is as follows:

	2007	2008
At January 1	2,008,447	962,313
Additions	2,487,143	1,180,905
Transferred to property, plant and equipment (note 17)	(3,533,277)	(289,064)
At December 31	962,313	1,854,154



**Table of Contents****20. INTEREST IN ASSOCIATES AND JOINTLY CONTROLLED ENTITIES**

	<b>December 31,</b>	
	<b>2007</b>	<b>2008</b>
Interest in associates	2,967,944	2,431,973
Interest in jointly controlled entities	100,191	114,005
	<b>3,068,135</b>	<b>2,545,978</b>

The above amount represents the share of net assets of the Company's interest in its associates and jointly controlled entities.

The particulars of these significant associates and jointly controlled entities, which are limited companies established and operating in the PRC, which principally affected the results or assets of the Group at December 31, 2008 are as follows:

<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 Chemical Industry Park Development Company Limited	RMB 2,372,439	38.26		Planning, development and operation of the Chemical Industry Park in Shanghai, PRC
Shanghai Secco Petrochemical Company Limited	US\$ 901,441	20		Manufacturing and distribution of chemical products
Shanghai Jinpu Plastics Packaging Material Company Limited	US\$ 20,204		50	Production of polypropylene film
Shanghai Jinsen Hydrocarbon Resins Company Limited	US\$ 23,395		40	Production of resins products
Shanghai Yamatake Automation Company Limited	US\$ 3,000		40	Service and maintenance of building automation systems and products
BOC-SPC Gases Company Limited	US\$ 32,000	50		Production and sales of industrial gases

**Table of Contents****20. INTEREST IN ASSOCIATES AND JOINTLY CONTROLLED ENTITIES** *(continued)*

Summary financial information on associates:

	Assets	Liabilities	Equity	Revenues	(Loss)/Profit
2008					
100 per cent	25,240,902	(14,233,529)	11,007,373	25,015,211	(324,948)
Group's effective interest	6,090,701	(3,658,728)	2,431,973	5,406,041	(30,232)
2007					
100 per cent	28,956,271	(15,016,047)	13,940,224	24,972,018	3,044,526
Group's effective interest	6,752,902	(3,784,958)	2,967,944	5,183,450	645,178

**21. OTHER INVESTMENTS**

Other investments comprise:

	December 31,	
	2007	2008
Available-for-sale equity securities	478,793	123,918
Other unlisted investments	272,834	202,939
	751,627	326,857
Less: provision for impairment losses	(37,200)	(37,200)
	714,427	289,657

Provision for impairment losses is analyzed as follows:

	2006	2007	2008
At January 1	56,228	38,838	37,200
Written back on disposals	(17,390)	(1,638)	
At December 31	38,838	37,200	37,200

**Table of Contents****22. GOODWILL****Cost:**

At December 31, 2007 and 2008	22,415
-------------------------------	--------

**Accumulated impairment losses:**

At January 1, 2007	
--------------------	--

Impairment loss	
-----------------	--

At December 31, 2007	
----------------------	--

At January 1, 2008	
--------------------	--

Impairment loss	(22,415)
-----------------	----------

At December 31, 2008	(22,415)
----------------------	----------

**Carrying amount:**

At December 31, 2008	
----------------------	--

At December 31, 2007	22,415
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The goodwill pertained to the Company's purchase of the entire equity in Shanghai Jinyang Acrylic Fibre Plant in 1996. The recoverable amount of the Jinyang facility is determined based on value in use calculation.

During the year ended December 31, 2008, the carrying amount of the cash-generating unit, Jinyang facility, was determined to be higher than its recoverable amount. The reduction in recoverable amount was a result of the expected reduction in production volume caused by the adverse changes in the business environment. The impairment loss recognized on the goodwill was RMB22,415 for the year ended December 31, 2008.

**23. DEBT**

Short-term debt consists of:

	<b>December 31,</b>	
	<b>2007</b>	<b>2008</b>
Short-term bank loans	2,317,642	8,428,204
Current portion of long-term bank loans	419,027	514,521
Current portion of long-term loans from related companies		20,000
Loans from related companies	1,355,300	410,000
	4,091,969	9,372,725

The Group's short-term debts are used primarily to finance working capital needs. At December 31, 2008, no loans and borrowings were secured by the way of pledge of property, plant and equipment (2007: nil). The Group's weighted average short-term interest rates were 5.34% and 5.80% at December 31, 2007 and 2008, respectively.

**Table of Contents****23. DEBT (continued)**

The Group's long-term debt, which are for the addition of plant and equipment and working capital purposes, consists of:

	Interest rate at December 31, 2008	Interest type	December 31,	
			2007	2008
<b>Arranged by the Company:</b>				
U.S. Dollar denominated:				
Payable semi-annually through 2008 (note (a))			9,097	
Renminbi denominated:				
Due in 2008			250,000	
Due in 2009	5.10%-5.35%	Fixed	450,000	450,000
Due in 2011	5.10%	Fixed		100,000
Due in 2013	5.18%-5.35%	Fixed		200,000
<b>Arranged by subsidiaries:</b>				
U.S. Dollar denominated:				
Payable annually through 2011	Interest free		10,519	9,842
Renminbi denominated:				
Payable due in 2008			135,000	
Payable due in 2009	5.18%-6.80%	Fixed	35,000	35,000
Payable due in 2010	6.80%	Fixed	100,000	100,000
Payable annually through 2010	Interest free		61,500	61,500
Payable annually through 2011	Interest free		7,200	7,200
Total long-term debt outstanding			1,058,316	963,542
Less: Amounts due within one year			(419,027)	(534,521)
Amounts due after one year			639,289	429,021

Note (a) Guaranteed by China Petrochemical Corporation

The aggregate maturities of long-term debt subsequent to December 31, 2008 are as follows:

2009	534,521
2010	124,760
2011	104,261
2012	
2013	200,000
	963,542

**Table of Contents****23. DEBT** *(continued)*

Included in short-term and long-term debts are the following amounts denominated in currencies other than the functional currency of the entity to which they relate:

	December 31,	
	2007	2008
United States Dollars	USD 86,556	USD 600,314

**24. SHARE CAPITAL**

Share capital represents:

	December 31,	
	2007	2008
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
	7,200,000	7,200,000

All the A and H shares rank pari passu in all respects.

**Capital management**

Management optimizes the structure of its capital, comprising equity and loans. In order to maintain or adjust the capital structure, management may cause the Group to issue new shares, adjust the capital expenditure plan, sell assets to reduce debt, or adjust the proportion of short-term and long-term loans. Management monitors capital on the basis of debt-to-equity ratio, which is calculated by dividing long-term loans (excluding current portion), including long-term bank loans and loans from the related parties, by the total of equity attributable to equity shareholders of the Company and long-term loans (excluding current portion), and liability-to-asset ratio, which is calculated by dividing total liabilities by total assets. Management's strategy is to make appropriate adjustments according to the operating and investment needs and the changes of market conditions, and to maintain the debt-to-equity ratio and the liability-to-asset ratio at a range considered reasonable by management. As at December 31, 2008, the debt-to-equity ratio and the liability-to-asset ratio of the Group were 3.08% (2007: 3.00%) and 50.02% (2007: 29.82%), respectively.

The schedule of the contractual maturities of loans and commitments are disclosed in note 23 and note 26, respectively.

There were no changes in the management's approach to capital management of the Group during the year. Neither the Company nor any of its subsidiaries are subject to externally imposed capital requirements.

**Table of Contents****25. SHARE PREMIUM AND RESERVES**

Movements on reserves comprise:

	2007	2008
<b>Share premium (note a)</b>		
Balance at January 1 and December 31	2,420,841	2,420,841
<b>Statutory surplus reserve (note b)</b>		
Balance at January 1	3,248,104	3,485,894
Appropriation	192,434	
General surplus reserve transfer to statutory surplus reserve (note c)	82,089	
Adjustment to statutory surplus reserve (note b)	(36,733)	
Balance at December 31	3,485,894	3,485,894
<b>General surplus reserve (note c)</b>		
Balance at January 1	82,089	
General surplus reserve transfer to statutory surplus reserve (note c)	(82,089)	
Balance at December 31		
<b>Capital reserve (note d)</b>		
Balance at January 1 and December 31	4,180	4,180
<b>Discretionary surplus reserve (note e)</b>		
Balance at January 1 and December 31	1,280,514	1,280,514
<b>Excess over share capital (note f)</b>		
Balance at January 1 and December 31	(148,604)	(148,604)
<b>Fair value reserve (note g)</b>		
Balance at January 1,	21,949	347,564
Unrealized gain/(loss) for change in fair value of available-for-sale securities, net of deferred tax	842,002	(165,832)
Transfer to profit or loss on disposal of available-for-sale securities, net of deferred tax	(516,387)	(98,829)
Balance at December 31	347,564	82,903
<b>Retained profits/(losses) (note h)</b>	6,057,649	(828,795)
	13,448,038	6,296,933

**Table of Contents**

**25. 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 the Company's profit after taxation, as determined under China Accounting Standards for Business Enterprises, 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 of 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.

Commencing from January 1, 2007, for PRC statutory reporting purpose, the Group has adopted the China Accounting Standards for Business Enterprises issued by the Ministry of Finance of the PRC (the "MOF") on February 15, 2006, which resulted in certain PRC accounting policies changed and applied retrospectively. The net profits for PRC statutory reporting purpose as determined in accordance with the China Accounting Standards for Business Enterprises for prior periods have been restated and the statutory surplus reserve has been adjusted based on 10% of the restated net profits. The adjustment to the statutory surplus reserve was reflected as a movement in 2007.

**Table of Contents**

**25. SHARE PREMIUM AND RESERVES** *(continued)*

Note c

From January 1, 2007, general surplus reserve has been combined with statutory surplus reserve under the China Accounting Standards for Business Enterprises issued by the MOF on February 15, 2006.

Note d

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 e

The transfer to this reserve from the retained profits is subject to the approval by shareholders at general meetings. Its usage is similar to that of statutory surplus reserve.

Note f

Effective from January 1, 2002, land use rights which are included in lease prepayments are carried at historical cost. Accordingly, the surplus on the revaluation of land use rights net of deferred tax is reversed to shareholders' equity. Under China Accounting Standards for Business Enterprises, land use rights are carried at revalued amounts.

Note g

The fair value reserve comprises the cumulative net change in the fair value of available-for-sale securities, net of deferred tax, held at the balance sheet date, which is based on reliably measured fair values at year end.

Note h

According to the Company's Articles of Association, the reserve available for distribution is the lower of the amount determined under China Accounting Standards for Business Enterprises and the amount determined under IFRS. As of December 31, 2008, the Company does not have any retained profit available for distribution to its equity holders as at December 31, 2008 (2007: RMB5,630,080). No final dividend (2007: RMB648,000) in respect of the financial year 2008 was declared after the balance sheet date.



**Table of Contents****26. COMMITMENTS AND CONTINGENCIES**

## (a) Capital commitments

The Group had capital commitments outstanding at December 31, 2008 not provided for in the financial statements as follows:

Property, plant and equipment

Contracted but not provided for	90,987
Authorized by the Board but not contracted for	2,450,250
	2,541,237

## (b) Contingent liabilities

## (i) Financial guarantees issued

At December 31, 2008, the Group was contingently liable with respect to guarantees issued to banks in favor of associates and joint ventures of RMB25,747 (2007: RMB30,747).

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. Management 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, 2007 and 2008, 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 Group's obligation under the guarantee arrangements.

## (ii) Income tax differences

With respect to uncertainties about enterprise income tax differences arising from 2006 and before as originated from a tax circular (Circular No. 664) issued by the State Administrative of Taxation in June 2007, the Company has been informed by the relevant tax authority to settle the enterprise income tax (EIT) for 2007 at a rate of 33 percent. To date, the Company has not been requested to pay additional EIT in respect of any years prior to 2007. Except for the above, there is no further development of this matter during the year ended December 31, 2008. No provision has been made in the financial statements for this uncertainty for tax years prior to 2007 because management believes it is not possible to reliably estimate the amount of the obligation, if any, that might exist.

**Table of Contents****27. 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% of the salaries, bonuses and certain allowances of its staff in 2008 (2007: 22%). 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.

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 up 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 saving accounts 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 plan and increased the amounts of contributions. For the year ended December 31, 2008, the Group's contribution to this plan amounted to RMB54,862 (2007: RMB55,048; 2006: RMB61,692).

