SINOPEC SHANGHAI PETROCHEMICAL CO LTD
Form 20-F
April 30, 2013
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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, 2012

OR

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

OR

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

Date of event requiring this shell company report

For the transition period from to

Commission file number 1-12158

(Exact name of Registrant as specified in its charter)

Sinopec Shanghai Petrochemical Company Limited

(Translation of Registrant s name into English)

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

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

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

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

None

(Title of Class)

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

None

(Title of Class)

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

2,330,000,000 H Shares, par value RMB1.00 per Share

4,870,000,000 domestic shares, par value RMB1.00 per Share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x 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 x

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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232,405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

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

Large Accelerated Filer x   Accelerated Filer ¨   Non-Accelerated Filer ¨

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

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

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This annual report includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical facts, included in this annual report that address activities, events or developments which we expect or anticipate will or may occur in the future are hereby identified as forward-looking statements for the purpose of the safe harbor provided by Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The words such as believe , intend , expect , anticipate , project , estimate , predict , plan and similar expressions are also intended to identify forward-looking stateme forward-looking statements address, among others, such issues as:

- amount and nature of future development,
- future prices of and demand for our products,
- future earnings and cash flow,
- capital expansion programs,
- future plans and capital expenditures,
- expansion and other development trends of the petrochemical industry,
- expected production or processing capacities, including expected rated capacities and primary distillation capacities, of units or facilities not yet in operation,
- expansion and growth of our business and operations; and
- our prospective operational and financial information.

These statements are based on assumptions and analyses made by us in light of our experience and our perception of historical trends, current conditions and expected future developments, as well as other factors we believe are appropriate in particular circumstances. However, whether actual results and developments will meet our expectations and predictions depends on a number of risks and uncertainties which could cause actual results to differ materially from our expectations, including the risks set forth in Item 3. Key Information Risk Factors and the following:

- fluctuations in crude oil and natural gas prices,
- fluctuations in prices of our products,
- failures or delays in achieving production from development projects,

potential acquisitions and other business opportunities,

continued availability of capital and financing;

general economic, market and business conditions, including volatility in interest rates, changes in foreign exchange rates and volatility in commodity markets; and

other risks and factors beyond our control.

Consequently, all of the forward-looking statements made in this annual report are qualified by these cautionary statements and readers are cautioned not to place undue reliance on these forward-looking statements. These forward-looking statements should be considered in light of the various important factors set forth above and elsewhere in this annual report. In addition, we cannot assure you that the actual results or developments anticipated by us will be realized or, even if substantially realized, that they will have the expected effect on us or our business or operations.

EXCHANGE RATES

Unless otherwise specified, references in this annual report to U.S. Dollars or U.S.$ 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 U.S. Dollars have been made at a rate of RMB6.2301 to U.S.$1.00, the noon buying rate on December 31, 2012 as set forth in the H.10 statistical release of the U.S. Federal Reserve Board. We do not represent that Renminbi or US dollar amounts could be converted into U.S. Dollars or Renminbi, as the case may be, at any particular rate.

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CERTAIN TERMS AND CONVENTIONS

References to we or us or Company 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 the Complex.

References to Sinopec Corp. are references to China Petroleum & Chemical Corporation, the controlling shareholder of the Company.

References to the Sinopec Group are references to China Petrochemical Corporation, the controlling company of Sinopec Corp.

References to the Complex are references to Shanghai Petrochemical Complex, our predecessor founded in 1972.

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

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

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

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

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

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

All references to tons are to metric tons.

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

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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 operations data (except for ADS data) and cash flows data for each of the years ended December 31, 2010, 2011 and 2012 and our selected consolidated balance sheets data as of December 31, 2011 and 2012 are derived from our consolidated financial statements included in Item 17. Financial Statements. Our selected consolidated statements of operations data and cash flows data for the years ended December 31, 2008 and 2009 and our consolidated balance sheets data as of December 31, 2008, 2009 and 2010 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,				
	2008 (RMB)	2009 (RMB)	2010 (RMB)	2011 (RMB)	2012 (RMB)
CONSOLIDATED STATEMENTS OF OPERATIONS DATA					
Net sales:					
Synthetic fibers	3,662,023	2,823,663	3,906,636	4,150,231	3,313,318
Resins and plastics	14,850,284	12,263,540	14,900,012	16,418,559	14,706,350
Intermediate petrochemicals	10,271,840	8,421,035	17,206,440	19,023,204	17,993,493
Petroleum products	27,552,859	18,917,890	28,733,890	37,350,244	38,301,388
Trading of petrochemical products	2,813,200	4,623,989	6,565,793	11,616,999	12,020,651
Others	179,565	295,147	783,111	950,416	882,074
(Loss)/profit from operations	(7,820,762)	2,019,978	2,963,594	1,059,824	(1,772,446)
(Loss)/earnings before income tax	(8,017,936)	2,163,011	3,529,878	1,296,706	(2,016,473)
Net (loss)/income attributable to equity shareholders of the Company	(6,241,067)	1,588,365	2,769,023	956,106	(1,528,397)
Net income attributable to non-controlling interests	36,717	64,471	25,358	30,416	23,255
Basic (loss)/earnings per share(a)	(0.87)	0.22	0.38	0.13	(0.21)
Basic (loss)/earnings per ADS(a)	(86.68)	22.06	38.46	13.28	(21.23)

(a)

The calculation of earnings per share is based on the weighted average number of shares outstanding of 7,200,000,000 in each of 2008, 2009, 2010, 2011 and 2012, respectively. Earnings per ADS are calculated on the basis that one ADS is equivalent to 100 H Shares.

	Years Ended December 31,				
	2008 (RMB)	2009 (RMB)	2010 (RMB)	2011 (RMB)	2012 (RMB)
CONSOLIDATED STATEMENTS OF CASH FLOWS DATA					
Net cash (used in)/generated from operating activities	(3,986,490)	3,346,890	3,973,719	2,219,994	(2,066,385)
Capital expenditure	1,511,072	2,120,292	1,356,845	3,481,235	4,259,859

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	Years Ended December 31,				
	2008 (RMB)	2009 (RMB)	2010 (RMB)	2011 (RMB)	2012 (RMB)
Net proceeds/ (repayment) related to corporate bonds		1,000,000		(1,000,000)	
Proceeds from loans and borrowings	32,528,758	29,211,434	39,355,780	35,106,127	53,365,372
Repayment of loans and borrowings	27,377,610	31,849,620	42,631,344	32,791,261	46,779,614

	Years Ended December 31,				
	2008 (RMB)	2009 (RMB)	2010 (RMB)	2011 (RMB)	2012 (RMB)
CONSOLIDATED BALANCE SHEETS DATA					
Current assets	6,511,351	9,061,425	8,531,841	9,665,814	12,891,424
Property, plant and equipment	13,272,899	14,977,205	13,570,559	12,501,980	17,468,748
Total assets	27,667,066	30,039,902	28,697,535	30,718,865	36,462,546
Short term debt(a)	9,372,725	7,774,673	4,395,438	5,512,074	11,023,877
Current liabilities	13,342,720	14,304,925	10,573,225	12,271,832	18,927,257
Long term debt (excluding current portion)	429,021	304,258	175,000	160,050	1,231,340
Total equity attributable to equity shareholders of the Company	13,630,972	15,136,434	17,689,457	17,925,563	16,037,166

(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 (U.S.$0.0064)
July 1, 1994-December 31, 1994	RMB0.085 (U.S.$0.0136)
January 1, 1995-June 30, 1995	RMB0.04 (U.S.$0.0064)
July 1, 1995-December 31, 1995	RMB0.09 (U.S.$0.0144)
January 1, 1996-June 30, 1996	RMB0.04 (U.S.$0.0064)
July 1, 1996-December 31, 1996	RMB0.08 (U.S.$0.0128)
January 1, 1997-December 31, 1997	RMB0.06 (U.S.$0.0096)
January 1, 1998-December 31, 1998	RMB0.03 (U.S.$0.0048)
January 1, 1999-December 31, 1999	RMB0.05 (U.S.$0.0080)
January 1, 2000-December 31, 2000	RMB0.06 (U.S.$0.0096)
January 1, 2001-December 31, 2001	No dividend
January 1, 2002-December 31, 2002	RMB0.05 (U.S.$0.0080)
January 1, 2003-December 31, 2003	RMB0.08 (U.S.$0.0128)
January 1, 2004-December 31, 2004	RMB0.20 (U.S.$0.0321)
January 1, 2005-December 31, 2005	RMB0.10 (U.S.$0.0161)
January 1, 2006-December 31, 2006	RMB0.04 (U.S.$0.0064)
January 1, 2007-December 31, 2007	RMB0.09 (U.S.$0.0144)
January 1, 2008-December 31, 2008	No dividend
January 1, 2009-December 31, 2009	RMB0.03 (U.S.$0.0048)
January 1, 2010-December 31, 2010	RMB0.10 (U.S.$0.0161)
January 1, 2011-December 31, 2011	RMB0.05 (U.S.$0.0080)
January 1, 2012-December 31, 2012	No dividend

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

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Exchange Rates

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

The following table sets forth information concerning exchange rates between Renminbi and U.S. Dollars for the periods indicated:

	Noon Buying Rates (RMB/U.S.$)			
Period	**Period End**	**Average[(1)]**	**High**	**Low**
2008	6.8225	6.9477	7.2946	6.7899
2009	6.8259	6.8307	6.8470	6.8176
2010	6.6000	6.7696	6.8330	6.6000
2011	6.2939	6.4630	6.6364	6.2939
2012	6.2301	6.3093	6.3879	6.2221
October 2012	6.2372	6.2627	6.2877	6.2372
November 2012	6.2265	6.2338	6.2454	6.2221
December 2012	6.2301	6.2328	6.2502	6.2251
January 2013	6.2186	6.2215	6.2303	6.2134
February 2013	6.2213	6.2323	6.2438	6.2213
March 2013	6.2108	6.2154	6.2246	6.2105

Source: The sources of the exchange rates are: (i) with respect to any period ending on or prior to December 31, 2008, the Federal Reserve Bank of New York, and (ii) with respect to any period ending on or after January 1, 2009, the H.10 statistical release of the Federal Reserve Board.

