

SINOPEC SHANGHAI PETROCHEMICAL CO LTD

Form 20-F

June 26, 2008

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**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, 2007**

**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**

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(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.**

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

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

**None**

(Title of Class)

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

**None**

(Title of Class)

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

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**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 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 file:

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

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### **CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS**

Information in this Annual Report which does not relate to historical financial information may be deemed to constitute forward-looking statements. The words or phrases may, will, expect, anticipate, plan, will likely result, estimate, project, believe, intends to or identify forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are subject to risks and uncertainties that could cause actual results to differ materially from historical results and those presently anticipated or projected in the forward-looking statements. We caution readers not to place undue reliance on any forward looking statements, which speak only as of the date made. We undertake no obligations 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 crude oil purchasing channels and methods, 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 RMB7.2946 to US\$1.00, the noon buying rate as certified for customs purposes by the Federal Reserve Bank of New York on December 31, 2007. 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 unit or, where appropriate, the throughput capacity, calculated by estimating the number of days in a year that the production unit is expected to operate, including downtime for regular maintenance, and multiplying that number by an amount equal to the unit's optimal daily output or throughput, as the case may be.

All references to tons are to metric tons.

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, 2005, 2006 and 2007 and the selected consolidated balance sheet data as of December 31, 2006 and 2007 are derived from our consolidated financial statements included in Item 18. Financial Statements. Our selected consolidated statements of income and cash flow data for the years ended December 31, 2003 and 2004 and the selected consolidated balance sheet data as of December 31, 2003, 2004 and 2005 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,				
	2003 (RMB)	2004 (RMB)	2005 (RMB)	2006 (RMB)	2007 (RMB)
<b>CONSOLIDATED STATEMENTS OF INCOME DATA</b>					
Net sales:					
Synthetic fibers	4,092,590	4,751,773	4,763,993	4,711,667	4,328,742
Resins and plastics	8,864,266	12,085,967	13,958,329	15,753,304	15,878,803
Intermediate petrochemicals	3,851,333	5,896,580	6,555,953	6,775,721	9,372,658
Petroleum products	10,329,149	13,101,919	17,954,954	19,387,666	21,036,581
All others	1,805,345	2,827,820	1,956,985	3,289,765	3,637,905
Income from operations	2,006,403	5,025,152	2,527,960	552,907	892,656
Income before income tax	1,590,365	4,696,229	2,287,594	964,200	2,151,352
Net income attributable to equity shareholders of the Company	1,401,690	3,971,103	1,850,449	844,407	1,634,080
Net income attributable to minority interests	43,610	88,065	70,845	66,555	49,056
Basic earnings per share(a)	0.20	0.55	0.26	0.12	0.23
Basic earnings per ADS(a)	19.47	55.15	25.70	11.73	22.70

- (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 2007, 2006, 2005, 2004 and 2003, respectively. Earnings per ADS is calculated on the basis that one ADS is equivalent to 100 shares.



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	Years Ended December 31,				
	2003 (RMB)	2004 (RMB)	2005 (RMB)	2006 (RMB)	2007 (RMB)
<b>CONSOLIDATED CASH FLOW DATA</b>					
Net cash flow generated from operating activities	2,276,957	4,589,711	3,943,578	1,696,615	1,441,998
Capital expenditures	1,284,868	2,205,957	1,142,927	2,008,779	2,134,123
Net proceeds from issuance of corporate bonds				2,977,800	
Proceeds from loans	7,490,040	5,214,936	9,836,199	13,939,126	17,605,887
Repayment of loans	7,619,254	6,981,696	11,393,941	15,910,127	16,166,938

	Years Ended December 31,				
	2003 (RMB)	2004 (RMB)	2005 (RMB)	2006 (RMB)	2007 (RMB)
<b>CONSOLIDATED BALANCE SHEET DATA</b>					
Property, plant and equipment, net	16,020,104	15,206,325	14,651,167	13,359,862	14,977,237
Total assets	27,101,481	28,276,601	26,810,371	27,406,060	29,853,050
Short term debt(a)	5,574,729	5,000,305	3,926,742	4,270,337	4,091,969
Long term debt (excluding current portion)	3,206,848	2,014,614	1,477,261	1,063,654	639,289
Total equity attributable to equity shareholders of the Company	15,021,886	18,416,989	18,829,987	18,976,343	20,648,038

(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\$0.0055)
July 1, 1994-December 31, 1994	RMB0.085 (US\$0.0117)
January 1, 1995-June 30, 1995	RMB0.04 (US\$0.0055)
July 1, 1995-December 31, 1995	RMB0.09 (US\$0.0123)
January 1, 1996-June 30, 1996	RMB0.04 (US\$0.0055)
July 1, 1996-December 31, 1996	RMB0.08 (US\$0.0110)
January 1, 1997-December 31, 1997	RMB0.06 (US\$0.0082)
January 1, 1998-December 31, 1998	RMB0.03 (US\$0.0041)
January 1, 1999-December 31, 1999	RMB0.05 (US\$0.0069)
January 1, 2000-December 31, 2000	RMB0.06 (US\$0.0082)
January 1, 2001-December 31, 2001	No dividend
January 1, 2002-December 31, 2002	RMB0.05 (US\$0.0069)
January 1, 2003-December 31, 2003	RMB0.08 (US\$0.0110)
January 1, 2004-December 31, 2004	RMB0.20 (US\$0.0274)
January 1, 2005-December 31, 2005	RMB0.10 (US\$0.0137)
January 1, 2006-December 31, 2006	RMB0.04 (US\$0.0055)
January 1, 2007-December 31, 2007	RMB0.09 (US\$0.0123)

See also [Item 8.A. Financial Information](#) Consolidated Statements and Other Financial Information [Dividend Policy](#).



**Table of Contents****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](#).

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
2003	8.2767	8.2771	8.2800	8.2765
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
December 2007	7.2946		7.4120	7.2946
January 2008	7.1818		7.2946	7.1818
February 2008	7.1115		7.1973	7.1100
March 2008	7.0120		7.1110	7.0105
April 2008	6.9870		7.0185	6.9840
May 2008	6.9400		7.0000	6.9377

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.**

**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. While we try to pass on crude oil cost increases with sales price increases, our ability to pass on cost increases to our customers is dependent on market conditions and government regulations. In particular, our major petroleum products such as gasoline, diesel, jet fuel, and LPG are subject to government price controls. In 2005, 2006 and 2007, approximately 58% and 53.96% and 54.06% of our net sales were from products subject to price controls. In 2007, our production costs in RMB terms increased slightly due to the fact that the price of crude oil on the international market continues to rise to record prices. The cost of crude oil accounted for 65.45% of our total cost of sales in 2007, and the average processing costs for crude oil increased by 2.26% compared to 2006. Moreover, the Chinese government controls the distribution of many petroleum products in China. Some of our petroleum products must be sold to designated customers such as the subsidiaries of China Petrochemical Corporation, and we cannot freely sell our petroleum products to take advantage of opportunities for higher prices. Therefore, in periods of high crude oil

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prices, such as now, we may not be able to fully cover increases in crude oil prices by increases in the sale prices of our petroleum products, which has had and will continue to have a material adverse effect on our financial condition, results of operations or cash flows.

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

Most of our revenues are attributable to petrochemical products, which have historically been cyclical and sensitive to the availability and price of feedstocks and general economic conditions. Markets for many of our products are sensitive to changes in industry capacity and output levels, cyclical changes in regional and global economic conditions, the price and availability of substitute products and changes in consumer demand, which from time to time have had a significant impact on product prices in the regional and global markets. Historically, the markets for these products have experienced alternating periods of tight supply, causing prices and margins to increase, followed by periods of capacity additions, possibly resulting in oversupply and declining prices and margins. As tariffs and other import restrictions are reduced and the control of product allocation and pricing is relaxed in China, the markets for many of our products have become increasingly subject to the cyclical nature of regional and global markets. Historically, international prices of crude oil have fluctuated widely due to many other factors that are beyond our control. We cannot assure you that future growth in demand for our products will be sufficient to alleviate any existing or future conditions of excess industry capacity or that such conditions will not be sustained or further aggravated by anticipated or unanticipated capacity additions or other events. In addition, we expect that the volatility and uncertainty of the prices of crude oil and petrochemical products will continue. Increasing crude oil prices and declines in prices of petrochemical products may adversely affect our business and results of operations and financial condition.

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

The petrochemical business is a capital intensive business. Our ability to maintain and increase our revenues, net income and cash flows depends upon continued capital spending. Our current business strategy contemplates capital expenditures for 2008 of approximately RMB2.5 billion (US\$342.72 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, 2008, we had aggregate outstanding indebtedness of approximately RMB4,528 million (US\$620.73 million). China Petroleum & Chemical Corporation ( Sinopec Corp ), our controlling shareholder, did not provide any guarantee or credit support for our debt for the year ended December 31, 2007 and for the three-month period ended March 31, 2008.

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.

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

Our principal market, Eastern China, which comprises 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. We believe this trend will continue and probably accelerate. Increased competition may have a material adverse effect on our financial condition and results of operations.

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

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

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

As of June 1, 2008, Sinopec Corp owned 55.56% of our shares. Accordingly, it has voting and management control over us, and its interests may be different from your interests and the interests of our other shareholders. Subject to our Articles of Association and applicable laws and regulations, Sinopec Corp will be in a position to cause us to declare dividends, determine the outcome of corporate actions requiring shareholder approval or effect corporate transactions without the approval of the holders of the H shares and ADSs. Any such increase in our dividend payout would reduce funds available for reinvestment in our business and any such actions or transactions could adversely affect us or our minority shareholders. Additionally, Sinopec Corp completed its initial public offering of shares in late 2000. As a public company, Sinopec Corp may experience changes in its own business strategy and policies. Although we are not currently aware of any such changes, they could, in turn, lead Sinopec Corp to change its policies or practices toward us in ways that we cannot predict, with corresponding unpredictable consequences for our business.

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

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

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

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

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

mandating distribution channels for our petroleum products;

setting the allocations and pricing of certain resources, 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.

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 petroleum products in both retail and wholesale markets in China. As a result of these measures, we face increased competition from foreign companies and imports. Overall, we think that China's WTO entry also creates substantial amounts of new investment and business in China, with a potential increase in sales opportunities for us. We do, however, believe that our products have been and will continue generally to be competitive with imported products in the PRC. Tariff reductions, however, could reduce our profit margins or otherwise negatively impact our revenue from certain products, including a small

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number of significant products. The PRC government may also reduce the tariffs imposed on production equipment that we may import in the future, as well as the restrictions on availability of imported raw materials (such as crude oil) currently enforced by the government. Although we believe that China's accession to the WTO may provide us with opportunities to increase our sales, we cannot be certain of its effect on our business or results of operations. In addition, we believe that major international petrochemical companies are preparing to enter the Chinese market amid industry restructuring on a global basis. Apart from posing direct competition against us in petroleum and petrochemical products, these international companies are characterized by large-scale investments across different sectors, full vertical integration and streamlined organization. We expect that domestic companies will face intense competition from their international counterparts as the China market becomes increasingly internationalized.

### **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:

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

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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 Renminbi against the US dollar has fluctuated daily. Due to the devaluation of the US dollar and other reasons, the value of the Renminbi against the US dollar increased in 2007. 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 on 31 December, 1997. 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 should be subject to the PRC Law on Tax Administration and Collection.

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 tax authorities that from 2007, our income tax rate would be adjusted from the original 15% to 33% with effect from 2007. We currently are unable to determine whether the relevant tax authorities will request payment of the difference in the income taxes for the previous years, and accordingly, we are unable to assess the outcome and the risks associated with this matter. With the implementation of the Enterprise Income Tax Law of the PRC, effective January 1, 2008, our income tax rate



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will become 25%. Our business and operating results will be affected due to the fact that we become subject to the 25% tax rate under the new law. 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.

### **Our inability to gain shareholder approval for certain 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. Our inability to complete such share reforms 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

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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.

### **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 of 2008 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, including goodwill, 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 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.

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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 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.

### 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.

**Table of Contents****B. Business Overview**

We are one of the largest petrochemical companies in China based on 2007 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 2007 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.

Our net sales by product category, as a percentage of total net sales in each of 2007, 2006 and 2005 are summarized as follows:

**Net Sales of RMB54,255 million (US\$7,437.69 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\$6,843.14 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%

**Net Sales of RMB45,190 million (US\$6,194.99 million) in 2005**

Synthetic fibers	10.54%
Resins and plastics	30.89%
Intermediate petrochemicals	14.51%
Petroleum products	39.73%
All others	4.33%
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

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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 2007, 2006 and 2005 are as follows:

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

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

**2005 Net Sales by Region (%)**

	<b>Eastern China</b>	<b>Other parts of China</b>	<b>Exports</b>
Synthetic fibers	75.86	22.47	1.67
Resins and plastics	92.53	7.46	0.01
Intermediate petrochemicals	91.95	7.80	0.25
Petroleum products	99.33	0.67	0.00
Total net sales	94.28	5.53	0.19

**Business Strategy**

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

In the near-term, our goal is to:

further streamline our production capacity by focusing on our aromatics-polyester products and by increasing our capacity to produce key intermediate products such as ethylene and propylene, and

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

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In order to support our ethylene expansion and to provide additional capacity and flexibility, we also plan to expand and renovate our oil refining capabilities. This expansion and renovation will enable us to produce additional feedstock for our ethylene expansion. By adding processing units to refine vacuum gas oil ( VGO )

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and residual oil, we should be able to produce more products such as gasoline and diesel products and certain intermediate petrochemical products which can be sold or used as feedstock for our own downstream products.

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

**Principal Products**

We produce over 60 different types of products representing a broad range of synthetic fibers, resins and plastics, intermediate petrochemicals and petroleum products. We use many of the important petroleum products and intermediate petrochemicals we produce in producing our own downstream products. The following table shows our 2007 net sales by major product as a percentage of total net sales together with the typical uses of these products.

Product	% of net sales	Typical Use
<b>SYNTHETIC FIBERS</b>		
Polyester staple fiber	1.29	Textiles and apparel
Acrylic staple fiber	4.94	Woven into fabrics or blended with other material fabrics to make fabric or acrylic top
Acrylic top	1.11	High bulk hand knitting yarn, blankets and fabrics
Others	0.64	
<b>Sub-total</b>	<b>7.98</b>	
<b>RESINS AND PLASTICS</b>		
Polyester chips	8.49	Polyester fibers, films and containers
PE pellets	10.64	Films, ground sheeting, wire and cable compound and other injection molding products such as housewares and toys
PP pellets	8.59	Extruded films or sheets, injection molded products such as housewares, toys and household electric appliance and automobile parts
PVA	1.13	PVA fibers, building coating materials and textile starch
Others	0.42	
<b>Sub-total</b>	<b>29.27</b>	
<b>INTERMEDIATE PETROCHEMICALS</b>		
Ethylene	1.30	Feedstock for Polyethylene, EG, PVC and other intermediate petrochemicals which can be further processed into resins and plastics and synthetic fiber.
Ethylene oxide	2.20	Intermediate for chemical and pharmaceutical industry, dyes, detergents and auxiliary agents
Benzene	3.88	Intermediate petrochemical products, styrene, plastics, explosives, dyes, detergents, epoxies and nylon
Butadiene	1.79	Synthetic rubber and plastics
Ethylene glycol	3.43	Fine chemicals
Others	4.68	
<b>Sub-total</b>	<b>17.28</b>	
<b>PETROLEUM PRODUCTS</b>		
Gasoline	5.23	Transportation fuels
Diesel	21.06	Agricultural fuels
Jet Fuel	5.57	Transportation fuels
Others	6.91	
<b>Sub-total</b>	<b>38.77</b>	
All others	6.70	



<b>Total</b>	100.00
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**Production Processes**

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

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Our refinery units refine crude oil into five basic components: (1) 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.

*Aromatics* Vacuum gas oil 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, acrylonitrile and polypropylene into various types of synthetic fibers.

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

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

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

*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.

**Table of Contents****Raw Materials**Crude Oil

Crude oil is our primary raw material and the most significant raw material we purchase from outside sources. In 2007, crude oil accounted for approximately 65.45% 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 2007, we did not experience any significant problems in obtaining sufficient crude oil to meet our production needs.

Sinopec Group is responsible for preparing an annual plan on demand and supply for crude oil and petroleum products that forms the basis of the Chinese government's annual balancing plan which effectively dictates how much crude oil we will receive each year. Likewise, under the balancing plan, some of our petroleum products are designated for sale to the subsidiaries of Sinopec Group or other designated customers and we must consult Sinopec Group to sell elsewhere. Therefore, we cannot freely sell our petroleum products to take advantage of any opportunities for higher-priced sales.

We have received confirmation from Sinopec Corp that we will receive an allocation of 0.25 million tons of domestic offshore crude oil and 9.95 million tons of foreign crude oil in 2008. 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 2008 allocation of crude oil. We believe that the mix of crude oil feedstocks currently available is satisfactory for our 2008 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 2008 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 2008 production capacity and goals.

In 2007, our crude oil was sourced as follows:

Domestic offshore crude oil	3.33%
Foreign crude oil	96.67%
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 to our oil terminal wharf. See Item 4.D. Property, Plants and Equipment - Wharfs.

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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 2007 was RMB3,871 (US\$530.67) per ton and RMB3,721 (US\$510.10) per ton, respectively. In 2007, we processed 8.636 million tons of foreign crude oil and 302,700 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 has undertaken that it will allocate crude oil to us in quantities and at prices no less favorable than the quantities received and prices paid by other enterprises that it controls. On this basis, we believe that changes in crude oil prices should not have a material effect on our competitiveness with other domestic producers. Nevertheless, any increase in the price of crude oil could have an adverse impact on our profitability to the extent that we are unable to pass cost increases on to our customers.

## Coal

Unlike crude oil, coal is not subject to government allocation. We purchase coal directly from the Datong mines in Shanxi Province. Coal is transported by rail from the mines to Qinhuangdao port and shipped by barge to Jinshanwei where it is delivered to the plant via a wharf and conveyer system. 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 2008 will be approximately 2.04 million tons. In 2007, we consumed approximately 1.73 million tons of coal, an increase from 2006 of approximately 0.13 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 2007, the total cost of these materials accounted for approximately 19.05% of our total cost of sales. We do not

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expect any difficulties in obtaining a supply of any of these ancillary raw materials in amounts sufficient to meet our needs in the foreseeable future.

## **Sales and Marketing**

### Distribution

The distribution of our petroleum products is subject to government regulations. We are required to sell certain petroleum 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 2007 that were subject to unified distribution by the government, sales by agents and sales based on our own discretion accounted for 52.12%, 34.57% and 13.31%, 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 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 2007. We generally do not experience seasonal fluctuations in product sales.

### Product breakdown

*Synthetic Fibers* In 2007, 16.05% 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 11.93% of our sales of synthetic fibers in 2007.

*Resins and Plastics* In 2007, approximately 4.45% of our resins and plastics sales were to provincial and municipal government trading companies and approximately 55.22% were sold to industrial users. No single customer accounted for more than 3.43% of our sales of resins and plastics in 2007.

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

Shanghai Chlor-Alkali Chemical Co. Ltd. (Chlor-Alkali) is the principal outside consumer of our ethylene. In 2007, we sold 8.20 tons of ethylene, representing 9.43% of our total 2007 production of such product, to Chlor-Alkali at prices mutually agreed upon by both parties. We expect to sell 8 tons of ethylene to Chlor-Alkali in 2008.

*Petroleum Products* In 2007, 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.

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### **Product Pricing**

Most of our products other than petroleum products are permitted to be sold at market prices. However, three types of petroleum products, gasoline, diesel and jet fuel, and certain other major products 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 2005, 2006 and 2007, approximately 58%, 53.96% and 54.06% 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. We believe that the Chinese government will continue relaxing state control over the pricing of petroleum products over time.

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 99.64% of our products were sold in 2007. 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 2007, 91.99% 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 this geographic advantage will be enhanced as China's accession into the WTO generates increasing demands for our products in Eastern China.

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

### **The Domestic Competitive Environment**

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

### **Foreign Competition and the World Trade Organization**

China joined the WTO on December 11, 2001. As part of its membership commitments, China agreed to eliminate certain tariff and non-tariff barriers to foreign competition in the domestic petrochemical industry that

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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 or plans to make 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. 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 state owned trading. 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.

## **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 2007, we had an approximate 1.56% share and imports had an approximate 3.69% share of total domestic polyester, acrylic and polypropylene consumption. We attribute the high level of imports to a variety of factors, including a shortage in the domestic supply and the importation of synthetic fibers into special economic zones in China, where tariffs are not imposed on imports processed for re-export.



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The following table summarizes the competitive position of our principal synthetic fibers according to domestic sales in 2007.

Product	Our share of domestic consumption (%)	Our competitive ranking	Location of principal domestic competitor	Principal domestic competitor's share of consumption (%)	Imports share of consumption (%)
Polyester staple fiber	1.04	15	Jiangsu	8.5	2.96
Acrylic	19.90	1	Jilin	12.09	25.52

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

**Resins and Plastics**

In 2007, we had an approximate 4.85% share and imports had an approximate 25.84% 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 2007.