**28. RELATED PARTY TRANSACTIONS**

- (a) Most of the transactions undertaken by the Group during the year ended December 31, 2008 have been affected on such terms as determined by China Petroleum & Chemical Corporation ( Sinopec Corp ), the immediate parent company, and 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, 2008, the value of crude oil purchased in accordance with Sinopec Corp's allocation was as follows:

	Years ended December 31,		
	2006	2007	2008
Purchases of crude oil	31,568,458	33,588,285	37,790,324

**Table of Contents****28. RELATED PARTY TRANSACTIONS** *(continued)*

(b) Other transactions between the Group and related parties during the year ended December 31, 2008 were as follows:

	Years ended December 31,		
	2006	2007	2008
Sales of goods and service fee income	20,173,106	22,907,085	29,908,286
Purchases other than crude oil	2,579,394	5,400,022	5,853,079
Insurance premiums paid	98,643	106,000	93,587
Net withdrawal from deposits in a related party	(101,353)	(50,177)	(6,418)
Interest received and receivable	229	908	649
Loans borrowed	576,000	1,475,300	543,000
Loans repayment	626,000	40,000	1,488,300
Interest paid and payable	7,529	9,813	26,682
Construction and installation fees	194,958	206,256	114,878
Proceeds from sales of property, plant & equipment	52,547		
Gains from disposal of investments	24,308	25,822	
Sales commissions	182,840	194,645	146,137
Net decrease of guarantees	(18,550)	(19,003)	
Rental income from related parties	12,611	13,216	19,009

(c) Cash deposits with related parties

	December 31,	
	2007	2008
Cash deposits, with maturity within 3 months	29,736	23,318

(d) Loans with related parties

	December 31,	
	2007	2008
Short-term loans	1,355,300	410,000
Long-term loans	120,000	120,000
	1,475,300	530,000

**Table of Contents****28. RELATED PARTY TRANSACTIONS** *(continued)*

(e) Key management personnel compensation and post-employment benefit plans

	Years ended December 31,		
	2006	2007	2008
Short-term employee benefits	4,529	5,301	5,008
Post-employment benefits	84	89	95
	4,613	5,390	5,103

Post-employment benefits are included in contributions to defined contribution retirement plans as disclosed in note 28(f).

(f) Contributions to defined contribution retirement plans

The Group participates in defined contribution retirement plans organized by municipal governments for its staff. The contributions to defined contribution retirement plans are as follows:

	Years ended December 31,		
	2006	2007	2008
Municipal retirement scheme costs	207,071	197,191	199,135
Supplementary retirement scheme costs	61,692	55,048	54,862

At December 31, 2006, 2007 and 2008, there was no material outstanding contribution to post-employment benefit plans.

(g) Transactions with other state-owned entities in the PRC

The Group is a state-controlled enterprise and operates in an economic regime currently dominated by entities directly or indirectly controlled by the PRC government (collectively referred as state-controlled entities) through its government authorities, agencies, affiliations and other organizations.

Apart from transactions with related parties, the Group has transactions with other state-controlled entities include but are not limited to the following:

- sales and purchase of goods and ancillary materials;
- rendering and receiving services;
- lease of assets, purchase of property, plant and equipment;
- placing deposits and obtaining finance;
- financial service arrangement; and
- use of public utilities.



**Table of Contents****28. RELATED PARTY TRANSACTIONS** *(continued)*(g) Transactions with other state-owned entities in the PRC *(continued)*

These transactions are conducted in the ordinary course of the Group's business on terms comparable to those with other entities that are not state controlled. The Group has established its procurement policies, pricing strategy and approval process for purchases and sales of products and services which do not depend on whether the counterparties are state-controlled entities or not.

Having considered the transactions potentially affected by related party relationships, the entity's pricing strategy, procurement policies and approval processes, and the information that would be necessary for an understanding of the potential effect of the related party relationship on the financial statements, the directors are of the opinion that the following transactions require disclosure of numeric details.

## (i) Transactions with other state-controlled energy and chemical companies

The Group's major domestic suppliers of crude oil are China National Offshore Oil Corporation and its subsidiaries and Sinochem International Corporation and its subsidiaries, which are state-controlled entities.

During the year ended December 31, 2006, 2007 and 2008, the aggregate amount of crude oil purchased by the Group from the above state-controlled energy and chemical companies are as follows:

	Years ended December 31,		
	2006	2007	2008
Purchases of crude oil	1,682,529	1,126,222	11,460,909

The amounts due from/to the above state-controlled energy and chemical companies are nil as at December 31, 2008 (December 31, 2006 and 2007: nil).

**Table of Contents****28. RELATED PARTY TRANSACTIONS** *(continued)*(g) Transactions with other state-owned entities in the PRC *(continued)*

(ii) Transactions with state-controlled banks

The Group deposits its cash with several state-controlled banks in the PRC. The Group also obtains short-term and long-term loans from these banks in the ordinary course of business. The interest rates of the bank deposits and loans are regulated by the People's Bank of China. The Group's interest income from and interest expense to these state-controlled banks in the PRC are as follows:

	2006	2007	2008
Interest income	56,597	45,992	59,249
Interest expense	324,267	231,707	531,289

During the year ended December 31, 2008, the Group entered into forward exchange contracts with state-controlled banks with total notional amounts of USD 460,224 (2007: nil; 2006: nil).

The amounts of cash deposited at and loans from state-controlled banks in the PRC are summarized as follows:

	2007	2008
Cash and cash equivalents at state-controlled banks in the PRC	745,401	604,367
Short-term loans and current portion of long-term loans	2,711,739	8,893,204
Long-term loans excluding current portion of long-term loans	465,000	300,000
Total loans from state-controlled banks in the PRC	3,176,739	9,193,204

## **Table of Contents**

### **29. OPERATING SEGMENT DATA**

Segment information is presented in respect of the Group's business segments. The format 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 principally operates in four operating segments: synthetic fibres, 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 fibres segment produces primarily polyester and acrylic fibres mainly 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 fibres and construction coating materials and containers. Low density polyethylene resins and plastics are used in cable jacketing, sheeting, the manufacture of molded 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 molded 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 fibres. 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.
- (e) All other operating segments represent the operating segments which do not meet the quantitative threshold for determining reportable segments. These include sales of consumer products, 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 31) are with affiliates of Sinopec Corp or other state-owned enterprises. Export sales accounted for approximately 0.4% and 0.7% of total sales in 2007 and 2008 respectively.



**Table of Contents****29. OPERATING SEGMENT DATA (continued)**

Reportable information on the Group's operating segments is as follows:

	Years ended December 31,		
	2006	2007	2008
<b>Sales and other income</b>			
<b>Manufactured Products</b>			
Synthetic Fibres			
External sales	4,727,261	4,342,215	3,670,362
Intersegment sales	71	85	73
Total	4,727,332	4,342,300	3,670,435
<b>Resins and Plastics</b>			
External sales	15,800,015	15,927,089	14,880,659
Intersegment sales	63,767	75,183	53,065
Total	15,863,782	16,002,272	14,933,724
<b>Intermediate Petrochemicals</b>			
External sales (note a)	6,800,577	9,406,507	10,296,256
Intersegment sales	14,536,675	16,966,433	17,801,810
Total	21,337,252	26,372,940	28,098,066
<b>Petroleum Products</b>			
External sales (note a)	19,977,755	21,997,362	28,372,037
Intersegment sales	1,187,744	1,336,695	2,153,355
Other income	282,142	93,900	2,312,227
Total	21,447,641	23,427,957	32,837,619
<b>All others</b>			
External sales	3,293,877	3,655,211	3,007,545
Intersegment sales	3,582,206	3,402,717	2,720,112
Total	6,876,083	7,057,928	5,727,657
Eliminations of intersegment sales	(19,370,463)	(21,781,113)	(22,728,415)
<b>Consolidated sales and other income</b>	<b>50,881,627</b>	<b>55,422,284</b>	<b>62,539,086</b>

**Table of Contents****29. OPERATING SEGMENT DATA (continued)**

Note (a): External sales include sales to Sinopec Corp Group companies as follows:

	Years ended December 31,		
	2006	2007	2008
<b>Sales to Sinopec Corp Group companies</b>			
Intermediate Petrochemicals	2,335,250	2,968,753	3,168,697
Petroleum Products	15,842,808	17,884,389	24,698,143
Total	18,178,058	20,853,142	27,866,840
	Years ended December 31,		
	2006	2007	2008
<b>Profit/ (loss) from operations</b>			
Synthetic Fibres	196,255	(82,083)	(1,651,458)
Resins and Plastics	1,162,103	656,475	(2,176,731)
Intermediate Petrochemicals	680,425	813,762	(42,654)
Petroleum Products	(1,697,730)	(644,234)	(3,945,873)
All others	211,854	148,736	(548)
<b>Consolidated profit/ (loss) from operations</b>	552,907	892,656	(7,817,264)
<b>Net financing costs</b>	(165,389)	(177,926)	(330,438)
<b>Investment income</b>		770,725	131,772
<b>Share of profits of associates and jointly controlled entities</b>	576,682	665,897	1,492
	411,293	1,258,696	(197,174)
<b>Profit/ (loss) before income tax</b>	964,200	2,151,352	(8,014,438)
<b>Income tax</b>	(53,238)	(468,216)	1,812,711
<b>Net income/(loss)</b>	910,962	1,683,136	(6,201,727)
<b>Attributable to:</b>			
Equity shareholders of the Company	844,407	1,634,080	(6,238,444)
Minority interests	66,555	49,056	36,717
	910,962	1,683,136	(6,201,727)

**Table of Contents****29. OPERATING SEGMENT DATA (continued)**

	<b>December 31,</b>	
	<b>2007</b>	<b>2008</b>
<b>Assets</b>		
<b>Segment assets</b>		
Synthetic Fibres	2,756,536	1,714,136
Resins and Plastics	2,768,515	1,826,536
Intermediate Petrochemicals	7,440,853	6,152,669
Petroleum Products	8,929,073	9,391,724
All others	2,639,287	2,350,640
<b>Total segment assets</b>	<b>24,534,264</b>	<b>21,435,705</b>
<b>Interest in associates and jointly controlled entities</b>	<b>3,068,135</b>	<b>2,545,978</b>
<b>Unallocated:</b>		
(including Cash and cash equivalents, Deposits, Income tax recoverable, Investments, Deferred tax assets, Investment property)	2,250,651	3,551,344
<b>Consolidated assets</b>	<b>29,853,050</b>	<b>27,533,027</b>
	<b>December 31,</b>	
	<b>2007</b>	<b>2008</b>
<b>Liabilities</b>		
<b>Segment liabilities</b>		
Synthetic Fibres	325,867	244,937
Resins and Plastics	1,195,267	993,272
Intermediate Petrochemicals	705,922	687,040
Petroleum Products	1,650,818	1,842,894
All others	274,309	200,173
<b>Total segment liabilities</b>	<b>4,152,183</b>	<b>3,968,316</b>
<b>Loans and borrowings</b>		
-current	4,091,969	9,372,725
<b>Loans and borrowings</b>		
-non-current	639,289	429,021
<b>Income tax payable</b>	<b>17,580</b>	<b>1,679</b>
<b>Consolidated liabilities</b>	<b>8,901,021</b>	<b>13,771,741</b>

**Table of Contents****29. OPERATING SEGMENT DATA** *(continued)*

	Years ended December 31,		
	2006	2007	2008
<b>Depreciation and amortization</b>			
Synthetic Fibres	236,559	227,503	223,146
Resins and Plastics	353,321	351,273	350,563
Intermediate Petrochemicals	664,667	603,707	560,086
Petroleum Products	407,835	352,532	339,068
All others	178,008	169,392	162,374
<b>Segment depreciation and amortization</b>	<b>1,840,390</b>	<b>1,704,407</b>	<b>1,635,237</b>
<b>Unallocated:</b>	12,678	14,879	13,440
<b>Consolidated depreciation and amortization</b>	<b>1,853,068</b>	<b>1,719,286</b>	<b>1,648,677</b>

	Years ended December 31,		
	2006	2007	2008
<b>Impairment losses on long lived assets</b>			
Synthetic Fibres	50,000	180,681	440,351
Resins and plastics			23,010
All others		19,614	
<b>Consolidated impairment losses on long lived assets</b>	<b>50,000</b>	<b>200,295</b>	<b>463,361</b>

	Years ended December 31,		
	2006	2007	2008
<b>Total capital expenditures for segment long-lived assets</b>			
Synthetic Fibres	145,513	130,392	73,653
Resins and Plastics	45,418	16,973	6,484
Intermediate Petrochemicals	1,083,542	773,720	1,175,451
Petroleum Products	586,570	1,098,320	58,374
All others	147,736	114,718	197,110
<b>Total segment capital expenditures</b>	<b>2,008,779</b>	<b>2,134,123</b>	<b>1,511,072</b>
<b>Unallocated:</b>			
<b>Consolidated capital expenditures for segment long-lived assets</b>	<b>2,008,779</b>	<b>2,134,123</b>	<b>1,511,072</b>

## **Table of Contents**

### **30. ACCOUNTING ESTIMATES AND JUDGEMENTS**

The Group's financial condition and results of operations are sensitive to accounting methods, assumptions and estimates that underlie the preparation of the financial statements. Management bases the assumptions and estimates on historical experience and on various other assumptions that management believes to be reasonable and which form the basis for making judgements about matters that are not readily apparent from other sources. On an on-going basis, management evaluates its estimates. Actual results may differ from those estimates as facts, circumstances and conditions change.

The selection of critical accounting policies, the judgements 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 the financial statements. The principal accounting policies are set forth in Note 2. Management believes the following critical accounting policies involve the most significant judgements and estimates used in the preparation of the financial statements.