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.

An investment in our ADSs involves significant risks. The risks and uncertainties described below are not the only ones we face. You should consider carefully all of the information in this annual report, including the risks and uncertainties described below and our consolidated financial statements and related notes, before making an investment in our ADSs. Any of the following risks could have a material adverse effect on our business, financial condition and results of operations. In any such case, the market price of our ADSs could decline, and you may lose all or part of your investment.

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

Most of our revenues are attributable to the sale of refined oil and petrochemical products, which have historically been cyclical and sensitive to the availability and price of raw materials and general economic conditions. Markets for many of our products are sensitive to changes in industry capacity and output levels, 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 our product prices in the regional and global markets. Due to the decrease in tariff charges, the removal of other restrictions on importation and the Chinese government s gradual relaxation of its control of the allocation of products and pricing, many of our products have become increasingly vulnerable to the cyclical nature of regional and global petroleum and petrochemical markets, which may adversely affect our operations.

We consume large amounts of crude oil to manufacture our products of which more than 90% is imported. In 2012, crude oil costs accounted for RMB55.54 billion, or 62.67% of our annual cost of sales. As a result, changes in crude oil prices can affect our profitability. In recent years, due to various reasons, the price of crude oil has fluctuated significantly. We cannot rule out the possibility of the occurrence of certain global emergencies which might disrupt our crude oil supply. We expect that the volatility and uncertainty of the prices of crude oil and petrochemical products will continue, and that increasing crude oil prices and declines in prices of petrochemical products may adversely affect our business, financial condition and results of operations.

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Some of our 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 of which more than 90% is imported. We attempt to mitigate the effect of increased costs due to rising crude oil prices. However, our ability to pass on these increased costs to our customers is dependent on market conditions and government regulations. Given that the increase of the sales prices of our products may lag behind the increase of crude oil costs, we may fail to completely cover the increased costs by increasing our sales prices, particularly where government regulations restrict the prices of certain of our fuel products. In particular, gasoline, diesel and jet fuel, and liquefied petroleum gas are subject to government price controls at present. In 2010, 2011 and 2012, approximately 34.41%, 36.70% and 40.09% of our net sales were from such products subject to price controls. In 2012, the domestic prices of refined oil products were not brought into line with the prices of crude oil on the international markets in a timely manner due to various policy concerns, *e.g.*, the government s desire to control the high inflation rate in China, which resulted in a decline of RMB539.7 million of the operating profit of our refining business over the previous year. Although the current price-setting mechanism for refined petroleum products in China allows the Chinese government to adjust price in the PRC market when the average international crude oil price fluctuates beyond certain levels within a certain time period (see Item 4. Information on the Company B. Business Overview Product Pricing), the Chinese government still retains discretion as to whether or when to adjust the prices of the refined oil products. The Chinese government generally exercises certain price control over refined oil products once international crude oil prices experience a sustained rise or become significantly volatile. For instance, some of our fuel products are required to be sold to designated distributors (such as the subsidiaries of Sinopec Corp.). Because we cannot freely sell our fuel products to take advantage of opportunities for higher prices, we may not be able to fully cover increases in crude oil prices by increasing the sale prices of our products, which has had and will possibly continue to have a material adverse effect on our financial condition, results of operations and cash flows.

Our development and operation 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 expenditure for 2013 of approximately RMB2.6 billion (U.S.$417.3 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, subject 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, 2013, we had an aggregate outstanding indebtedness of approximately RMB9.526 billion (U.S.$1.529 billion). Most of our loans are with state-controlled banks in China and structured as short term debt obligations with payment due in one year or less. These banks have generally been willing to provide new short term loans while we pay off existing loans. Sinopec Corp., our controlling shareholder, did not provide any guarantee or credit support for our debt for the year ended December 31, 2012 and for the three-month period ended March 31, 2013.

Our ability to obtain external financing in the future and our ability to make timely repayments of our debt obligations are 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 condition of markets for our products; the cost of financing and the condition of financial markets; the issuance of relevant government approvals and other project risks associated with the development of infrastructure in China; and the continuing willingness of banks to provide new loans as we pay down existing debt.

While we anticipate that we will rely less on debt to finance capital expenditures and operations as the global economic outlook continues to improve, our business, results of operations and financial condition could be adversely affected if we fail to obtain sufficient funding for our operations or development plans.

We could face increasing competition.

Our principal market, Eastern China, which is comprised of Shanghai, Shandong, Jiangsu, Anhui, Zhejiang, Jiangxi and Fujian, has enjoyed stronger economic growth and a higher demand for petrochemical products than other regions of China. As a result, we believe that our competitors will try to expand their sales and build up their distribution networks in our principal market. We believe this will have an adverse impact on the production and sale of our major products. Moreover, Chinese private enterprises have gradually overcome technological and funding barriers to extend their business from the downstream processing sector to the upstream petrochemical field. These enterprises have advantages in many areas such as flexibility in operation costs, preferential policy treatments and regional presence, and may use these advantages to compete with us in our target market.

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

As of March 31, 2013, Sinopec Corp. owned 55.56% of our shares. Accordingly, it has voting and management control over us, and its interests may be different from 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. Sinopec Corp. may also experience changes in its own business strategy and policies. Although we are not currently aware of any specific changes, Sinopec Corp. may change its policies or practices toward us in ways that we cannot predict, with corresponding unpredictable consequences for our business. Additionally, Sinopec Corp. may leverage its controlling shareholder position to influence our decisions with regard to the manufacturing and operation, allocation of financial resources and appointment and removal of senior managements, which could adversely affect us or our minority shareholders.

We have also engaged from time to time and will continue to engage in a variety of transactions with Sinopec Corp., Sinopec Group, the controlling company of Sinopec Corp., and their various subsidiaries or affiliates which provide a number of services to us, including the supply of raw materials, product distribution and sales agency, project design and installment service, petrochemical industry related insurance and financial services. We also sell oil and petrochemical products to Sinopec Corp. and its affiliates. Our transactions with these companies are governed by a Mutual Product Supply and Sales Services Framework Agreement with
Sinopec Corp. and a Comprehensive Services Framework Agreement with Sinopec Group, the terms of which were negotiated on an arm s length basis, see Item 7. Related Party Transactions B. Intercompany Service Agreements and Business-related Dealings. Our business and results of operations could be adversely affected if Sinopec Corp. or Sinopec Group refuses to engage in such transactions or if they seek to amend the contracts between the parties in a way adverse to us. In addition, Sinopec Corp. has interests in businesses which compete or are likely to compete, either directly or indirectly, with our businesses. Because Sinopec Corp. is our controlling shareholder and its interests may conflict with our own interests, Sinopec Corp. may take actions that favor itself over our interests.

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 payments and fines 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 (*i.e.*, waste water, waste gas and waste residue). In addition, our production and operations require permits that are subject to renewal, modification and revocation. At present, we believe that our operations substantially comply with all applicable Chinese environmental laws and regulations as they have been previously interpreted and enforced. The Chinese government (including the local governments), however, has moved, and may move further, toward the adoption of more regulations and more stringent environmental standards. Chinese national or local authorities may also apply more rigorous enforcement of such regulations which would require additional expenditures on environmental matters.

Our operations are exposed to risks relating to operating hazards and production safety and we have limited insurance coverage for resulting losses.

Our operations involve the handling and storage of explosives and other hazardous articles. In addition, our operations involve the use of heavy machinery, which involves inherent risks that cannot be entirely eliminated through our preventive efforts. As a result, we may encounter fires, explosions and other unexpected incidents during our operations, which may cause personal injuries or death, property damage, environmental damage, interruption of operations and reputational damages to us. Each of such incidents could have a material adverse impact on our business, financial condition and results of operations.

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We maintain a package of insurance coverage plan through Sinopec Group on our property, facilities and inventory. In addition, we maintain insurance policies for such assets as the engineering construction projects and products in transit with third-party s commercial insurance company. 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. Our insurance coverage may not be sufficient to cover all the financial losses caused by the operating hazards. Resulting losses required to be compensated or otherwise paid by us due to such operating hazards that are not fully insured may have a material adverse effect on our financial condition and results of operations.

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

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

- mandating distribution channels for our fuel products;
- setting 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 addition, we have in the past 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 governmental authorities and general economic conditions in China.

While in general we attempt to obtain governmental approval as far in advance as practicable, we are unable to predict the timing and outcome of such governmental reviews and approvals. If any of our 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 and had committed to eliminate some tariff and non-tariff barriers to foreign competitions in the domestic petrochemical industry that benefited us in the past. In particular, China:

- has reduced tariffs on imported petrochemical products that compete with ours;

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

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

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

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

As a result of these measures, we face increased competition from foreign companies and imports. In 2013, we expect the global financial crisis to continue to have a negative effect on the market for petrochemical products, and in turn our business. The petrochemical industry has experienced a slow recovery. In addition, competition for our products has increased, as many overseas companies have switched their focus to sales in China. In addition, tariff reductions could reduce our profit margins or otherwise negatively impact our revenue from certain products, including a small number of significant products. The Chinese government may also reduce the tariffs imposed on production equipment that we may import in the future.

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

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

structure;

- level of government involvement;
- level of development;
- level of capital reinvestment;
- control of foreign exchange; and
- allocation of resources.

Before its adoption of reform and open-door policies beginning in 1978, China was primarily a planned economy. Since that time, the Chinese government has been reforming the Chinese economic system, and has also begun reforming the government structure. These reforms have resulted in significant economic growth and social progress. Although the Chinese government still owns a significant portion of the productive assets in China, economic reform policies since the late 1980s have emphasized autonomous enterprises and the utilization of market mechanisms. We 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 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 currencies, 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 the ADSs; 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 (SAFE) by producing commercial documents evidencing the foreign exchange transactions, provided that they are processed through Chinese banks licensed to engage in foreign exchange transactions. The Chinese government has stated publicly that it intends to eventually make the Renminbi freely convertible. 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 SAFE. 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 necessary for our business. In that case, our business may be materially adversely affected, and we may default on our obligations.