Product	Our share of domestic consumption (%)	Our competitive ranking	Location of principal domestic competitor	Principal Domestic competitor's Share of consumption (%)	Imports share of consumption (%)
Polyester chips	5.48	12	Jiangsu	10.50	3.09
PE	4.75	2	Beijing	8.62	40.57
PP	4.39	2	Nanjing	6.69	30.60

Sources: Statistics provided to us by Sinopec Group.

**Intermediate Petrochemicals**

In 2007, we were one of the largest sellers of intermediate petrochemicals in China and held an approximate 5.06% share of the total domestic consumption. Imports had an approximate 31.41% share of domestic consumption. Ethylene, benzene and butadiene are our major intermediate petrochemical products. In 2007, 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 2007.

Product	Our share of domestic consumption (%)	Our competitive ranking	Location of principal domestic competitor	Principal Domestic competitor's Share of consumption (%)	Imports share of consumption (%)
Ethylene glycol	6.22	1	Jiangsu	3.51	76.33

**Petroleum Products**

In 2007, we had an approximate 2.09% share of the total domestic petroleum products market while imports had an approximate 5.17% 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.

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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 2007, we sold approximately 98.68% of our petroleum products in Eastern China.

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### **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.

In 2007, Secco achieved a total sales revenue of RMB24.219 billion, representing a year-on-year growth of 11.14% from its sales revenue of RMB21.791 billion in the preceding year. Secco's total profit in 2007 was RMB2.959 billion, rising by 8.55% from the profit of RMB2.726 billion in the preceding year. In 2007, the market price of crude oil overall showed a trend of continuing increase. The average price of the raw materials used by Secco increased by 12.40% in 2007 from that in 2006. 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, allowing it to retain its profit rate in 2007, and even achieving slight growth.

### **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 2007, we were assessed a total of RMB36.92 million (US\$5.06 million) in fees for discharges of waste substances. As of June 1, 2008, 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, 2007, was approximately RMB23.2 billion (US\$3.18 billion) on our property and facilities and approximately RMB1.8 billion (US\$0.25 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 1970s, the Chinese government organized petroleum refining and

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petrochemical production and processing facilities into large complexes that would permit integrated production of petroleum products, intermediate petrochemicals, resins and plastics, and synthetic fibers.

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

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

As part of this restructuring, Sinopec was also restructured in July 1998. The succeeding entity, Sinopec Group, was authorized to conduct a petrochemical business and to control the exploration of crude oil and natural gas and crude oil refining, mainly in the southern and eastern regions of China. China Petroleum and Natural Gas Corporation, another major state-owned petrochemical company, was also restructured, 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

**Table of Contents****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 2007, 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.

Name of company	Particulars of issued capital (millions)	Type of legal entity	Percentage of equity held by Sinopec Group (%)	Percentage of equity held by Sinopec Group's subsidiary (%)	Principal activities
China Petrochemical International Company Limited	RMB1,663	Limited company	100.00		Trading of petrochemical products
Sinopec Sales Company Limited	RMB1,700	Limited company	100.00		Marketing and distribution of refined petroleum products
Sinopec Yangzi Petrochemical Company Limited	RMB16,337	Limited company	100.00		Manufacturing of intermediate petrochemical products and petroleum products
Sinopec Zhongyuan Petroleum Company Limited	RMB875	Limited company	100.00		Exploration and production of crude oil and natural gas
Sinopec Shengli Oil Field Dynamic Company Limited	RMB364	Limited company	100.00		Exploration and production of crude oil and distribution of petrochemical products
Sinopec Fujian Petrochemical Company Limited	RMB2,253	Limited company	50.00		Manufacturing of plastics, intermediate petrochemical products and petroleum products
Sinopec Shanghai Petrochemical Company Limited	RMB7,200	Limited company	55.56		Manufacturing of synthetic fibers, resin and plastics, intermediate petrochemical products and petroleum products
Sinopec Kantons Holdings Limited	HK\$104	Limited company		72.34	Trading of crude oil and petroleum products

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Name of company	Particulars of issued capital (millions)	Type of legal entity	Percentage of equity held by Sinopec Group (%)	Percentage of equity held by Sinopec Group's subsidiary (%)	Principal activities
Sinopec Wuhan Petroleum Group Company Limited	RMB147	Limited company	46.25		Marketing and distribution of refined petroleum products
Sinopec Yizheng Chemical Fiber Company Limited	RMB4,000	Limited company	42.00		Production and sale of polyester chips and polyester fibers
Sinopec Zhongyuan Petrochemical Company Limited	RMB2,400	Limited company	93.51		Manufacturing of chemical products
Sinopec Shell (Jiangsu) Petroleum Marketing Company Limited	RMB 830	Limited company	60.00		Marketing and distribution of refined petroleum products
BP Sinopec (Zhejiang) Petroleum Company Limited	RMB800	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	RMB223	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

**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.

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The following table sets forth the Rated Capacities and weighted average utilization rates of our principal production units for petroleum products and intermediate petrochemicals in 2007:

<b>Production Unit (number of units)</b>	<b>Rated Capacity (tons)</b>	<b>Utilization Rate (%)</b>
Crude oil distillation units <sup>(2)</sup>	14,000,000	58.84
Hydrocracker <sup>(2)</sup>	3,000,000	72.15
Ethylene units <sup>(2)</sup>	850,000	103.39
Aromatics unit	235,000	96.19
PTA unit	400,000	96.86
EO/EG unit <sup>(2)</sup>	525,000	83.73
Acrylonitrile unit	130,000	105.58
Acetaldehyde unit	42,000	68.92
Acetic acid unit	45,000	61.42
Cracking and catalyzing	1,000,000	93.02
Delayed Coking <sup>(2)</sup>	1,000,000	101.23

Our two crude oil distillation units were designed and built in China. In 2007, the actual amount of crude oil we processed was approximately 8.94 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 2007:

<b>Production Unit (number of units)</b>	<b>Rated Capacity (tons)</b>	<b>Utilization Rate (%)</b>
Polyester units <sup>(3)</sup>	550,000	100.19
Polyester staple units <sup>(2)</sup>	154,000	72.85
Polyester filament units <sup>(3)</sup>	45,000	38.41
Acrylic staple fiber units <sup>(4)</sup>	191,000	111.11
Acrylic top units <sup>(2)</sup>	32,000	111.05
PE units <sup>(3)</sup>	408,000	102.60
PE film blowing facilities <sup>(2)</sup>	32,000	0.00
PP units <sup>(3)</sup>	400,000	101.38
PP staple fiber unit	17,000	0.00
PVA unit	86,000	106.73

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.





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### **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 sufficient for all of 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 conduct a regular maintenance program on all production equipment. Maintenance is performed by Sinopec Group, as the successor to Sinopec, under a services agreement we entered into with Sinopec in March 1998. In addition, we employ approximately 2,632 engineers, technicians and other personnel who are employed by the various production units to perform day-to-day maintenance and repair.

### **Transportation-Related Fixtures**

Crude oil, our principal raw material, is transported by oil tanker to an oil terminal wharf. Our products leave the factory by water, rail, road and pipeline. In 2007, approximately 76.48% 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 2007, products representing 22.69% 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 2007, products representing 23.15% of total sales volume were shipped from these facilities. We believe that we have a competitive advantage because a greater proportion of our products are shipped by water as opposed to rail and truck, which is subject to capacity constraints on China's rail and highway networks. Additionally, we own facilities for receiving crude oil and coal at docks that we own and transporting such materials by pipeline or conveyor to our production facilities.

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 2007, products representing 3.90% 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.

**Table of Contents****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 RMB2.5 billion in 2008. This amount will be funded internally and by bank loans.

<b>Name of Project</b>	<b>Rated Capacity (tons/year)</b>	<b>Start Date</b>	<b>Expected Completion Date</b>	<b>Status</b>
<b>Refining Capacity Expansion</b>				
3.3 million tons of diesel oil plus hydrogen refining device	3,300,000	2005	2007	Completed
1.2 million tons of delayed coking unit	1,200,000	2006	2007	Completed
Refinery Reconstruction Project	16,000,000	2009	2011	Feasibility Study
<b>Expansion of New and Existing Downstream Production Facilities</b>				
380,000-ton EG Unit	380,000	2005	2007	Completed
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	2009	2011	Feasibility Study
<b>Other Projects</b>				
No. 3 and No. 4 Flue Gas Desulphurization ( FGD )	N/A	2008	2009	Basic Design
Expansion of No. 6 Power Generation Unit	N/A	2006	2007	Completed
Upgrade of No. 2 ethylene unit SRT-III cracking furnace	N/A	2007	2007	Completed

N/A not applicable.

In 2005, 2006 and 2007, we invested RMB1.143 billion, RMB2.009 billion, and RMB2.134 billion, respectively, in capital expansion projects.

**Refining Capacity Expansion Plans**

To accommodate the adjustment in our product mixes, to process the heavy and low-quality of crude oil we purchase in order to control our cost, and to enhance the quality of operations of oil refining facilities, we have constructed a set of diesel oil plus hydrogen refining devices with Rated Capacity of 3.3 million tons per year and a set of 1.2 million tons of delayed coking unit. The construction of the diesel oil plus hydrogen refining devices commenced in 2005 and was completed and delivered to operation in 2007.

Upon completion of the project, the quality of the diesel oil we produce can reach Europe III discharge standards, and is expected to reach Europe IV discharge standards after further renovation.

The construction of the delayed coking unit commenced in December 2006 and was completed in November 2007.

Currently preparation for a refinery reconstruction project, which will enhance crude oil reprocessing capacity, is under development. The feasibility study report pertaining to the refinery reconstruction project is being prepared and technical preparations with respect thereto are being undertaken. The project will commence construction in 2009 and be completed in 2011 pending examination and approval.

**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.



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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 be completed in April 2009.

To meet the demands of national social and economic development and to upgrade out-of-date devices and realize production economies of scale, we are proposing 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. The unit began pile foundation construction in February 2008, civil construction in June 2008 and is expected to be completed in the second quarter of 2009. The No. 1 ethylene unit reconstruction is undergoing a process of examination by the state, while 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 2009 and be completed in 2011.

## 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 boiler. To satisfy our further development and safeguard the balance of steam and power, we plan to expand the No. 6 power generation unit and construct a new 620-ton steam/hour boiler with one set of ancillary high temperature and high pressure double extraction steam power generation unit with the capacity of 100 megawatt, which unit has completed in 2007 and joined in grid interconnection by the end of the same year. The reconstruction of the No. 2 ethylene unit SRT-III cracking furnace implemented to reduce the energy consumption index has been finished during the period when such unit was halted for examination and repair in 2007.

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

Not applicable.

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

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

##### **General**

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

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.

##### **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 2007. 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 IAS 36 Impairment of Assets. We review the carrying amounts of long-lived assets periodically in order to assess whether the recoverable amounts have declined below the carrying amounts. We test these assets for impairment whenever events or changes in circumstances indicate that their recorded carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to the 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 and cash generating units are not readily available. In determining the value in use, we discount cash flows that we expect the asset to generate 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.

For the year ended December 31, 2007, RMB200 million in impairment losses for long-lived assets of synthetic fiber segment (2006: RMB50 million; 2005: nil) were recognized in our consolidated statements of income under IFRS.

**Table of Contents****Depreciation**

Property, plant and equipment are depreciated on a straight-line basis over the estimated useful lives of the assets, after taking into account their estimated residual value. We review the estimated useful lives of the assets regularly in order to determine the amount of depreciation expense to be recorded during any reporting period. The useful lives are based on our historical experience with similar assets and taking into account anticipated technological changes. The depreciation expense for future periods is adjusted if there are significant changes from previous estimates. There have been no significant changes to the original estimates of useful lives or residual values in 2005, 2006 and 2007.

**Impairment for bad and doubtful debts**

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

The following table summarizes the changes in allowances for doubtful debts for the years ended December 31, 2005, 2006 and 2007:

	<b>Years ended December 31,</b>		
	<b>2005</b>	<b>2006</b>	<b>2007</b>
As of January 1,	45,282	25,845	30,911
Provision for the year	13,683	8,513	3,687
Written-off	(33,120)	(3,447)	(10,007)
December 31,	25,845	30,911	24,591

**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.

	<b>Years ended December 31,</b>		
	<b>2005</b>	<b>2006</b>	<b>2007</b>
Balance as of January 1	56,670	50,070	41,355
Allowance for the year	1,636	33,407	35,753
Written-off	(8,236)	(42,122)	(3,316)
Balance as of December 31	50,070	41,355	73,792

**Income tax**

As discussed in note 26(b) to the financial statements regarding the prior years' tax privilege, the directors of the Company consider that it is uncertain whether the relevant tax authorities will retrospectively claim additional enterprise income tax (EIT) from the Company and that it is not possible to reliably estimate the eventual outcome of this matter. Consequently, no provision has been made in these financial statements in respect of the EIT differences arising from prior years.

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

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

	2005			Years ended December 31, 2006			2007		
	Sales Volume ( '000 Tons)	Net Sales (Millions of RMB)	% of Total	Sales Volume ( '000 Tons)	Net Sales (Millions of RMB)	% of Total	Sales Volume ( '000 Tons)	Net Sales (Millions of RMB)	% of Total
Synthetic Fibers	355.2	4,764.0	10.6	337.0	4,711.7	9.4	296.0	4,328.7	7.9
Resins and Plastics	1,505.8	13,958.3	30.9	1,558.9	15,753.3	31.6	1,549.0	15,878.8	29.3
Intermediate Petrochemicals	1,010.5	6,556.0	14.5	1,009.3	6,775.7	13.6	1,232.4	9,372.7	17.3
Petroleum Products	5,400.0	17,955.0	39.7	5,109.8	19,387.6	38.8	5,376.2	21,036.6	38.8
All others		1,957.0	4.3		3,289.8	6.6		3,637.9	6.7
Total	8,271.5	45,190.3	100.0	8,015.0	49,918.1	100.0	8,453.6	54,254.7	100.0

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The following table sets forth a summary statement of income (1) for the periods indicated:

	Years ended December 31,					
	2005		2006		2007	
	Millions of RMB	% of Net sales	Millions of RMB	% of Net sales	Millions of RMB	% of Net sales
<b>Synthetic fibers</b>						
Net sales	4,764.0	10.6	4,711.7	9.4	4,328.7	7.9
Operating expenses	(4,500.6)	(10.0)	(4,515.4)	(9.0)	(4,410.8)	(8.1)
Operating profit	263.4	0.6	196.3	0.4	(82.1)	(0.2)
<b>Resins and Plastics</b>						
Net sales	13,958.3	30.9	15,753.3	31.6	15,878.8	29.3
Operating expenses	(12,467.6)	(27.6)	(14,591.2)	(29.3)	(15,222.3)	(28.1)
Operating profit	1,490.7	3.3	1,162.1	2.3	656.5	1.2
<b>Intermediate Petrochemicals</b>						
Net sales	6,556.0	14.5	6,775.7	13.6	9,372.7	17.3
Operating expenses	(5,575.0)	(12.3)	(6,095.3)	(12.2)	(8,558.9)	(15.8)
Operating profit	981.0	2.2	680.4	1.4	813.8	1.5
<b>Petroleum products</b>						
Net sales	17,955.0	39.7	19,387.6	38.8	21,036.6	38.8
Other income	632.8	1.4	282.1	0.6	93.9	0.2
Operating expenses	(19,034.7)	(42.1)	(21,367.4)	(42.8)	(21,774.7)	(40.2)
Operating profit	(446.9)	(1.0)	(1,697.7)	(3.4)	(644.2)	(1.2)
<b>All Others</b>						
Net sales	1,957.0	4.3	3,289.8	6.6	3,637.9	6.7
Operating expenses	(1,717.2)	(3.8)	(3,078.0)	(6.2)	(3,489.2)	(6.4)
Operating profit	239.8	0.5	211.8	0.4	148.7	0.3
<b>Total</b>						
Net sales	45,190.3	100.0	49,918.1	100.0	54,254.7	100.0
Other income	632.8	1.4	282.1	0.6	93.9	0.2
Operating expenses	(43,295.1)	(95.8)	(49,647.3)	(99.5)	(53,455.9)	(98.6)
Operating profit	2,528.0	5.6	552.9	1.1	892.7	1.6
Net financing costs	(179.4)	(0.4)	(165.4)	(0.3)	(177.9)	(0.3)
Investment income					770.7	1.5
Share of (losses)/profits of associates and jointly controlled entities	(61.0)	(0.1)	576.7	1.1	665.9	1.2
Profit before tax	2,287.6	5.1	964.2	1.9	2,151.4	4.0
Income tax	(366.3)	(0.8)	(53.2)	(0.1)	(468.3)	(0.9)
Profit after tax	1,921.3	4.3	911.0	1.8	1,683.1	3.1



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Attributable to:						
Equity shareholders of the Company	1,850.5	4.1	844.4	1.7	1,634.1	3.0
Minority interests	70.8	0.2	66.6	0.1	49.0	0.1
Profit after tax	1,921.3	4.3	911.0	1.8	1,683.1	3.1

- (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.

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**Table of Contents****Results of Operations**

Year ended December 31, 2007 compared with year ended December 31, 2006.

**Net sales**

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.

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.

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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 unfilled 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**

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.

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### *(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.

### *(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 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

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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.

### **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 RMB 200.3 million in 2007.

### **Income from operations**

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.

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

In 2007, share of 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 equity in Secco's profit for 2006 was RMB545.2 million compared to the Company's equity 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.](#)

### **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.

### **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.

Effective from January 1, 1993, the Company began to enjoy a preferential income tax rate of 15% under the approval of the State's tax authorities. According to the relevant taxation regulations issued by the Ministry of Finance and the State Administration of Taxation, the first nine H-Share listed companies (including the Company) were permitted to pay income tax at a 15% tax rate for the years of 1996 and 1997. From 1998 to 2006, this tax privilege was not expressly revoked by the relevant government authorities although there is some uncertainty as to the tax rate applicable to us for this period. In 2007, the Company was notified by the Shanghai tax authorities that the income tax rate for 2007 would be adjusted from the previous 15% to 33%. Consequently the Company accrued taxation in 2007 at a 33% rate. Following the implementation of the Enterprise Income

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Tax Law of The People's Republic of China, since January 1, 2008 our income tax rate will be 25%. See Item 3.D. Risk Factors Changes in PRC tax laws may affect our business and operating results.

### **Net Income**

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

Year ended 31 December 2006 compared with year ended 31 December 2005.

### **Net sales**

Total net sales increased by 10.46% to RMB49,918.1 million in 2006 as compared with RMB45,190.3 million in 2005. In 2006, demand for petrochemical products remained strong, driving product prices to rise continuously. However, the rise has since then slowed down remarkably. The weighted average prices of synthetic fibres, resins and plastics, intermediate petrochemicals and petroleum products for 2006 increased to varying degrees as compared to 2005.

#### *(i) Synthetic fibres*

Net sales of synthetic fibre products decreased by 1.10% to RMB4,711.7 million in 2006 as compared with RMB4,764.0 million in 2005. Although the weighted average price of synthetic fibres increased by 4.26%, 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 5.14% as compared to 2005 because the sales volume of certain major synthetic fibre products, except industrial fibre and acrylic top, decreased by varying degrees.

Net sales of synthetic fibre products accounted for 9.44% of our total net sales in 2006, a decrease of 1.10 percentage points as compared to 2005.

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

Net sales of resins and plastics increased by 12.86% to RMB15,753.3 million in 2006 as compared with RMB13,958.3 million in 2005. Weighted average price of resins and plastics increased by 9.02% as compared to 2005 and sales volume increased by 3.52% as compared to 2005. Among our resins and plastics products for 2006, sales volume of polyester pellet, polyethylene and polypropylene increased by 7.10%, 5.04% and 1.66%, respectively, while the our average sales prices had increased by 4.12%, 11.49% and 9.85%, respectively.

Net sales of resins and plastics accounted for 31.56% of our total net sales in 2006, an increase of 0.67 percentage point as compared to 2005.

#### *(iii) Intermediate petrochemicals*

Net sales of intermediate petrochemicals increased by 3.35% to RMB6,775.7 million in 2006 as compared with RMB6,556.0 million in 2005, with weighted average price of intermediate petrochemicals increasing by 3.47% and sales volume decreasing by 0.11% as compared to 2005. Among our intermediate petrochemical products, the weighted average prices of our major products such as ethylene and butadiene increased by 15.09% and 7.40%, respectively, while the weighted average prices of pure benzene, ethylene glycol and ethylene oxide decreased by 6.87%, 7.62% and 11.86% respectively. The sales volumes of ethylene, butadiene, ethylene glycol and ethylene oxide decreased by 4.55%, 1.40%, 81.71% and 12.65%, respectively, except for pure benzene of which the sales volume increased.