#### **Impairments for long lived assets**

If circumstances indicate that the net book value of a long-lived asset 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. Long-lived assets are reviewed for impairment at the end of each reporting period or whenever events or changes in circumstance have indicated that their carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to recoverable amount. For goodwill, the recoverable amount is estimated annually. The recoverable amount is the greater of the net selling price and the value in use. It is difficult to precisely estimate selling price because quoted market prices for the Group's assets or cash-generating units are not readily available. In determining the value in use, expected cash flows generated by the asset or the cash-generating unit are discounted to their present value, which requires significant judgement relating to level of sale volume, selling price and amount of operating costs. The Group uses all readily available information in determining an amount that is a reasonable approximation of recoverable amount, including estimates based on reasonable and supportable assumptions and projections of sale volume, selling price and amount of operating costs.

#### **Depreciation**

Property, plant and equipment, are depreciated on a straight-line basis over the estimated useful lives of the assets, after taking into account the estimated residual value. The Group reviews the estimated useful lives of the assets annually in order to determine the amount of depreciation expense to be recorded during any reporting period. The useful lives are based on the Group's 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.

**Table of Contents**

**30. ACCOUNTING ESTIMATES AND JUDGEMENTS** *(continued)*

**Impairment for bad and doubtful debts**

Management estimates impairment losses for bad and doubtful debts resulting from the inability of the customers to make the required payments. Management bases the estimates on the ageing of the accounts receivable balance, customer credit-worthiness, and historical write-off experience. If the financial condition of the customers were to deteriorate, actual impairment losses would be higher than estimated.

**Allowance for diminution in value of inventories**

If the costs of inventories fall below their net realisable values, an allowance for diminution in value of inventories is recognized. Net realisable value represents the estimated selling price in the ordinary course of business, less the estimated costs of completion and the estimated costs necessary to make the sale. Management bases the estimates on all available information, including the current market prices of the finished goods and raw materials, and historical operating costs. If the actual selling prices were to be lower or the costs of completion were to be higher than estimated, the actual allowance for diminution in value of inventories could be higher than estimated.

## **Table of Contents**

### **31. FINANCIAL INSTRUMENTS**

#### ***Overview***

Financial assets of the Group include cash and cash equivalents, other investments, trade debtors, bills receivable, derivative financial instruments, other debtors and amounts due from related parties. Financial liabilities of the Group include loans and borrowings, trade creditors, bills payable, other creditors and amounts due to related parties.

The Group has exposure to the following risks from its use of financial instruments:

credit risk;

liquidity risk; and

market risk

The Board of Directors has overall responsibility for the establishment, oversight of the Group's risk management framework, and developing and monitoring the Group's risk management policies.

The Group's risk management policies are established to identify and analyze the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities. The Group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations. Internal audit department undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the Group's audit committee.

#### ***Credit risk***

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's deposits placed with financial institutions and receivables from customers. The majority of the Group's trade debtors and amounts due from related parties relate to sales of petroleum and chemical products to third parties and related parties operating in the petroleum and chemical industries. Management performs ongoing credit evaluations of its customers' financial condition and generally does not require collateral on trade debtors and related parties. The Group maintains an impairment loss for doubtful accounts and actual losses have been within management's expectations. The details of the Group's credit policy for and quantitative disclosures in respect of the Group's exposure on credit risk for trade debtors are set out in Note 15.

The carrying amounts of trade debtors, bills receivable, other debtors, and amounts due from related parties, represent the Group's maximum exposure to credit risk in relation to financial assets.

**Table of Contents**

**31. FINANCIAL INSTRUMENTS** *(continued)*

***Liquidity risk***

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. Management's approach in managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation. Management prepares monthly cash flow budget to ensure that they will always have sufficient liquidity to meet its financial obligation as they fall due. Management arranges and negotiates financing with financial institutions and maintains a certain level of standby credit facilities to reduce the liquidity risk.

At December 31, 2008, the Group's current liabilities exceeded its current assets by RMB6,831,369. In 2009, the liquidity of the Group is primarily dependent on its ability to maintain adequate cash inflow from operations, the renewal of its short-term bank loans and on its ability to obtain adequate external financing, including the issuance of short-term corporate bonds, to support its working capital and meet its debt obligation when they become due. At December 31, 2008, the Group has standby credit facilities with several PRC financial institutions which provide the Group to borrow up to RMB9,600,000 (2007: RMB2,900,000) on an unsecured basis, at a weighted average interest rate of 5.30% (2007: 6.29%). At December 31, 2008, the Group's outstanding borrowings under these facilities were RMB6,933,385 (2007: RMB1,812,642) and were included in short-term bank loans.

Management has carried out a detailed review of the cash flow forecast of the Group for the twelve months ending December 31, 2009. Based on such forecast, management believes that adequate sources of liquidity exist to fund the Group's working capital and capital expenditure requirements, and meet its short term debt obligations as they become due. In preparing the cash flow forecast, management has considered historical cash requirements of the Group as well as other key factors, including the availability of the above-mentioned banking facilities which may impact the operations of the Group during the next twelve-month period. Management is of the opinion that the assumptions used in the cash flow forecast are reasonable.

The following table sets out the remaining contractual maturities at the balance sheet date of the Group's financial liabilities, which are based on contractual undiscounted cash flows (including interest payments computed using contractual rates or, if floating, based on prevailing rates current at the balance sheet date) and the earliest date the Group would be required to repay:



**Table of Contents****31. FINANCIAL INSTRUMENTS** *(continued)**Liquidity risk (continued)***Non-derivative financial instruments**

	Carrying amount	Total contractual undiscounted cash flow	2008		
			Within 1 year or on demand	More than 1 year but less than 2 years	More than 2 years but less than 5 years
Loans and borrowings (current)	9,372,725	(9,741,390)	(9,741,390)		
Loans and borrowings (non-current)	429,021	(510,928)	(22,437)	(147,368)	(341,123)
Trade creditors	1,272,811	(1,272,811)	(1,272,811)		
Bills payable	263,443	(263,443)	(263,443)		
Other creditors	679,415	(679,415)	(679,415)		
Amounts due to related parties	1,752,647	(1,752,647)	(1,752,647)		
	13,770,062	(14,220,634)	(13,732,143)	(147,368)	(341,123)

**Derivative financial instruments**

## Derivatives settled gross:

## Forward contracts (note 16)

- outflow	(3,024,525)	(3,058,361)	(3,058,361)		
- inflow	3,122,169	3,157,098	3,157,098		

**Non-derivative financial instruments**

	Carrying amount	Total contractual undiscounted cash flow	2007		
			Within 1 year or on demand	More than 1 year but less than 2 years	More than 2 years but less than 5 years
Loans and borrowings (current)	4,091,969	(4,179,154)	(4,179,154)		
Loans and borrowings (non-current)	639,289	(723,741)	(39,271)	(549,201)	(135,269)
Trade creditors	1,504,454	(1,504,454)	(1,504,454)		
Bills payable	300,575	(300,575)	(300,575)		
Other creditors	1,442,284	(1,442,284)	(1,442,284)		
Amounts due to related parties	904,870	(904,870)	(904,870)		
	8,883,441	(9,055,078)	(8,370,608)	(549,201)	(135,269)

**Table of Contents****31. FINANCIAL INSTRUMENTS** *(continued)***Market risk**

## (a) Currency risk

Currency risk arises on financial instruments that are denominated in a currency other than the functional currency in which they are measured. The Group's currency risk exposure primarily relates to short-term and long-term debts denominated in US dollars. The Group entered into forward exchange contracts to manage such exposure. All of the forward exchange contracts have maturities of less than one year from the balance sheet date.

The changes in the fair value of forward exchange contracts that economically hedge monetary liabilities in foreign currencies are recognized as finance costs in the profit or loss. The net fair value of forward exchange contracts used by the Group as economic hedges of monetary liabilities in foreign currencies at December 31, 2008 was RMB97,644 (2007: RMB nil).

The following table details the Group's exposure at the balance sheet date to currency risk mainly arising from loans and borrowings denominated in a currency other than the functional currency of the entity to which they relate.

	<i>The Group</i>	
	2007	2008
	USD 000	USD 000
Gross exposure arising from loans and borrowings	(86,556)	(600,314)
Notional amounts of forward exchange contracts		460,224
	(86,556)	(140,090)

A 5 percent strengthening of Renminbi against the USD at December 31 would have increased net profit for the year and retained earnings of the Group by approximately RMB35,905 (2007: RMB21,181; 2006: 86,917). This analysis has been determined assuming that the change in foreign exchange rates had occurred at the balance sheet date and had been applied to the foreign currency balances to which the Group has significant exposure as stated above, and that all other variables, in particular interest rates, remain constant. The analysis is performed on the same basis for 2007.

Other than the amounts as disclosed above, the amounts of other financial assets and liabilities of the Group are substantially denominated in the functional currency of respective entity of the Group.

**Table of Contents****31. FINANCIAL INSTRUMENTS** *(continued)***Market risk** *(continued)*

## (b) Interest rate risk

The Group's interest rate risk exposure arises primarily from its short-term and long-term debts. Debts carrying interest at variable rates and at fixed rates expose the Group to cash flow interest rate risk and fair value interest rate risk respectively. The interest rates of loans and borrowings of the Group are disclosed in note 23.

As at December 31, 2008, it is estimated that a general increase / decrease of 100 basis points in variable interest rates, with all other variables held constant, would decrease / increase the Group's net profit for the year and retained earnings by approximately RMB42,341 (2007: RMB12,146; 2006: 17,642). This sensitivity analysis has been determined assuming that the change in interest rates had occurred at the balance sheet date and the change was applied to the Group's debts outstanding at that date with exposure to cash flow interest rate risk. The analysis is performed on the same basis for 2007.

**Fair value**

The disclosures of the fair value estimates, methods and assumptions, set forth below for the Group's financial instruments, are made to comply with the requirements of IFRS 7 and IAS 39 and should be read in conjunction with the Group's consolidated financial statements and related notes. The estimated fair value amounts have been determined by management using market information and valuation methodologies considered appropriate. However, considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Group could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The fair value of long term loans is estimated by discounting future cash flows thereon using current market interest rates offered to the Group for debts with substantially the same characteristics and maturities ranging 5.31% to 5.94% (2007: 7.17% to 7.74%). The following table presents the carrying amounts and fair values of the Group's long term loans at December 31, 2007 and 2008.

Liabilities	2007		2008	
	Carrying amount	Fair value	Carrying amount	Fair value
Long-term loans	1,058,316	1,034,682	963,542	958,461

The fair value of available-for-sale equity securities, which amounted to RMB123,918 as at December 31, 2008 (2007: RMB478,793) was based on quoted market price on a PRC stock exchange. The fair value of forward exchange contracts which amounted to RMB97,644 as at December 31, 2008 (2007: nil) was based by discounting the contractual forward price and deducting the current spot rate. Unquoted equity investments are individually and in the aggregate not material to the Group's financial condition or results of operations. There are no listed market prices for such interests in the PRC and, accordingly, a reasonable estimate of fair value could not be made without incurring excessive costs. The Group intends to hold these unquoted equity investments for long term purpose.

The fair values of all other financial instruments approximate their carrying amounts due to the short-term maturity of these instruments.

**Table of Contents**

**32 POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE ANNUAL ACCOUNTING PERIOD ENDED DECEMBER 31, 2008**

Up to the date of issue of these financial statements, the IASB has issued a number of amendments, new standards and interpretations which are not yet effective for the year ended December 31, 2008 and which have not been adopted in these financial statements.

Management is in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application and has so far concluded that the adoption of these amendments, new standards and new interpretations is unlikely to have a significant impact on the Group's results of operations and financial position.

**33. PARENT COMPANIES**

The Directors consider the immediate parent company and the ultimate parent company at December 31, 2008 to be China Petroleum & Chemical Corporation and China Petrochemical Corporation, respectively, which are incorporated in the PRC. China Petroleum & Chemical Corporation produces financial statements available for public use.

**Table of Contents**

**Shanghai Secco Petrochemical Company Limited**

**Index**

**Years Ended December 31, 2006, 2007 and 2008 (Unaudited)**

**Financial Statements of Shanghai Secco Petrochemical Company Limited (1)**

	<b>Page</b>
<u>Independent Auditors Report</u>	F-64
<u>Balance Sheets</u> <u>December 31, 2007 and 2008 (Unaudited)</u>	F-65
<u>Income Statements</u> <u>Years Ended December 31, 2006, 2007 and 2008 (Unaudited)</u>	F-67
<u>Cash Flow Statements</u> <u>Years Ended December 31, 2006, 2007 and 2008 (Unaudited)</u>	F-68
<u>Statements of Changes in Equity</u> <u>Years Ended December 31, 2006, 2007 and 2008 (Unaudited)</u>	F-70
<u>Notes to the Financial Statements</u>	F-71

- (1) The financial statements of Shanghai Secco Petrochemical Company Limited, an investee of Sinopec Shanghai Petrochemical Company Limited, are included in this Annual Report on Form 20-F of Sinopec Shanghai Petrochemical Company Limited to comply with Rule 3-09 of Regulation S-X of the U.S. Federal Securities Laws.