The change of currency policy and the fluctuation of Renminbi might adversely affect our business and operation results.

The exchange rate between the Renminbi and the U.S. Dollar or other foreign currencies might fluctuate and be affected by the change in Chinese political and economic conditions. In July 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 against the U.S. Dollar. Nevertheless, the Chinese government continues to receive significant international pressures to further liberalize its currency policy which could result in China adjusting its currency policy further.

A small portion of our cash and cash equivalents is denominated in foreign currencies (including the U.S. Dollar). The appreciation in the value of Renminbi against foreign currencies (including the U.S. Dollar) may cause a decrease in the Renminbi value of our cash and cash equivalents that are denominated in foreign currencies. In addition, the appreciation of Renminbi may harm the exports of our downstream manufacturers, thus adversely affecting the market demand for our products.

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As most of our revenue is denominated in Renminbi, and most of our purchase of crude oil and some equipment and certain loan repayments are made in foreign currencies, any depreciation of the Renminbi would increase our cost and adversely affect our capacity of making profits. In addition, any depreciation of the Renminbi could adversely affect the value of the dividends of our H shares and ADSs, which we declare in Renminbi and pay in foreign currencies.

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

Pursuant to regulations issued by the China Securities Regulatory Commission (the CSRC), we were required to obtain 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 October 2006 and December 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 for various reasons. 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 imposing a cap and a basket on the price fluctuation rate set at 5% daily, stricter trading information disclosure requirements that are similarly applicable to ST and *ST shares and more restrictions on future financing abilities. Since March 26, 2007, the Shanghai Stock Exchange has required us to make public announcements periodically regarding the status of our share reforms. In addition, the CSRC is expected to impose stricter scrutiny on any securities-related applications filed by publicly listed PRC companies that are required to but have failed to complete such share reforms, their major shareholders and ultimate beneficial owners. The failure to complete the proposed share reforms may adversely affect our market image, the environment of our operation 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 the ceaseless improvement of the PRC Company Law and Securities Law, Chinese legal provisions for the protection of shareholders rights and access to information are different from 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 defined by our Articles of Associations regarding the Company s affairs 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 other relevant Chinese laws or regulations relating to our affairs, to submit such claim or dispute to arbitration with the China International Economic and Trade Arbitration Commission or to the Hong Kong International Arbitration Center. Our Articles of Association further provide that any arbitration decisions with respect to such disputes or claims shall be final and binding on all parties. As a result, you will have no legal right to a court proceeding.

Currently, United States financial regulatory and law enforcement agencies, including but not limited to the SEC, PCAOB, U.S. Department of Justice and NYSE, have limited or may have no ability to conduct investigations within the PRC concerning the Company, its officers, directors, auditors, market research services or other professional services or experts based in the PRC.

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The Company s operations and assets are physically located in the PRC. The PRC has limited or no agreements in place to facilitate cooperation with the SEC Division of Enforcement and other U.S. regulatory agencies charged with protecting investors for investigations within its jurisdiction. This may result in U.S. financial regulators, including but not limited to the SEC, the Public Company Accounting Oversight Board (PCAOB) and the U.S. Department of Justice, having limited access to the Company s books, records, testimony, on-site investigations of operations, subpoena power and other investigative actions, including those stemming from investor tips, complaints and referrals. Such limitations may result in the Company s investors receiving less protection from U.S. regulators than investors in companies operating in other jurisdictions because the Company and its service providers, particularly its auditors, are subject to less scrutiny than companies and service providers that are subject to regular investigations and inspections by U.S. regulators. For example, the PCAOB is currently unable to conduct independent regulatory inspections of PCAOB-registered firms audit work related to a company s operations in China where the documentation of the audit work is located in China. As a result, our investors may be deprived of the benefits of the PCAOB s oversight of our independent registered public accounting firm through such inspections.

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 (IRS) 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 H Shares or 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. We do not intend to provide information to permit you to make a qualified electing fund election to avoid the adverse U.S. tax consequences described above. The same adverse U.S. federal income tax consequences will apply to U.S. investors who acquire our H Shares or ADSs during the current taxable year or any subsequent taxable year if we are treated as a PFIC for that taxable year.

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

We do not believe that we are currently a PFIC. However, because the PFIC determination is highly fact intensive and made at the end of each taxable year, there can be no assurance that we will not be a PFIC for the current or any future taxable year or that the IRS will not challenge our determination concerning our PFIC status. For further discussion of the adverse U.S. federal income tax consequences of our possible classification as a PFIC, see Item 10. Additional Information E. Taxation U.S. Taxation.

We have in the past sourced a small portion of crude oil from Iran that may be targeted by economic sanctions under relevant U.S. laws, and if such activities are determined by the U.S. governmental authorities as sanctionable activities, we could be sanctioned or otherwise penalized.

The United States has adopted a number of measures since 1996 that provide for the possible imposition of sanctions against non-U.S. companies engaged in certain activities in and with Iran in the energy sector, including the Executive Order 13622 issued on July 30, 2012 and the Iran Threat Reduction and Syria Human Rights Act of 2012 (ITRSHRA) issued on August 10, 2012. The sanctionable activities include certain investments, the provision of goods, services, technology, or support that could contribute to the development of petroleum and petrochemical resources or the production of refined petroleum products in Iran, the exportation of refined petroleum products to Iran, the transportation of crude oil from Iran, or the engagement in a significant transaction for the purchase or acquisition of petroleum or petroleum products from Iran.

We have sourced a small portion of our crude oil from Iran in the past through a wholly-owned subsidiary of Sinopec Corp., our controlling shareholder, and we may continue to purchase crude oil from Iran. In addition, Sinopec Corp., our current controlling shareholder, and Sinopec Group, the controlling shareholder of Sinopec Corp., have engaged in operations in or purchasing crude oil sourced from Iran and may continue to do so in the future. Furthermore, we have no control over the activities of Sinopec Group or Sinopec Corp. in connection with any activities that they may conduct in Iran.

If our purchases of crude oil from Iran are determined to be sanctionable activities by the U.S. President and/or the relevant U.S. governmental authorities, we may be subject to one or more of the twelve sanctions options available under the Iran Sanctions Act of 1996 (as amended) and the ITRSHRA, which include restrictions on bank financing, outright blocking of the Company s property within U.S. jurisdiction and prohibition of U.S. persons from investing or purchasing a significant amount of equity or debt instruments of the Company. In addition, many

states in the United States have adopted legislation requiring state pension funds to divest themselves of securities in any company with active business operations in Iran. We cannot assure that we or any of our affiliates will not be sanctioned by the U.S. President and/or the relevant U.S. governmental authorities in light of the activities by us or our affiliates in Iran. The imposition of any such sanctions on us or our affiliates will have a negative impact on our business, reputation or stock price.

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Sinopec Group, the controlling shareholder of Sinopec Corp. which is our current controlling shareholder, or its affiliates current or future activities in certain countries are the subject of economic sanctions under relevant U.S. laws and could result in negative media and investor attention to us and possible imposition of sanctions on Sinopec Group, which could materially and adversely affect our shareholders

Sinopec Group undertakes, from time to time and without our involvement, overseas investments and operations in the oil and gas industry, including the exploration and production of oil and gas, refining and Liquefied Natural Gas, or LNG, projects. Sinopec Group s overseas asset portfolio includes oil and gas development projects in Iran, Sudan and Syria, which countries are on the sanction list published and administrated by the U.S. Department of the Treasury s Office of Foreign Assets Control, or OFAC. We cannot predict the interpretation or implementation of government policy at the U.S. federal, state or local levels with respect to any current or future activities by Sinopec Group or its affiliates in countries or with individuals or entities that are the subject of U.S. sanctions. Similarly, we cannot predict whether U.S. sanctions will be further tightened, or the impact that such actions may have on Sinopec Group. It is possible that the United States could subject Sinopec Group to sanctions due to these activities. Certain U.S. state and local governments and colleges have restrictions on the investment of public funds or endowment funds, respectively, in companies that are members of corporate groups with activities in certain countries that are the subject of U.S. sanctions. These investors may not wish to invest, and may divest their investment, in us because of our relationship with Sinopec Group and its investments and activities in those OFAC sanctioned countries. It is possible that, as a result of activities by Sinopec Group or its affiliates in countries that are the subject of U.S. sanctions, we may be subject to negative media or investor attention, which may distract management, consume internal resources and affect investors perception of our company.

Further, the Iran Sanctions Act of 1996 (as amended) authorizes the imposition of sanctions on companies that engage in certain activities in and with Iran, especially in Iran s energy sector. It is possible that Sinopec Group or its affiliates engage in activities that are targeted for sanction purposes by ISA. It is possible that the U.S. government would determine, and in the event that the U.S. government so determines, that Sinopec Group, or an entity it owns or controls, had engaged in any such activities and if the most extreme sanction under the ISA, blocking, were applied to Sinopec Group s property, including controlled subsidiaries, Sinopec Group could be prohibited from engaging in business activities in the United States or with U.S. individuals or entities, and U.S. transactions in our securities and distributions to U.S. individuals and entities with respect to our securities could also be prohibited.

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 Sinopec Group, 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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Construction Projects

The Complex and we, as its successor, have completed five 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. The fifth stage of construction (2003-2009) was mainly designed to optimize our structure and realize sustainable development, and mainly included 3,300,000t/a diesel hydrogenation unit, 1,200,000t/a delayed coking unit and other projects implemented for removing bottlenecks in refinery, the building of new 600,000t/a PX hydrocarbon complex unit, 150,000t/a C5 segregation unit, 380,000t/a ethane unit, etc.