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Net sales of intermediate petrochemicals accounted for 13.57% of our total net sales in 2006, a decrease of 0.93 percentage point as compared to 2005.

### *(iv) Petroleum products*

Net sales of petroleum products increased by 7.98% to RMB19,387.6 million in 2006 as compared with RMB17,955.0 million in 2005, with an increase of 14.11% in the weighted average price as compared to 2005. The weighted average prices of gasoline, diesel oil and jet fuel increased by 18.01%, 10.98% and 22.13%, respectively, but we reduced our sales volumes by 7.95%, 12.60% and 15.68%, respectively, 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.

Net sales of petroleum products accounted for 38.84% of our total net sales in 2006, a decrease of 0.89 percentage point as compared to 2005.

We received a cash government grant of RMB282 million (2005: RMB633 million; 2004: nil) from the Ministry of Finance of the PRC as a compensation for loss incurred due to the distortion of the correlation of domestic refined petroleum product prices and crude oil prices in 2006. There are no unfilled conditions or other contingencies attached to the receipt or usage of this government grant. However, there is no assurance that we will continue to receive such grant in the future.

### *(v) Other activities*

Revenues for other activities increased by 68.10% to RMB3,289.8 million in 2006 as compared with RMB1,957.0 million in 2005. Such increases in revenue were mainly attributed to increases in trading volume of our petrochemical products.

## **Operating Expenses**

Our operating expenses comprise of cost of sales, selling and administrative expenses, other operating expenses and other operating income. Such operating expenses increased by 14.67% to RMB49,647.3 million in 2006 as compared with RMB43,295.1 million in 2005, mainly due to increase in international crude oil prices. The operating expenses of synthetic fibres, resins and plastics, intermediate petrochemicals, petroleum products, and other activities amounted to RMB4,515.4 million, RMB14,591.2 million, RMB6,095.3 million, RMB21,367.4 million and RMB3,078.0 million, respectively, representing increases of 0.32%, 17.03%, 9.35%, 12.25% and 79.24%, respectively as compared to 2005.

### *(i) Synthetic fibres*

Operating expenses of synthetic fibres increased by RMB14.8 million as compared to 2005, mainly due to an increase in raw material prices for synthetic fibres.

### *(ii) Resins and plastics*

Operating expenses of resins and plastics increased by RMB2,123.6 million as compared to 2005, mainly due to increased costs for raw materials such as ethylene and propylene. Moreover, sales volume of polyester chips increased by more than 30,000 tons or 7.10% as compared to 2005, which also contributed to the increase in cost of sales and selling expenses of resins and plastics.

### *(iii) Intermediate petrochemicals*

Operating expenses of intermediate petrochemicals increased by RMB520.3 million as compared to 2005, due to increased costs for raw materials such as naphtha.

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### *(iv) Petroleum products*

Operating expenses of petroleum products increased by RMB2,332.7 million as compared to 2005, mainly due to the continuous increase in crude oil price (which is a major production raw material for us), which has directly led to a significant increase in cost of sales and selling expenses of petroleum products.

### *(v) Other activities*

Operating expenses of other activities increased by RMB1,360.8 million as compared to 2005, which was attributable to increased purchasing costs as a result of increased business volume.

## **Cost of sales**

Cost of sales increased by 14.68% to RMB49,182.2 million in 2006, as compared with RMB42,887.7 million in 2005. Cost of sales accounted for 98.53% of the net sales for 2006 and 94.90% for 2005, primarily due to the significant increase in 2006 in crude oil price which is our major raw material. The gross margin decreased from 6.39% in 2005 to 2.01% in 2006 because the average increase in selling price of its products lagged behind the continued rising cost of crude oil.

### *(i) Crude Oil*

In 2006, we processed 8,920,300 tons of crude oil (of which 110,000 tons were processed on a sub-contracting basis), a decrease of 572,700 tons as compared with 9,493,000 tons in 2005 (274,000 tons of sub-contracting processing in 2005). The volumes of imported oil and offshore oil we processed were 8,572,000 tons and 348,300 tons, respectively.

The total cost of crude oil we processed in 2006 amounted to RMB33,307.6 million, an increase of 12.62% as compared with RMB29,576.4 million in 2005 and accounting for 67.72% of the cost of sales. Our weighted average cost of crude oil was RMB3,780.56 per ton, representing an increase of 17.84% as compared to 2005. The weighted average cost of imported oil and offshore oil was RMB3,787 per ton and RMB3,636 per ton, respectively.

### *(ii) Other expenses*

Expenses for other ancillary materials were RMB7,901.8 million in 2006, an increase of 13.63% as compared with RMB6,954.0 million in 2005, primarily due to a significant increase in the purchasing costs of intermediate petrochemicals such as liquified petroleum gas and propylene during 2006. Depreciation expenses increased from RMB1,714.4 million in 2005 to RMB1,848.5 million in 2006. Energy and power costs increased to RMB974.8 million due to increases in coal prices and electricity tariffs in 2006. Compared to the same period of 2005, labor costs increased to RMB1,210.3 million during 2006, while maintenance costs decreased to RMB874.5 million.

## **Selling and administrative expenses**

Selling and administrative expenses amounted to RMB522.0 million, representing an increase of 17.46% as compared with RMB444.4 million in the same period of the previous year due to the increase in our income from principal operations and our increase in marketing efforts during 2006.

## **Other operating income**

Other operating income mainly includes income from unlisted investments, rental income from investment properties and gain on disposal of fixed asset. Other operating income was RMB297.4 million in 2006, an increase of 24.64% as compared with RMB238.6 million in 2005, mainly due to the increase in income from fixed asset disposals and rental income from investment properties during 2006.



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### **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 19.35% from RMB201.5 million in 2005 to RMB240.5 million in 2006, primarily due to the increase in expenses on net losses from fixed asset disposals and the provision made for impairments of fixed assets during 2006.

### **Income from operations**

Operating profit was RMB552.9 million, representing a significant decrease of 78.13% as compared with RMB2,528.0 million in 2005 primarily due to a significant increase in our production cost as a result of the rising crude oil price during 2006 while our petroleum product prices were subject to the State's control and were significantly below international prices.

#### *(i) Synthetic fibres*

Operating profit of synthetic fibres decreased by RMB67.1 million in 2006 as compared with 2005, mainly due to decrease of the sales volume of synthetic fibres by 5.14% in 2006 as compared with 2005.

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

Operating profit of resins and plastics decreased by RMB328.6 million in 2006 as compared to 2005, mainly due to increases in the cost of ethylene and propylene and other raw materials, which outweighed the price increase in resins and plastics.

#### *(iii) Intermediate petrochemicals*

Operating profit of intermediate petrochemicals decreased by RMB300.6 million in 2006 as compared to 2005, mainly due to increased costs for raw material, including naphtha.

#### *(iv) Petroleum products*

Petroleum products suffered operating loss, as the increase in average selling price of petroleum products was insufficient to offset the increase in average crude oil prices.

#### *(v) Other activities*

Operating profit of other activities decreased by RMB28.0 million in 2006 as compared with 2005.

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

In 2006, share of profits of associates and jointly controlled entities was RMB576.7 million, representing an increase of RMB637.7 million against a loss of RMB61.0 million recorded in 2005, primarily due to the growth achieved by the 20% held investee, Secco. The Company's equity in Secco's loss for 2005 was RMB71.5 million compared to the Company's equity in Secco's net profit of RMB545 million.

### **Net financing costs**

Our net financing costs were RMB165.4 million in 2006, a decrease of 7.80% as compared with RMB179.4 million in 2005, which was primarily due to a foreign currency exchange gain of RMB81.2 million recognized during 2006 as a result of the appreciation of RMB, thereby lowering our financing costs.

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

Our income tax decreased to RMB53.2 million in 2006 as compared with RMB366.3 million in 2005. Such decrease was primarily due to a substantial decrease in total pre-tax profit. Our effective tax rate was 5.5% in 2006 compared to 16.0% in 2005. The decrease in our effective tax rate is primarily due to our equity in earnings of Secco (whose results improved substantially over last year), which are not subject to income taxes. We continued to pay income tax at a preferential rate of 15% in 2006.

**Net Income**

Net income was RMB911.0 million in 2006, a significant decrease of 52.59% as compared with RMB1,921.3 million in 2005.

**B. Liquidity and Capital Resources.**

Our primary sources of liquidity historically have been from cash generated from operations and loans from unaffiliated banks. We believe, based on our credit history, that short-term credit from banks is readily available to us. Our primary uses of liquidity are for working capital, operating expenses, capital expenditures and repayment of loans. We believe our sources of liquidity are sufficient for our present requirements.

*Cash flows provided from operating activities*

Our net cash inflows provided by operating activities amounted to RMB1,442.0 million in 2007, a decrease of RMB254.6 million as compared with RMB1,696.6 million in 2006. Because the increase in the costs of our crude oil which was slightly below the increase in the sales prices of various major products during the reporting period, net cash inflows from profit before tax (net of depreciation) amounted to RMB3,853.7 million in 2007, representing an increase of RMB1,065.8 million of net cash flows as compared with RMB2,787.9 million in 2006. Increased inventory balances at the end of the year due to the increasing cost of crude oil, led to a net cash outflows of RMB1,034.6 million in 2007 (as compared with a net cash outflows of RMB48.3 million during the same period of the previous year). Changes in the year-end amounts of operating payables, other payables and bills payable led to a decrease in cash outflows of RMB643.3 million in 2007 (as compared with a decrease in cash outflows of RMB345.6 million during the same period of the previous year). Increases in the year-end balances of debtors, bills receivables and deposits led to a decrease in operating cash inflows of RMB387.7 million in 2007 (as compared with a decrease in cash inflows of RMB585.3 million during the same period of the previous year as a result of an increase in such year-end balances). The increase of payables and receivables was due to the slow payment of the Company's customers and the Company postponed the settlement of the payables to suppliers. In addition, our income tax payment increased significantly due to a significant increase in profit during the reporting period. In 2007, income tax payment led to a cash outflow of RMB674.5 million (as compared with RMB63.4 million cash outflow in 2006).

*Net cash used in investing activities*

Net cash outflow for investing activities decreased from RMB1,352.5 million in 2006 to RMB511.2 million in 2007, mainly representing an increase in investment income received and proceeds from disposal of investments.

*Cash flows used in financing activities*

Net cash outflow used in financing activities increased from RMB794.2 million in 2006 to RMB930.1 million in 2007, mainly representing an increase in the amount of redemption of corporate bonds.

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### *Borrowings*

Our total borrowings in 2007 amounted to RMB4,731.3 million, representing a decrease of RMB602.7 million, of which short-term bank loans decreased by RMB180.7 million and long-term bank loans expiring within one year increased by RMB2.4 million. On the other hand, we issued RMB2 billion short-term commercial papers to institutional investors within the PRC inter-bank debenture market in December 2006. The short-term commercial papers matured on December 11, 2007 and were fully redeemed. Short-term borrowings and loans were primarily used to meet our needs of working capital. Short-term bank loans carried floating interest rates denominated in Renminbi and short-term commercial papers carried an interest rate of 3.83%. As of December 31, 2007, our long-term bank loans totaled an amount of RMB639.3 million, a decrease of RMB424.4 million. Most of our long-term bank loans were used for capital expansion projects for the past years.

We managed our asset-liability ratio by enhancing controls over both liabilities (including borrowings) and financing risks. We generally do not experience any seasonality in borrowings. Rather, due to the nature of the 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 29.82% in 2007 compared to 29.53% in 2006. 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 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 2005, 2006 and 2007 were RMB79.5 million, RMB51.6 million and RMB53.5 million, respectively, representing approximately 0.2%, 0.1% and 0.1% of the total sales, respectively, in those years.

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

### **D. Trend Information**

The international situation is likely to remain relatively stable in 2008. Affected by turbulent financial markets, the rising price of oil and other factors, the world economy will continue to grow but may grow at a reduced rate. Along with the continuing progress of industrialization, urbanization, marketization and globalization, China's economy is expected to maintain rapid but stable growth, although perhaps at a slightly lower rate than in previous years. The growth of the international economy and China's domestic economy will continue to provide a large opportunity for the development of the petroleum and petrochemical industry. The stable growth in demand for petroleum, natural gas, processed oil and major chemical products as a result of economic development is expected to enable the domestic market of petrochemical products to maintain a high growth rate. However, petrochemical enterprises will still be faced with many challenges. For example, it is increasingly likely that oil prices will remain high for the long term. The economic cycle of the world's petrochemical industry may also see some changes. The Chinese government may continue to keep certain control over the domestic price of processed oil and maintain a tight monetary policy. The continued appreciation of the Renminbi, tax rebates for product exports, and the Reach Act enacted by the European Union may also impact petrochemical enterprises. The rapid expansion of international and domestic petrochemical production capacities will also further intensify market competition. China's sustainable development strategy may impose

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increasingly strict requirements on safety, environmental protection, energy conservation and emission reduction. All of these factors may, to a certain extent, affect the production and operation of the domestic petroleum and petrochemical industry and bring about more costs and risks to industry operations.

With regard to market competition, we believe that major international players are preparing to enter the Chinese market amid industry restructuring on a global basis. Apart from posing direct competition against us in processed oil and petrochemical products, these international companies are characterized by large-scale investments across different sectors, full vertical integration and streamlined organization. Domestic companies are expected to face intense competition from their international counterparts as the Chinese market becomes increasingly internationalized. In terms of our production and operation, we will, directed by a scientific outlook on development, continuously strive to become a modern petrochemical enterprise that is of first class in China, advanced in the world and competitive on the international market, continue to make internal improvements, including the full implementation of our cost reduction strategy, while we simultaneously seek to expand operations. By implementing certain restructuring projects, we will work to solve problems such as the relatively poor supporting capacity of our oil refining facilities and some problems related the structure of our chemical products, fuels and power generation. We will work to improve our technologies, upgrade the quality of our products and equipment, reduce costs and promote efficiency, optimize use of our industrial facilities, focus on our core businesses, and look to boost our overall competitiveness and economic returns.

**E. Off-balance Sheet Arrangements**

As of December 31, 2007, our contingent liabilities amounted to RMB30.7 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, 2006 were RMB49.8 million. Our guarantees issued to banks in favor of associated companies, other unlisted investments and subsidiaries are limited to the respective share in equity interest held by us. Please refer to Note 26(b) to our consolidated financial statements included in Item 18. Financial Statements for more detailed information on our guarantees and commitments.

**F. Contractual Obligations and Commercial Commitments**

The following table sets forth our obligations to make future payments under contracts effective as of December 31, 2007.

	Total (RMB 000)	As of December 31, 2007 Payment due by period			
		Less than 1 year (RMB 000)	1-3 years (RMB 000)	4-5 years (RMB 000)	More than 5 years (RMB 000)
<b>Contractual obligations</b>					
Short-term loan	3,672,942	3,672,942			
Long-term loan	1,058,316	419,027	634,859	4,430	
Total contractual obligations	4,731,258	4,091,969	634,859	4,430	
<b>Estimated future interest payments</b>					
Fixed rate	38,250	36,164	2,086		
Variable rate	133,387	90,292	43,095		
Total estimated future interest payments	171,637	126,456	45,181		
<b>Other commercial commitments</b>					
Capital commitments (note)	3,858,951	2,500,070	1,358,881		
Total commercial commitments	3,858,951	2,500,070	1,358,881		

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



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

Our staff costs for 2007 were RMB1,209.0 million.

**Capital Expenditures**

In 2007, our capital expenditures amounted to RMB2,134.1 million, representing an increase of RMB125.3 million as compared with RMB2,008.8 million in 2006. The expenditures in 2007 were for the following projects:

<b>Project</b>	<b>Total Investment RMB 000</b>	<b>Progress</b>
600,000-ton aromatics unit	1,001,480	In progress
1.2 million-ton delayed coking unit	874,000	Completion
620-ton steam/hour boiler and 100 MW electric generating set project	672,692	Completion
<b>Total</b>	<b>2,548,172</b>	

The estimated capital expenditure for 2008 is RMB2,500 million, mainly for the construction of projects in progress such as the 600,000-ton aromatics unit and the 150,000-ton C5 segregation unit, and preparatory work related to other technological renovation projects.

**Purchase, Sale and Investment**

Except as disclosed in this report, during the year 2007, 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, 2007, we have not pledged any of our property or equipment.

**Table of Contents****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>
<b><u>Directors</u></b>		
Rong Guangdao	52	Chairman of the Board of Directors and President
Du Chongjun	53	Vice Chairman of the Board of Directors and Vice President
Han Zhihao	56	Director and Chief Financial Officer
Li Honggen	52	Director and Vice President
Dai Jinbao	52	Director
Shi Wei	48	Director and Vice President
Lei Dianwu	45	External Director
Xiang Hanyin	53	External Director
Chen Xinyuan	43	Independent Director and Director of the Audit Committee
Sun Chiping	50	Independent Director
Jiang Zhiquan	57	Independent Director
Zhou Yunnong	66	Independent Director and Director of the Remuneration and Appraisal Committee
<b><u>Other Executive Officers</u></b>		
Zhang Jianping	45	Vice President
Tang Chengjian	52	Vice President
Zhang Jingming	50	Secretary of the Company
<b><u>Supervisory Committee</u></b>		
Gao Jinping	41	Chairman of the Supervisory Committee
Zhang Chenghua	52	Supervisor
Wang Yanjun	47	Supervisor
Zhai Yalin	44	External Supervisor
Wu Xiaoqi	51	External Supervisor
Liu Xiangdong	57	Independent Supervisor
Yin Yongli	68	Independent Supervisor





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**Table of Contents****Directors**

**Rong Guangdao**, 52, 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. In June 2004, Mr. Rong was elected 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). 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**, 53, 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.

**Han Zhihao**, 56, 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 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 Company, 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. In August 2000, he was appointed Vice President of Shanghai Chemical Industrial Park Development Company Limited. In August 2002, he was appointed 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. 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.

**Dai Jinbao**, 52, is Executive Director of the Company, Deputy Secretary of the Communist Party Committee of the Company's Refining and Chemical Division and Chairman of the Labor Union. Mr. Dai joined

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the Complex in November 1973 and was Deputy Director of No. 1 Chemical Plant of the Company. In December 1997, he was appointed Director of No.1 ethylene Complex of the Refining and Chemical Division of the Company. In May 2003, he was appointed Chairman of the Labor Union of the Company's Refining and Chemical Division. In August 2005, he was appointed Deputy Secretary of the Communist Party Committee of the Company's Refining and Chemical Division. In June 2006, he was appointed Director of the Company. Mr. Dai graduated from the Shanghai Second Polytechnic University majoring in business management. Mr. Dai is an engineer by professional title.

**Shi Wei**, 48, 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 and then Deputy Manager of the Refining and Chemical Division of the Company, and Manager of the Environmental Department. In April 2001, he was appointed Secretary of the Communist Party Committee and then Manager of the Refining and Chemical Division in July 2002. 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 the 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.

## **External Directors**

**Lei Dianwu**, 45, 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**, 53, 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 Chemical Division of Sinopec Corp. Mr. Xiang has rich experience in management of chemical enterprise operating. 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.

## **Independent Directors**

**Chen Xinyuan**, 43, 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

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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 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**, 57, 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 (executive) of Shanghai Construction Engineering Administration Bureau, Deputy Secretary of the Communist Party Committee (executive), Vice Chairman and General Manager of 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 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 appointed 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

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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 shareholders 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.

**Gao Jinping**, 41, 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 Complex, Deputy Secretary of the Communist Party Committee of the Experimental Plant and Chemical Division of the Company. In October 2001, Mr. Gao was elected as 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. In June 2004, Mr. Gao was elected 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 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**, 52, 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 December 1999, Mr. Zhang was appointed Deputy Secretary of the Communist Party Committee, Secretary of the Communist Party Discipline Supervisory Committee and 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**, 47, is a Supervisor and Vice Chairwoman of the Labor Union of the Company. Ms. Wang joined the Complex in July 1982 and was Chairwoman of the Labor Union of the Plastics Plant of the Company. In January 1999, Ms. Wang was appointed Chairwoman of the Labor Union of Plastics Division of the Company. In June 2002, Ms. Wang was Chairwoman of the Labor Union of Chemical Division of the Company. In July 2004, Ms. Wang was appointed 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. Mr. Zhai began his career in 1986 and had been successively

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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**, 51, is Deputy Director of Supervisory Bureau of China Petrochemical Corporation and Deputy Director of Supervisory Department of Sinopec Corp. Mr. Wu began his career in 1971 and had been successively Deputy Office Head Class Disciplinary Monitor of Inspection Bureau of China Petrochemical Corporation's Disciplinary Division, Deputy Head (Deputy Director) and Head (Director) of the Office of Inspection Bureau of China Petrochemical Corporation's Disciplinary Division, and Director of Section 1 of Inspection Bureau of China Petrochemical Corporation's Disciplinary Division. From April 2004 to April 2005, he was 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. Since April 2005, Mr. Wu has been Deputy Director of Supervisory Bureau of China Petrochemical Corporation and Deputy Director of Supervisory Department of Sinopec Corp. Mr. Wu graduated from Shijiazhuang Army Command Academy and has a senior professional title.