**Table of Contents**

**Independent Auditors' Report**

The Board of Directors and Shareholders of

Shanghai Secco Petrochemical Company Limited:

We have audited the accompanying balance sheet of Shanghai Secco Petrochemical Company Limited ( the Company ) as of December 31, 2007, and the income statement, statement of changes in equity, and cash flow statement for the years ended December 31, 2006 and 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with the auditing standards generally accepted in United States of America. 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 financial statements referred to above present fairly, in all material respects, the financial position of Shanghai Secco Petrochemical Company Limited as of December 31, 2007, and the results of its operations and its cash flows for the years ended December 31, 2006 and 2007, in conformity with the requirements of China Accounting Standards for Business Enterprises (2006) issued by the Ministry of Finance of the People's Republic of China.

China Accounting Standards for Business Enterprises (2006) vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature of such differences is presented in Note 38 to the financial statements.

**KPMG**

Certified Public Accountants

Hong Kong, China, April 1, 2008

**Table of Contents**

Shanghai Secco Petrochemical Company Limited

Balance sheet as of December 31, 2007 and 2008 (Unaudited)

*(Expressed in Renminbi)*

	<i>Note</i>	<i>2007</i> <i>RMB 000</i>	<i>2008</i> <i>RMB 000</i> <i>(Unaudited)</i>
<b>Assets</b>			
<b>Current assets</b>			
Cash at bank and on hand	5	1,566,397	1,748,561
Bills receivable	6	1,198,306	277,261
Accounts receivable	7	512,035	88,466
Prepayments	8	70,432	151,585
Other receivables	9	18,314	13,043
Inventories	10	2,002,500	1,003,329
Other current assets	11	1,455,309	28,192
<b>Total current assets</b>		<b>6,823,293</b>	<b>3,310,437</b>
<b>Non-current assets</b>			
Fixed assets	12	12,813,676	11,633,383
Construction in progress	13	148,821	693,033
Intangible assets	14	1,368,122	1,265,174
Long-term deferred expenses	15	12,053	12,005
Deferred tax assets	16	70,603	32,242
<b>Total non-current assets</b>		<b>14,413,275</b>	<b>13,635,837</b>
<b>Total assets</b>		<b>21,236,568</b>	<b>16,946,274</b>

The notes on pages F-71 to F-105 form part of these financial statements.

**Table of Contents**

## Shanghai Secco Petrochemical Company Limited

Balance sheet as of December 31, 2007 and 2008 (Unaudited) (continued)

*(Expressed in Renminbi)*

	<i>Note</i>	<b>2007</b> <b>RMB 000</b>	<b>2008</b> <b>RMB 000</b> <i>(Unaudited)</i>
<b>Liabilities and investors equity</b>			
<b>Current liabilities</b>			
Short-term loans	18		102,519
Bills payable	19		3,258
Accounts payable		1,087,670	587,774
Advances from customers		243,215	124,841
Employee benefits payable	20	79,042	93,931
Taxes (recoverable)/payable	4(3)	(45,645)	74,650
Interest payable		17,921	11,434
Dividend payable			370,000
Other payables		83,690	19,535
Long-term loans due within one year	21	556,397	534,971
<b>Total current liabilities</b>		<b>2,022,290</b>	<b>1,922,913</b>
<b>Non-current liabilities</b>			
Long-term loans	22	8,772,455	7,972,311
Special payables			2,482
<b>Total non-current liabilities</b>		<b>8,772,455</b>	<b>7,974,793</b>
<b>Total liabilities</b>		<b>10,794,745</b>	<b>9,897,706</b>
<b>Investors equity</b>			
Paid-in capital	23	7,443,585	7,443,585
Capital reserve	24	(509)	(509)
Surplus reserve	25	39,393	98,580
Retained earnings/(Accumulated losses)		2,959,354	(493,088)
<b>Total equity</b>		<b>10,441,823</b>	<b>7,048,568</b>
<b>Total liabilities and investors equity</b>		<b>21,236,568</b>	<b>16,946,274</b>

The notes on pages F-71 to F-105 form part of these financial statements.



**Table of Contents**

Shanghai Secco Petrochemical Company Limited

Income statement

for the years ended December 31, 2006, 2007 and 2008 (Unaudited)

*(Expressed in Renminbi)*

	<i>Note</i>	<i>2006</i> <i>RMB 000</i>	<i>2007</i> <i>RMB 000</i>	<i>2008</i> <i>RMB 000</i> <i>(Unaudited)</i>
Operating income	27	21,790,806	24,218,596	22,851,386
Less: Operating costs	28	(18,038,293)	(20,357,771)	(22,314,753)
Business taxes and surcharges		(594)	(503)	(588)
Selling and distribution expenses		(352,307)	(321,285)	(330,461)
General and administrative expenses		(288,557)	(443,189)	(502,516)
Financial expenses	29	(423,960)	(238,032)	(157,523)
Impairment reversal/(loss)	30	9,980	(127)	(37,157)
Add: Investment income	31		39,238	24,043
Operating profit/(loss)		2,697,075	2,896,927	(467,569)
Add: Non-operating income		12,058	10,654	13,217
Less: Non-operating expenses		(799)	(1,194)	(948)
(Including: Loss from disposal of non-current assets)		(267)	(893)	(185)
Profit/(loss) before income tax		2,708,334	2,906,387	(455,300)
Add: Income tax benefit/(expenses)	32	17,636	52,967	(38,361)
Net profit/(loss) for the year		2,725,970	2,959,354	(493,661)

The notes on pages F-71 to F-105 form part of these financial statements.

**Table of Contents**

Shanghai Secco Petrochemical Company Limited

Cash flow statement

for the years ended December 31, 2006, 2007 and 2008 (Unaudited)

*(Expressed in Renminbi)*

	<i>Note</i>	<b>2006</b> <i>RMB 000</i>	<b>2007</b> <i>RMB 000</i>	<b>2008</b> <i>RMB 000</i> <i>(Unaudited)</i>
<b>Cash flows from operating activities:</b>				
Cash received from sale of goods		24,861,800	27,458,031	27,919,030
Refund of taxes		154	230	118
Other cash received relating to operating activities		71,555	64,618	78,277
<b>Sub-total of cash inflows</b>		<b>24,933,509</b>	<b>27,522,879</b>	<b>27,997,425</b>
<b>Cash paid for goods</b>				
Cash paid for goods		(19,945,622)	(22,924,708)	(24,475,251)
Cash paid to and for employees		(198,586)	(218,791)	(247,360)
Cash paid for all types of taxes		(562,294)	(923,535)	(463,198)
Other cash paid relating to operating activities		(43,516)	(16,026)	(18,604)
<b>Sub-total of cash outflows</b>		<b>(20,750,018)</b>	<b>(24,083,060)</b>	<b>(25,204,413)</b>
<b>Net cash inflow from operating activities</b>	33	<b>4,183,491</b>	<b>3,439,819</b>	<b>2,793,012</b>
<b>Cash flows from investing activities:</b>				
Cash received from disposal of investments			2,572,000	2,236,000
Cash received from return on investments			37,929	25,352
Net cash received from disposal of fixed assets		257		44
<b>Sub-total of cash inflows</b>		<b>257</b>	<b>2,609,929</b>	<b>2,261,396</b>
<b>Cash paid for acquisition of fixed assets, intangible assets and other long-term assets</b>				
Cash paid for acquisition of fixed assets, intangible assets and other long-term assets		(851,533)	(311,201)	(638,212)
Cash paid for acquisition of investments		(1,454,145)	(2,572,000)	(782,000)
Other cash paid relating to investing activities		(1,586)		
<b>Sub-total of cash outflows</b>		<b>(2,307,264)</b>	<b>(2,883,201)</b>	<b>(1,420,212)</b>
<b>Net cash (outflow)/inflow from investing activities</b>		<b>(2,307,007)</b>	<b>(273,272)</b>	<b>841,184</b>

The notes on pages F-71 to F-105 form part of these financial statements.

**Table of Contents**

Shanghai Secco Petrochemical Company Limited

Cash flow statement for the years ended December 31, 2006, 2007 and 2008 (Unaudited) (continued)

*(Expressed in Renminbi)*

	<i>Note</i>	<i>2006</i> <i>RMB 000</i>	<i>2007</i> <i>RMB 000</i>	<i>2008</i> <i>RMB 000</i> <i>(Unaudited)</i>
Cash flows from financing activities:				
Cash received from investors		347,594		
Cash received from borrowings			9,366,238	102,519
Sub-total of cash inflows		347,594	9,366,238	102,519
Cash repayments of borrowings				
Cash paid for profits distribution and interest		(320,000)	(10,056,238)	(531,541)
Other cash paid relating to financing activities		(613,779)	(2,563,383)	(3,022,862)
Sub-total of cash outflows		(938,354)	(12,620,050)	(3,554,403)
Net cash outflow from financing activities		(590,760)	(3,253,812)	(3,451,884)
Effect of foreign exchange rate changes on cash and cash equivalents		(6,858)	(1,157)	(148)
Net increase/(decrease) in cash and cash equivalents		1,278,866	(88,422)	182,164
Add: cash and cash equivalents at the beginning of the year		375,953	1,654,819	1,566,397
Cash and cash equivalents at the end of the year		1,654,819	1,566,397	1,748,561

The notes on pages F-71 to F-105 form part of these financial statements.

**Table of Contents**

Shanghai Secco Petrochemical Company Limited

Statement of changes in equity

for the years ended December 31, 2006, 2007 and 2008 (Unaudited)

*(Expressed in Renminbi)*

	<i>Note</i>	<i>Paid-in capital RMB 000</i>	<i>Capital reserve RMB 000</i>	<i>Surplus reserve RMB 000</i>	<i>(Accumulated losses)/retained earnings RMB 000</i>	<i>Total RMB 000</i>
Balance at January 1, 2006		7,095,496	(14)		(756,314)	6,339,168
Changes in equity for the year						
Net profit for the year					2,725,970	2,725,970
Contribution by investors		348,089	(495)			347,594
Appropriation of profits						
- Appropriation for surplus reserve				39,393	(39,393)	
- Appropriation for staff and workers bonus and welfare fund					(19,696)	(19,696)
Balance at December 31, 2006		7,443,585	(509)	39,393	1,910,567	9,393,036
Balance at January 1, 2007		7,443,585	(509)	39,393	1,910,567	9,393,036
Changes in equity for the year						
Net profit for the year					2,959,354	2,959,354
Distributions to investors	26(2)				(1,910,567)	(1,910,567)
Balance at December 31, 2007		7,443,585	(509)	39,393	2,959,354	10,441,823
Balance at January 1, 2008		7,443,585	(509)	39,393	2,959,354	10,441,823
Changes in equity for the year						
Net loss for the year					(493,661)	(493,661)
Appropriation of profits						
- Appropriation for surplus reserve	26(1)			59,187	(59,187)	
- Distributions to investors	26(2)				(2,870,000)	(2,870,000)
- Appropriation for staff and workers bonus and welfare fund					(29,594)	(29,594)
Balance at December 31, 2008 (Unaudited)		7,443,585	(509)	98,580	(493,088)	7,048,568

The notes on pages F-71 to F-105 form part of these financial statements.

**Table of Contents**

Shanghai Secco Petrochemical Company Limited

Notes to the financial statements

*(Expressed in Renminbi)*

**1 COMPANY STATUS**

Shanghai Secco Petrochemical Co., Ltd. (the Company) is an equity joint venture established in Shanghai, the People's Republic of China (PRC) by China Petroleum and Chemical Corporation (Sinopec), Sinopec Shanghai Petrochemical Co., Ltd. (SPCL) and BP Chemicals East China Investments Ltd. (BPCECIL) (registered in the United Kingdom). The Company obtained an approval certificate [Wai Jing Mao Zi Shen Zi (2001) No. 0099] from the Ministry of Commerce (formerly Ministry of Foreign Trade and Economic Co-operation) on September 13, 2001, and a business license (Qi He Hu Zong Zi No. 029541 (Shi ju)) on October 29, 2001 issued by the State Administration of Industry and Commerce of the PRC. The registered capital is USD 901,440,964.

According to the joint venture agreement and articles of association, the Company's period of operation is 50 years and its principal activities are to produce, market and sell ethylene, polyethylene, styrene, polystyrene, propylene, acrylonitrile, polypropylene, butadiene, aromatics and co-products; provide related after-sales services and technical advice with respect to such main petrochemical products and co-products; engage in polymers application development; and provide ancillary utilities services to suppliers and processors. The Company commenced its manufacturing operations on March 31, 2005.

**2 BASIS OF PREPARATION**

**(1) Statement of compliance**

The financial statements have been prepared in accordance with the requirements of the China Accounting Standards for Business Enterprises (CAS (2006)) issued by the Ministry of Finance (MOF). These financial statements present truly and completely the financial position, the results of operations and the cash flows of the Company.