The Company commenced the sixth stage of construction in 2010 (Phase 6 Project) and completed in December 2012. The purpose of the Phase 6 Project was to improve the Company s overall industrial structure and core competitiveness and its capability of maintaining sustainable developments. The Phase 6 Project focused on utilizing intensively natural resources and forming a complete set of facilities in accordance with the fundamental industrial model of integrating oil refining and petrochemical. It was expected to further achieve the reform of oil refining and to strengthen and expand the Company s core business while continuing to explore the development of fine chemicals and products with high added value. Phase 6 Project consisted of refining capacity expansion projects, technology development and fine chemicals projects, see Item 4. Information on the Company D. Property, Plant and Equipment Capital Expansion Program.

Over the past 39 years, the Company has established its own 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 Stock 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 Stock Exchange Stock Index.

Description of Principal Capital Expenditures and Divestitures

In the fourth quarter of 2001, we established 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 U.S.$901,440,964 of which we were obligated to contribute an amount in Renminbi equivalent to U.S.$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 D. Property, Plant and Equipment Capital Expansion Program.

B. Business Overview

We are one of the largest petrochemical companies in China based on 2012 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.

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Based on 2012 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 business lines as a percentage of total net sales in each of 2010, 2011 and 2012 are summarized as follows:

Net Sales of RMB72,095.9 million in 2010

Synthetic fibers	5.42%
Resins and plastics	20.67%
Intermediate petrochemicals	23.87%
Petroleum products	39.86%
Trading of petrochemical products	9.11%
Others	1.07%
Total	100.00%

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Net Sales of RMB89,509.7 million in 2011

Synthetic fibers	4.64%
Resins and plastics	18.34%
Intermediate petrochemicals	21.25%
Petroleum products	41.73%
Trading of petrochemical products	12.98%
Others	1.06%
Total	100.00%

Net Sales of RMB87,217.3 million in 2012

Synthetic fibers	3.80%
Resins and plastics	16.86%
Intermediate petrochemicals	20.63%
Petroleum products	43.92%
Trading of petrochemical products	13.78%
Others	1.01%
Total	100.00%

We derive a substantial portion of our revenues from customers in Eastern China (comprising Shanghai and its six neighboring provinces), an area that has experienced economic growth above the national average in recent years. We believe that we are well- positioned to take advantage of opportunities which may arise through the economic growth of China generally and in this area in particular. Shown by geographic region and exports, our net sales by business lines as a percentage of total net sales for each of 2010, 2011 and 2012 are as follows:

2010 Net Sales by Region (%)

	Eastern China	Other parts of China	Exports
Synthetic fibers	85.05	14.08	0.87
Resins and plastics	87.20	12.80	0
Intermediate petrochemicals	83.07	14.08	2.85
Petroleum products	99.55	0.45	0
Trading of petrochemical products	88.90	0.36	10.74
Total net sales	92.32	7.01	0.67

2011 Net Sales by Region (%)

	Eastern China	Other parts of China	Exports
Synthetic fibers	83.27	16.20	0.53
Resins and plastics	87.77	12.22	0.01
Intermediate petrochemicals	85.68	12.44	1.88
Petroleum products	99.70	0.30	0
Trading of petrochemical products	89.43	0.79	9.78
Total net sales	93.25	6.32	0.43

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2012 Net Sales by Region (%)

	Eastern China	Other parts of China	Exports
Synthetic fibers	84.61	14.83	0.56
Resins and plastics	86.50	13.50	0
Intermediate petrochemicals	89.32	9.31	1.37
Petroleum products	97.94	2.06	0
Trading of petrochemical products	92.54	0.58	6.88
Total net sales	94.18	4.68	1.14

Business Strategy

In 2013, we aim to develop the Company into a leading oil refining petrochemical enterprise. We will continue to focus on the improvement of quality and efficiency of developments, the adjustment of structure, the furtherance of reform and the improvement of management. We will proactively work on our underlying competitiveness, production and operation competence, management capabilities, research and development strength, the team of employees and the improvement of environment. We strive to utilize our advantages deriving from the launching of the Refinery Revamping and Expansion Project and the technological advancement programs and improve our economic returns.

To achieve its business objectives in 2013, the Company plans to carry out tasks in the following areas:

(a) Strengthening management of safety and environmental protection and promoting safe, green and low carbon development.

The Company will implement a green and low-carbon development strategy to further improve safety management and environmental protection. This includes diversifying safety management measures, actively launching safety competitions, and strengthening the grid management at construction sites, health, safety and environment (HSE) supervision and management during the direct operation process, the emergency response management and HSE supervision over outsourcing contractors. The Company will take greater efforts and establish a long-term mechanism to protect the environment. In addition, we will further and expand deodorizing programs in the manufacturing sites, continue to decrease the disposal of solid wastes, enhance the emergency response management with regard to the protection of water resources, the prevention and control of air pollution and the improvement of air quality, and get prepared for the measurement of carbon emissions.

(b) Enhancing plant operation capacity to ensure a safe, stable, long-cycle and full capacity operation of the plants.

The Company will bring in advanced management concepts in order to improve the plant operation management. We will strengthen the management of plant operation and manage to run well the newly built plants of Phase 6 Project. We will improve the organization and coordination of major production operations, and continue to organize special competitions for a safe, stable, long-cycle and full capacity operation among the production units. Furthermore, we will implement the unified management on the dispatch of production, electrical power and thermal power. In order to increase the Company s energy resources utilization efficiency, we will promote the energy conservation and the reduction of feedstock consumption, finish power balance tests on 20 integrated units and implement energy performance contracting. We will also improve our comprehensive capability for equipment management, implement plans for the long-cycle operation of the plants and strengthen the management of scheduled inspection and repair so as to lead the safe, stable, long-cycle, full capacity and good operation of the plants to a higher level.

(c) Further optimizing production operation and realizing the potential of economic returns.

The Company will closely monitor the market, optimize business operation and endeavor to utilize the advantage deriving from the integrated refining and chemical operation in order to improve the operational capability. We will improve the oil price trend analysis and increase the extent of centralization in terms of crude oil procurement in order to optimize the crude oil procurement and increase the economic return and we plan to fully utilize the facilities potential capacities. With regard to the optimization of intermediate raw materials and our product mix, we will endeavor to achieve the optimized selection of raw materials, optimize the balance of materials and the adjustment of refined oil structure and increase the output of products, which will create economic returns. With regard to the sales, we will optimize the sales strategies and the material supply model, and endeavor to increase the market share of Shanghai IV refined oil products. Efforts will be made with respect to the sale of new products and the construction of a logistics line which allows delivery within 2 to 3 hours. We will also implement the low inventory strategy. As to the cost control, we will continue to leverage off the launching of the Refinery Revamping and Expansion Project and the optimization of the refinery and chemical system, implement various measures to decrease costs and fees, further emphasize the cost management among employees, and strictly control the expenditures. We will also establish a scientific and efficient strategy regarding

equipment repair and reduce the unreasonable inspection and repair expenses. Furthermore, we will strengthen the capital management and optimize the use of capital.

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(d) Pushing forward technological advancement and informationization in order to support future growth.

The Company will continue to explore a technological innovation system featured by a combination of production and study as well as research and utilization in order to accelerate the informationization progress and improve technologies. With regard to the further development of new products and technologies, we will speed up the technological breakthrough for a new carbon fiber, launch a pilot project with a capacity of 1,000 tons for norbornene/ethylidene norbornene and hydrogenated petroleum resins, and push forward the development and utilization of new environmental protection technologies. Efforts will be made to improve the marketing and stable expansion of production of new products, including specialized materials for binary random copolymer, fire-retardant polyester series, NEP polyester chips, gel dyed acrylic and precursor liquid coloring acrylic. As parts of our efforts to push forward the informationization progress, we will launch APC systems for various plants such as those for online blending of diesel, aromatics complex, CDU and EO/EG plant, and the construction of process simulation systems for various plants, such as No. 3 diesel hydrogenation plant and butadiene plant. We aim to establish a production and operation monitoring and analysis system in order to enhance our utilization of information systems.

(e) Strengthening corporate management and improving scientific management skill.

In order to improve the scientific management skill, the Company will specify measures to be taken to fulfill each working assignment, establish a working system for the benchmarking management, and standardize the process management. We will increase the operational level of our integrated management system so as to promote the standardized operation. As parts of our efforts to enhance the effect of performance tests, we will establish and improve a goal oriented performance test system, adequately exert the orientation and incentive effect of performance tests and improve the correlation between the organizational performance and individual employee performance.

(f) Strengthening team building and creating a stable and harmonious environment for developments.

In order to build a first-class workforce, we will carry out the medium and long-term human resources planning, improve the setup of channels catering to the growth of various types of competent staff from time to time, and improve the staff training and the optimization of human resources. As parts of our efforts to create a great environment for developments, we will further refine and enrich the essence of our company s culture, actively cultivate our company s core values, take care for the staff s welfare and livelihood and push forward the healthy, stable and harmonious development of the Company.

Principal Products

We produce four principal types of products with different specifications, including synthetic fibers, resins and plastics, intermediate petrochemicals and petroleum products. We use many of the important petroleum products and intermediate petrochemicals we produce in producing our own downstream products.

In 2012, the volume of our physical production remained stable, with a total volume of products amounting to 11,844,100 tons, representing a decrease of 1.31% over the previous year. The Company processed 11,193,500 tons of crude oil (including 563,000 tons of crude oil processed on a sub-contract basis), representing an increase of 3.01%. Total production output of refined oil, including gasoline, diesel and jet fuel was 5,878,800 tons, representing an increase of 2.32%, among which the Company produced 1,020,300 tons of gasoline, 4,027,900 tons of diesel and 830,600 tons of jet fuel, representing an increase of 5.35%, 1.21% and 4.18%, respectively. The Company produced 914,700 tons of ethylene and 504,400 tons of propylene, representing an increase of 0.51% and 4.71%, respectively. The Company produced 866,200 tons of paraxylene, representing a decrease of 6.16%. The Company also produced 1,087,500 tons of synthetic resins and copolymers (excluding polyesters and polyvinyl alcohol), representing a decrease of 0.95%; 1,015,600 tons of synthetic fiber monomers, representing an increase of 7.33%; 636,100 tons of synthetic fiber polymers, representing a decrease of 4.23%; and 251,600 tons of synthetic fibers, representing an increase of 0.64%. We continue to produce premium products of a stable quality.