**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**, 68, is Chairman of Management Committee of Tianhua Certified Public Accountant. In June 2005, he was appointed 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 Rightson Certified Public Accountants. Since June 2004, Mr. Yin has been appointed Chairman of Huazheng Certified Public Accountant. Since June 2005, Mr. Yin has been Chairman of Management Committee of Tianhua Certified Public Accountant. 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**, 45, is a Vice President of the company. He joined the Complex in 1987, and successively held the positions of Vice Chief Engineer of Oil Refining Chemical Department Arene Factory, Vice Director of the Plastic Factory, Deputy Manager of Plastics Department of Shanghai Petrochemical, Director of the

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Chemical Institute, Director of Production Department of Shanghai Petrochemical. In February 2002, he became the assistant to the President of our company and Director of Production Department. In July 2004, he was appointed Vice President of our company. Mr. Zhang graduated from East China Chemical Institute specializing in Petroleum Refinery and received a Master's Degree in Petroleum Processing from the same school in 1987. He is a qualified senior engineer.

**Tang Chengjian**, 52, is a Vice President of our company. He joined the Complex in 1974, and successively held the positions of Deputy Secretary of Communist Party Committee, Trade Union Director, Deputy Director and Director of Thermal Power Factory at the Complex. He was appointed the Vice President of our company in July 2004. Mr. Tang graduated from Shanghai Power Technology School with a specialization in power plant steam turbines; received a graduate diploma from Shanghai Power College in power plant and power systems; received a bachelor degree from Shanghai No. 2 Industry University in project management; and a MBA from China Europe International Industrial and Commercial Institute in 2001. He is a qualified engineer.

**Zhang Jingming**, 50, is Secretary to the Board of directors and General Counsel of the Company. Mr. Zhang joined the Complex in 1978. He has held various positions including Project Manager of the International Department, the Company's Securities Affairs Representative in Hong Kong, Deputy Director of the International Department and Deputy Director of the Board Secretariat. In June 1999, Mr. Zhang was appointed Secretary to the Board and Director of the Board Secretariat. In June 2001, Mr. Zhang was appointed Director of Strategic Research Department of the Company. In January 2005, Mr. Zhang was appointed General Counsel of the Company. Mr. Zhang graduated from the Shanghai Foreign Language Institute in 1987. During 1992 and 1993, he enrolled at the fourth Sino-British joint MBA program at Northwestern Polytechnic University. Mr. Zhang subsequently left for the University of Hull in the United Kingdom to pursue his studies in an MBA program, and in July 1995, he earned an MBA by the University of Hull. In 2002, Mr. Zhang completed his studies in a master program in international economic law at East China University of Politics 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, 2007 was approximately RMB5.12 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.

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The following table sets forth the compensation on an individual basis for our directors, supervisors and executive officers who received compensation from us in 2007.

Name	Position with the Company	Remuneration in 2007 (RMB 000)
Rong Guangdao	Chairman of the Board of Directors and President	544
Du Chongjun	Vice Chairman of the Board of Directors and Vice President	544
Han Zhihao	Director and Chief Financial Officer	466
Shi Wei	Director and Vice President	466
Li Honggen	Director and Vice President	440
Dai Jinbao	Director	219
Lei Dianwu	External Director	0
Xiang Hanyin	External Director	0
Chen Xinyuan	Independent Director	80
Sun Chiping	Independent Director	80
Jiang Zhiquan	Independent Director	80
Zhou Yunnong	Independent Director	80
Gao Jinping	Chairman of the Supervisory Committee	458
Zhang Chenghua	Supervisor	233
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	465
Tang Chengjian	Vice President	459
Zhang Jingming	Company Secretary and Corporate Counselor	289
<b><i>C. Board Practices.</i></b>		

**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 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.

**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.

**Table of Contents****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.

**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).

***D. Employees.***

As of December 31, 2007, we had 19,252 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,		
	2007	2006	2005
Management	1,533	1,580	2,004
Engineers, technicians and factory personnel	11,067	14,163	16,427
Accounting, marketing and other	6,652	7,179	7,050
Total	19,252	22,922	25,481

Approximately 30.1% of our work force graduated from university or technical colleges. 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, 2007, 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



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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 2007, we paid RMB1,209 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.

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 June 16, 2008. 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 June 16, 2008.

<b>Name</b>	<b>Position</b>	<b>Shares held at December 31, 2007</b>
Rong Guangdao	Chairman and President	3,600
Du Chongjun	Vice Chairman	1,000
Han Zhihao	Director and Chief Financial Officer	0
Li Honggen	Director and Vice President	0
Dai Jinbao	Director	0
Shi Wei	Director and Vice President	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

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

**Table of Contents****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 June 1, 2008 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.	2,303,698,101	32.00%
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 June 1, 2008, a total of 2,330,000,000 H Shares were outstanding. As of June 1, 2008, a total of 3,339,543 ADSs, representing the equivalent of 333,954,300 H Shares, were outstanding and held by 115 holders of record. A total of 720,000,000 A Shares were outstanding on June 1, 2008.

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

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

Business-related dealings

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

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Upon approval and authorization by the 2005 Extraordinary General Meeting held on June 28, 2005, we entered into a Sales and Purchases Framework Agreement with Sinopec Corp and a Comprehensive Services Framework Agreement with Sinopec. As these agreements were set to expire on December 31, 2007, we entered into a new Product Supply and Sales Services Framework Agreement with Sinopec Corp and a new Comprehensive Services Framework Agreement with Sinopec upon approval and authorization by the 2007 Extraordinary General Meeting held on December 13, 2007. Under the Product Supply and Sales Services Framework Agreement, we purchase raw materials from and sell petroleum products and petrochemicals to Sinopec Corp and its associates. Under the Comprehensive Services Framework Agreement, we accept transportation, design, construction and installation, insurance agency and financial services 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 2007. At the Second 2005 Extraordinary General Meeting held on December 30, 2005, our shareholders approved certain caps on the annual transaction values of certain on-going connected transactions for the years ended December 31, 2005, December 31, 2006 and December 31, 2007. The directors, including each of the independent non-executive directors confirm that such continuing connected transaction values did not exceed the caps so approved. At the 2007 Extraordinary General Meeting held on December 13, 2007, our shareholders also approved certain caps on the annual transaction values of certain on-going connected transactions for the years ended December 31, 2008, December 31, 2009 and December 31, 2010.

On August 25, 2005, the petrochemical products agency sales contract with Sinopec Corp was considered and approved at the second meeting of the fifth session of the Board. Pursuant to the contract, we appoint Sinopec Corp as a non-exclusive sales agent for the sales of synthetic resins, synthetic fibers, synthetic fiber monomers and polymers, organic petrochemical products and by-products from ethylene cracking and aromatic plants and other substandard products related to the above five products.

The purchases by us of crude oil-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 accept transportation, design, construction and installation, insurance agency and financial services from Sinopec and its associates in order to secure steady and reliable services at reasonable prices.

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 Huadong China Sales Company	17,884,389	32.28
	Other related parties	5,022,696	9.07
Purchases	Sinopec Transport and Storage Company	22,377,518	41.58
	Other related parties	16,356,661	30.39
Installation fees	Sinopec and its subsidiaries	206,256	34.78
Transportation costs	Sinopec Transport and Storage Company	254,128	67.58

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This includes: an amount of RMB20,853,142,000 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 2007.

### 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 valuer independent of the Company and Sinopec Corp. and upon arm 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.

We transferred 12.67% of our equity interest in China Jin Shan United Trading Co., Ltd., to China Petrochemical International Co., Ltd., a wholly-owned subsidiary of our controlling shareholder, Sinopec Corp, on April 28, 2005 for a purchase price of RMB10,000,000. RMB3,140,116 in gain was generated from the transaction in 2005. The pricing principle was based on a value appraised by a qualified asset appraiser independent to us and China Petrochemical International Co., Ltd. The face value of such portion of assets amounted to RMB6,859,883.70 and its assessed value amounted to RMB9,999,300.00. The transaction represented an opportunity for China Petrochemical International Co., Ltd. to increase its sales of products by expanding its trading, distribution and marketing network.

We transferred our land use rights in land covering an area of 690,000 sq. meters located at Zhusimen, Nanao Village, Cezi Township, Dinghai District, Zhoushan Municipality, Zhejiang Province, to China Petrochemical Corporation Pipelines Transportation Co., a branch company of our controlling shareholder, Sinopec Corp, on September 29, 2005, at a consideration of RMB62,741,700. RMB36,815,994 in gain was generated from the transaction in 2005. The pricing principle was based on a value appraised by a qualified property appraiser that was independent to both us and China Petrochemical Corporation Pipelines Transportation Co. The face value of such portion of assets amounted to RMB21,795,807 and its assessed value amounted to RMB62,741,700. We were of the view that the disposal of the surplus land generated immediate working capital to us. The discrepancy between the face value and the assessed value was due to the increase in property valuation.

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### **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 waivers**

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

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

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

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

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

our auditors review the transactions each year.

If, however, disclosure of any such transactions is necessary to enable investors to appraise our position or to avoid the establishment of a fraudulent market in our shares or if such transactions may have any material effect on the trading of our shares on the HKSE, we are required to disclose the relevant transaction to the HKSE as soon as practicable. The expression "ordinary course of business" will be determined in the context of the actual business of the relevant company and the expression "normal commercial terms" will be applied by reference to transactions of a similar nature and to be made by similar entities within China or, in the absence of available comparison, by reference to our history and pattern of dealings. Please also see Note 28 to our consolidated financial statements included in [Item 18. Financial Statements](#).

### **Other related party transactions**

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

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

Not applicable.

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

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

Please see [Item 18. 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.

#### **Export Sales**

In 2007, export sales accounted for RMB201.0 million (US\$27.55 million) or 0.37% 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.

**Table of Contents****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.

	Price per H Share (HK\$)		Price per ADS (US\$)		Price per A Share (RMB)	
	High	Low	High	Low	High	Low
2002	1.28	0.69	15.61	8.74	4.46	2.80
2003	3.45	1.70	46.26	14.35	6.02	3.07
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
2006						
First Quarter	5.00	2.97	64.60	38.60	6.20	4.03
Second Quarter	4.75	3.28	62.00	41.49	7.18	5.21
Third Quarter	4.23	3.40	53.20	44.20	6.76	5.48
Fourth Quarter	4.04	3.13	51.44	40.85	6.55	4.72
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
Most Recent Six Months						
January 2008	4.88	3.34	61.88	41.77	17.60	12.56
February 2008	3.88	3.50	50.18	44.77	13.80	12.00
March 2008	3.68	2.37	47.08	31.37	12.93	9.32
April 2008	3.50	2.63	43.95	33.93	9.80	6.70
May 2008	3.39	2.83	43.65	36.92	8.30	7.70

**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.



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### ***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.

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.



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

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

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

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

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

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

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



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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.

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.

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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**

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.

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.

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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:

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.



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

Shareholders are entitled to attend and vote at meetings either in person or by proxy. 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 the 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.

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

The following decisions must be adopted by special resolution:

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

the issue of our debentures;

our division, merger, dissolution and liquidation;

amendments to our Articles of Association;

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.

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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.

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

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

proposals for our financial policies;

the increase or reduction of our registered capital;

the issue of securities of any kind and their listing;

any repurchase of our shares;

significant 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.

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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;

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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;

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.

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### **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**

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).

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.

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### **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.

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.

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### ***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 New Enterprise Income Tax Law and its implementation rules, effective January 1, 2008, dividends by Chinese companies to foreign enterprises, which have no establishment or residence in China or whose dividends from China do not relate to their establishment or residence in China, are ordinarily subject to a Chinese withholding tax levied at a flat rate of 10%. However, according to the Tax Notice, a foreign enterprise with no permanent establishment in China receiving dividends paid with respect to a Chinese company's Overseas Shares and B Shares will temporarily not be subject to the 10% withholding tax. In the event that the Tax Notice is withdrawn, a 10% withholding tax may be imposed in accordance with the New Enterprise Income Tax Law, subject to reduction by an applicable income tax treaty.

#### **Capital Gains Tax**

According to the Individual Income Tax Law, the New Enterprise Income Tax Law, their respective implementing regulations, and the Notice on Questions Relating to Reduced Income Tax on Foreign Enterprise Income in China from Interest, issued by the State Council on November 18, 2000 (the Rate Reduction Notice), 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

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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, their respective implementing regulations and the Rate Reduction Notice, subject to reduction by an applicable income tax treaty.

### Tax Treaties

China has an income tax treaty with the United States that currently limits the rate of Chinese withholding tax to 10% for dividends paid to individuals and corporations that qualify for treaty benefits. However, this treaty does not offer reduced tax rates for capital gains. Since the Tax Notice remains in force to temporarily exempt dividends and capital gains from the Chinese taxes described above, it may not be necessary for foreign individuals and corporations to rely on this treaty at this time.

### 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

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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.

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 relates to the ADSs, this discussion is based in part upon the representations of the depositary and the assumption that each obligation in the deposit agreement and any related agreement will be performed in accordance to 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





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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 depositary'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 will be a PFIC for our 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.

*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 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.

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*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 two 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 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.

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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**

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.

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 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, including goodwill (an active asset). In calculating goodwill, we have valued our total assets based on our market capitalization, determined using the market price of our shares. Such market price may fluctuate. If our market capitalization is less than anticipated or subsequently declines, this will decrease the value of our goodwill and we may become a PFIC. Furthermore, we have made a number of assumptions regarding the amount of value allocable to goodwill. We believe our valuation approach is reasonable. However, it is possible that the IRS will challenge the valuation of our assets, including goodwill, 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 a PFIC, 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.

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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.

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.

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 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 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



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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 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.

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).

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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.

### ***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

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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 2007 or 2006.

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, 2007 and 2006.

	As of December 31, 2007						Total Recorded Amount	Fair Value	
	2008	2009	2010	2011	2012	2013			
	(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%		
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%		
In RMB	3,445,300	485,000	100,000				4,030,300	4,015,929	
Average interest rate <sup>(1)</sup>	5.41%	6.88%	5.91%				5.60%		

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



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	As of December 31, 2006						Total Recorded Amount	Fair Value
	2007	2008	2009	2010	2011	Thereafter		
	(RMB equivalent in thousands, except interest rates)							
<b>Fixed rate bank and other loans</b>								
In U.S. Dollars	14,056	9,654					23,710	22,410
Average interest rate	1.80%	1.80%					1.80%	
<b>Variable rate bank and other loans</b>								
In U.S. Dollars	2,001,726						2,001,726	2,001,726
Average interest rate <sup>(1)</sup>	5.90%						5.90%	
In RMB	2,243,500	510,000	450,000				3,203,500	3,185,978
Average interest rate <sup>(1)</sup>	4.00%	5.48%	5.51%				4.45%	

(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 long-term debt and, to a limited extent, cash and cash equivalents denominated in foreign currencies. We have no program of foreign currency hedging activities and did not engage in any foreign currency hedging activities in 2007 or 2006.

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, 2007 and 2006.

	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>								
<b>Cash and cash equivalents:</b>								
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
<b>Debt:</b>								
Fixed rate bank and other loans in U.S. Dollars	9,097						9,097	8,641
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	2,629			10,519	9,150

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

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	As of December 31, 2006						Total Recorded Amount	Fair Value
	2007	2008	2009	2010	2011	Thereafter		
(RMB equivalent in thousands, except interest rates)								
On-balance sheet financial instruments								
Cash and cash equivalents:								
In Hong Kong Dollars	11,834						11,834	11,834
In U.S. Dollars	40,121						40,121	40,121
In Euro	1,201						1,201	1,201
In Japanese Yen	4						4	4
Debt:								
Fixed rate bank and other loans In U.S. Dollars	14,056	9,654					23,710	22,410
Average interest rate	1.80%	1.80%					1.80%	
Variable rate bank and other loans in U.S. Dollars	2,001,726						2,001,726	2,001,726
Average interest rate <sup>(1)</sup>	5.90%						5.90%	
Interest free bank and other loans in U.S. Dollars	2,811	2,811	2,811	2,811	2,811		14,055	11,783

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

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

Not applicable.

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**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.***

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 adequate and effective to ensure that material information relating to our company, including our consolidated subsidiaries, was made known to them by others within our company and our consolidated subsidiaries.

***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, 2007. Based on that evaluation, our management has concluded that our internal control over financial reporting was effective as of December 31, 2007 based on these criteria.

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.

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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.

### ***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, 2007, 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, 2007, 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, 2006 and 2007, and the related consolidated statements of income, equity and cash flows for each of the years in the three-year period ended December 31, 2007, and our report dated April 7, 2008 expressed an unqualified opinion on those consolidated financial statements.

**/S/ KPMG**

Hong Kong, China

April 7, 2008

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

For the year ended December 31, 2007, 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 2006 and 2007.

	<b>For the year ended December 31, (in thousands of RMB)</b>	
	<b>2006</b>	<b>2007</b>
Audit fees <sup>(1)</sup>	7,721	8,727
Audit-related fees <sup>(2)</sup>		
Tax fees <sup>(3)</sup>		
All other fees <sup>(4)</sup>	300	
<b>Total</b>	<b>8,021</b>	<b>8,727</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:

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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.

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**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.

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**PART III**

**ITEM 17. FINANCIAL STATEMENTS.**

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-62 to F-105.

**ITEM 18. FINANCIAL STATEMENTS.**

See pages F-1 to F-61.

**ITEM 19. EXHIBITS**

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



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**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: June 25, 2008

/s/ RONG GUANGDAO  
Rong Guangdao, Chairman

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**SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED**

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**Years Ended December 31, 2005, 2006 and 2007**

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

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<u>Consolidated Balance Sheets</u>	
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<u>Financial Statements of Shanghai Secco Petrochemical Company Limited (1)</u>	
Years Ended December 31, 2005 (Unaudited), 2006 and 2007	F-48

- (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.

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**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Shareholders of

Sinopec Shanghai Petrochemical Company Limited:

We have audited the accompanying consolidated balance sheets of Sinopec Shanghai Petrochemical Company Limited and subsidiaries (the Group ) as of December 31, 2006 and 2007, and the related consolidated statements of income, equity, and cash flows for each of the years in the three-year period ended December 31, 2007. 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, 2006 and 2007, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2007, 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, 2007, 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 April 7, 2008 expressed an unqualified opinion on the effectiveness of the Group s internal control over financial reporting.

**KPMG**

Hong Kong, China

April 7, 2008

**Table of Contents****SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED****AND SUBSIDIARIES****Consolidated Balance Sheets****As of December 31, 2006 and 2007****(Amounts in thousands)**

		December 31,	
		2006	2007
	Note	Renminbi	Renminbi
<b>Assets</b>			
Current assets:			
Cash and cash equivalents		894,650	893,165
Inventories	14	4,163,256	5,197,849
Amounts due from related companies	28	695,286	515,222
Trade debtors, net	15	358,690	212,257
Bills receivable		1,212,110	1,757,131
Other debtors and prepayments	16	239,114	262,918
Income tax recoverable			98,222
Total current assets		7,563,106	8,936,764
Non-current assets:			
Property, plant and equipment, net	17	13,359,862	14,977,237
Investment property	18	501,904	512,793
Construction in progress	19	2,008,447	962,313
Lease prepayments and other assets		603,290	649,337
Interest in associates and jointly controlled entities	20	2,787,795	3,068,135
Other investments	21	528,931	714,427
Deferred tax assets	11	30,310	9,629
Goodwill	22	22,415	22,415
Total non-current assets		19,842,954	20,916,286
Total assets		27,406,060	29,853,050
<b>Liabilities and Shareholders Equity</b>			
Current liabilities:			
Loans and borrowings	23	4,270,337	4,091,969
Amounts due to related companies	28	599,773	904,870
Trade creditors		1,385,577	1,504,454
Bills payable		7,026	300,575
Accrued expenses and other creditors		732,951	1,442,284
Income tax payable		34,386	17,580
Total current liabilities		7,030,050	8,261,732
Non-current liabilities:			
Loans and borrowings	23	1,063,654	639,289
Total non-current liabilities		1,063,654	639,289

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Total liabilities		8,093,704	8,901,021
Shareholders' equity:			
Share capital	24	7,200,000	7,200,000
Share premium and reserves	25	11,776,343	13,448,038
Total equity attributable to equity shareholders of the Company		18,976,343	20,648,038
Minority interests		336,013	303,991
Total equity		19,312,356	20,952,029
Total liabilities and shareholders' equity		27,406,060	29,853,050

See accompanying notes to consolidated financial statements.