**(2) Accounting year**

The accounting year of the Company is from January 1 to December 31.

**(3) Measurement basis**

The measurement basis used in the preparation of the financial statements is historical cost basis.

## **Table of Contents**

### (4) Functional currency and presentation currency

The Company's functional currency is Renminbi. These financial statements are presented in Renminbi.

## 3 SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES

### (1) Translation of foreign currencies

When the Company receives capital in foreign currencies from investors, the capital is translated to Renminbi at the spot exchange rate on the date of the receipt. Other foreign currency transactions are, on initial recognition, translated to Renminbi at the spot exchange rates on the dates of the transactions.

A spot exchange rate is an exchange rate quoted by the People's Bank of China.

Monetary items denominated in foreign currencies are translated to Renminbi at the spot exchange rates at the balance sheet date. The resulting exchange differences are recognized in profit or loss, except those arising from the principals and interests on foreign currency borrowings specifically for the purpose of acquisition, construction of qualifying assets (see Note 3(15)). Non-monetary items denominated in foreign currencies that are measured at historical cost are translated to Renminbi using the foreign exchange rate at the transaction date.

### (2) Cash and Cash equivalents

Cash and cash equivalents comprise cash on hand and demand deposits.

### (3) Inventories

Inventories are carried at the lower of cost and net realizable value.

Cost of inventories comprises all costs of purchase, costs of conversion and other costs. Inventories are initially measured at their actual cost. Cost of inventories is calculated using the weighted average method. In addition to the purchasing cost of raw materials, work in progress and finished goods include direct labour costs and an appropriate allocation of production overheads.

Any excess of the cost over the net realizable value of each class of inventories is recognized as a provision for diminution in the value of inventories. Net realizable value is the estimated selling price in the normal course of business less the estimated costs to completion and the estimated expenses and related taxes necessary to make the sale.

The Company maintained a perpetual inventory system.

**Table of Contents**

## (4) Fixed assets and construction in progress

Fixed assets represent the tangible assets held by the Company for use in the production of goods, supply of services or for operation and administrative purposes with useful lives over one year.

Fixed assets are stated in the balance sheet at cost less accumulated depreciation and impairment losses (see Note 3(8)). Construction in progress is stated in the balance sheet at cost less impairment losses (see Note 3(8)).

The cost of a purchased fixed asset comprises the purchase price, related taxes, and any directly attributable expenditure for bringing the asset to working condition for its intended use. The cost of self-constructed assets includes the cost of materials, direct labour, capitalized borrowing costs (see Note 3(15)), and any other costs directly attributable to bringing the asset to working condition for its intended use.

Construction in progress is transferred to fixed assets when it is ready for its intended use. No depreciation is provided against construction in progress.

Where the individual component parts of an item of fixed asset have different useful lives or provide benefits to the Company in different patterns thus necessitating use of different depreciation rates or methods, they are recognized as a separate fixed asset.

The subsequent costs including the cost of replacing part of an item of fixed assets are recognized in the carrying amount of the item if the recognition criteria are satisfied, and the carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing of fixed assets are recognized in profit or loss as incurred.

Gains or losses arising from the retirement or disposal of an item of fixed asset are determined as the difference between the net disposal proceeds and the carrying amount of the item and are recognized in profit or loss on the date of retirement or disposal.

Fixed assets are depreciated using the straight-line method over their estimated useful lives. The estimated useful lives, residual values and depreciation rates of each class of fixed assets are as follows:

	Estimated useful life	Estimated residual value	Depreciation rate
Plants and buildings	10-40 years	3%	2.43%-9.70%
Machinery and equipment	10-28 years	3%	3.46%-9.70%
Office and other equipment	4-5 years	3%	19.40%-24.25%
Motor vehicles	8 years	3%	12.13%

Useful lives, residual values and depreciation methods are reviewed at least at each financial year end.

**Table of Contents**

## (5) Operating lease charges

Rental payments under operating leases are recognized as costs or expenses on a straight-line basis over the lease term.

## (6) Intangible assets

Intangible assets are stated in the balance sheet at cost less accumulated amortization (where the estimated useful life is finite) and impairment losses (see Note 3(8)). For an intangible asset with finite useful life, its cost less residual value and impairment loss is amortized on the straight-line method over its estimated useful life. The respective amortization periods for intangible assets are as follows:

	Estimated useful lives
Land use right	47 years
Patent	10 years
Computer software	5 years

An intangible asset is regarded as having an indefinite useful life and is not amortized when there is no foreseeable limit to the period over which the asset is expected to generate economic benefits for the Company. At the balance date, the Company doesn't have any intangible assets with indefinite useful lives.

## (7) Long-term deferred expenses

Long-term deferred expenses represent catalyst costs, which are amortized on a straight-line basis over their estimated useful lives.



**Table of Contents**

(8) Impairment of non-financial long-term assets

The carrying amounts of the following assets are reviewed at each balance sheet date based on the internal and external sources of information to determine whether there is any indication of impairment:

- fixed assets
- construction in progress
- intangible assets

If any indication exists that an asset may be impaired, recoverable amount of the asset is estimated.

An asset group is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or asset groups. An asset group is composed of assets directly relating to cash-generation. Identification of an asset group is based on whether major cash inflows generated by the asset group are largely independent of the cash inflows from other assets or asset groups. In identifying an asset group, the Company also considers how management monitors the Company's operations and how management makes decisions about continuing or disposing of the Company's assets.

The recoverable amount of an asset, asset group or set of asset groups is the higher of its fair value less costs to sell and its present value of expected future cash flows.

An asset's fair value less costs to sell is the amount determined by the price of a sale agreement in an arm's length transaction, less the costs that are directly attributable to the disposal of the asset. The present value of expected future cash flows of an asset is determined by discounting the future cash flows, estimated to be derived from continuing use of the asset and from its ultimate disposal, to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss is recognized if the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognized in profit or loss. A provision for impairment loss of the asset is recognized accordingly. Impairment losses related to an asset group or a set of asset groups reduce the carrying amount of the assets in the asset group or set of asset groups on a pro rata basis. However, that the carrying amount of an impaired asset will not be reduced below the highest of its individual fair value less costs to sell (if determinable), the present value of expected future cash flows (if determinable) and zero.

An impairment loss is not reversed in subsequent periods.

**Table of Contents**

(9) Financial instruments

Financial instruments comprise cash at bank and on hand, receivables, payables and loans and borrowings, etc.

(a) Recognition and measurement of financial assets and financial liabilities

A financial asset or financial liability is recognized in the balance sheet when the Company becomes a party to the contractual provisions of a financial instrument.

The Company classifies financial assets and liabilities into different categories at initial recognition based on the purpose of acquiring assets or assuming liabilities: loans and receivables, and other financial liabilities.

Financial assets and financial liabilities are measured initially at fair value. Any attributable transaction costs are included in their initial costs. Subsequent to initial recognition financial assets and liabilities are measured as follows:

- Receivables

Receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Subsequent to initial recognition, receivables are subsequently stated at amortized cost using the effective interest method.

- Other financial liabilities

Financial liabilities other than the financial liabilities at fair value through profit or loss are classified as other financial liabilities.

Subsequent to initial recognition, other financial liabilities are measured at amortized cost using the effective interest method.

**Table of Contents**

(b) Impairment of financial assets

The carrying amounts of financial assets are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, impairment loss is provided.

- Receivables

Receivables are assessed for impairment both on an individual basis and on a collective group basis.

Where impairment is assessed on an individual basis, an impairment loss in respect of a receivable is calculated as the excess of its carrying amount over the present value of the estimated future cash flows (exclusive of future credit losses that have not been incurred) discounted at the original effective interest rate. All impairment losses are recognized in profit or loss.

The assessment is made collectively where receivables share similar credit risk characteristics (including those having not been individually assessed as impaired), based on their historical loss experiences, and adjusted by the observative figures reflecting present economic conditions.

If, after an impairment loss has been recognized on receivables, there is objective evidence of a recovery in value of the financial asset which can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through profit or loss. A reversal of an impairment loss will not result in the asset's carrying amount exceeding that which would have been determined had no impairment loss been recognized in prior years.

**Table of Contents**

(c) Derecognition of financial assets and financial liabilities

A financial asset is derecognized if the Company's contractual rights to the cash flows from the financial asset expire or if the Company transfers substantially all the risks and rewards of ownership of the financial asset to another party.

Where a transfer of a financial asset in its entirety meets the criteria of the derecognition, the difference between the two amounts below is recognized in profit or loss:

- carrying amount of the financial asset transferred
  
- the consideration received from the transfer.

The Company derecognizes a financial liability (or part of it) only when the underlying present obligation (or part of it) is discharged.

(10) Employee benefits

Employee benefits are all forms of considerations given and other related expenditures incurred in exchange for services rendered by employees. Employee benefits are recognized as a liability in the period in which the associated services are rendered by employees, with a corresponding increase in cost of relevant assets or expenses in the current period.

(a) Retirement benefits

Pursuant to the relevant laws and regulations of the PRC, the Company has joined a defined contribution basic retirement scheme for the employees arranged by local Labor and Social Security Bureaus. The Company makes contributions to the retirement scheme at the applicable rates based on the amounts stipulated by the government organization. The contributions are charged to profit or loss on an accrual basis. When employees retire, the local Labor and Social Security Bureaus are responsible for the payment of the basic retirement benefits to the retired employees. The Company does not have any other obligations in this respect.

(b) Housing fund and other social insurances

Besides the retirement benefits, pursuant to the relevant laws and regulations of the PRC, the Company has joined defined social security contributions for employees, such as a housing fund, basic medical insurance, unemployment insurance, injury insurance and maternity insurance. The Company makes contributions to the housing fund and other social insurances mentioned above at the applicable rate(s) based on the employees' salaries. The contributions are recognized as cost of assets or charged to profit or loss on an accrual basis.

**Table of Contents**

(11) Income tax

Current tax and deferred tax are recognized in profit or loss.

Current tax is the expected tax payable calculated at the applicable tax rate on taxable income for the year, and any adjustment to tax payable in respect of previous years.

Deferred tax assets arise from deductible temporary differences, being the differences between the carrying amounts of assets for financial reporting purposes and their tax bases, which include the tax credits carry forward to subsequent periods. Deferred tax assets are recognized to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

At the balance sheet date, the amount of deferred tax recognized is measured based on the expected manner of realization or settlement of the carrying amount of the assets, using tax rates that are expected to be applied in the period when the asset is realized in accordance with tax laws.

(12) Provisions and contingent liabilities

A provision is recognized if, as a result of a past event, the Company has a present obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Where the effect of time value of money is material, provisions are determined by discounting the expected future cash flows.

In terms of a possible obligation resulting from a past transaction or event, whose existence will only be confirmed by the occurrence or non-occurrence of uncertain future events or a present obligation resulting from a past transaction or event, where it is not probable that the settlement of the above obligation will cause an outflow of economic benefits, or the amount of the outflow cannot be estimated reliably, the possible or present obligation is disclosed as a contingent liability.

## **Table of Contents**

### (13) Revenue recognition

Revenue is the gross inflow of economic benefit in the periods arising in the course of the Company's ordinary activities when the inflows result in increase in investors' equity, other than increase relating to contributions from investors. Revenue is recognized in profit or loss when it is probable that the economic benefits will flow to the Company, the revenue and costs can be measured reliably and the following respective conditions are met:

#### (a) Sale of goods

Revenue from sale of goods is recognized when all of the general conditions stated above and following conditions are satisfied:

- The significant risks and rewards of ownership of goods have been transferred to the buyer
  
- The Company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold.

Revenue from the sale of goods is measured at the fair value of the considerations received or receivable under the sales contract or agreement.

#### (b) Rendering of services

When the outcome of a transaction involving the rendering of services can be estimated reliably, revenue from the rendering of services is recognized in the income statement by reference to the stage of completion of the transaction based on the proportion of costs incurred to date to the estimated total costs.

#### (c) Interest income

Interest income is recognized on a time proportion basis with reference to the principal outstanding and the applicable rate.

### (14) Government grants

Government grants are transfers of monetary assets from the government to the Company at no consideration.

A government grant is recognized when there is reasonable assurance that the grant will be received and that the Company will comply with the conditions associated with the grant.

If a government grant is in the form of a transfer of a monetary asset, it is measured at the amount that is received or receivable.

A government grant that compensates the Company for expenses incurred is recognized in profit or loss immediately.

**Table of Contents**

(15) Borrowing costs

Borrowing costs incurred directly attributable to the acquisition, construction of a qualifying asset are capitalized as part of the cost of the asset.

Except for the above, other borrowing costs are recognized as financial expenses in the income statement when incurred.

In the capitalization period, the amount of interest (including amortization of any discount or premium on borrowing) to be capitalized in each accounting period is determined as follows:

Where funds are borrowed specifically for the acquisition, construction of a qualifying asset, the amount of interest to be capitalized is the interest expense calculated using effective interest rates during the period less any interest income earned from depositing the borrowed funds before being used on the asset.