The following table shows our 2012 net sales by major products as a percentage of total net sales together with the typical uses of these products.

Product	% of net sales	Typical Use
SYNTHETIC FIBERS		
Polyester staple fiber	0.72%	Textiles and apparel
Acrylic staple fiber	2.84%	Woven into fabrics or blended with other material fabrics to make fabric or acrylic top
Others	0.24%	

Sub-total	3.80%	
RESINS AND PLASTICS		
Polyester chips	4.81%	Polyester fibers, films and containers
PE pellets	6.42%	Films, ground sheeting, wire and cable compound and other injection molding products such as housewares and toys

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Product	% of net sales	
PP pellets	4.93%	Extruded films or sheets, injection molded products such as housewares, toys and household electric appliance and automobile parts
PVA	0.45%	PVA fibers, building coating materials and textile starch
Others	0.25%	
Sub-total	16.86%	
INTERMEDIATE PETROCHEMICALS		
Ethylene	1.06%	Feedstock for polyethylene, EG, PVC and other intermediate petrochemicals which can be further processed into resins, plastics and synthetic fiber.
Ethylene oxide	1.73%	Intermediate for chemical and pharmaceutical industry, dyes, detergents and auxiliary agents
Benzene	3.33%	Intermediate petrochemical products, styrene, plastics, explosives, dyes, detergents, epoxies and nylon
Paraxylene	6.64%	Intermediate petrochemicals and polyester
Butadiene	2.44%	Synthetic rubber and plastics
Ethylene glycol	2.16%	Fine chemicals
Others	3.27%	
Sub-total	20.63%	
PETROLEUM PRODUCTS		
Gasoline	7.95%	Transportation fuels
Diesel	24.95%	Transportation fuels and agricultural fuels
Jet Fuel	4.05%	Transportation fuels
Others	6.97%	
Sub-total	43.92%	
TRADING OF PETROCHEMICAL PRODUCTS	13.78%	
OTHERS	1.01%	
Total	100.00%	

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Production Processes

The key sectors in our vertically integrated production plants are the ethylene units which produce ethylene and propylene, and our aromatics plants which principally produce paraxylene (PX) and benzene. Ethylene is a major raw material in the production of polyethylene (PE) and monoethylene glycol (MEG) which, together with pure terephthalic acid (PTA), is used to manufacture polyester. Propylene is a 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. Part of the Naphtha and part of the AGO is fed to the ethylene units primarily to produce ethylene and propylene. Part of the Naphtha is fed to the reforming prehydrogenation units to produce refined Naphtha which shall be used for the production of Aromatics. The other part of the AGO is processed into diesel oil, and kerosene is fed to the jet fuel sweetening unit to produce jet fuel. Part of the VGO is further processed in a hydrocracking unit producing mainly light and heavy naphtha, liquefied petroleum gas (LPG), diesel oil, various aromatic hydrocarbon products and jet fuel. The other part of the VGO and residual oil can be further processed into gasoline, diesel oil, LPG, propylene and other products.

Intermediate Petrochemicals

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

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

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

Resins and Plastics and Synthetic Fibers

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

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

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

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

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

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

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

Raw Materials

We optimized the composition of crude oil resources with the establishment of a mechanism for measuring crude oil optimization level. Furthermore, we optimized the raw materials of ethylene, aromatic and the composition of raw materials and fuels for the production of hydrogen. The cost of raw materials was reduced and the utilization rate of resources was increased. The Company realized a value of RMB690 million due to these arrangements.

Crude Oil

Crude oil is our primary raw material and the most significant raw material we purchase from outside sources. In 2012, crude oil accounted for approximately 62.67% of our total cost of sales. Accordingly, the supply and price of crude oil are key factors in determining our profitability.

Supply and Transportation All crude oil required by us, whether from domestic or foreign sources, is purchased through the channels of Sinopec Corp. as an agent. During 2012, 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 our planned volume of crude oil processing in 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 at market prices and we must consult with Sinopec Group in order to sell elsewhere.

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We have received confirmation from Sinopec Corp. that it will purchase on our behalf 15.5 million tons of imported crude oil and nil tons of domestic offshore crude oil in 2013. Sinopec Corp. has further confirmed that, subject to China s national crude oil policy and our actual production needs, it will continue to purchase on our behalf sufficient quantities and appropriate kinds of crude oil, including domestic offshore and imported crude oil, to satisfy our anticipated annual needs. We anticipate fully utilizing our 2013 supply of crude oil. We believe that the mix of crude oil feedstocks currently available is sufficient for our 2013 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 supply 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 imported crude oil, we will continue to be able to obtain from the market such imported crude oil that is compatible with our refining equipment. The overall mix of foreign versus domestic crude oil we process in 2013 will depend on a variety of factors, including the amount of future supply of domestic offshore crude oil and the availability, price, quality, processing profitability and compatibility with our refining capabilities of imported crude oil. Provided there are no significant modifications to the existing channels of crude oil acquisition, we believe that sufficient supplies of crude oil will be available on the domestic or international markets for our 2013 production capacity and goals.

In 2012, our crude oil was sourced as follows:

Domestic offshore crude oil	2.89%
Imported crude oil	97.11%
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 our increased use of imported crude oil will not materially and adversely impact our business and results of operations.

Foreign and domestic offshore crude oil is supplied by tanker and pipeline to our oil terminal wharf and oil storage tank. See Item 4.D. Property, Plants and Equipment -Wharfs.

In the past, we have not experienced disruption in our crude oil supply. We have on-site crude oil storage tanks at Chenshan wharf capable of storing approximately 300,000 cubic meters of crude oil, primarily to provide crude oil to our No. 2 atmosphere vacuum distillation facility. This crude oil storage can provide us with approximately a 2-week 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 crude oil of the same quality in the international market, while imported crude oil is generally sold to us at prevailing international market prices. The average cost of imported crude oil and domestic offshore crude oil in 2012 was RMB5,228.58 (U.S.$839.24) per ton and RMB5,090.85 (U.S.$817.14) per ton, respectively. In 2012, we processed 10,869,500 tons of imported crude oil and 324,000 tons of domestic offshore crude oil (including 563,000 tons of crude oil processed on a sub-contract basis).

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 China National Petroleum Corporation (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 such 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.

On March 26, 2013, the NDRC announced adjustments to the existing refined oil pricing mechanism, which include, among other things, (i) shortening of price reference period from 22 working days to 10 working days; (ii) lifting the 4% downward and upward fluctuation cap on

benchmark crude oil prices; (iii) adjusting the composition of domestic benchmark crude oil types in response to changes of types of imported crude oil and crude oil trading in the overseas market. In the cases of changes such as significant increase in domestic prices or significant fluctuations of crude oil price, NDRC may issue additional procedural guidelines, such as implementing ad hoc suspension or delay of price adjustment upon approval by the State Council.

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We purchase crude oil through Sinopec Corp. and its affiliates in sources selected and quantities confirmed by the Company at market prices. On this basis, we believe that changes in crude oil prices should not have a material effect on our competitiveness with other domestic producers. Nevertheless, any increase in the price of crude oil could have an adverse impact on our profitability to the extent that we are unable to pass cost increases on to our customers.

Changes in crude oil prices can affect the Company s profitability. In 2012, international crude oil prices fluctuated at a high level, primarily due to geopolitical risks in the Middle East, the European and US macroeconomic outlook and the occurrence of material changes to the demand and supply of US crude oil, and . In 2012, the price of West Texas Intermediate (WTI) crude oil on the New York Mercantile Exchange fluctuated within a broad range of U.S.$77-U.S.$109/barrel (U.S.$75-U.S.$114/barrel in 2011), with peak and the bottom closing prices of U.S.$109.77/barrel and U.S.$77.69/barrel, respectively (U.S.$113.93/barrel and U.S.$75.67/barrel, respectively in 2011), for the year. The peak and the bottom closing prices of Brent crude oil futures on the London Intercontinental Exchange were U.S.$126.22/barrel and U.S.$89.23/barrel, respectively (U.S.$126.64/barrel and U.S.$93.33/barrel, respectively in 2011), for the year. In 2012, the average price of WTI crude oil on the New York Mercantile Exchange was U.S.$94.145/barrel, an decrease of U.S.$0.969 or 1% from U.S.$95.114 in 2011; the average price of Brent crude oil on the London Intercontinental Exchange was U.S.$111.673/barrel, an increase of U.S.$0.761, or 0.7% from U.S.$110.95 in 2011; and the average price of a package of OPEC oil was U.S.$109.461/barrel, an increase of 1.9% compared to the daily average price of U.S.$107.47 in 2011, reaching a record high. In 2012, we processed 11,193,500 tons of crude oil (including 563,000 tons of crude oil processed on a sub-contract basis), representing an increase of 326,800 tons over the previous year or 3.01%. The volumes of imported crude oil and domestic offshore crude oil processed by us were 10,869,500 tons and 324,000 tons, respectively. As a result, the average unit cost of crude oil we processed (for our own account) increased by 3.56% from RMB5,044.64 (U.S.$809.72) per ton in 2011 to RMB5,224.38 (U.S.$838.57) per ton in 2012. Our total costs of crude oil processing reached RMB55,538.0 million (U.S$8,914.5 million) in 2012, a slight increase of 3.77%, or RMB2,016.1million (U.S.$323.6 million), compared to RMB53,521.9 million (U.S.$8,590.9 million) for 2011, which represent 62.67% of our total cost of sales.