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**Table of Contents****SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED****AND SUBSIDIARIES****Consolidated Statements of Income****Years ended December 31, 2005, 2006 and 2007****(Amounts in thousands, except per share data)**

	Note	Years ended December 31,		
		2005 Renminbi	2006 Renminbi	2007 Renminbi
Sales		45,955,903	50,599,485	55,328,384
Less Sales taxes and surcharges		(765,689)	(681,362)	(1,073,695)
Net sales		45,190,214	49,918,123	54,254,689
Other income	4	632,820	282,142	93,900
Cost of sales	5	(42,887,742)	(49,182,232)	(52,646,516)
Gross profit		2,935,292	1,018,033	1,702,073
Selling and administrative expenses		(444,449)	(521,990)	(504,712)
Other operating income	6	249,843	496,043	1,197,361
Other operating expenses	7	(238,611)	(297,394)	(216,553)
Income from operations		2,527,960	552,907	892,656
Financial income		96,776	137,997	82,280
Financial expenses		(276,174)	(303,386)	(260,206)
Net financing costs	9	(179,398)	(165,389)	(177,926)
Investment income	10			770,725
Share of (losses) / profits of associates and jointly controlled entities		(60,968)	576,682	665,897
Income before income tax		2,287,594	964,200	2,151,352
Income tax	11	(366,300)	(53,238)	(468,216)
Net income		1,921,294	910,962	1,683,136
Attributable to:				
Equity shareholders of the Company		1,850,449	844,407	1,634,080
Minority interests		70,845	66,555	49,056
Net income		1,921,294	910,962	1,683,136
Basic earnings per share	12	RMB 0.26	RMB 0.12	RMB 0.23
Dividends attributable to the year	13	720,000	288,000	648,000

See accompanying notes to consolidated financial statements.

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**Table of Contents****SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED****AND SUBSIDIARIES****Consolidated Statements of Equity****For the years ended December 31, 2005, 2006 and 2007****(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, 2005		7,200,000	2,420,841	4,051,672	4,744,476	18,416,989	373,084	18,790,073
Derecognition of negative goodwill					2,549	2,549		2,549
Balances at January 1, 2005 (adjusted)		7,200,000	2,420,841	4,051,672	4,747,025	18,419,538	373,084	18,792,622
Profit attributable to shareholders					1,850,449	1,850,449	70,845	1,921,294
<b>Total recognized income and expense</b>					<b>1,850,449</b>	<b>1,850,449</b>	<b>70,845</b>	<b>1,921,294</b>
Appropriation	25			340,926	(340,926)			
Dividends approved in respect of previous year	13(b)				(1,440,000)	(1,440,000)		(1,440,000)
Dividends paid to minority shareholders							(96,476)	(96,476)
Balances at December 31, 2005		7,200,000	2,420,841	4,392,598	4,816,548	18,829,987	347,453	19,177,440
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
Unrealized gain for changes in fair values of available-for-sale securities, net of deferred tax				21,949		21,949		21,949
<b>Total income and expense recognized directly in equity</b>				<b>21,949</b>		<b>21,949</b>		<b>21,949</b>
Profit attributable to shareholders					844,407	844,407	66,555	910,962
<b>Total recognized income and expense</b>				<b>21,949</b>	<b>844,407</b>	<b>866,356</b>	<b>66,555</b>	<b>932,911</b>
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
Unrealized gains for changes in fair value of available-for-sale securities, net of deferred tax				842,002		842,002		842,002
Transfer to profit or loss on disposal of available-for-sale securities, net of deferred tax				(516,387)		(516,387)		(516,387)
<b>Total income and expense recognized directly in equity</b>				<b>325,615</b>		<b>325,615</b>		<b>325,615</b>
Profit attributable to shareholders					1,634,080	1,634,080	49,056	1,683,136
<b>Total recognized income and expense</b>				<b>325,615</b>	<b>1,634,080</b>	<b>1,959,695</b>	<b>49,056</b>	<b>2,008,751</b>
Adjustment to Reserves	25			(36,733)	36,733			
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)



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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
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See accompanying notes to consolidated financial statements.

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**Table of Contents****SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED****AND SUBSIDIARIES****Consolidated Statements of Cash Flows****For the years ended December 31, 2005, 2006 and 2007****(Amounts in thousands)**

	Years ended December 31,		
	2005 Renminbi	2006 Renminbi	2007 Renminbi
Net cash generated from operating activities	(a) 3,943,578	1,696,615	1,441,998
Cash flows from investing activities:			
Interest income received	39,631	56,827	46,421
Investment income received	79,688	47,596	393,062
Capital expenditure	(1,142,927)	(2,008,779)	(2,134,123)
Proceeds from disposal of property, plant and equipment	131,845	254,843	68,708
Purchase of investments and addition of interests in associates	(347,170)	(54,206)	
Proceeds from disposal of investments	45,691	351,178	1,114,701
Proceeds from maturities of time deposits	4,000		
Net cash used in investing activities	(1,189,242)	(1,352,541)	(511,231)
Cash flows from financing activities:			
Net proceeds from issue of corporate bonds		2,977,800	
Proceeds from loans	9,836,199	13,936,126	17,605,887
Repayment of loans	(11,393,941)	(15,910,127)	(16,166,938)
Redemption of corporate bonds		(1,000,000)	(2,000,000)
Dividends paid to equity shareholders of the Company	(1,440,000)	(720,000)	(288,000)
Dividends paid to minority shareholders	(96,476)	(77,995)	(81,078)
Net cash used in financing activities	(3,094,218)	(794,196)	(930,129)
Net (decrease) / increase in cash and cash equivalents	(339,882)	(450,122)	638
Cash and cash equivalents at beginning of year	1,690,500	1,347,237	894,650
Effect of foreign exchange rate changes	(3,381)	(2,465)	(2,123)
Cash and cash equivalents at end of year	1,347,237	894,650	893,165

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, 2005, 2006 and 2007****(Amounts in thousands)**

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

	Years ended December 31,		
	2005 Renminbi	2006 Renminbi	2007 Renminbi
Income before income tax	2,287,594	964,200	2,151,352
Interest income	(39,631)	(56,827)	(46,421)
Income from unlisted investments	(101,350)	(97,179)	(122,709)
Share of losses / (profits) of associates and jointly controlled entities	60,968	(576,682)	(665,897)
Transfer from equity on disposal of available-for-sale securities			(770,725)
Interest expense	276,174	303,386	260,206
Depreciation for property, plant and equipment	1,692,213	1,810,990	1,687,435
Depreciation for investment property	12,847	12,678	14,879
Impairment losses for property, plant and equipment		50,000	200,295
Amortization of lease prepayments	13,441	29,400	16,972
Unrealized exchange gain	(53,174)	(78,841)	(16,535)
(Gain) / loss on disposal of property, plant and equipment	(15,298)	(19,569)	44,045
Increase in inventories	(387,229)	(48,278)	(1,034,593)
Decrease / (increase) in debtors, bills receivable and deposits	1,170,872	(585,256)	(387,688)
(Decrease) / increase in creditors, other creditors and bills payable	(33,850)	345,628	643,342
(Decrease) / increase in balances with related companies	(207,470)	(1,870)	485,161
Cash generated from operations	4,676,107	2,051,780	2,459,119
Interest paid	(301,537)	(344,064)	(342,574)
Income tax paid	(430,992)	(63,386)	(674,547)
Income tax refund		52,285	
Net cash generated from operating activities	3,943,578	1,696,615	1,441,998

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 fibers, resins and plastics, intermediate petrochemicals and petroleum products. Substantially all of its products are sold in the PRC domestic market.

At December 31, 2007, 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 fiber 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



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**SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED**

**AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

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

None of the subsidiaries have issued any debt securities.

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 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.

**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

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**SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED**

**AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

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

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.

(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(t)). 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.

(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:



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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

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**Table of Contents****SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED****AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Continued)****(All Renminbi amounts in thousands, except per share data and except otherwise stated)**

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(t)).

**(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(t)). 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, machinery, equipment and others	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. 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.

**(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(t)). The cost of 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(t)). 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.

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**SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED**

**AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

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

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 comprise 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.

(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(t)), 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) 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.

(k) 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.

(1) 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.

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**SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED**

**AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

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

(m) 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.

(n) 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 retirement or 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 retirement or 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.

(o) 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.

(p) Net financing costs

Net financing costs comprise interest payable on borrowings calculated using the effective interest rate method, interest income on bank deposits, foreign exchange gains and losses and bank charges.

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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

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**SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED**

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**Notes to Consolidated Financial Statements (Continued)**

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

(q) 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.

(r) 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.

(s) 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.

(t) 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, that do not have a quoted market price in an active market (see note 2(t) (ii)) 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.



(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 periodically in order to assess whether the recoverable amounts have declined below the carrying amounts. These assets are tested for impairment whenever events or changes in circumstances indicate that their recorded carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to the recoverable amount. For goodwill, the recoverable amount is estimated at each balance sheet date.

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**SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED**

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**Notes to Consolidated Financial Statements (Continued)**

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

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.

The Group 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.

(u) Dividends payable

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

(v) 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

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**SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED**

**AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

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

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.

**(w) 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.

**(x) 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.

**(y) 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.

The Group 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.

**3. CHANGES IN ACCOUNTING POLICIES**

The IASB has issued a number of new and revised IFRS and Interpretations that are first effective or available for early adoption for the current accounting period of the Group.

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There have been no significant changes to the accounting policies applied in these financial statements for the years presented as a result of these developments. However, as result of the adoption of IFRS 7, *Financial instruments: Disclosures* and the amendment to IAS 1, *Presentation of financial statements: Capital disclosures*, there have been some additional disclosures provide as follows:

As a result of the adoption of IFRS 7, the financial statements include expanded disclosure about the significance of the Group's financial instrument and the nature and extent of risks arising from those instruments, compared with the information previously required to be disclosed by IAS 32, *Financial instruments: Disclosure and presentation*.

These disclosures are provided throughout these financial statements, in particular in note 31.

The amendment to IAS 1 introduces additional disclosure requirements to provide information about the level of capital and the Group's objectives, policies and processes for managing capital. These new disclosures are set out in note 24.

Both IFRS 7 and the amendment to IAS 1 do not have any material impact on the classification, recognition and measurement of the amounts recognized in the financial instruments.

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, 2007, the Group 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 unfilled 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.

**5. COST OF SALES**

Cost of sales represents:

	Years ended December 31,		
	2005	2006	2007
Costs of raw materials			
crude oil	29,576,407	33,307,637	34,456,334
other ancillary materials	6,953,588	7,901,778	10,022,551
Depreciation	1,688,110	1,806,444	1,681,874
Repairs and maintenance	896,022	874,461	1,023,794
Research and development	54,451	51,610	53,548
Employer's pension costs			
municipal retirement scheme costs	165,046	207,071	197,191

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supplementary retirement scheme costs	56,917	61,692	55,048
Staff costs	1,168,461	1,210,266	1,209,035
Amortization of lease prepayments	13,441	29,400	16,972
Others	2,315,299	3,731,873	3,930,169
	42,887,742	49,182,232	52,646,516

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**Table of Contents****SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED****AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Continued)**

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

**6. OTHER OPERATING INCOME**

Other operating income represents:

	Years ended December 31,		
	2005	2006	2007
Income from rendering of services	57,421	35,068	36,282
Gain on disposal of property, plant and equipment	42,233	83,386	7,745
Rental income from investment property	18,681	42,643	40,021
Amortization of deferred income	11,518	23,033	
Income from unlisted investments	101,350	97,179	122,709
Others	7,408	16,085	9,796
	238,611	297,394	216,553

**7. OTHER OPERATING EXPENSES**

Other operating expenses represent:

	Years ended December 31,		
	2005	2006	2007
Loss on disposal of property, plant and equipment	26,935	63,817	51,790
Employee reduction expenses (note 8)	109,410	83,603	208,013
Impairment losses on property, plant and equipment (note (i) and 17)		50,000	200,295
Donations	8,079	380	14,250
Others	57,070	42,730	46,910
	201,494	240,530	521,258

- (i) Impairment loss recognized on property, plant and equipment, primarily relates to the assets of synthetic fibres segment, was RMB181,681 (2006: RMB50,000; 2005: RMB nil) for the year ended December 31, 2007. The impairment loss relates to certain synthetic fibres facilities that have reduced volume of production during the year. In measuring the amounts of impairment charges, the carrying amounts of these assets were compared to the present value of the expected future cash flows of the assets, as well as information about their fair values less costs to sell.

**8. EMPLOYEE REDUCTION EXPENSES**

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In accordance with the Group's voluntary employee reduction plan, the Group recorded employee reduction expenses of RMB208,013 during the year ended December 31, 2007 (2006: RMB83,603; 2005: RMB109,410) payable in cash in respect of the voluntary resignation of approximately 2,622 employees (1,280 employees in 2006 and 1,645 employees in 2005).

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**Table of Contents****SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED****AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Continued)**

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

**9. NET FINANCING COSTS**

Net financing costs represent:

	Years ended December 31,		
	2005	2006	2007
Interest income	(39,631)	(56,827)	(46,421)
Net foreign exchange gain	(57,145)	(81,170)	(35,859)
<b>Financial income</b>	<b>(96,776)</b>	<b>(137,997)</b>	<b>(82,280)</b>
Interest on loans and borrowings	309,357	367,716	329,643
Less: borrowing costs capitalized as construction in progress	(33,183)	(64,330)	(69,437)
Financial expenses	276,174	303,386	260,206
<b>Net financing costs</b>	<b>179,398</b>	<b>165,389</b>	<b>177,926</b>

Interest costs capitalized as a component of the cost of construction in progress amounted to RMB33,183, RMB64,330 and RMB69,437 in 2005, 2006 and 2007 respectively. Interest costs have been capitalized at a rate of 5.27%-7.47% per annum (2006: 5.18%-5.85%; 2005: 2.98%-5.56%) for construction in progress.

**10. INVESTMENT INCOME**

Investment income represents the gain on disposal of available-for-sale securities transferred from equity during the year ended December 31, 2007 (2006: Nil; 2005: Nil).

**11. TAXATION**

(a) Taxation in the consolidated income statement represents:

	Years ended December 31,		
	2005	2006	2007
Current tax			
Provision for income tax for the year	340,532	71,183	557,078
(Over) / under-provision in respect of prior years		(6,911)	2,439
Deferred taxation	25,768	(11,034)	(91,301)

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**Table of Contents****SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED****AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Continued)****(All Renminbi amounts in thousands, except per share data and except otherwise stated)**

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

	Years ended December 31,		
	2005	2006	2007
Income before income tax	2,287,594	964,200	2,151,352
Expected PRC income tax expense at a statutory tax rate of 33% (2006: 15%; 2005: 15%)	343,139	144,630	709,946
Tax effect of non-deductible expenses	7,679	7,361	47,056
Tax effect of non-taxable income	(4,438)	(5,414)	(32,201)
(Over) / under-provision in prior years		(6,911)	2,439
Effect of change in tax rate on deferred tax			(23,083)
Tax effect of share of losses / (profits) recognized under the equity method	9,145	(86,503)	(219,746)
Tax effect of unused tax losses not recognized for deferred tax	7,090	9,688	22,621
Tax effect of differential tax rate on subsidiaries income	3,685	(9,613)	(38,816)
Actual tax expense	366,300	53,238	468,216

The State Administration of Taxation ( SAT ) issued a tax circular Enterprise Income Tax Issues relating to Nine Companies Listed Overseas ( Circular No. 664 ) in June 2007 which requested the relevant local tax authorities to rectify, immediately, the expired concessionary tax policy for the nine listed companies authorized by the State Council to issue shares in Hong Kong in 1993 which, at the time of writing, was still being applied. The notice stated that the difference in enterprise income tax ( EIT ) arising from the expired preferential rate and the applicable rate should be settled according to the provisions of Law on the Administration of Tax Collection .

The Company is one of the nine listed companies mentioned above and applied the preferential EIT rate of 15% in prior years. The Company communicated with the relevant tax authority to assess the situation and was informed that the EIT rate for the Company would be adjusted from the original 15% to 33% from 2007. The Company has not been requested to pay additional EIT in respect of any prior year.

In response to the SAT notice and communication with the relevant tax authority, the charge for PRC income tax for the year is calculated at the rate of 33% (2006: 15%; 2005: 15%) on the estimated assessable income of the period determined in accordance with relevant income tax rules and regulations. The directors of the Company consider that it is uncertain whether the relevant tax authorities will retrospectively claim additional EIT from the Company and that it is not possible to reliably estimate the eventual outcome of this matter. Consequently, no provision has been made in these financial statements in respect of the EIT differences arising from prior years.

The Company did not carry out business overseas and therefore does not incur overseas income taxes.

Pursuant to the PRC enterprise income tax law passed by the Tenth National People's Congress on March 16, 2007, the new enterprise income tax rates for domestic and foreign enterprises are unified at 25 per cent. and will be effective from January 1, 2008.

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As the EIT rate applicable to the Company will be changed from 33% in 2007 to 25% in 2008, deferred tax recognized as at December 31, 2007 is based on the 25% tax rate that is expected to apply to the period when the asset is realized or the liability is settled (2006: 15%; 2005: 15%).

## (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, 2006	2007	December 31, 2006	2007	December 31, 2006	2007
<b>Current</b>						
Provisions	12,141	40,075			12,141	40,075
<b>Non-current</b>						
Provisions for impairment losses	16,342	77,310			16,342	77,310
Lease prepayments	18,880	30,592			18,880	30,592
Capitalization of borrowing costs			(20,799)	(32,070)	(20,799)	(32,070)
Fair value of available-for-sale securities			(3,873)	(115,855)	(3,873)	(115,855)
Others	7,619	11,822		(2,245)	7,619	9,577
<b>Deferred tax assets / (liabilities)</b>	<b>54,982</b>	<b>159,799</b>	<b>(24,672)</b>	<b>(150,170)</b>	<b>30,310</b>	<b>9,629</b>

As at December 31, 2007, a subsidiary of the Company provided valuation allowance against tax value of losses carried forward for PRC income tax purpose. The total deductible losses available to offset their future PRC taxation income are RMB112,444, if any. The deductible losses carried forward of RMB14,539, RMB29,357 and RMB68,548 will expire in 2010, 2011 and 2012, respectively.

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

	Balance at January 1, 2005	Recognized in consolidated statements of income	Balance at December 31, 2005
<b>Current</b>			
Provisions	32,600	(21,204)	11,396
<b>Non-current</b>			
Provision for impairment losses	8,842		8,842
Lease prepayments	19,928	(525)	19,403
Capitalization of borrowing costs	(12,453)	(4,039)	(16,492)

Net deferred tax assets	48,917	(25,768)	23,149
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**Table of Contents****SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED****AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Continued)**

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

	Balance at January 1, 2006	Recognized in consolidated statements of income	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 income	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>

**12. BASIC EARNINGS PER SHARE**

The calculation of basic earnings per share is based on the profit attributable to shareholders of RMB1,634,080 (2006: RMB844,407; 2005: RMB1,850,449) and 7,200,000 (2006: 7,200,000; 2005: 7,200,000) shares in issue during the year.

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

**13. DIVIDENDS**

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(a) Dividends attributable to the year:

	Years ended December 31,		
	2005	2006	2007
Final dividend proposed after the balance sheet date of RMB0.09 per share (2006: RMB0.04 per share)	720,000	288,000	648,000

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Pursuant to a resolution passed at the directors' meeting on April 7, 2008, a final dividend of RMB0.09 per share totaling RMB648,000 (2006: RMB288,000; 2005: RMB720,000) was proposed for shareholders' approval at the Annual General Meeting. The final dividend proposed after the balance sheet date has not been recognized as a liability at the balance sheet date.

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

	Years ended December 31,		
	2005	2006	2007
Final dividend in respect of the previous financial year, approved and paid during the year, of RMB0.04 per share (2006: RMB0.10 per share; 2005: RMB0.20 per share)	1,440,000	720,000	288,000

**14. INVENTORIES**

Inventories in the balance sheet comprise:

	December 31,	
	2006	2007
Raw materials	873,130	1,669,945
Work in progress	1,661,487	1,871,324
Finished goods	1,014,225	986,782
Spare parts and consumables	614,414	669,798
	4,163,256	5,197,849

At December 31, 2007, the Group had inventories carried at net realizable value with carrying amount of RMB626,212 (2006: RMB208,157).