Where funds are borrowed generally and used for the acquisition, construction of a qualifying asset, the amount of interest to be capitalized on such borrowings is determined by applying a capitalization rate to the weighted average of the excess amounts of cumulative expenditures on the asset over the above amounts of specific borrowings. The capitalization rate is the weighted average of the interest rates applicable to the general-purpose borrowings.

The effective interest rate is determined as the rate that exactly discounts estimated future cash flow through the expected life of the borrowing or, when appropriate, a shorter period to the carrying amount of the borrowings.

The capitalization period is the period from the date of commencement of capitalization of borrowing costs to the date of cessation of capitalization, excluding any period over which capitalization is suspended. Capitalization of borrowing costs commences when expenditure for the asset is being incurred, borrowing costs are being incurred and activities of acquisition, construction that are necessary to prepare the asset for its intended use are in progress, and ceases when the assets become ready for their intended use. Capitalization of borrowing costs is suspended when the acquisition, construction activities are interrupted abnormally and the interruption lasts over three months.

**Table of Contents**

(16) Related parties

If the Company has the power to control, jointly control or exercise significant influence over another party, or vice versa, or where the Company and one or more parties are subject to common control, jointly control, or significant influence from another party, they are considered to be related parties. Related parties may be individuals or enterprises. Enterprises with which the Company is under common control only from the State and that have no other related party relationships are not regarded as related parties of the Company. The Company's related parties include, but are not limited to:

- (a) the Company's parent
- (b) enterprises that are controlled by the Company's parent
- (c) investors that have joint control over the Company
- (d) investors that exercise significant influence over the Company
- (e) principal individual investors and close family members of such individuals
- (f) key management personnel of the Company and close family members of such individuals
- (g) key management personnel of the Company's parent
- (h) close family members of key management personnel of the Company's parent
- (i) other enterprises that are controlled, jointly controlled or significantly influenced by principal individual investors, key management personnel of the Company, and close family members of such individuals.

(17) Significant accounting estimates and judgments

The preparation of financial statements requires management to make estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised and in any future periods affected.



**Table of Contents**

Key sources of estimation uncertainty are as follows:

(a) Impairment of receivables

As described in Note 3(9) (b), receivables that are measured at amortization cost are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, impairment loss is provided. Objective evidence of impairment includes observable data that comes to the attention of the Company about loss events such as a significant decline in the estimated future cash flow of an individual debtor or the portfolio of debtors, and significant changes in the financial condition that have an adverse effect on the debtor. If there is an indication that there has been a change in the factors used to determine the provision for impairment, the impairment loss recognized in prior years is reversed.

(b) Impairment of non-financial long-term assets

As described in Note 3(8), non-financial long-term assets are reviewed at each balance sheet date to determine whether the carrying amount exceeds the recoverable amount of the assets. If any such indication exists, impairment loss is provided.

The recoverable amount of an asset (asset group) is the greater of its net selling price and its present value of expected future cash flows. Since a market price of the asset (the asset group) cannot be obtained reliably, the fair value of the asset cannot be estimated reliably. In assessing value in use, significant judgements are exercised over the asset's production, selling price, related operating expenses and discounting rate to calculate the present value. All relevant materials which can be obtained are used for estimation of the recoverable amount, including the estimation of the production, selling price and related operating expenses based on reasonable and supportable assumption.

(c) Depreciation and amortization

As described in Note 3(4) and (6), fixed assets and intangible assets are depreciated and amortized using the straight-line method over their estimated useful lives after taking into account residual value. The estimated useful lives are regularly reviewed to determine the depreciation and amortization costs charged in each reporting period. The estimated useful lives are determined based on historical experiences of similar assets and the estimated technical changes. If there is an indication that there has been a change in the factors used to determine the depreciation or amortization, the amount of depreciation or amortization is revised.

**Table of Contents**

## 4 TAXATION

- (1) The types of taxes applicable to the Company's sale of goods and rendering of services include business tax and value added tax (VAT). Their tax rates are as follows:

The types of taxes	Taxation Basis and rates
Business tax	5% of taxable income
VAT	Output VAT is 17% of product sales and taxable services revenue, based on tax laws. The remaining balance of output VAT, after subtracting the deductible input VAT of the period, is VAT payable

- (2) Income tax

The income tax rate applicable to the Company for the year is 18% (2007:15%).

Pursuant to the Income Tax Law of PRC for Foreign Invested Enterprises and Foreign Enterprises, starting from the year in which a taxable profit is made after the offset of deductible losses incurred in prior years, the Company is entitled to a preferential tax treatment of a tax-free period for the first and second profit making years and a 50% reduction in the income tax rate for the third to fifth years. This year is the third profit making year.

On March 16, 2007, the Fifth Plenary Session of the Tenth National People's Congress passed the Corporate Income Tax Law of the PRC (the new tax law) which took effect on January 1, 2008, when the current tax law was abolished. The new tax law adopts an uniform tax rate of 25% for all enterprises including foreign investment enterprises and revokes the current tax exemption, reduction and protective treatments only applicable to foreign investment enterprises. State Council of the PRC passed the implementation guidance (Implementation Guidance) on December 26, 2007, which set out the details of how the existing preferential income tax rate will be adjusted to the statutory rate of 25%. According to the Implementation Guidance, the Company, which is eligible for a 100% or 50% relief from PRC Enterprise Income Tax, will continue to enjoy the preferential income tax rate up to the end of the derating period, after which, the 25% standard rate applies.

- (3) Taxes (recoverable)/payable

	2007 RMB 000	2008 RMB 000 (Unaudited)
VAT (recoverable)/payable	(47,177)	73,828
Others	1,532	822
Total	(45,645)	74,650

**Table of Contents**

## 5 CASH AT BANK AND ON HAND

	2007 RMB 000	2008 RMB 000 (Unaudited)
Cash on hand	32	
Demand deposits	1,566,365	1,748,561
<b>Total</b>	<b>1,566,397</b>	<b>1,748,561</b>

## 6 BILLS RECEIVABLE

	2007 RMB 000	2008 RMB 000 (Unaudited)
Bank acceptance bills	1,198,306	277,261

All of the above bills held by the Company are due within one year.

## 7 ACCOUNTS RECEIVABLE

- (1) Accounts receivable by customers type:

	<i>Note</i>	2007 RMB 000	2008 RMB 000 (Unaudited)
Amounts due from related parties	36(2) (ii)	283,160	64,999
Amounts due from other customers		228,875	27,891
<b>Subtotal</b>		<b>512,035</b>	<b>92,890</b>
Less: provision for bad and doubtful debts			(4,424)
<b>Total</b>		<b>512,035</b>	<b>88,466</b>

- (2) The ageing analysis of the Company's accounts receivables is as follows:

	2007 Amounts RMB 000	2007 Percentage of total accounts receivable	Bad debt provision RMB 000	2008 (unaudited) Amounts RMB 000	2008 (unaudited) Percentage of total accounts receivable	Bad debt provision RMB 000
Within 1 year (inclusive)	512,035	100%		92,890	100%	(4,424)

The ageing is counted starting from the date accounts receivable is recognized.

8 PREPAYMENTS

Prepayments are made for purchases. All the prepayments are due within one year.

F-85

**Table of Contents**

## 9 OTHER RECEIVABLES

(1) Other receivables by customers type:

	<i>2007</i> <i>RMB 000</i>	<i>2008</i> <i>RMB 000</i> <i>(Unaudited)</i>
Amounts due from related parties		
Amounts due from other parties	18,314	13,043
<b>Total</b>	<b>18,314</b>	<b>13,043</b>

(2) The ageing analysis of the Company's other receivables is as follows:

	<i>2007</i> <i>Amounts</i> <i>RMB 000</i>	<i>2007</i> <i>Percentage</i> <i>of total</i> <i>other</i> <i>receivables</i>	<i>Bad debt</i> <i>provision</i> <i>RMB 000</i>	<i>2008 (unaudited)</i> <i>Amounts</i> <i>RMB 000</i>	<i>2008 (unaudited)</i> <i>Percentage</i> <i>of total</i> <i>other</i> <i>receivables</i>	<i>Bad debt</i> <i>provision</i> <i>RMB 000</i>
Within 1 year (inclusive)	17,021	93%		11,407	87%	
1 and 2 years (inclusive)	1,035	6%		470	4%	
2 and 3 years (inclusive)	258	1%		1,040	8%	
After 3 years				126	1%	
<b>Total</b>	<b>18,314</b>	<b>100%</b>		<b>13,043</b>	<b>100%</b>	

The ageing is counted starting from the date of recognition of other receivables.

## 10 INVENTORIES

	<i>2007</i> <i>RMB 000</i>	<i>2008</i> <i>RMB 000</i> <i>(Unaudited)</i>
Raw materials	949,683	584,480
Work in progress	41,485	41,611
Semi-finished goods	397,696	126,576
Finished goods	619,189	288,948
<b>Subtotal</b>	<b>2,008,053</b>	<b>1,041,615</b>
Less: Provision for diminution in value of inventories	(5,553)	(38,286)
<b>Total</b>	<b>2,002,500</b>	<b>1,003,329</b>

**Table of Contents**

An analysis of provision for diminution in value of inventories is as follows:

	2007			2008 (unaudited)		
	<i>Semi-finished goods</i> RMB 000	<i>Finished goods</i> RMB 000	<i>Total</i> RMB 000	<i>Semi-finished goods</i> RMB 000	<i>Finished goods</i> RMB 000	<i>Total</i> RMB 000
Opening balance as at January 1	(3,279)	(2,147)	(5,426)		(5,553)	(5,553)
Add: Provision made during the year		(5,553)	(5,553)	(6,761)	(31,525)	(38,286)
Less: Reversal during the year	3,279	2,147	5,426		5,553	5,553
Closing balance as at December 31		(5,553)	(5,553)	(6,761)	(31,525)	(38,286)

## 11 OTHER CURRENT ASSETS

	2007 RMB 000	2008 RMB 000 (Unaudited)
Prepaid income tax		28,192
Entrusted loan		
- principal	1,454,000	
- interest receivable	1,309	
<b>Total</b>	<b>1,455,309</b>	<b>28,192</b>

The Company entrusted Bank of Communications Shanghai Branch to grant loans. Details of loan balances as at December 31, 2007 are as follows:

<i>Borrower</i>	<i>Balance</i>	<i>Duration</i>	<i>Interest rate</i>
SPCL	391,000	2007.10.09-2008.01.09	3.80%
SPCL	336,000	2007.12.26-2008.06.26	3.58%
BP (China) Holdings Ltd. ( BP Holdings )	391,000	2007.10.09-2008.01.09	3.80%
BP Zhuhai Chemical Co., Ltd ( BP Zhuhai )	336,000	2007.12.26-2008.06.26	3.58%
<b>Total</b>	<b>1,454,000</b>		

**Table of Contents**

## 12 FIXED ASSETS

	<i>Plant and buildings RMB 000</i>	<i>Machinery and equipment RMB 000</i>	<i>Office and other equipment RMB 000</i>	<i>Motor vehicles RMB 000</i>	<i>Total RMB 000</i>
<b>Cost:</b>					
As at January 1, 2007	1,247,955	14,875,108	85,781	3,850	16,212,694
Additions		877	16,454	649	17,980
Transfer from construction in progress		25,716			25,716
Disposals		(79,995)	(3,406)		(83,401)
As at December 31, 2007	1,247,955	14,821,706	98,829	4,499	16,172,989
<b>Accumulated depreciation:</b>					
As at January 1, 2007	(136,557)	(1,987,080)	(36,624)	(563)	(2,160,824)
Charge for the year	(73,289)	(1,115,659)	(17,620)	(474)	(1,207,042)
Written back on disposal		5,934	2,619		8,553
As at December 31, 2007	(209,846)	(3,096,805)	(51,625)	(1,037)	(3,359,313)
<b>Carrying amount:</b>					
As at December 31, 2007	1,038,109	11,724,901	47,204	3,462	12,813,676
As at December 31, 2006	1,111,398	12,888,028	49,157	3,287	14,051,870
<b>Cost:</b>					
As at January 1, 2008	1,247,955	14,821,706	98,829	4,499	16,172,989
Additions		481	8,941	139	9,561
Transfer from construction in progress		11,919			11,919
Disposals			(2,809)		(2,809)
As at December 31, 2008 (unaudited)	1,247,955	14,834,106	104,961	4,638	16,191,660
<b>Accumulated depreciation:</b>					
As at January 1, 2008	(209,846)	(3,096,805)	(51,625)	(1,037)	(3,359,313)
Charge for the year	(73,289)	(1,109,900)	(17,847)	(552)	(1,201,588)
Written back on disposal			2,624		2,624
As at December 31, 2008 (unaudited)	(283,135)	(4,206,705)	(66,848)	(1,589)	(4,558,277)
<b>Net book value:</b>					
As at December 31, 2008 (unaudited)	964,820	10,627,401	38,113	3,049	11,633,383
As at December 31, 2007	1,038,109	11,724,901	47,204	3,462	12,813,676

The Company is still in the progress of application of the property certificate for the plant and buildings.