Coal

Most of the coal used for our electricity generation is purchased through a unified system of procurement administered by Sinopec Corp., and the rest is purchased directly by us from mines. Coal is transported by rail from the mines to Qinhuangdao port and shipped by barge to Jinshanwei where it is delivered to the plant via a wharf and a conveyer system. Our cost of coal is primarily dependent on coal price and 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 2013 will be approximately 2.01 million tons. In 2012, we consumed approximately 2.13 million tons of coal, an increase from 2011 of 0.03 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 natural gas, MX, methanol, ammonia, sodium hydroxide, sulfur, acetone, acrylonitrile, PTA, propylene and a variety of catalytic agents. In 2012, the total cost of these materials accounted for approximately 14.05% of our total cost of sales. We do not expect any difficulties in obtaining a supply of any of these ancillary raw materials in amounts sufficient to meet our needs in the foreseeable future.

Sales and Marketing

Distribution

The distribution of our fuel products is subject to government regulations. We are required to sell certain refined products to the subsidiaries of Sinopec Group or customers designated by Sinopec Group. Since the second half of 2005, Sinopec Group has executed reforms to its system of selling petrochemical products and implemented what it refers to as a Five Consolidations strategy featuring consolidated marketing strategy, consolidated promotion, consolidated logistics optimization, consolidated sales and consolidated branding . As a result, the sales of our major petrochemical products are now conducted in a consolidated manner by sales agents designated by Sinopec Group. However, we have the autonomy to decide on the distribution method of our other products in accordance with market conditions. The products we sold in 2012 that were subject to planned distribution by Sinopec Group, sales by agents and sales based on our own discretion accounted for 51.16%, 43.32% and

5.52%, respectively, of the total products we sold.

We generally sell our products to large trading companies and industrial users with whom we have long-standing relationships, including Sinopec Group or customers designated by Sinopec Group. We believe that the transition to sales of major petrochemical products by agents designated by Sinopec Group will increase our distribution efficiency, reduce horizontal competition and enhance our overall bargaining power, 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.

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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 2012. In general we managed to keep a stable link between production and sales in 2012.

Product breakdown

Synthetic Fibers In 2012, 9.49% 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 13.77% of our sales of synthetic fibers in 2012.

Resins and Plastics In 2012, approximately 4.74% of our resins and plastics sales were to provincial and municipal government trading companies and approximately 63.68% were sold to industrial users. No single customer accounted for more than 3.22% of our sales of resins and plastics in 2012.

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

Sinopec Yizheng Chemical Fibre Company Limited (Yizheng) and Oriental Petrochemical (Shanghai) Corporation (Oriental) are the principal outside consumers of our paraxylene. In 2012, we sold 112.3 thousand tons and 148.9 thousand tons of paraxylene, representing 12.96% and 17.19% of our total 2012 production of such product, to Yizheng and Oriental respectively, at prices mutually agreed upon by the relevant parties.

Petroleum Products In 2012, our primary gasoline and diesel customer was Sinopec Huadong Sales Company Limited.

Trading of Petrochemical Products In 2012, our primary trading customer was Sinopec Chemical Commercial Holding Company Limited.

Product Pricing

Most of our products are permitted to be sold at market prices. However, four types of petroleum products (gasoline, diesel and jet fuel, and liquefied petroleum gas) that we sell are subject to varying degrees of government pricing control and are, accordingly, sold at prices set by the Chinese government, which may sometimes be below our costs. In 2010, 2011 and 2012, approximately 34.41%, 36.70% and 40.09% of our net sales were from products subject to price controls. In 2012, the domestic prices of refined oil products were not brought into line with the prices of crude oil on the international markets in a timely manner due to various policy concerns, e.g., the government s desire to control the high inflation rate in China, which resulted in the decline of RMB539.7 million of the operating profit of our refining business over the previous year. Price controls may apply to these products in various ways. Such price controls are sometimes applied exclusively to our products, exclusively to our competitors products or sometimes applied to neither our products nor our competitors products. The Chinese government has adopted changes to the pricing mechanism for domestic refined oil to be indirectly aligned with international crude oil prices in a controlled manner through use of certain
formula(s).

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 98.86% of our products in volume were sold in 2012. 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 2012, 94.18% 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.

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

The Domestic Competitive Environment

Prior to 1993, because distribution and pricing of our products were determined in accordance with the State Plan, we did not operate in a competitive environment. With the liberalization of control over pricing and product allocation by the Chinese government, competition in the domestic market has been gradually increasing. At the same time, Chinese private enterprises have gradually overcome technological and funding barriers to extend their business from the downstream processing sector to the upstream petrochemical field. These enterprises have advantages in many areas such as flexibility in operation costs, preferential policy treatment and regional presence, and may use these advantages to compete with us in markets for our products.

Foreign Competition and the World Trade Organization

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

- has reduced tariffs on imported petrochemicals products that compete with ours;
- increased levels of permitted foreign investment in the domestic petrochemicals industry, allowing foreign investors to own 100% of a domestic petrochemicals company from December 11, 2004;
- has gradually relaxed restrictions on the import of crude oil by non-state owned companies;
- has granted foreign-owned companies the right to import petrochemical products; and
- has permitted foreign-owned companies to distribute and market fuel products in both retail and wholesale markets in China.

As a result of these measures, we are facing increasing competition from foreign companies and imports, but, we think that China s WTO entry will also create substantial amounts of new investment and business in China, with a corresponding increase in sales opportunities for us.

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 2012, we had an approximate 0.87% share and imports had an approximate 1.45% share of total domestic polyester and acrylic consumption.

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The following table summarizes the competitive position of our principal synthetic fibers according to domestic sales in 2012.

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 (%)
Acrylic	19.00%	1	Jilin Province	28.00%	21.39%

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

Resins and Plastics

In 2012, we had an approximate 3.64% share and imports had an approximate 28.08% 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 2012.

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	5.19%	30	Jiangsu Province	12.00%	2.02%
PE	3.33%	3	Guangdong Province	5.18%	44.07%
PP	2.95%	5	Guangdong Province	3.50%	26.80%

Intermediate Petrochemicals

In 2012, we were one of the largest sellers of intermediate petrochemicals in China, holding an approximate 2.74% share of total domestic consumption, while imports had an approximate 27% share of domestic consumption. Ethylene glycol, paraxylene, benzene and butadiene are our major intermediate petrochemical products. In 2012, we were a major producer of ethylene glycol, paraxylene and benzene in China. The following table summarizes the competitive position of our principal intermediate petrochemicals according to domestic sales in 2012.

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	4.32%	1	Zhejiang Province	15.00%	73.40%
Paraxylene	6.57%	2	Jiangsu Province	9.21%	47.68%
Benzene	5.61%	1	Jiangsu Province	5.30%	6.26%
Butadiene	4.95%	12	Zhejiang Province	5.78%	12.84%

Petroleum Products

In 2012, we had an approximate 1.95% share of total domestic petroleum products market while imports had an approximate 3.48% share. Although we have one of the largest refining capabilities in China, we use most of our refining capacity to produce feedstock for our own downstream processing of petrochemical products.

The domestic markets for each of our major petroleum products are geographically concentrated because these markets tend to be highly localized with individual producers controlling a large share of the markets in their locality. In 2012, we sold approximately 97.94% of our

petroleum products in Eastern China.

Investments

We established Secco, a Sino-foreign equity joint venture, in late 2001 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. In 2009, Secco had expanded the capacity of certain facilities to 1,090,000 tons of ethylene per annum. We own 20% of the equity interest of Secco.

In 2012, Secco achieved a sales revenue of RMB27.158 billion (U.S.$4.36 billion), representing a decrease of 1.93% from its sales revenue of RMB27.693 billion (U.S.$4.45 billion) in 2011. The decrease of sales revenue was primarily attributable to the relatively lower market demand in the second half of 2012, in correspondence to which Secco selected to control the production capacity of manufacturing facilities. Secco produced 1,040.9 thousand tons of ethylene in 2012, representing a decrease of 24.3 thousand tons over the previous year, down by 2.28%. Secco achieved a net loss of RMB349.03 million (U.S.$56.02 million) in 2012, as compared to a net profit of RMB17.04 million (U.S.$2.74 million) in 2011. The decrease in net profit was primarily due to the fluctuations of international crude oil price and the continuous increase in the price of naphtha raw material. The prices of the majority of domestic petrochemical products fell during 2012, in particular, the price of polyolefin products was at a low level. All the above reasons contributed to Secco s net loss in 2012.

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 a significant amount of waste substances in the plants and discharge them into the environment after such waste substances are processed and meet the discharge standards. During 2012, we were assessed a total of RMB30.77 million (U.S.$4.94 million) in fees for discharges of waste substances. As of March 31, 2013, 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. In 2012, the Company continued to carry out various energy-saving and emissions reduction measures in accordance with the relevant domestic energy conservation and emissions reduction requirements, and achieved all energy-saving and emissions reduction goals set by the Chinese government during the year. In 2012, the Company s overall level of energy consumption per RMB10,000 product value was 0.998 ton of standard coal on a par with that for 2011. Furthermore, the Company provided 57,344,700 tons of water for production (2011: 58,069,200 tons), representing a decrease of 724,500 tons, or 1.25% year-on-year, while the recycling rate of industrial water reaching 96.90%. The use volume of fresh water decreased by 2.40%.The total volume of each COD, solid wastes, industrial waste water and SO2 discharge declined by 2.97%, 18.10% 1.53% and 6.65% respectively. Various indices, such as waste water discharge compliance rate and the hazardous waste treatment ratio, comply with environmental protection requirements. The average heat efficiency rate of heaters was 91.89%, increased by 0.27 percentage points over the previous year. In 2012, the Company s various projects, such as the Flue-gas Desulphurisation Project for Furnaces of Coal-fired Power Plants, the Removal of Foul Gas from the De-aeration Pool of the Waste Water Treatment Plants, Tail Gas Regenerative Thermal Oxidation Facilities at PTA Plants, Flare Gas Recovery System and the addition of Recycled Hydrogen Desulfurization Unit to the Diesel Hydrogenation Plant (with a capacity 550,000 tons/year), played an effective role in the energy conservation and emissions reduction.