Allowance for diminution in value of inventories, primarily related to spare parts and consumables, is analyzed as follows:

At January 1, 2005	56,670
Provision for the year	1,636
Write-off	(8,236)
At December 31, 2005	50,070
Provision for the year	33,407
Write-off	(42,122)



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At December 31, 2006	41,355
Provision for the year	35,753
Write-off	(3,316)
At December 31, 2007	73,792

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**Table of Contents****SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED****AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Continued)**

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

**15. TRADE DEBTORS**

Trade debtors comprise:

	December 31,	
	2006	2007
Trade debtors	389,601	236,848
Less: Impairment losses for bad and doubtful debts	(30,911)	(24,591)
	358,690	212,257

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

At January 1, 2005	45,282
Provision for the year	13,683
Written-off	(33,120)
At December 31, 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

**16. OTHER DEBTORS AND PREPAYMENTS**

Other debtors and prepayments comprise:

	December 31,	
	2006	2007
Purchase deposits	68,661	47,939
Prepayments in connection with construction work and equipment purchases	2,884	
Sundry debtors	167,569	214,979
	239,114	262,918



**Table of Contents****SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED****AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Continued)**

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

**17. PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment comprise:

	Buildings	Plant and other fixed assets	Total
<b>Cost or valuation:</b>			
At January 1, 2006	5,501,887	26,702,532	32,204,419
Additions	41,376	147,671	189,047
Transferred from construction in progress (note 19)	128,200	502,704	630,904
Disposals	(47,923)	(812,917)	(860,840)
At December 31, 2006	5,623,540	26,539,990	32,163,530
At January 1, 2007	5,623,540	26,539,990	32,163,530
Additions	27,041	145,737	172,778
Transferred from construction in progress (note 19)	113,445	3,419,832	3,533,277
Disposals	(97,443)	(537,517)	(634,960)
At December 31, 2007	5,666,583	29,568,042	35,234,625
<b>Accumulated depreciation and impairment losses:</b>			
At January 1, 2006	2,953,509	14,599,743	17,553,252
Charge for the year	164,172	1,646,818	1,810,990
Impairment loss		50,000	50,000
Written back on disposals	(35,814)	(574,760)	(610,574)
At December 31, 2006	3,081,867	15,721,801	18,803,668
At January 1, 2007	3,081,867	15,721,801	18,803,668
Charge for the year	184,765	1,502,670	1,687,435
Impairment loss	48,335	151,960	200,295
Written back on disposals	(33,524)	(400,486)	(434,010)
At December 31, 2007	3,281,443	16,975,945	20,257,388
<b>Net book value:</b>			
At December 31, 2007	2,385,140	12,592,097	14,977,237
At December 31, 2006	2,541,673	10,818,189	13,359,862

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

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Buildings in Hong Kong with a net book value of RMB32,944 (2006: RMB34,129) 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.

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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.

**18. INVESTMENT PROPERTY**

	<b>2006</b>	<b>2007</b>
<b>Cost:</b>		
At January 1	528,465	528,465
Additions		25,768
At December 31	528,465	554,233
<b>Accumulated depreciation:</b>		
At January 1	13,883	26,561
Charge for the year	12,678	14,879
At December 31	26,561	41,440
<b>Net book value:</b>		
At December 31	501,904	512,793

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, 2007 was estimated by the directors to be approximately RMB715,779 by reference to market values of like properties in the relevant regions (2006: RMB622,098). The investment property has not been valued by an external independent valuer.

Rental income of RMB40,021 was received by the Group during the year ended December 31, 2007 (2006: RMB42,643).

**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:

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	2006	2007
At January 1	787,376	2,008,447
Additions	1,851,975	2,487,143
Transferred to property, plant and equipment (note 17)	(630,904)	(3,533,277)
At December 31	2,008,447	962,313

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**Table of Contents****SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED****AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Continued)**

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

**20. INTEREST IN ASSOCIATES AND JOINTLY CONTROLLED ENTITIES**

	December 31,	
	2006	2007
Interest in associates	2,708,323	2,967,944
Interest in jointly controlled entities	79,472	100,191
	2,787,795	3,068,135

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 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, 2007 are as follows:

Company		Registered Capital	Percentage of equity held by the Company %	Percentage of equity held by subsidiaries %	Principal activities
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

Summary financial information on associates:

	Assets	Liabilities	Equity	Revenues	Profit
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



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2006

100 per cent	29,206,140	(16,392,029)	12,814,111	22,477,236	2,747,085
Group's effective interest	6,751,136	(4,042,813)	2,708,323	4,671,386	574,437

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**Table of Contents****SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED****AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Continued)**

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

**21. OTHER INVESTMENTS**

Other investments comprise:

	December 31,	
	2006	2007
Available-for-sale equity securities	105,185	478,793
Other unlisted investments	462,584	272,834
	567,769	751,627
Less provision for impairment losses	(38,838)	(37,200)
	528,931	714,427

Provision for impairment losses is analyzed as follows:

	2005	2006	2007
At January 1	61,750	56,228	38,838
Written back on disposals	(5,522)	(17,390)	(1,638)
At December 31	56,228	38,838	37,200

**22. GOODWILL****Cost:**

At December 31, 2007 and 2006	22,415
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Goodwill related to the Company's purchase of the entire equity in Shanghai Jinyang Acrylic Fibre Plant in 1996.

**23. DEBT**

Short-term debt consists of:

December 31,

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	2006	2007
Short-term bank loans	1,853,692	2,317,642
Current portion of long-term bank loans	416,645	419,027
Corporate bonds	2,000,000	
Loans from related companies		1,355,300
	4,270,337	4,091,969

The Group's short-term debts are used primarily to finance working capital needs. At December 31, 2007, no bank loans and borrowings were secured by the way of pledge of property, plant and equipment (2006: RMB Nil). The Group's weighted average short-term interest rates were 5.87% and 5.34% at December 31, 2006 and 2007, respectively.

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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, 2007	Interest type	December 31, 2006	2007
<b>Arranged by Central Treasury of the Company:</b>				
U.S. Dollar denominated:				
Due in 2007	5.70%	Floating	383,034	
Payable semi-annually through 2008 (note (a))	1.80%	Fixed	23,710	9,097
Renminbi denominated:				
Due in 2008	6.30% - 7.47%	Fixed	400,000	250,000
Due in 2009	6.30% - 7.47%	Fixed	450,000	450,000
<b>Arranged by subsidiaries:</b>				
U.S. Dollar denominated:				
Payable annually through 2011	Interest free		14,055	10,519
Renminbi denominated:				
Payable due in 2007	5.85%	Fixed	8,500	
Payable due in 2008	5.27% - 6.72%	Fixed	110,000	135,000
Payable due in 2009	5.27% - 6.48%	Fixed		35,000
Payable due in 2010	5.91%	Fixed		100,000
Payable annually through 2010	Interest free		82,000	61,500
Payable annually through 2011	Interest free		9,000	7,200
Total long-term bank loans outstanding			1,480,299	1,058,316
Less: Amounts due within one year			(416,645)	(419,027)
Amounts due after one year			1,063,654	639,289

Note (a) Guaranteed by China Petrochemical Corporation

The aggregate maturities of long-term loans subsequent to December 31, 2007 are as follows:

2008	419,027
2009	509,929
2010	124,930
2011	4,430
	1,058,316

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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,	
	2006	2007
United States Dollars	USD261,901	USD86,556

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**Table of Contents****SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED****AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Continued)****(All Renminbi amounts in thousands, except per share data and except otherwise stated)****24. SHARE CAPITAL**

Share capital represents:

	<b>December 31,</b>	
	<b>2006</b>	<b>2007</b>
Registered, issued and paid up capital:		
4,870,000,000 A shares of RMB1.00 each	4,870,000	4,870,000
2,330,000,000 H shares of RMB1.00 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**

The Group optimizes the structure of its capital, comprising equity and loans. In order to maintain or adjust the capital structure, the Group may issue new shares, adjust the capital expenditure plan, sell assets to reduce debt, or adjust the proportion of short-term and long-term loans. The Group monitors capital on the basis of debt-to-equity ratio, which is calculated by dividing current and non-current loans by the total of equity attributable to equity shareholders of the Company, and liability-to-asset ratio, which is calculated by dividing total liabilities by total assets. The Group's strategy is to make appropriate adjustments according to the operating and investment needs and the changes of market conditions, and has maintained the debt-to-equity ratio and the liability-to-asset ratio at a range considered as reasonable by management. As at December 31, 2007, the debt-to-equity ratio and the liability-to-asset ratio of the Group were 22.91% (2006: 28.11%) and 29.82% (2006: 29.53%), 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 Group's approach to capital management during the year. Neither the Company nor any of its subsidiaries are subject to externally imposed capital requirements.

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Movements on reserves comprise:

	2006	2007
<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	3,174,419	3,248,104
Appropriation	73,685	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	3,248,104	3,485,894
<b>General surplus reserve (note c)</b>		
Balance at January 1	82,089	82,089
General surplus reserve transfer to statutory surplus reserve (note c)		(82,089)
Balance at December 31	82,089	
<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 December 31	21,949	347,564
<b>Retained profits (note h)</b>	4,867,270	6,057,649
	11,776,343	13,448,038

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



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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, 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, certain PRC accounting policies have been changed and applied retrospectively. The net profits 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 the current year.

*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, 2007, the retained earnings available for distribution of the Company was RMB5,630,080 (2006: RMB4,186,180). Final dividend of RMB648,000 (2006: RMB288,000) in respect of the financial year 2007 was declared after the balance sheet date.



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## (a) Capital commitments

The Group had capital commitments outstanding at December 31, 2007 not provided for in the financial statements as follows:

<b>Property, plant and equipment</b>	
Contracted but not provided for	311,991
Authorized by the Board but not contracted for	3,546,960
	3,858,951

## (b) Contingent liabilities

## (i) Financial guarantees issued

At December 31, 2007, the Group was contingently liable with respect to guarantees issued to banks in favor of associates and joint ventures of RMB30,747 (2006: RMB49,750).

Guarantees issued to banks in favor of associates and joint ventures are given to the extent of the Company's respective interest in these entities. The Group monitors the conditions that are subject to the guarantees to identify whether it is probable that a loss has occurred, and recognize any such losses under guarantees when those losses are estimable. At December 31, 2006 and 2007, 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

As discussed in note 11, the Group has certain income tax exposures with regard to prior years. At present, the directors of the Company consider that it is not possible to reliably estimate the eventual outcome of this matter and therefore no provision has been made in the financial statements for additional taxes, penalties and interest, if any.

**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 2007 (2006: 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.

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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, 2007, the Group's contribution to this plan amounted to RMB55,048 (2006: RMB61,692; 2005: RMB65,685).

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- (a) Most of the transactions undertaken by the Group during the year ended December 31, 2007 have been affected with such counterparties and on such terms as have been determined by China Petroleum & Chemical Corporation ( Sinopec Corp ), the immediate parent company, and 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, 2007, the value of crude oil purchased in accordance with Sinopec Corp's allocation was as follows:

	Years ended December 31,		
	2005	2006	2007
Purchases of crude oil	27,180,740	31,223,530	33,334,157

- (b) Other transactions between the Group and other related parties during the year ended December 31, 2007 were as follows:

	Years ended December 31,		
	2005	2006	2007
Sales of goods and service fee income	20,068,746	20,173,106	22,907,085
Purchases other than crude oil	2,318,351	2,579,394	5,400,022
Insurance premiums paid	95,521	98,643	106,000
Net withdrawal from deposits in a related party	(70,389)	(101,353)	(50,177)
Interest received and receivable	1,035	229	908
Loans borrowed	130,000	576,000	1,475,300
Loans repayment	130,000	626,000	40,000
Interest paid and payable	6,649	7,529	9,813
Transportation fees	415,497	344,928	254,128
Construction and installation fees	183,191	194,958	206,256
Proceeds from sales of property, plant & equipment	62,742	52,547	
Gains from disposal of investments	24,063	24,308	25,822
Sales commissions	70,752	182,840	194,645
Net decrease of guarantees	(33,586)	(18,550)	(19,003)

- (c) Deposits with related parties

December 31

	2006	2007
Deposits, with maturity within 3 months	79,913	29,736

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## (d) Loans with related parties

	December 31,	
	2006	2007
Short-term loans		1,355,300
Long-term loans		120,000
		1,475,300

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

	Years Ended December 31,	
	2006	2007
Short-term employee benefits	4,529	5,301
Post-employment benefits	84	89
	4,613	5,390

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:

	2006	2007
	RMB 000	RMB 000
Municipal retirement scheme costs	207,071	197,191
Supplementary retirement scheme costs	61,692	55,048

At December 31, 2006 and 2007, 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; and

use of public utilities.

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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 (CNOOC Group), which are state-controlled entities.

During the year ended December 31, 2007, the aggregate amount of crude oil purchased by the Group's refining segment from CNOOC Group was RMB1,126,222 (2006: RMB1,682,519; 2005: RMB2,095,315).

The amounts due from / to CNOOC Group are nil as at December 31, 2007 (2006: Nil).

## (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 expenses to these state-controlled banks in the PRC are as follows:

	2005	2006	2007
Interest income	39,315	56,597	45,992
Interest expenses	285,647	324,267	231,707

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

	2006	2007
Cash and cash equivalents at state-controlled banks in the PRC	731,971	745,401
Short-term loans and current portion of long-term loans	2,245,225	2,711,739
Long-term loans excluding current portion of long-term loans	983,710	465,000

Total loans from state-controlled banks in the PRC

3,228,935

3,176,739

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**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 fibers, resins and plastics, intermediate petrochemicals and petroleum products. All of the Group's products are produced through intermediate steps from the principal raw material of crude oil. The specific products of each segment are as follows:

- (a) The synthetic fibers segment produces primarily polyester and acrylic fibers 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 fibers and construction coating materials and containers. Low density polyethylene resins and plastics are used in cable jacketing, sheeting, the manufacture of moulded products, such as housewares and toys and for agricultural and packaging uses. Polypropylene resins are used in the manufacturing of extruded films or sheets and injection moulded products such as housewares, toys and household electric appliance and automobile parts.
- (c) The intermediate petrochemicals segment primarily produces ethylene and benzene. Most of the intermediate petrochemicals produced by the Group are used by the Group as raw materials in the production of other petrochemicals, resins, plastics and synthetic fibers. A portion of the intermediate petrochemicals as well as certain by-products of the production process are sold to outside customers.
- (d) The Group's petroleum products segment has crude oil distillation facilities used to produce vacuum and atmospheric gas oils used as feedstocks of the Group's downstream processing facilities. Residual oil and low octane gasoline fuels are produced primarily as a co-product of the crude oil distillation process. A proportion of the residual oil is further processed into qualified refined gasoline and diesel oil. In addition, the Group produces a variety of other transportation, industrial and household heating fuels, such as diesel oils, jet fuels, heavy oils and liquefied petroleum gases.
- (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 0.5% and 0.4% of total sales in 2006 and 2007 respectively.

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

	Years ended December 31,		
	2005	2006	2007
<b>Sales and other income</b>			
<b>Manufactured Products</b>			
Synthetic Fibers			
External sales	4,781,787	4,727,261	4,342,215
Intersegment sales	79	71	85
<b>Total</b>	<b>4,781,866</b>	<b>4,727,332</b>	<b>4,342,300</b>
Resins and Plastics			
External sales	14,010,287	15,800,015	15,927,089
Intersegment sales	53,020	63,767	75,183
<b>Total</b>	<b>14,063,307</b>	<b>15,863,782</b>	<b>16,002,272</b>
Intermediate Petrochemicals			
External sales (note a)	6,586,556	6,800,577	9,406,507
Intersegment sales	13,848,105	14,536,675	16,966,433
<b>Total</b>	<b>20,434,661</b>	<b>21,337,252</b>	<b>26,372,940</b>
Petroleum Products			
External sales (note a)	18,616,544	19,977,755	21,997,362
Intersegment sales	1,064,616	1,187,744	1,336,695
Other income	632,820	282,142	93,900
<b>Total</b>	<b>20,313,980</b>	<b>21,447,641</b>	<b>23,427,957</b>
<b>All others</b>			
External sales	1,960,729	3,293,877	3,655,211
Intersegment sales	3,687,428	3,582,206	3,402,717
<b>Total</b>	<b>5,648,157</b>	<b>6,876,083</b>	<b>7,057,928</b>
Eliminations of intersegment sales	(18,653,248)	(19,370,463)	(21,781,113)
<b>Consolidated sales and other income</b>	<b>46,588,723</b>	<b>50,881,627</b>	<b>55,422,284</b>

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

	Years ended December 31,		
	2005	2006	2007
<b>Sales to Sinopec Corp Group companies</b>			

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Synthetic Fibers	489,240		
Intermediate Petrochemicals	1,931,950	2,335,250	2,968,753
Petroleum Products	15,855,347	15,842,808	17,884,389
Total	18,276,537	18,178,058	20,853,142

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

	Years ended December 31,		
	2005	2006	2007
<b>Profit from operations</b>			
Synthetic Fibers	263,359	196,255	(82,083)
Resins and Plastics	1,490,740	1,162,103	656,475
Intermediate Petrochemicals	981,025	680,425	813,762
Petroleum Products	(446,867)	(1,697,730)	(644,234)
All others	239,703	211,854	148,736
<b>Consolidated profit from operations</b>	2,527,960	552,907	892,656
<b>Net financing costs</b>	(179,398)	(165,389)	(177,926)
<b>Investment income</b>			770,725
<b>Share of (losses) / profits of associates and jointly controlled entities</b>	(60,968)	576,682	665,897
	(240,366)	411,293	1,258,696
<b>Profit from ordinary activities before taxation</b>	2,287,594	964,200	2,151,352
<b>Income tax</b>	(366,300)	(53,238)	(468,216)
<b>Net income</b>	1,921,294	910,962	1,683,136
<b>Attributable to:</b>			
Equity shareholders of the Company	1,850,449	844,407	1,634,080
Minority interests	70,845	66,555	49,056
	1,921,294	910,962	1,683,136

	December 31,	
	2006	2007
<b>Assets</b>		
<b>Segment assets</b>		
Synthetic Fibers	2,877,473	2,756,536
Resins and Plastics	3,115,456	2,768,515
Intermediate Petrochemicals	5,876,117	7,440,853
Petroleum Products	8,507,134	8,929,073
All others	2,263,875	2,639,287
<b>Total segment assets</b>	22,640,055	24,534,264
<b>Interest in associates and jointly controlled entities</b>	2,787,795	3,068,135
<b>Unallocated:</b>		
(including Cash and cash equivalents, Deposits, Income tax recoverable, Investments, Deferred tax assets, Investment property and Goodwill)	1,978,210	2,250,651
<b>Consolidated assets</b>	27,406,060	29,853,050



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

	December 31,	
	2006	2007
<b>Liabilities</b>		
<b>Segment liabilities</b>		
Synthetic Fibers	254,614	325,867
Resins and Plastics	851,001	1,195,267
Intermediate Petrochemicals	366,284	705,922
Petroleum Products	1,076,017	1,650,818
All others	177,411	274,309
<b>Total segment liabilities</b>	2,725,327	4,152,183
<b>Unallocated:</b>		
(including Loans and borrowings, Income tax payable and Deferred income)	5,368,377	4,748,838
<b>Consolidated liabilities</b>	8,093,704	8,901,021

	Years ended December 31,		
	2005	2006	2007
<b>Depreciation and amortization</b>			
Synthetic Fibers	222,910	236,559	227,503
Resins and Plastics	350,625	353,321	351,273
Intermediate Petrochemicals	596,717	664,667	603,707
Petroleum Products	368,210	407,835	352,532
All others	167,192	178,008	169,392
<b>Segment depreciation and amortization</b>	1,705,654	1,840,390	1,704,407
<b>Unallocated:</b>	12,847	12,678	14,879
<b>Consolidated depreciation and amortization</b>	1,718,501	1,853,068	1,719,286

	Years ended December 31,		
	2005	2006	2007
<b>Impairment losses</b>			
Synthetic Fibers		50,000	180,681
All others			19,614
<b>Consolidated impairment losses</b>		50,000	200,295

	Years ended December 31,		
	2005	2006	2007
<b>Total capital expenditures for segment long-lived assets</b>			
Synthetic Fibers	172,106	145,513	130,392
Resins and Plastics	17,323	45,418	16,973
Intermediate Petrochemicals	497,787	1,083,542	773,720



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Petroleum Products	335,586	586,570	1,098,320
All others	104,003	147,736	114,718
<b>Total segment capital expenditures</b>	<b>1,126,805</b>	<b>2,008,779</b>	<b>2,134,123</b>
<b>Unallocated:</b>	<b>16,122</b>		
<b>Consolidated capital expenditures for segment long-lived assets</b>	<b>1,142,927</b>	<b>2,008,779</b>	<b>2,134,123</b>

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**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. The Group bases the assumptions and estimates on historical experience and on various other assumptions that the Group 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. The Group 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. The carrying amounts of long-lived assets are reviewed periodically in order to assess whether the recoverable amounts have declined below the carrying amounts. These assets are tested for impairment whenever events or changes in circumstances indicate that their recorded carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to 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 and cash generating units are not readily available. In determining the value in use, expected cash flows generated by the assets 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 values. The Group reviews 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 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.

**Impairment for bad and doubtful debts**

The Group estimates impairment losses for bad and doubtful debts resulting from the inability of the customers to make the required payments. The Group 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 write-offs would be higher than estimated.

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**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. The Group 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.

**Income tax**

As discussed in note 26(b), the directors of the Company consider that it is uncertain whether the relevant tax authorities will retrospectively claim additional EIT from the Company and that it is not possible to reliably estimate the eventual outcome of this matter. Consequently, no provision has been made in these financial statements in respect of the EIT differences arising from prior years.

**31. FINANCIAL INSTRUMENTS**

***Overview***

Financial assets of the Group include cash and cash equivalents, other investments, trade debtors, bills receivable, 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 no derivative instruments that are designated and qualified as hedging instruments at December 31, 2007 and 2006.