**Table of Contents**

## 13 CONSTRUCTION IN PROGRESS

	<i>2007</i> <i>RMB 000</i>	<i>2008</i> <i>RMB 000</i> <i>(Unaudited)</i>
Cost		
Balance at the beginning of the year	28,027	148,821
Additions during the year	151,377	556,131
Transferred to fixed assets	(25,716)	(11,919)
Transferred to intangible assets	(4,867)	
Balance at the end of the year	(148,821)	693,033

## 14 INTANGIBLE ASSETS

	<i>Land use right</i> <i>RMB 000</i>	<i>Patent</i> <i>RMB 000</i>	<i>Computer software</i> <i>RMB 000</i>	<i>Total</i> <i>RMB 000</i>
Cost				
As at January 1, 2007	770,967	880,076	23,414	1,674,457
Additions during the year			3,239	3,239
Transferred from construction in progress			4,867	4,867
As at December 31, 2007	770,967	880,076	31,520	1,682,563
Accumulated amortization				
As at January 1, 2007	(31,624)	(162,461)	(10,277)	(204,362)
Charge for the year	(16,430)	(88,007)	(5,642)	(110,079)
As at December 31, 2007	(48,054)	(250,468)	(15,919)	(314,441)
Net book value				
As at December 31, 2007	722,913	629,608	15,601	1,368,122
As at December 31, 2006	739,343	717,615	13,137	1,470,095
	<i>Land use right</i> <i>RMB 000</i>	<i>Patent</i> <i>RMB 000</i>	<i>Computer software</i> <i>RMB 000</i>	<i>Total</i> <i>RMB 000</i>
Cost				
As at January 1, 2008	770,967	880,076	31,520	1,682,563
Additions during the year		208	8,474	8,682
As at December 31, 2008 (unaudited)	770,967	880,284	39,994	1,691,245
Accumulated amortization				
As at January 1, 2008	(48,054)	(250,468)	(15,919)	(314,441)
Charge for the year	(16,430)	(88,022)	(7,178)	(111,630)
As at December 31, 2008 (unaudited)	(64,484)	(338,490)	(23,097)	(426,071)

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Net book value				
As at December 31, 2008 (unaudited)	706,483	541,794	16,897	1,265,174
As at December 31, 2007	722,913	629,608	15,601	1,368,122

F-89

**Table of Contents**

## 15 LONG-TERM DEFERRED EXPENSES

	<i>2007</i> <i>RMB 000</i>	<i>2008</i> <i>RMB 000</i> <i>(Unaudited)</i>
Balance at the beginning of the year	37,273	12,053
Additions for the year	7,775	22,800
Amortization for the year	(32,995)	(22,848)
Balance at the end of the year	12,053	12,005

## 16 DEFERRED TAX ASSETS

	<i>2007</i>		<i>2008 (unaudited)</i>	
	<i>Deductible temporary difference RMB 000</i>	<i>Deferred tax assets RMB 000</i>	<i>Deductible temporary difference RMB 000</i>	<i>Deferred tax assets RMB 000</i>
Deferred tax assets				
Income tax credit for purchases of domestically-produced equipment	527,700	47,493		
Provision for diminution in value of inventories	5,553	500		
Pre-operating expenses	235,149	22,610		
Deductible losses			134,342	32,242
Total	768,402	70,603	134,342	32,242

In accordance with the accounting policy set out in Note 3(11), the Company has not recognized deferred tax assets in respect of cumulative tax losses of RMB320,958,000 (2007: RMB nil) as it is not probable that the related tax benefit will be realized. The deductible tax losses expire in 2013 under current tax law.

**Table of Contents**

## 17 PROVISIONS FOR IMPAIRMENT

At December 31, 2007 and 2008, the provisions for impairment of the Company are set out as follows:

Item	2007			Balance at the end of the year RMB 000
	Balance at the beginning of the year RMB 000	Charge for the year RMB 000	Reversal during the year RMB 000	
Inventories	5,426	5,553	(5,426)	5,553
Total	5,426	5,553	(5,426)	5,553

Item	2008			Balance at the end of the year RMB 000
	Balance at the beginning of the year RMB 000	Charge for the year RMB 000	Reversal during the year RMB 000	
Receivables		4,424		4,424
Inventories	5,553	38,286	(5,553)	38,286
Total	5,553	42,710	(5,553)	42,710

## 18 SHORT-TERM LOANS

	2007				2008 (unaudited)			
	Principal in foreign currency 000	Exchange rate	RMB/ RMB equivalent RMB 000	Credit/ guaranteed	Principal in foreign currency 000	Exchange rate	RMB/ RMB equivalent RMB 000	Credit/ guaranteed
Bank loans USD LIBOR+0.2%					15,000	6.8346	102,519	Credit

## 19 BILL PAYABLE

	2007 RMB 000	2008 RMB 000 (Unaudited)
Bank acceptance bills		3,258

**Table of Contents**

## 20 EMPLOYEE BENEFITS PAYABLE

	2007 RMB 000	2008 RMB 000 (Unaudited)
Staff welfare fees	21,023	42,690
Social insurances		
Housing fund		6
Medical insurance premium	986	1,127
Basic old age insurance premium	2,183	2,500
Unemployment insurance premium	211	242
Supplementary old age pension		166
Labor union fee, staff and workers education fee	1,345	371
Others	53,294	46,829
Total	79,042	93,931

## 21 LONG-TERM LOANS DUE WITHIN ONE YEAR

	2007				2008 (unaudited)			
	<i>Principal in foreign currency 000</i>	<i>RMB/RMB equivalent RMB 000</i>	<i>interest rate (p.a.)</i>	<i>Credit/ guaranteed</i>	<i>Principal in foreign currency 000</i>	<i>RMB/RMB equivalent RMB 000</i>	<i>interest rate (p.a.)</i>	<i>Credit/ guaranteed</i>
Bank loans:								
- RMB		148,800	10% lower than RMB benchmark interest rate	Credit		153,600	10% lower than RMB benchmark interest rate	Credit
- USD	55,800	407,597	LIBOR+ 0.2%	Credit	55,800	381,371	LIBOR+ 0.2%	Credit
Total		556,397				534,971		

## 22 LONG-TERM LOANS

	2007				2008 (unaudited)			
	<i>Principal in foreign currency 000</i>	<i>RMB/RMB equivalent RMB 000</i>	<i>interest rate (p.a.)</i>	<i>Credit/ guaranteed</i>	<i>Principal in foreign currency 000</i>	<i>RMB/RMB equivalent RMB 000</i>	<i>interest rate (p.a.)</i>	<i>Credit/ guaranteed</i>
Bank loans:								
- RMB		4,651,200	10% lower than RMB benchmark interest rate	Credit		4,497,600	10% lower than RMB benchmark interest rate	Credit
- USD	564,200	4,121,255		Credit	508,400,000	3,474,711		Credit

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LIBOR+  
0.2%

LIBOR+  
0.2%

Total	8,772,455	7,972,311
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According to the loan contract, the Renminbi loans are repayable in 28 installments during the period from June 20, 2008 to December 20, 2021.

F-92

**Table of Contents**

The US dollar loans are repayable in 12 installments during the period from June 20, 2008 to December 20, 2013.

The maturity analysis of the Company's long-term loan is set out below:

	<i>2007</i> <i>RMB 000</i>	<i>2008</i> <i>RMB 000</i> <i>(Unaudited)</i>
Due after 1 year but within 2 years (inclusive)	561,197	645,707
Due after 2 years but within 3 years (inclusive)	679,218	671,694
Due after 3 years	7,532,040	6,654,910
Total	8,772,455	7,972,311

## 23 PAID-IN CAPITAL

Registered capital

	<i>2007 and 2008 (unaudited)</i> <i>%</i>	
	<i>Amount in</i> <i>USD 000</i>	
BPCECIL	450,720	50%
Sinopec	270,432	30%
SPCL	180,288	20%
	901,440	100%

Paid-in capital

	<i>2007 and 2008 (unaudited)</i> <i>%</i>		
	<i>Amount in</i> <i>USD 000</i>	<i>Amount in</i> <i>RMB 000</i>	
BPCECIL	450,720	3,721,792	50%
Sinopec		2,233,076	30%
SPCL		1,488,717	20%
		7,443,585	100%

## 24 CAPITAL RESERVE

*2007 and 2008 (unaudited)*  
*RMB 000*

F-93



**Table of Contents**

## 25 SURPLUS RESERVE

	<i>2007</i> <i>RMB 000</i>	<i>2008</i> <i>RMB 000</i> <i>(Unaudited)</i>
General reserve fund	19,697	49,290
Enterprise expansion fund	19,696	49,290
<b>Total</b>	<b>39,393</b>	<b>98,580</b>

## 26 APPROPRIATION OF PROFITS

## (1) Appropriation to surplus reserve

In accordance with the Board of Director s Meeting resolution on April 1, 2008, the Company made appropriations to the following surplus reserve for 2008:

(i) Surplus reserve - Enterprise expansion fund	1%
(ii) Surplus reserve - General reserve fund	1%
(iii) Staff and workers bonus and welfare fund	1%

## (2) Cash dividends attributable to investors

The Board of Directors approved on April 1, 2008 and September 18, 2008, the appropriation of cash dividends totalling RMB2,870,000,000 (2007: RMB1,910,567,000) to the Company s investors.

## 27 OPERATING INCOME

	<i>2006</i> <i>RMB 000</i>	<i>2007</i> <i>RMB 000</i>	<i>2008</i> <i>RMB 000</i> <i>(Unaudited)</i>
Operating income from principal activities			
-Sale of goods	21,657,400	24,056,676	22,711,463
-Rendering of services	119,997	150,562	128,147
Sub-total	21,777,397	24,207,238	22,839,610
Other operating income	13,409	11,358	11,776
<b>Total</b>	<b>21,790,806</b>	<b>24,218,596</b>	<b>22,851,386</b>

**Table of Contents**

## 28 OPERATING COSTS

	<i>2006</i> <i>RMB 000</i>	<i>2007</i> <i>RMB 000</i>	<i>2008</i> <i>RMB 000</i> <i>(Unaudited)</i>
Operating cost from principal activities			
-Sale of goods	17,947,673	20,286,631	22,235,805
-Rendering of services	77,991	64,652	72,300
Sub-total	18,025,664	20,351,283	22,308,105
Other operating costs	12,629	6,488	6,648
Total	18,038,293	20,357,771	22,314,753

## 29 FINANCIAL EXPENSES

	<i>2006</i> <i>RMB 000</i>	<i>2007</i> <i>RMB 000</i>	<i>2008</i> <i>RMB 000</i> <i>(Unaudited)</i>
Interest expense from loans	617,916	624,453	516,375
Less: Interest income from deposits and receivables	(38,678)	(61,040)	(62,622)
Net exchange gains	(157,429)	(325,948)	(296,926)
Other financial expenses	2,151	567	696
Total	423,960	238,032	157,523

## 30 IMPAIRMENT REVERSAL/(LOSS)

	<i>2006</i> <i>RMB 000</i>	<i>2007</i> <i>RMB 000</i>	<i>2008</i> <i>RMB 000</i> <i>(Unaudited)</i>
Accounts receivable			(4,424)
Inventories	9,980	(127)	(32,733)
	9,980	(127)	(37,157)

## 31 INVESTMENT INCOME

	<i>2006</i> <i>RMB 000</i>	<i>2007</i> <i>RMB 000</i>	<i>2008</i> <i>RMB 000</i> <i>(Unaudited)</i>
Interest income from entrusted loans		39,238	24,043



**Table of Contents**

## 32 INCOME TAX BENEFIT/(EXPENSES)

## (1) Income tax benefit/(expenses) for the year represent

	<i>2006</i> <i>RMB 000</i>	<i>2007</i> <i>RMB 000</i>	<i>2008</i> <i>RMB 000</i> <i>(Unaudited)</i>
Current tax expenses for the year			
Deferred taxation	17,636	52,967	(38,361)
<b>Total</b>	<b>17,636</b>	<b>52,967</b>	<b>(38,361)</b>

The analysis of deferred tax benefit/(expenses) are set out below:

	<i>2006</i> <i>RMB 000</i>	<i>2007</i> <i>RMB 000</i>	<i>2008</i> <i>RMB 000</i> <i>(Unaudited)</i>
Origination and reversal of temporary differences	17,636	47,993	(38,361)
Change in tax rate		4,974	
<b>Total</b>	<b>17,636</b>	<b>52,967</b>	<b>(38,361)</b>

## (2) Reconciliation between income tax expenses and accounting profits is as follows:

	<i>2006</i> <i>RMB 000</i>	<i>2007</i> <i>RMB 000</i>	<i>2008</i> <i>RMB 000</i> <i>(Unaudited)</i>
Profit/(loss) before income tax	2,708,334	2,906,387	(455,300)
Expected income tax expenses/(benefit) at a tax rate of 18% (2007:15%; 2006: 15%)	406,250	435,958	(81,954)
Tax effect of non-taxable income	(406,250)	(435,958)	
Reversal of deferred tax assets recognized in previous years (Note 16)			70,603
Tax effect of unused tax losses not recognized			57,772
Effect of change in tax rate on deferred tax		(4,974)	
Others	(17,636)	(47,993)	(8,060)
<b>Income tax (benefit)/expenses</b>	<b>(17,636)</b>	<b>(52,967)</b>	<b>38,361</b>

**Table of Contents**

## 33 SUPPLEMENT TO CASH FLOW STATEMENT

(1) Reconciliation of net profit/(loss) to cash flows from operating activities:

	<i>2006</i> <i>RMB 000</i>	<i>2007</i> <i>RMB 000</i>	<i>2008</i> <i>RMB 000</i> <i>(Unaudited)</i>
Net profit/(loss)	2,725,970	2,959,354	(493,661)
Add: (Reversal of)/provision for receivables and inventories	(9,980)	127	37,157
Depreciation of fixed assets	1,163,596	1,207,042	1,201,588
Amortization of intangible assets	108,792	110,079	111,630
Amortization of long-term deferred expenses	4,633	32,995	22,848
Loss on disposal of fixed assets	267	764	141
Financial expenses	462,638	299,072	226,493
Gains arising from investment		(39,238)	(24,043)
(Increase)/decrease in gross inventories	(194,914)	(212,276)	966,438
(Increase)/decrease in operating receivable	(694,471)	(524,884)	1,264,309
Increase/(decrease) in operating payables	634,596	(340,249)	(558,249)
(Increase)/decrease in deferred tax assets	(17,636)	(52,967)	38,361
<b>Net cash inflow from operating activities</b>	<b>4,183,491</b>	<b>3,439,819</b>	<b>2,793,012</b>

## 34 SEGMENT REPORT

The Company does not engage in multiple businesses or operate in multiple locations, therefore no segment analysis is provided.