Despite our continuous efforts to protect the environment and save energies, 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 participate in a package of insurance coverage plan through Sinopec Group as its controlled subsidiary, which, as of December 31, 2012, was approximately RMB32.964 billion (U.S.$5.29 billion) on our property and facilities and approximately RMB3.511 billion (U.S.$0.56 billion) on our inventory. In addition, we maintain insurance policies for such assets as the engineering construction projects and products in transit with third-party s commercial insurance company. 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 are uncertainties under Chinese law as to what percentage insurance claims we may demand against Sinopec Group.

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

Government Regulations

Following the development of several major oil fields and a growth in demand for petroleum and petrochemical products in China in the early 1970 s, the Chinese government organized petroleum refining and petrochemical production and processing plants 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 plants. 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 development industry .

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-owned Assets Supervision and Administration 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.

Business Operations Relating to Iran Threat Reduction and Syria Human Rights Act of 2012

In 2012, we sourced a small amount of crude oil from Iran through a wholly-owned subsidiary of Sinopec Corp., our controlling shareholder, and such amount represented 6.3% of our total purchase volume of crude oil in 2012. Details of our 2012 purchase volume and purchase expenses are provided below:

	Volume (thousand tons)	% of total	Amount (RMB billion)	% of total
Iran	722.2	6.33	3.59	6.05
Others	10,681.0	93.67	55.78	93.95
Total	11,403.2	100.00	59.37	100.00

In addition, based on feedback to our inquiries to Sinopec Group, the controlling shareholder of Sinopec Corp., Sinopec Group, directly or indirectly, engaged in a small amount of business activities in Iran such as providing engineering support and designs. Sales revenue from these business activities accounted for 0.08% of Sinopec Group s total unaudited sales revenue in 2012. No profits were generated from these business activities in 2012.

We have no performance obligations under any contract to continue to purchase crude oil sourced from Iran in 2013.

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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	74.25
Shanghai Golden Phillips Petrochemical Company Limited	60.00
Zhejiang Jin Yong Acrylic Fiber Company Limited	75.00
Shanghai Golden Conti Petrochemical Company Limited	100.00

Sinopec Corp.

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

Overview

Sinopec Corp. is an integrated petroleum and petrochemical company with upstream, midstream and downstream operations. Based on trading volume in 2012, 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 Percentage of equity held by Sinopec Corp. and its subsidiary (%)	Principal activities
China Petrochemical International Company Limited	RMB1,400	Limited company	100.00	Trading of petrochemical products
Sinopec Chemical Commercial Holding Company Limited	RMB1,000	Limited company	100.00	Marketing and distribution of petrochemical products

Sinopec Qingdao Petrochemical Company Limited	RMB1,595	Limited company	100.00	Manufacturing of intermediate petrochemical products and petroleum products
Sinopec Sales Company Limited	RMB1,700	Limited company	100.00	Marketing and distribution of refined petroleum products
Sinopec Yangzi Petrochemical Company Limited	RMB13,203	Limited company	100.00	Manufacturing of intermediate petrochemical products and petroleum products
Sinopec Zhongyuan Petrochemical Company Limited	RMB2,400	Limited company	93.51	Manufacturing of petrochemical products
Fujian Petrochemical Company Limited	RMB5,019	Limited company	50.00	Manufacturing of plastics, intermediate petrochemical products and petroleum products

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Name of Company	Particulars of issued capital (millions)	Type of legal entity	Percentage of equity Percentage of equity held by Sinopec Corp. and its subsidiary (%)	Principal activities
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$207	Limited company	72.34	Trading of crude oil and petroleum products
Sinopec Yizheng Chemical Fiber Company Limited	RMB4,000	Limited company	42.00	Production and sale of polyester chips and polyester fibers
Sinopec International Petroleum Exploration and Production Company Limited	RMB8,000	Limited company	100.00	Investment in exploration, production sales, etc. of petroleum and nature gas
Sinopec Shell (Jiangsu) Petroleum Marketing Company Limited	RMB830	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 petroleum refined products
Sinopec Qingdao Refining and Chemical Company Limited	RMB5,000	Limited company	85.00	Manufacturing of intermediate petrochemical products and petroleum products
China International United Petroleum & Chemical Co., Ltd.	RMB3,000	Limited company	100.00	Trading of crude oil and petrochemical products
Sinopec Hainan Refining & 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
Sinopec Fuel Oil Sales Company Limited	RMB2,200	Limited Company	100.00	Marketing and distribution of refined petroleum products

D. Property, Plant 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 transferees.

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Plants and Facilities

The following tables set forth the Rated Capacities of our principal production units. The actual production capacity of a production unit can exceed the 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 the Rated Capacity rather than actual production capacity and may vary with technical enhancements, changes in production management and scheduling of maintenance.

The following table sets forth the Rated Capacities and weighted average utilization rates of our principal production units for petroleum products and intermediate petrochemicals in 2012:

Production Unit (number of units)	Rated Capacity (tons)	Utilization Rate (%)
Crude oil distillation units (2)	14,000,000	79.95
Hydrocracker (2)	3,000,000	89.36
Ethylene units (2)	850,000	108.25
Aromatics unit	835,000	103.74
PTA unit	400,000	95.47
EO/EG unit (2)	525,000	100.88
Acrylonitrile unit	130,000	105.47
*Cracking and catalyzing (2)	4,500,000	86.32
Delayed Coking (2)	2,200,000	105.41
Reforming prehydrogenation unit	750,000	85.71
C5 segregation unit (2)	205,000	121.45

* For cracking and catalyzing units, the utilization rate of 86.32% only applies to one unit. The second unit was launched for operation in the beginning of 2013, as such its utilization rate is not available as the date of this annual report.

Our two crude oil distillation units were designed and built in China. In 2012, the actual quantity of crude oil we processed was approximately 11.1935 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 2012:

Production Unit (number of units)	Rated Capacity (tons)	Utilization Rate (%)
Polyester units (3)	550,000	107.71
Polyester staple units (2)	154,000	42.61
Polyester filament units	21,000	88.87
Acrylic staple fiber units (4)	141,000	117.66
PE units (3)	408,000	109.60
PP units (3)	400,000	108.27
Vinyl acetate unit (2)	102,000	91.33

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 the design of equipment which was imported into China in the 1960s and that we substantially improved. In 1996, we acquired two additional acrylic fiber units which use technology from Kawasaki Corporation of Japan. We produce PP in three identical units using technology from Himont Corporation of Italy. The PVA unit uses technology acquired from Kuraray Corporation of Japan.

Power Facilities

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

Other Facilities

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

Maintenance

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

In 2012, the Company prioritized the HSE works, and implemented an HSE accountability system at each working level to ensure a sound safety and environment friendly practice. There were no accidents involving serious consequences such as major fires, explosions or environmental pollution during the year. Overall production remained stable. Both the number of times and the duration of unplanned shutdowns of the major production plants decreased by 49.12% and 46.42%, respectively. Important technical and economic indicators were improved, with 62.26% of such indicators reflecting a stronger performance than the previous year, and 33.02% of such indicators reaching the advanced industrial level.

Transportation-Related Fixtures

Crude oil, our principal raw material, is transported by pipeline and oil tanker to a crude oil terminal wharf and storage tanks. Our products leave the factory by water, rail, road and pipeline. In 2012, approximately 54.07% 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 one chemical wharf at Jinshan with five berths of 2,000, 5,000, 8,000, 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 2012, products representing 15.17% 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 2012, products representing 2.78% of total sales volume were shipped from these facilities. We believe that we have a competitive advantage because a greater proportion of our products are shipped by water as opposed to rail and truck, which is subject to capacity constraints on China s rail and highway networks. Additionally, we own facilities for receiving crude oil and coal at docks that we own and transporting such materials by pipeline or conveyor to our production facilities.

We own an oil terminal wharf at Chenshan in Zhejiang Province, which is comprised of four berths, among which each of two berths is capable of handling 80,000 ton vessels, one is capable of handling 15,000 ton vessels and the other 50,000 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 500,000 tons. The depot provides access via a spur line to the Chinese national railway system. In 2012, products representing 1.53% 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.

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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 RMB2.6 billion in 2013. This amount will be funded by our own capital and by bank loans.

Name of Project	Rated Capacity (tons/year)	Start Date	Expected Completion Date	Status
The Carbon Fiber Project with a capacity of 1,500 tons/year	1,500	2010	Phase I 2012	Phase I completed
The No. 2 and No. 3 Aromatics Complexes Energy-saving Up-grade Project	N/A	2012	2014	Under construction
The SL-2 Cracking Furnace of No. 2 Ethylene Unit Transformation for Improving Energy Efficiency	N/A	2012	2013	Under construction
The Transformation for Improving Manufacturing Capacity for Epoxy Ethane	N/A	2012	2013	Under construction

N/A not applicable.

In 2010, 2011 and 2012, we invested RMB1.357 billion, RMB3.225 billion and RMB3.811 billion respectively, in capital expansion projects.

Refining Capacity Expansion

With a view to accommodating the need to adjust our product mixes, we adhere to the direction of purchasing more heavy and low-quality crude oil, improve the overall processing procedures, enhance our reprocessing capacity, and continuously increase the operating adaptability and overall efficiency of our refining facilities. The construction of the Phase 6 Project, which follows the direction of giving considerations to both low cost and product diversity, and to both mass and refined production, emphasizes low cost and mass production in the upstream supply and high added value and refined production in the downstream production, and focuses on the reconstruction of refining facilities, fine chemicals, structure adjustment and system perfection, has been substantially completed. The construction of the Refinery Revamping and Expansion Project was completed and the relevant facilities were put into operation in December 2012.

Expansion of New and Existing Downstream Petrochemical Products

As an integrated petrochemical complex, we produce a wide range of intermediate and downstream petrochemical products. We plan to utilize our currently available resources and develop higher-margin downstream products and fine chemicals, with raw materials including cracking carbon 5, carbon 4, epoxy ethane, vinyl acetate and acrylonitrile. With a view towards enhancing our competitive power and the ability to keep sustainable development, we plan to further increase the overall resource utility rate and adjust and improve our company s industrial structure through the measures discussed below.