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 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.

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**SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED**

**AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

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

The Group 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 relating to trade receivables are set out in Note 15.

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

***Liquidity risk***

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group'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. The Group prepares monthly cash flow budget to ensure that they will always have sufficient liquidity to meet its financial obligation as they fall due. The Group arranges and negotiates financing with financial institutions and maintains a certain level of standby credit facilities to reduce the liquidity risk.

At December 31, 2007, the Group has standby credit facilities with several PRC financial institutions which allows the Group to borrow up to RMB2,900,000 (2006: RMB2,900,000) on an unsecured basis, at a weighted average interest rate of 6.29% (2006: 5.95%). At December 31, 2007, the Group's outstanding borrowings under these facilities were RMB1,812,642 (2006: RMB1,618,692) and were included in short-term bank loans.

**Table of Contents****SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED****AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Continued)****(All Renminbi amounts in thousands, except per share data and except otherwise stated)**

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:

**The Group**

	Carrying amount RMB 000	Total contractual undiscounted cash flow RMB 000	2006		
			Within 1 year or on demand RMB 000	More than 1 year but less than 2 years RMB 000	More than 2 years but less than 5 years RMB 000
Loans and borrowings (current)	4,270,337	4,405,610	4,405,610		
Loans and borrowings (non-current)	1,063,654	1,193,902	52,731	611,552	529,619
Trade creditors	1,385,577	1,385,577	1,385,577		
Bills payable	7,026	7,026	7,026		
Other creditors	732,951	732,951	732,951		
Amounts due to related parties	599,773	599,773	599,773		
	8,059,318	8,324,839	7,183,668	611,552	529,619

	Carrying amount RMB 000	Total contractual undiscounted cash flow RMB 000	2007		
			Within 1 year or on demand RMB 000	More than 1 year but less than 2 years RMB 000	More than 2 years but less than 5 years RMB 000
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****SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED****AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Continued)****(All Renminbi amounts in thousands, except per share data and except otherwise stated)****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 has no hedging policy on foreign currency balances, and principally reduces the currency risk by monitoring the level of foreign currency.

Included in loans and borrowings are the following amounts denominated in a currency other than the functional currency of the entity to which they relate:

	2006	2007
United States Dollars	USD261,901	USD86,556

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 RMB21,181 (2006: RMB86,917). 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 2006.

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.

**(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, 2007, 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 RMB12,146 (2006: RMB17,642). 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 in existence at that date with exposure to cash flow interest rate risk. The analysis is performed on the same basis for 2006.

**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 the Group 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.



**Table of Contents****SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED****AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Continued)****(All Renminbi amounts in thousands, except per share data and except otherwise stated)**

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 7.17% to 7.74% (2006: 6.00% to 6.48%). The following table presents the carrying amounts and fair values of the Group's long term loans at December 31, 2006 and 2007.

	2006		2007	
	Carrying amount	Fair value	Carrying amount	Fair value
<b>Liabilities</b>				
Long-term loans	1,480,299	1,445,950	1,058,316	1,034,682

The fair value of available-for-sale equity securities was based on quoted market price on a PRC stock exchange. 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.

### 32. POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE ANNUAL ACCOUNTING PERIOD ENDED DECEMBER 31, 2007

Up to the date of issue of these financial statements, the IASB has issued the following amendments, new standards and interpretations which are not yet effective for the annual accounting period ended December 31, 2007 and which have not been adopted in these financial statements:

	Effective for accounting period beginning on or after
IFRS 8, Operating Segments	January 1, 2009
Revised IAS 1, Presentation of financial statements	January 1, 2009
Revised IAS 23, Borrowing costs	January 1, 2009
IFRIC 11, IFRS 2 Group and treasury share transactions	March 1, 2007
IFRIC 12, Service concession arrangements	January 1, 2008
IFRIC 13, Customer loyalty programmes	July 1, 2008
IFRIC 14, IAS 19 The limit on a defined benefit asset, minimum funding requirements and their interaction	January 1, 2008

The Group 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. Up to the date of issuance of these financial statements, the Group believes that the adoption of IFRIC 11, IFRS 2, IFRIC 12, IFRIC 13, IFRIC 14 and IAS 19 are not applicable to any of the Group's operations and that the adoption of IFRS 8, Revised IAS 1 and Revised IAS 23 are unlikely to have a significant impact on the Group's results of operations and financial position.



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**SINOPEC SHANGHAI PETROCHEMICAL COMPANY LIMITED**

**AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

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

**33. NON-ADJUSTING POST BALANCE SHEET EVENTS**

In March 2008, the Group received a grant income of RMB247,280 as a 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 first quarter of 2008.

**34. PARENT COMPANIES**

The Directors consider the immediate parent company and the ultimate parent company at December 31, 2007 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.

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**SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED**

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**Years Ended December 31, 2005 (Unaudited), 2006 and 2007**

**Financial Statements of Shanghai Secco Petrochemical Company Limited (1)**

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- (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.

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**Independent Auditors Report**

The Board of Directors and Shareholders of

Shanghai Secco Petrochemical Company Limited:

We have audited the accompanying balance sheets of Shanghai Secco Petrochemical Company Limited ( the Company ) as of December 31, 2006 and 2007, and the related income statement, statement of changes in equity, and cash flow statement for the years then ended. 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, 2006 and 2007, and the results of its operations and its cash flows for the years then ended 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.

As more fully described in Notes 3 and 4 to the financial statements, commencing January 1, 2007, the Company has adopted the China Accounting Standards for Business Enterprises issued by the Ministry of Finance of the PRC (the MOF ) on February 15, 2006 that have resulted in certain changes in PRC accounting policies.

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, 2006 and 2007***(Expressed in Renminbi)*

	Note	2006 RMB 000	2007 RMB 000
<b>Assets</b>			
<b>Current assets</b>			
Cash at bank and on hand	6	1,654,819	1,566,397
Bills receivable	7	664,533	1,198,306
Accounts receivable	8	330,704	512,035
Prepayments	9	264,717	70,432
Other receivables	10	14,249	18,314
Inventories	11	1,790,351	2,002,500
Other current assets	12	1,454,000	1,455,309
<b>Total current assets</b>		<b>6,173,373</b>	<b>6,823,293</b>
<b>Non-current assets</b>			
Fixed assets	13	14,051,870	12,813,676
Construction in progress	14	28,027	148,821
Intangible assets	15	1,470,095	1,368,122
Long-term deferred expenses	16	37,273	12,053
Deferred tax assets	17	17,636	70,603
<b>Total non-current assets</b>		<b>15,604,901</b>	<b>14,413,275</b>
<b>Total assets</b>		<b>21,778,274</b>	<b>21,236,568</b>
<b>Liabilities and investors' equity</b>			
<b>Current liabilities</b>			
Accounts payable		1,075,676	1,087,670
Advances from customers		372,383	243,215
Employee benefits payable	19	84,274	79,042
Taxes payable/(recoverable)	5(3)	75,471	(45,645)
Interest payable		49,020	17,921
Other payables		397,020	83,690
Long-term loans due within one year	20	477,769	556,397
<b>Total current liabilities</b>		<b>2,531,613</b>	<b>2,022,290</b>
<b>Non-current liabilities</b>			
Long-term loans	21	9,853,625	8,772,455
<b>Total non-current liabilities</b>		<b>9,853,625</b>	<b>8,772,455</b>
<b>Total liabilities</b>		<b>12,385,238</b>	<b>10,794,745</b>
<b>Investors' equity</b>			
Paid-in capital	22	7,443,585	7,443,585
Capital reserve	23	(509)	(509)

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Surplus reserve	24	39,393	39,393
Retained earnings		1,910,567	2,959,354
Total equity		9,393,036	10,441,823
Total liabilities and investors equity		21,778,274	21,236,568

These financial statements have been approved by the Board of Directors of the Company on April 1, 2008.

**Didier Baudrand**  
Legal Representative

**Zhang Zhiliang**  
General Manager

**Hua Xin**  
Chief Financial Officer

The notes on pages F-71 to F-105 form part of these financial statements.

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**Table of Contents****SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED****Income Statement****For the Years Ended December 31, 2005 (Unaudited), 2006 and 2007***(Expressed in Renminbi)*

	Note	2005 RMB 000 (Unaudited)	2006 RMB 000	2007 RMB 000
Operating income	26	12,705,140	21,790,806	24,218,596
Less: Operating costs	27	(12,132,306)	(18,038,293)	(20,357,771)
Business taxes and surcharges		(361)	(594)	(503)
Selling and distribution expenses		(267,743)	(352,307)	(321,285)
General and administrative expenses		(754,279)	(288,557)	(443,189)
Financial expenses	28	(284,218)	(423,960)	(238,032)
Impairment loss	29	(15,406)	9,980	(127)
Add: Investment income	30			39,238
Operating (loss)/profit		(749,173)	2,697,075	2,896,927
Add: Non-operating income		6,517	12,058	10,654
Less: Non-operating expenses		(1,074)	(799)	(1,194)
(Including: Loss from disposal of non-current assets)		(363)	(267)	(893)
(Loss)/profit before income tax		(743,730)	2,708,334	2,906,387
Add: Income tax benefit	31		17,636	52,967
Net (loss)/profit for the year		(743,730)	2,725,970	2,959,354

These financial statements have been approved by the Board of Directors of the Company on April 1, 2008.

**Didier Baudrand**  
Legal Representative

**Zhang Zhiliang**  
General Manager

**Hua Xin**  
Chief Financial Officer

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, 2005 (Unaudited), 2006 and 2007***(Expressed in Renminbi)*

	Note	2005 RMB 000 (Unaudited)	2006 RMB 000	2007 RMB 000
<b>Cash flows from operating activities:</b>				
Cash received from sale of goods		14,466,263	24,861,800	27,458,031
Refund of taxes		1,450	154	230
Other cash received relating to operating activities		18,719	71,555	64,618
<b>Sub-total of cash inflows</b>		<b>14,486,432</b>	<b>24,933,509</b>	<b>27,522,879</b>
<b>Cash paid for goods</b>				
Cash paid for goods		(14,040,129)	(19,945,622)	(22,924,708)
Cash paid to and for employees		(170,901)	(198,586)	(218,791)
Cash paid for all types of taxes		(40,283)	(562,294)	(923,535)
Other cash paid relating to operating activities		(24,348)	(43,516)	(16,026)
<b>Sub-total of cash outflows</b>		<b>(14,275,661)</b>	<b>(20,750,018)</b>	<b>(24,083,060)</b>
<b>Net cash inflow from operating activities</b>	32	<b>210,771</b>	<b>4,183,491</b>	<b>3,439,819</b>
<b>Cash flows from investing activities:</b>				
Cash received from disposal of investments				2,572,000
Cash received from return on investments				37,929
Net cash received from disposal of fixed assets			257	
<b>Sub-total of cash inflows</b>			<b>257</b>	<b>2,609,929</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		(2,683,935)	(851,533)	(311,201)
Cash paid for acquisition of investments			(1,454,145)	(2,572,000)
Other cash paid relating to investing activities		(74,373)	(1,586)	
<b>Sub-total of cash outflows</b>		<b>(2,758,308)</b>	<b>(2,307,264)</b>	<b>(2,883,201)</b>
<b>Net cash outflow from investing activities</b>		<b>(2,758,308)</b>	<b>(2,307,007)</b>	<b>(273,272)</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, 2005 (Unaudited), 2006 and 2007 (Continued)***(Expressed in Renminbi)*

	Note	2005 RMB 000 (Unaudited)	2006 RMB 000	2007 RMB 000
<b>Cash flows from financing activities:</b>				
Cash received from investors		1,092,975	347,594	
Cash received from borrowings		3,071,667		9,366,238
Sub-total of cash inflows		4,164,642	347,594	9,366,238
Cash repayments of borrowings		(820,000)	(320,000)	(10,056,238)
Cash paid for profits distribution and interest		(492,190)	(613,779)	(2,563,383)
Other cash paid relating to financing activities		(6,905)	(4,575)	(429)
Sub-total of cash outflows		(1,319,095)	(938,354)	(12,620,050)
Net cash outflow from financing activities		2,845,547	(590,760)	(3,253,812)
Effect of foreign exchange rate changes on cash and cash equivalents		(1,244)	(6,858)	(1,157)
Net increase/(decrease) in cash and cash equivalents		296,766	1,278,866	(88,422)
Add: cash and cash equivalents at the beginning of the year		79,187	375,953	1,654,819
Cash and cash equivalents at the end of the year		375,953	1,654,819	1,566,397

These financial statements have been approved by the Board of Directors of the Company on April 1, 2008.

**Didier Baudrand**  
Legal Representative

**Zhang Zhiliang**  
General Manager

**Hua Xin**  
Chief Financial Officer

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, 2005 (Unaudited), 2006 and 2007***(Expressed in Renminbi)*

	Note	Paid-in capital RMB 000	Capital reserve RMB 000	Surplus reserve RMB 000	(Accumulated losses)/ retained earnings RMB 000	Total RMB 000
Balance at January 1, 2005 (Unaudited)		6,002,521	(14)		(12,584)	5,989,923
Changes in equity for the year						
Net profit for the year					(743,730)	(743,730)
Contribution by investors		1,092,975				1,092,975
Balance at December 31, 2005 (Unaudited)		7,095,496	(14)		(756,314)	6,339,168
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	25				(1,910,567)	(1,910,567)
Balance at December 31, 2007		7,443,585	(509)	39,393	2,959,354	10,441,823

These financial statements have been approved by the Board of Directors of the Company on April 1, 2008.

**Didier Baudrand**  
Legal Representative

**Zhang Zhiliang**  
General Manager

**Hua Xin**  
Chief Financial Officer

The notes on pages F-71 to F-105 form part of these financial statements.

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**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 in 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 USD901,440,964.

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 and other 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.

(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

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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. 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.

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**SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED**

**Notes to the Financial Statements (Continued)**

*(Expressed in Renminbi)*

(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 maintains a perpetual inventory system.

(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.



**Table of Contents****SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED****Notes to the Financial Statements (Continued)***(Expressed in Renminbi)*

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:

	<b>Estimated useful life</b>	<b>Estimated residual value</b>	<b>Depreciation rate</b>
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 each year end.

**(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 such intangible assets are as follows:

	<b>Estimated useful lives</b>
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.

**(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.

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**SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED**

**Notes to the Financial Statements (Continued)**

*(Expressed in Renminbi)*

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 allocated to the asset group or set of asset groups, and then reduce the carrying amount of the other 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.

(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.

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**SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED**

**Notes to the Financial Statements (Continued)**

*(Expressed in Renminbi)*

- 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.

(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 in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognized, the 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.

(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.

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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

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**SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED**

**Notes to the Financial Statements (Continued)**

*(Expressed in Renminbi)*

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.

(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 deductible losses 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.

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.

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**Table of Contents**

**SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED**

**Notes to the Financial Statements (Continued)**

*(Expressed in Renminbi)*

(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 services performed to date to the total services to be performed.

(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 related to that compensates the Company for expenses incurred is recognized in profit or loss immediately.



(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.

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**SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED**

**Notes to the Financial Statements (Continued)**

*(Expressed in Renminbi)*

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.

(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.

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**SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED**

**Notes to the Financial Statements (Continued)**

*(Expressed in Renminbi)*

(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.

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.

**4 CHANGES IN ACCOUNTING POLICIES**

(1) Changes in accounting policies and their effects

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The Company adopted CAS (2006) on January 1, 2007. The significant accounting policies applicable to the Company under CAS (2006) are summarized in Note 3. Apart from the reclassification adjustments as set out below, there was no significant impact on the financial statements of the Company upon adoption of CAS(2006). Certain items in the comparative figures of 2005 and 2006 have been reclassified to conform with the requirements of CAS 38.

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**Table of Contents****SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED****Notes to the Financial Statements (Continued)***(Expressed in Renminbi)*

Affected asset and liability items in the balance sheet as at December 31, 2006

	Before adjustment RMB 000	Adjustment RMB 000	After adjustment RMB 000
Short-term investments	1,454,000	(1,454,000)	
Other current assets		1,454,000	1,454,000
Fixed assets	14,566,444	(514,574)	14,051,870
Intangible assets	955,521	514,574	1,470,095
Other payables	457,153	(60,133)	397,020
Staff welfare payable	21,802	(21,802)	
Employee benefits payable		84,274	84,274
Other creditors	2,708	(2,708)	
Tax payable	75,102	369	75,471

Affected income and expense items in the income statement for the year ended December 31, 2005 (Unaudited)

	Before adjustment RMB 000	Adjustment RMB 000	After adjustment RMB 000
Sales from principal activities	12,690,197	(12,690,197)	
Other operating income	14,943	(14,943)	
Operating income		12,705,140	12,705,140
Cost of sales from principal activities	(12,117,727)	12,117,727	
Other operating costs	(14,579)	14,579	
Operating costs		(12,132,306)	(12,132,306)
Business taxes and surcharges		(361)	(361)
General and administrative expenses	(769,685)	15,406	(754,279)
Impairment loss		(15,406)	(15,406)
Subsidy income	6,457	(6,457)	
Non-operating income	60	6,457	6,517

Affected income and expense items in the income statement for the year ended December 31, 2006

	Before adjustment RMB 000	Adjustment RMB 000	After adjustment RMB 000
Sales from principal activities	21,777,397	(21,777,397)	
Other operating income	13,409	(13,409)	
Operating income		21,790,806	21,790,806
Cost of sales from principal activities	(18,025,664)	18,025,664	
Other operating costs	(13,223)	13,223	
Operating costs		(18,038,293)	(18,038,293)
Business taxes and surcharges		(594)	(594)

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General and administrative expenses	(278,577)	(9,980)	(288,557)
Impairment loss		9,980	9,980
Subsidy income	11,515	(11,515)	
Non-operating income	543	11,515	12,058

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**Table of Contents****SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED****Notes to the Financial Statements (Continued)***(Expressed in Renminbi)***5 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:

Business tax rate:	5%
VAT rate:	17%

- (2) Income tax

In accordance with State Tax Bureau notices (Guo Shui Han [2003] 420), the income tax rate applicable to the Company for the year ended December 31, 2007 was 15% (2005:15%; 2006: 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.

2007 is the second year that the Company makes a taxable profit after the offset of deductible losses incurred in prior years. The applicable income tax rate was 0%.

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 a 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. The 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 standard 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. The applicable new rates were considered to measure the Company's deferred tax assets as at December 31, 2007.

- (3) Taxes payable/(recoverable)

	2006 RMB 000	2007 RMB 000
VAT payable/(recoverable)	73,916	(47,177)
Others	1,555	1,532
<b>Total</b>	<b>75,471</b>	<b>(45,645)</b>



**6 CASH AT BANK AND ON HAND**

	<b>2006</b>	<b>2007</b>
	<b>RMB 000</b>	<b>RMB 000</b>
Cash on hand	48	32
Demand deposits	1,654,771	1,566,365
<b>Total</b>	<b>1,654,819</b>	<b>1,566,397</b>

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**Table of Contents****SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED****Notes to the Financial Statements (Continued)***(Expressed in Renminbi)***7 BILLS RECEIVABLE**

	2006 RMB 000	2007 RMB 000
Bank acceptance bills	664,533	1,198,306

All of the above bills held by the Company are due within one year.

**8 ACCOUNTS RECEIVABLE**

(1) Accounts receivable by customers type:

	Note	2006 RMB 000	2007 RMB 000
Amounts due from related parties	35(2) (ii)	183,082	283,160
Amounts due from others customers		147,622	228,875
<b>Total</b>		<b>330,704</b>	<b>512,035</b>

(2) The ageing analysis of the Company's accounts receivables is as follows:

	Amounts RMB 000	2006 Percentage of total accounts receivables	Bad debt provision RMB 000	Amounts RMB 000	2007 Percentage of total accounts receivables	Bad debt provision RMB 000
Within 1 year	330,704	100%		512,035	100%	

The ageing is counted starting from the date accounts receivable is recognized.

**9 PREPAYMENTS**

Prepayments are made for purchase. All the prepayments are due within one year.

**10 OTHER RECEIVABLES**

(1) Other receivables by customers type:

	Note	2006 RMB 000	2007 RMB 000
Amounts due from related parties	35(2) (ii)	537	18,314
Amounts due from others parties		13,712	18,314
<b>Total</b>		<b>14,249</b>	<b>18,314</b>

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**Table of Contents****SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED****Notes to the Financial Statements (Continued)***(Expressed in Renminbi)*

(2) The ageing analysis of the Company's other receivables is as follows:

	Amounts RMB 000	2006 Percentage of total other receivables	Bad debt provision RMB 000	Amounts RMB 000	2007 Percentage of total other receivables	Bad debt provision RMB 000
Within 1 year (inclusive)	13,541	95%		17,021	93%	
1 and 2 years (inclusive)	708	5%		1,035	6%	
2 and 3 years (inclusive)				258	1%	
Total	14,249	100%		18,314	100%	

The ageing is counted starting from the date of recognition of other receivables.