## 35 RISK ANALYSIS, SENSITIVITY ANALYSIS, AND DETERMINATION OF FAIR VALUES FOR FINANCIAL INSTRUMENTS

The Company has exposure to the following risks from its use of financial instruments:

Credit risk

Liquidity risk

Interest rate risk

Foreign currency risk

This note presents information about the Company's exposure to each of the above risks and their sources, the Company's objectives, policies and processes for measuring and managing risks, etc.

## **Table of Contents**

The Company's risk management policies are established to identify and analyse the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Company's activities. The internal audit of the Company undertakes both regular and ad hoc reviews of risk management controls and procedures.

### (1) Credit risk

The Company's credit risk is primarily attributable to receivables and designated loans. Exposure to these credit risks are monitored by management on an ongoing basis.

In respect of receivables, the Company has established a credit policy under which individual credit evaluations are performed on all customers requiring credit over a certain amount. These evaluations focus on the external ratings of the customers and their bank credit records where available. Receivables are due within 15 to 60 days from the date of billing. Debtors with overdue balances are requested to settle all outstanding balances before any further credit is granted. Normally, the Company does not obtain collateral from customers.

In monitoring customer credit risk, customers are grouped according to some factors, such as ageing.

Majority of sales transactions are settled by upfront payments prior to goods deliveries or bank acceptance notes issued by customers. Credit term is only granted to certain customers with good credit ratings and certain related parties. At balance sheet date, the ageing of accounts receivables is within three months and ageing of most other receivables is within one year, so the credit risk of receivables is relatively low.

All the Company's designated loans were lent to its related parties, and there was no delay payment based on the historical records. So the credit risk of the designated loans is relatively low.

The maximum exposure to credit risk is represented by the carrying amount of each financial asset, in the balance sheet. Company does not provide any other guarantees which would expose the Company to credit risk.

### (2) Liquidity risk

The Company is responsible for their own cash management, including short term investment of cash surpluses and the raising of loans to cover expected cash demands. The Company's policy is to regularly monitor its liquidity requirements and its compliance with lending covenants, to ensure that it maintains sufficient reserves of cash to meet its liquidity requirements in the short and longer term.

The maturity analysis of the entrusted loans and long term debts are disclosed in Note 11 and Note 22.

**Table of Contents**

(3) Interest rate risk

The Company adopts an interest rate policy of ensuring that interest rate risk is under control. The Company has achieved an appropriate mix of fixed and floating rate exposure consistent with the Company's policy.

(4) Foreign currency risk

In respect of accounts receivables and payables denominated in foreign currencies other than the functional currency of the Company, the Company ensures that its net exposure is kept to an acceptable level by buying or selling foreign currencies at spot rates when necessary to address short-term imbalances.

(5) Fair values

All financial instruments are carried at amounts not materially different from their fair values as at December 31, 2007 and 2008.

(6) Estimation of fair values

The following summarizes the major methods and assumptions used in estimating the fair values of financial assets and liabilities.

(a) Receivables

The fair value is estimated as the present value of the future cash flows, discounted at the market interest rates at the balance sheet date.

(b) Loans and other non-derivative financial liabilities

The fair value is estimated as the present value of future cash flows, discounted at the market rate of interest at the balance sheet date.

**Table of Contents**

## 36 RELATED PARTY RELATIONSHIPS AND TRANSACTIONS

(1) Information on the investors of the Company is listed as follows:

	<i>Registered place</i>	<i>Business nature</i>	<i>Shareholding percentage</i>	<i>Proportion of voting rights</i>
Sinopec	Beijing, the PRC	Oil and gas exploration, development, production and marketing, crude oil processing, oil products trading and distribution	30%	25%
SPCL	Shanghai, the PRC	Crude oil processing, petroleum products, synthetic resins and plastics products, synthetic fibre raw materials and synthetic fibres	20%	25%
BPCECIL	Wales, the UK	Investment	50%	50%

(2) The amounts of the Company's related party transactions during the year and its balances with related parties at the year end are summarized as follows:

i) The material transactions with related parties are summarized as follows:

Receiving construction services

	<i>2006 RMB 000</i>	<i>2007 RMB 000</i>	<i>2008 RMB 000 (Unaudited)</i>
Sinopec International Co., Ltd. ( Sinopec International )	3,717	896	
SPCL	58		3,051
BPCECIL			182
BP Singapore Pte Limited ( BP Singapore )			558
Jinshan Associated Trading Corporation ( JAT )	11,141		
Other fellow subsidiaries of Sinopec, SPCL	1,466	943	75,559
	16,382	1,839	79,350



**Table of Contents**Purchase of goods

	<i>2006</i> <i>RMB 000</i>	<i>2007</i> <i>RMB 000</i>	<i>2008</i> <i>RMB 000</i> <i>(Unaudited)</i>
Sinopec Shanghai Gaoqiao Branch ( Sinopec Gaoqiao Branch )	4,876,223	4,624,063	5,218,164
Sinopec Maoming Branch	832,050		
Sinopec Guangzhou Branch	210,391	202,539	140,902
Sinopec Zhenhai Branch	6,871,035	8,474,446	7,286,226
SPCL	706,459	1,031,613	885,581
Sinopec Jinling Branch		172,248	
JAT	17,223	9,702	125,196
Shanghai Jindi Petrochemical Co., Ltd ( Shanghai Jindi )	344,334	94,517	
Hangzhou Refinery China Petrochemical Corporation ( Hangzhou Refinery )		79,142	47,335
BP Singapore Pte Limited ( BP Singapore )	92,268	46,935	27,088
Other fellow subsidiaries of Sinopec, SPCL	16,282	34,205	118,330
	13,966,265	14,769,410	13,848,822

Sale of goods

	<i>2006</i> <i>RMB 000</i>	<i>2007</i> <i>RMB 000</i>	<i>2008</i> <i>RMB 000</i> <i>(Unaudited)</i>
Sinopec Assets Management Corporation Baling Petrochemical Branch			110,754
Sinopec International Industry Co., Ltd ( Sinopec International Industry )	92,360		
Sinopec International	59,352	82,151	77,078
Sinopec Gaoqiao Branch	926,397	2,327,563	2,584,691
Sinopec Sales Company Shanghai Branch ( SCS )	8,996		
SPCL	909,854	1,624,352	719,913
JAT	706,042	243,699	611,509
Zhejiang Jinyong Acrylic Co., Ltd. ( Jinyong Acrylic )	723,803	729,079	351,136
Shanghai Jinhua Industry Co., Ltd. ( Jinhua Industry )	307		
BP Singapore	50,361		
	3,477,472	5,006,844	4,455,081

**Table of Contents**Lease

	2006 RMB 000	2007 RMB 000	2008 RMB 000 (Unaudited)
SPCL	3,203	2,153	1,077

*Entrusted loans*

	2006 RMB 000	2007 RMB 000	2008 RMB 000 (Unaudited)
Sinopec	391,000		
SPCL	336,000	727,000	
BP Holdings	391,000	391,000	
BP Zhuhai	336,000	336,000	
<b>Total</b>	<b>1,454,000</b>	<b>1,454,000</b>	

ii) The balances of transactions with related parties at December 31, are set out as follows:

	Accounts receivable RMB 000	Prepayments RMB 000	2007 Accounts payable RMB 000	Advances from customers RMB 000	Other payables RMB 000
Sinopec International				2,183	4
Sinopec Zhenhai			408,244		
Sinopec Gaoqiao Branch	142,629		246,490		
SPCL	81,111		36,537		
Jingyong Acrylic	16,651				
Hangzhou Refinery			1,538		
JAT	42,769		129		
Other fellow subsidiaries of Sinopec, SPCL			1,599		93
	283,160		694,537	2,183	97

	Accounts receivable RMB 000	Prepayments RMB 000	2008 (unaudited) Accounts payable RMB 000	Advances from customers RMB 000	Other payables RMB 000
Sinopec International				352	4
Sinopec Zhenhai			102,637		
Sinopec Gaoqiao Branch	22,665	7,251			
SPCL	2,639				
Jingyong Acrylic	8,847				
JAT	30,848	11,781	120		
BP Singapore			137		
Other fellow subsidiaries of Sinopec, SPCL		29,520	39,743	4,134	1,966

64,999	48,552	142,637	4,486	1,970
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F-102

**Table of Contents**

## 37 COMMITMENTS

## (a) Capital commitments

As at December 31, the capital commitments of the Company are summarized as follows:

	<i>2007</i> <i>RMB 000</i>	<i>2008</i> <i>RMB 000</i> <i>(Unaudited)</i>
Contracted for	20,791	836,037
Authorized but not contracted for	437,413	1,010,853
<b>Total</b>	<b>458,204</b>	<b>1,846,890</b>

## (b) Operating lease commitments

As at December 31, the total future minimum lease payments under non-cancellable operating leases are payable as follows:

	<i>2007</i> <i>RMB 000</i>	<i>2008</i> <i>RMB 000</i> <i>(Unaudited)</i>
Within 1 year (inclusive)	11,156	11,292
1 and 2 years (inclusive)		4,736
2 and 3 years (inclusive)		395
<b>Total</b>	<b>11,156</b>	<b>16,423</b>

**Table of Contents**

38 SIGNIFICANT DIFFERENCES BETWEEN FINANCIAL STATEMENTS PREPARED UNDER THE CHINA ACCOUNTING STANDARDS FOR BUSINESS ENTERPRISES (2006) AND ACCOUNTING PRINCIPLES GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA

The Company's accounting policies conform with China Accounting Standards for Business Enterprises (2006), which differ in certain significant respects from accounting principles generally accepted in the United States of America ( U.S. GAAP ). Information relating to the nature of such differences is presented below.

(a) Staff and workers' bonus and welfare fund

Under China Accounting Standard for Business Enterprises (2006), staff and workers' bonus and welfare fund should be treated as profit appropriation.

Under U.S. GAAP, staff and workers' bonus and welfare fund is recognized as an expense in the income statement.

(b) Foreign currency transaction exchange gains and losses

Under China Accounting Standards for Business Enterprises (2006), foreign currency 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.

Under U.S. GAAP, such foreign currency transaction exchange gains and losses are included in current earnings.

(c) Deferred income taxes

Under China Accounting Standards for Business Enterprises (2006), under the tax effect accounting method, a deferred tax debit resulting from timing differences should be recognized and presented as a deferred tax debit only if there will be sufficient taxable income during the period of their reversal.

Under U.S. GAAP, deferred income taxes are generally recognized for all temporary differences that exist between the carrying amounts of all assets and liabilities and their respective tax bases amounts. A valuation allowance is recognized to the extent it is more likely than not a deferred tax asset will not be realized.

(d) Presentation of land use rights

Under China Accounting Standards for Business Enterprises (2006), land use rights are classified under Intangible Assets .

Under U.S. GAAP, the costs of such land use rights are considered to be prepaid expenses and are generally classified under Lease Prepayments in the balance sheet.

(e) Presentation of financing expenses

Under China Accounting Standards for Business Enterprises (2006), financing expenses and investment income are included in the calculation of Operating profit .

**Table of Contents**

Under U.S. GAAP, such financing expenses and investment income generally are excluded from Operating Profit .

(f) Presentation of cash flow statement

Under China Accounting Standards for Business Enterprises (2006), investment income received is classified as investing activities.

Under U.S. GAAP, such investment income received is classified as operating activities.

F-105

**Table of Contents**

**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.