**11 INVENTORIES**

	2006 RMB 000	2007 RMB 000
Raw materials	864,873	949,683
Work in progress	42,288	41,485
Semi-finished goods	387,594	397,696
Finished goods	501,022	619,189
Subtotal	1,795,777	2,008,053
Less: Provision for diminution in value of inventories	(5,426)	(5,553)
Total	1,790,351	2,002,500

An analysis of provision for diminution in value of inventories is as follows:

	Semi-finished goods RMB 000	2006 Finished goods RMB 000	Total RMB 000	Semi-finished goods RMB 000	2007 Finished goods RMB 000	Total RMB 000
Opening balance as at January 1	(6,979)	(8,427)	(15,406)	(3,279)	(2,147)	(5,426)
Add: Provision made during the year	(3,279)	(2,147)	(5,426)		(5,553)	(5,553)
Less: Reversal during the year	6,979	8,427	15,406	3,279	2,147	5,426

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Closing balance as at December 31	(3,279)	(2,147)	(5,426)	(5,553)	(5,553)
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**Table of Contents****SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED****Notes to the Financial Statements (Continued)***(Expressed in Renminbi)***12 OTHER CURRENT ASSETS**

	2006 RMB 000	2007 RMB 000
Designated loan		
- principal	1,454,000	1,454,000
- interest receivable		1,309
Less: Provision for diminution in value		
<b>Total</b>	<b>1,454,000</b>	<b>1,455,309</b>

The Company entrusted Bank of Communications Shanghai Branch to grant loans. Details of loan balances as at December 31, 2007 are as follows:

Borrower	Balance	Duration	Interest rate
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>		

**13 FIXED ASSETS**

	Plant and buildings RMB 000	Machinery and equipment RMB 000	Office and other equipment RMB 000	Motor vehicles RMB 000	Total RMB 000
<b>Cost:</b>					
As at January 1, 2006	1,247,955	14,869,101	78,372	2,340	16,197,768
Additions		3,973	10,228	1,510	15,711
Transfer from construction in progress		2,034			2,034
Disposals			(2,819)		(2,819)
<b>As at December 31, 2006</b>	<b>1,247,955</b>	<b>14,875,108</b>	<b>85,781</b>	<b>3,850</b>	<b>16,212,694</b>
<b>Accumulated depreciation:</b>					
As at January 1, 2006	(63,268)	(913,716)	(22,336)	(203)	(999,523)
Charge for the year	(73,289)	(1,073,364)	(16,583)	(360)	(1,163,596)
Written back on disposal			2,295		2,295

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As at December 31, 2006	(136,557)	(1,987,080)	(36,624)	(563)	(2,160,824)
Carrying amount:					
As at December 31, 2006	1,111,398	12,888,028	49,157	3,287	14,051,870
As at January 1, 2006	1,184,687	13,955,385	56,036	2,137	15,198,245

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**Table of Contents****SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED****Notes to the Financial Statements (Continued)***(Expressed in Renminbi)*

	<b>Plant and buildings RMB 000</b>	<b>Machinery and equipment RMB 000</b>	<b>Office and other equipment RMB 000</b>	<b>Motor vehicles RMB 000</b>	<b>Total RMB 000</b>
<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

The Company is still in the progress of application of the property certificate for the plant and buildings.

**14 CONSTRUCTION IN PROGRESS**

	<b>2006 RMB 000</b>	<b>2007 RMB 000</b>
<b>Cost</b>		
Balance at the beginning of the year	1,671	28,027
Additions during the year	28,390	151,377
Transferred to fixed assets	(2,034)	(25,716)
Transferred to intangible assets		(4,867)
Balance at the end of the year	28,027	148,821



**Table of Contents****SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED****Notes to the Financial Statements (Continued)***(Expressed in Renminbi)***15 INTANGIBLE ASSETS**

	<b>Land use right RMB 000</b>	<b>Patent RMB 000</b>	<b>Computer software RMB 000</b>	<b>Total RMB 000</b>
<b>Cost</b>				
As at January 1, 2006	770,967	880,076	20,499	1,671,542
Additions during the year			2,915	2,915
As at December 31, 2006	770,967	880,076	23,414	1,674,457
<b>Accumulated amortization</b>				
As at January 1, 2006	(15,194)	(74,454)	(5,922)	(95,570)
Charge for the year	(16,430)	(88,007)	(4,355)	(108,792)
As at December 31, 2006	(31,624)	(162,461)	(10,277)	(204,362)
<b>Carrying amount</b>				
As at December 31, 2006	739,343	717,615	13,137	1,470,095
As at January 1, 2006	755,773	805,622	14,577	1,575,972
<b>Cost</b>				
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
<b>Accumulated amortization</b>				
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)
<b>Net book value</b>				
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

**16 LONG-TERM DEFERRED EXPENSES**

	<b>2006</b>	<b>2007</b>
	<b>RMB 000</b>	<b>RMB 000</b>
Balance at the beginning of the year		37,273
Additions for the year	41,906	7,775
Amortization for the year	(4,633)	(32,995)
Balance at the end of the year	37,273	12,053

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**Table of Contents****SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED****Notes to the Financial Statements (Continued)***(Expressed in Renminbi)***17 DEFERRED TAX ASSETS**

	2006		2007	
	Deductible temporary difference RMB 000	Deferred tax assets RMB 000	Deductible temporary difference RMB 000	Deferred tax assets RMB 000
Deferred tax assets				
Income tax credit for purchase of homemade machine			527,700	47,493
Provision for diminution in value of inventories			5,553	500
Pre-operating expenses	343,679	17,636	235,149	22,610
<b>Total</b>	<b>343,679</b>	<b>17,636</b>	<b>768,402</b>	<b>70,603</b>

**18 PROVISIONS FOR IMPAIRMENT**

At December 31, 2006 and 2007, the provisions for impairment of the Company are set out as follows:

	2006	2007
	Inventories RMB 000	Inventories RMB 000
Balance at the beginning of the year	(15,406)	(5,426)
Charge for the year	(5,426)	(5,553)
Reversal during the year	15,406	5,426
Balance at the end of the year	(5,426)	(5,553)

**19 EMPLOYEE BENEFITS PAYABLE**

	2006	2007
	RMB 000	RMB 000
Staff welfare fees	21,023	21,023
Social insurances		
Medical insurance premium	909	986
Basic old age insurance premium	2,014	2,183
Unemployment insurance premium	194	211
Labor union fee, staff and workers education fee	1,700	1,345
Others	58,434	53,294
<b>Total</b>	<b>84,274</b>	<b>79,042</b>

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**Table of Contents****SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED****Notes to the Financial Statements (Continued)***(Expressed in Renminbi)***20 LONG-TERM LOANS DUE WITHIN ONE YEAR**

	2006				2007			
	Principal in foreign currency 000	RMB/ RMB equivalent RMB 000	Interest rate (p.a.)	Secured/ guaranteed	Principal in foreign currency 000	RMB/ RMB equivalent RMB 000	Interest rate (p.a.)	Secured/ guaranteed
Bank loans:								
- RMB		150,975	10% lower than RMB benchmark interest rate	Guaranteed by BP International and Sinopec		148,800	10% lower than RMB benchmark interest rate	Credit
- USD	41,850	326,794	LIBOR+ 0.7%	Guaranteed by BP International and Sinopec	55,800	407,597	LIBOR+ 0.2%	Credit
Total		477,769				556,397		

**21 LONG-TERM LOANS**

	2006				2007			
	Principal in foreign currency 000	RMB/ RMB equivalent RMB 000	Interest rate (p.a.)	Secured/ guaranteed	Principal in foreign currency 000	RMB/ RMB equivalent RMB 000	Interest rate (p.a.)	Secured/ guaranteed
Bank loans:								
- RMB		5,339,025	10% lower than RMB benchmark interest rate	Guaranteed by BP International and Sinopec		4,651,200	10% lower than RMB benchmark interest rate	Credit
- USD	578,150	4,514,600	LIBOR+ 0.7%	Guaranteed by BP International and Sinopec	564,200	4,121,255	LIBOR+ 0.2%	Credit

Total	9,853,625	8,772,455
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On December 20, 2007, the Company made early repayment of all the long-term loans as at December 31, 2006. On the same date, the Company borrowed Renminbi loans amounting to RMB 4,800,000,000 and US dollar loans amounting to USD620,000,000 from Bank of China, Industrial & Commercial Bank of China, China Construction Bank, Bank of Communications, Shanghai Pudong Development Bank and Sinopec Finance Co., Ltd.

According to the loan contract, the Renminbi loans are repayable in 28 instalments during the period from June 20, 2008 to December 20, 2021.

The US dollar loans are repayable in 12 instalments during the period from June 20, 2008 to December 20, 2013.

**Table of Contents****SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED****Notes to the Financial Statements (Continued)***(Expressed in Renminbi)*

The maturity analysis of the Company's long-term loan is set out below:

	2006 RMB 000	2007 RMB 000
Due after 1 year but within 2 years (inclusive)	985,559	561,197
Due after 2 years but within 3 years (inclusive)	1,025,588	679,218
Due after 3 years	7,842,478	7,532,040
Total	9,853,625	8,772,455

**22 PAID-IN CAPITAL**

Registered capital

	2006 and 2007	
	Amount USD 000	%
BPCECIL	450,720	50%
Sinopec	270,432	30%
SPCL	180,288	20%
	901,440	100%

Paid-in capital

	2006 and 2007		
	Amount in original currency USD 000	Amount in RMB 000 equivalent	%
BPCECIL	450,720	3,721,792	50%
Sinopec		2,233,076	30%
SPCL		1,488,717	20%
		7,443,585	100%

**23 CAPITAL RESERVE**

2006 and 2007  
RMB 000

Foreign currency capital translation differences	(509)
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24 SURPLUS RESERVE

	General reserve fund RMB 000	Enterprise expansion fund RMB 000	Total RMB 000
At December 31, 2006 and 2007	19,697	19,696	39,393

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**Table of Contents****SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED****Notes to the Financial Statements (Continued)***(Expressed in Renminbi)***25 APPROPRIATION OF PROFITS**

Cash dividends attributable to investors

The Board of Directors approved on March 1, 2007 and June 26, 2007, the appropriation of cash dividends totalling RMB1,910,566,958 (2006: Nil) to the Company's investors.

**26 OPERATING INCOME**

	2005 RMB 000 (Unaudited)	2006 RMB 000	2007 RMB 000
Operating income from principal activities			
-Sale of goods	12,616,859	21,657,400	24,056,676
-Rendering of services	73,338	119,997	150,562
Sub-total	12,690,197	21,777,397	24,207,238
Other operating income	14,943	13,409	11,358
Total	12,705,140	21,790,806	24,218,596

**27 OPERATING COSTS**

	2005 RMB 000 (Unaudited)	2006 RMB 000	2007 RMB 000
Operating cost from principal activities			
-Sale of goods	12,057,162	17,947,673	20,286,631
-Rendering of services	60,565	77,991	64,652
Sub-total	12,117,727	18,025,664	20,351,283
Other operating costs	14,579	12,629	6,488
Total	12,132,306	18,038,293	20,357,771

**28 FINANCIAL EXPENSES**

2005	2006	2007
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	<b>RMB 000</b> <b>(Unaudited)</b>	<b>RMB 000</b>	<b>RMB 000</b>
Interest expense from loans	478,793	617,916	624,453
Less: Borrowing costs capitalized	(71,339)		
Net interest expense	407,454	617,916	624,453
Less: Interest income from deposits and receivables	(4,733)	(38,678)	(61,040)
Net exchange gains	(125,159)	(157,429)	(325,948)
Other financial expenses	6,656	2,151	567
<b>Total</b>	<b>284,218</b>	<b>423,960</b>	<b>238,032</b>

**29 IMPAIRMENT LOSS**

	<b>2005</b> <b>RMB 000</b> <b>(Unaudited)</b>	<b>2006</b> <b>RMB 000</b>	<b>2007</b> <b>RMB 000</b>
Inventories	(15,406)	9,980	(127)

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**Table of Contents****SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED****Notes to the Financial Statements (Continued)***(Expressed in Renminbi)***30 INVESTMENT INCOME**

	2005 RMB 000 (Unaudited)	2006 RMB 000	2007 RMB 000
Interest income from designated loans			39,238

**31 INCOME TAX BENEFIT**

(1) Income tax benefit for the year represents

	2005 RMB 000 (Unaudited)	2006 RMB 000	2007 RMB 000
Current tax expenses for the year			
Deferred taxation		17,636	52,967
<b>Total</b>		<b>17,636</b>	<b>52,967</b>

The analysis of deferred tax expenses is set out below:

	2005 RMB 000 (Unaudited)	2006 RMB 000	2007 RMB 000
Origination and reversal of temporary differences		17,636	47,993
Change in tax rate			4,974
<b>Total</b>		<b>17,636</b>	<b>52,967</b>

(2) Reconciliation between income tax expenses and accounting profits is as follows:

	2005 RMB 000 (Unaudited)	2006 RMB 000	2007 RMB 000
(Loss) / profit before income tax	(743,729)	2,708,334	2,906,387

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Expected income tax expenses at a tax rate of 15%	(111,559)	406,250	435,958
Tax effect of non-taxable income		(406,250)	(435,958)
Tax effect of tax loss to offset future taxable profit	93,923		
Tax effect of pre-operating expenses not recognized for deferred tax	17,636		
Effect of change in tax rate on deferred tax			(4,974)
Others		(17,636)	(47,993)
Income tax benefit		(17,636)	(52,967)

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**Table of Contents****SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED****Notes to the Financial Statements (Continued)***(Expressed in Renminbi)***32 SUPPLEMENT TO CASH FLOW STATEMENT**

(1) Reconciliation of net (loss)/profit to cash flows from operating activities:

	<b>2005</b>	<b>2006</b>	<b>2007</b>
	<b>RMB 000</b>	<b>RMB 000</b>	<b>RMB 000</b>
	<b>(Unaudited)</b>		
Net (loss)/profit	(743,730)	2,725,970	2,959,354
Add: Provision for / (reversal of) impairment of assets	15,406	(9,980)	127
Depreciation of fixed assets	987,376	1,163,596	1,207,042
Amortization of intangible assets	84,385	108,792	110,079
Amortization of long-term deferred expenses	542,651	4,633	32,995
Loss on disposal of fixed assets	363	267	764
Financial expenses	288,951	462,638	299,072
Gains arising from investments			(39,238)
Increase in gross inventories	(1,398,042)	(194,914)	(212,276)
Increase in operating receivables	(370,834)	(694,471)	(524,884)
Increase/(decrease) in operating payables	804,245	634,596	(340,249)
Increase in deferred tax assets		(17,636)	(52,967)
<b>Net cash inflow from operating activities</b>	<b>210,771</b>	<b>4,183,491</b>	<b>3,439,819</b>

**33 SEGMENT REPORT**

The Company does not engage in multiple businesses or operate in multiple locations, therefore no segment analysis is provided.

**34 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.

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.

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**SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED**

**Notes to the Financial Statements (Continued)**

*(Expressed in Renminbi)*

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 its 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 and adequate committed lines of funding from major financial institutions to meet its liquidity requirements in the short and longer term.

The maturity analysis of the designated loans and long-term debts are disclosed in Note 12 and 21.

(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, 2006 and 2007.





**Table of Contents****SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED****Notes to the Financial Statements (Continued)***(Expressed in Renminbi)*

## (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.

**35 RELATED PARTY RELATIONSHIPS AND TRANSACTIONS**

## (1) Information on the investors of the Company is listed as follows:

	Registered place	Business nature	Shareholding percentage	Proportion of voting rights
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*

	<b>2005</b>	<b>2006</b>	<b>2007</b>
	<b>RMB 000</b>	<b>RMB 000</b>	<b>RMB 000</b>
	<b>(Unaudited)</b>		
Sinopec International Co., Ltd. ( Sinopec International )	109,803	3,717	896
SPCL	64,325	58	
Jinshan Associated Trading Corporation ( JAT )	15,214	11,141	
Other fellow subsidiaries of Sinopec, SPCL	35,086	1,466	943
	224,428	16,382	1,839

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**Table of Contents****SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED****Notes to the Financial Statements (Continued)***(Expressed in Renminbi)**Purchase of goods*

	2005 RMB 000 (Unaudited)	2006 RMB 000	2007 RMB 000
Sinopec International	81,925		
Sinopec Shanghai Gaoqiao Branch ( Sinopec Gaoqiao Branch )	3,429,090	4,876,223	4,624,063
Sinopec Maoming Branch		832,050	
Sinopec Guangzhou Branch		210,391	202,539
Sinopec Zhenhai Branch	4,070,950	6,871,035	8,474,446
SPCL	741,596	706,459	1,031,613
CIUPC	444,842		
Sinopec Jinling Branch	259,798		172,248
JAT	62,800	17,223	9,702
Shanghai Jindi Petrochemical Co., Ltd ( Shanghai Jindi )	75,780	344,334	94,517
Hangzhou Refinery China			
Petrochemical Corporation ( Hangzhou Refinery )			79,142
BP Singapore Pte Limited ( BP Singapore )	711,627	92,268	46,935
O&D Trading Limited	19,621		
Other fellow subsidiaries of Sinopec, SPCL	10,432	16,282	34,205
	9,908,461	13,966,265	14,769,410

*Sales of goods*

	2005 RMB 000 (Unaudited)	2006 RMB 000	2007 RMB 000
Sinopec International Industry Co., Ltd ( Sinopec International Industry )	70,046	92,360	
Sinopec International		59,352	82,151
Sinopec Gaoqiao Branch	433,045	926,397	2,327,563
Sinopec Sales Company Shanghai Branch ( SCS )	24,389	8,996	
SPCL	472,191	909,854	1,624,352
JAT	253,896	706,042	243,699
Zhejiang Jinyong Acrylic Co., Ltd. ( Jinyong Acrylic )	516,808	723,803	729,079
Shanghai Jinhua Industry Co., Ltd. ( Jinhua Industry )		307	
BP Singapore	64,996	50,361	
	1,835,371	3,477,472	5,006,844

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**Table of Contents****SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED****Notes to the Financial Statements (Continued)***(Expressed in Renminbi)**Lease*

	2005 RMB 000 (Unaudited)	2006 RMB 000	2007 RMB 000
SPCL		3,203	2,153

*Designated loans*

	2005 RMB 000 (Unaudited)	2006 RMB 000	2007 RMB 000
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>

The Board of Directors of the Company is of the opinion that the above transactions with related parties were conducted under normal commercial terms or relevant agreements.

- ii) The balances of transactions with related parties at December 31, are set out as follows:

	2006					
	Accounts receivable RMB 000	Prepayments RMB 000	Other receivables RMB 000	Accounts payable RMB 000	Advances from customers RMB 000	Other payables RMB 000
Sinopec International			537		2,074	1,975
Sinopec Zhenhai				366,116		
Sinopec Gaoqiao Branch	52,275			229,365		
SPCL	52,630			506		
Jingyong Acrylic	32,034					
JAT	46,143	650		2,800		
Other fellow subsidiaries of Sinopec SPCL				3,297		701
	183,082	650	537	602,084	2,074	2,676



**Table of Contents****SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED****Notes to the Financial Statements (Continued)***(Expressed in Renminbi)*

	2007					
	Accounts receivable RMB 000	Prepayments RMB 000	Other receivables RMB 000	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

**36 COMMITMENTS**

## (a) Capital commitments

As at December 31, capital commitments of the Company are summarized as follows:

	2006 RMB 000	2007 RMB 000
Contracted for	15,925	20,791
Authorized but not contracted for	3,514	437,413
	19,439	458,204

## (b) Operating lease commitments

As at December 31, the total future minimum lease payments under non-cancellable operating leases are payable as follows:

	2006 RMB 000	2007 RMB 000
Within 1 year (inclusive)	10,510	11,156

**37 COMPARATIVE FIGURES**

The Company adopted the CAS (2006) on January 1, 2007. The relevant adjustments of comparative figures have been disclosed in Note 4.

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**SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED**

**Notes to the Financial Statements (Continued)**

*(Expressed in Renminbi)*

**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 .

Under U.S. GAAP, such financing expenses and investment income generally are excluded from Operating Profit .

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**SHANGHAI SECCO PETROCHEMICAL COMPANY LIMITED**

**Notes to the Financial Statements (Continued)**

*(Expressed in Renminbi)*

(f) Presentation of cash flow statement

Under China Accounting Standards for Business Enterprises (2006), interest income and investment income received are classified as investing activities.

Under U.S. GAAP, such interest income and investment income received are classified as operating activities.

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**Exhibit Index**

<b>No.</b>	<b>Exhibit</b>
12.1	Certification of Chairman Required by Rule 13a-14(a).
12.2	Certification of Chief Financial Officer Required by Rule 13a-14(a).
13.1	Certification of Chairman Required by Rule 13a-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code.
13.2	Certification of Chief Financial Officer Required by Rule 13a-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code.