To take advantage of our expertise in producing acrylics fiber and to improve our industrial structure and upgrade certain products, we plan to construct a carbon fiber project with a capacity of 1,500 tons/year. Sinopec Corp. approved the basic design for this project in December 2010; pile foundation construction was commenced in December 2010; civil engineering was commenced in February 2011 and one series of facilities under phase I were launched for trial operation in 2012.

We plan to construct a new 100,000t/a EVA production unit with imported technology. The revised feasibility study report for this project was submitted to Sinopec Corp. for approval in September 2011. The construction of this project is scheduled to be commenced in 2013 and completed in 2015.

We plan to adjust the production structure to improve No. 1 glycol unit s capacity of producing epoxyethane by utilizing SD technology. Sinopec Corp. approved the feasibility study report for this project in April 2011. The construction was commenced in August 2012 and is scheduled to be completed in June 2013.

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Other Projects

The basic design for the Up-grading Project for the Optimization of the system and reduction in energy and feedstock consumption of the No.2 PTA Plan was approved by Sinopec Corp. in May 2010. The Company started civil engineering in 2010 and the project was completed and put into operation in 2012. The feasibility study report for No. 2 and No. 3 aromatic hydrocarbon unit transformation for improving energy efficiency was approved by Sinopec Corp. in April 2011; and this project is scheduled to be commenced in 2013 and completed in 2014. The feasibility study report for No. 2 combined heat and power furnace transformation project for the purpose of achieving industrial standards and efficiency improvement was approved by Sinopec Corp. on October 28, 2011. The basic design was approved in July 2012 and the construction was completed in 2012. The feasibility study report for SL-2 cracking furnace of No. 2 ethylene unit transformation for improving energy efficiency was submitted to Sinopec Corp. for approval in July 2011. The construction was commenced in September 2012 and is scheduled to be completed in 2013.

In order to further our capacity of maintaining sustainable development and to echo the government s requirement of protecting the environment, we planned the No.5 and No. 6 Furnace Secondary Desulfurisation Project for Department of Thermoelectric. The basic design of the project was approved by Sinopec Corp. in June 2011. The construction commenced in September 2011 and was completed in June 2012. We also plan to commence the project of dust abatement and denitrification unit construction for No. 3 and No. 4 furnaces. The feasibility study report of the project was submitted to Sinopec Corp. for approval on December 29, 2011. The construction was commenced in December 2012 and is scheduled to be completed in August 2013.

ITEM 4A. UNRESOLVED STAFF COMMENTS.

None.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS.

General

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

You should read the following discussion and analysis in conjunction with our audited financial statements and our selected financial data, in each case, together with the accompanying notes included elsewhere in this annual report. Our audited financial statements have been prepared in accordance with IFRS, as issued by the International Accounting Standards Board.

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 2012. 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 and 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 included in Item 17. 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. We believe the following critical accounting policies involve the most significant judgments and estimates used in the preparation of our financial statements.

Impairments for long-lived assets

If circumstances indicate that the net book value of a long-lived asset may not be recoverable, the asset may be considered impaired, and an impairment loss may be recognized in accordance with International Accounting Standard No. 36 Impairment of Assets. Long-lived assets are reviewed for indication of impairment at the end of each reporting period or whenever events or changes in circumstance have indicated that their carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to the recoverable amount. The recoverable amount is the greater of the net selling price and the value in use. It is difficult to precisely estimate selling prices because quoted market prices for our assets or cash-generating units are not readily available. In determining the value in use, expected cash flows generated by the asset or the cash-generating unit are discounted to their present value, which requires significant judgment relating to level of sale volume, selling price and amount of operating costs. We use all readily available information in determining an amount that is a reasonable approximation of recoverable amount, including estimates based on reasonable and supportable assumptions and projections of sale volume, selling price and amount of operating costs. During the years ended December 31, 2010, 2011 and 2012, we recognized impairment charges on property, plant and equipment of RMB238 million, RMB11 million and RMB nil, respectively.

Depreciation

Property, plant and equipment are depreciated on a straight-line basis over the estimated useful lives of the assets, after taking into account the estimated residual values. We review the estimated useful lives of the assets annually 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, taking into account anticipated technological changes. The depreciation expense for future periods is adjusted if there are significant changes from previous estimates. There were no significant changes in these estimates during the years ended December 31, 2010, 2011 and 2012.

Impairment for bad and doubtful debts

We estimate impairment losses for bad and doubtful debts resulting from the inability of the customers to make the required payments. We base the estimates on the aging of the accounts receivable balance, customer credit-worthiness and historical write-off experience. If the financial condition of the customers were to deteriorate, actual impairment losses would be higher than estimated. Impairment provisions for bad and doubtful debts were a reversal of RMB3 million, a reversal of RMB2 million and a provision of
RMB0.2 million, during the years ended December 31, 2010, 2011 and 2012, respectively.

Inventory management

At the beginning of every year, the management team determines the appropriate levels of inventories to maintain on the basis of annual production and operating plans, financial budgets and market conditions. Every six months, the management team conducts an inventory status analysis in conjunction with its supply, production, marketing, financial and other departments and develops a plan for keeping inventories at an appropriate level.

Management assesses the realizability of our inventories based on the estimates of the net realizable value of the inventories at the end of each reporting period. 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. 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. If the actual selling prices were to be lower or the costs of completion were to be higher than the estimates, the actual allowance for diminution in value of inventories could be higher than estimated. In addition, management periodically reviews inventory aging information to assess if any obsolete inventories are required to be written down at the period end. Based on our assessments, we recorded write-down of inventories of RMB12 million, RMB110 million and RMB204 million respectively for the years ended December 31, 2010, 2011 and 2012. Barring unforeseeable changes that may occur to the current economic environment in either China or worldwide, our management does not anticipate encountering major difficulties with our attempt to realize by the end of 2013 the bulk of our inventories as of December 31, 2012 after deducting for diminution in values.

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Income tax

In June 2007, the State Administrative of Taxation issued a tax circular (Circular No.664) to the local tax authorities requesting the relevant local tax authorities to rectify the applicable enterprise income tax (EIT) for nine listed companies, which included us. After the notice was issued, we were required by the relevant tax authority to settle the EIT for 2007 at a rate of 33 percent. To date, we have not been requested by the tax authorities to pay additional EIT in respect of any years prior to 2007. There is no further development of this matter during the year ended December 31, 2012. No provision has been made in the financial statements at December 31, 2012 for this uncertainty because we believe it is not probable that the Company will be required to pay additional EIT for tax years prior to 2007.

Recognition of deferred tax assets

Deferred tax assets are recognized in respect of temporary deductible differences and the carryforward of unused tax losses. We recognize deferred tax assets only to the extent that it is probable that future taxable profit will be available against the assets which can be realized or utilized. At the end of each reporting period, we assess whether previously unrecognized deferred tax assets should be recognized. The Company recognizes a previously unrecognized deferred tax asset to the extent that it is probable that future taxable profit will allow the deferred tax asset to be utilized. In addition, we assess the carrying amount of deferred tax assets that are recognized at the end of each reporting period. The Company reduces the carrying amount of a deferred tax asset to the extent that it is no longer probable that sufficient taxable profit will be available for the deferred tax asset to be utilized.

In making the assessment of whether it is probable the Company will realize or utilize the deferred tax assets, we primarily rely on the generation of future taxable income to support the recognition of deferred tax assets. In order to fully utilize the deferred tax assets recognized at December 31, 2012, the Company would need to generate future taxable income of at least RMB4,210 million, of which RMB1,497 million is required to be generated by 2013 prior to the expiration of the unused tax losses incurred in 2008 and RMB2,260 million is required to be generated by 2017 prior to the expiration of the unused tax losses incurred in the current year.

Management believes that it is probable that the Company will generate sufficient taxable income before the unused tax losses expire. Favorable factors include the enlargement of crude oil refinery capacity of the Company and the new pricing mechanism in the PRC for setting gasoline and diesel prices to more closely track crude oil costs. Uncertainties which could affect the estimated taxable income include various factors such as the volatility of international crude oil prices and the cyclical nature of the petroleum and petrochemical industry. Upon changes in facts and circumstances, management may conclude that deferred tax assets may not be realizable in future periods, resulting in a future reduction in the carrying amount of a deferred tax asset.

Government Policies

The impact of government economic, fiscal, and monetary policies can materially affect our financial condition, results of operations, and cash flows (see Item 3. Key Information D. Risk Factors).

In particular, we consume large amounts of crude oil to manufacture our products of which more than 90% is imported. We attempt to mitigate the effect of increased costs due to rising crude oil prices. However, our ability to pass on these increased costs to our customers is dependent on government regulations, among other factors. Given that the increase of the sales prices of our products can lag behind the increase of crude oil costs, we sometimes fail to completely cover the increased costs by increasing our sales prices, particularly where government regulations restrict the prices of certain of our fuel products such as gasoline, diesel and jet fuel, and liquefied petroleum gas. In 2010, 2011 and 2012, approximately 34.41%, 36.70% and 40.09% of our net sales were from such products subject to price controls. In 2012, the domestic prices of refined oil products were not brought into line with the prices of crude oil in the international markets in a timely manner due to various policy concerns, *e.g.*, the government s desire to control the high inflation rate in China, which resulted in the decline of RMB539.7 million of the operating profit of our refining business over the previous year. Although the current price-setting mechanism for refined petroleum products in China allows the Chinese government to adjust price in the PRC market when the average international crude oil price fluctuates beyond certain levels within a certain time period (see Item 4. Information on the Company B. Business Overview Product Pricing), the Chinese government still retains discretion as to whether or when to adjust the prices of the refined oil products. The Chinese government generally exercises certain price control over refined oil products once international crude oil prices experience a sustained rise or become significantly volatile. Moreover, the Chinese government controls the distribution of many fuel products in China. For instance, some of our fuel products are required to be sold to designated distributors (such as the subsidiaries of Sinopec Corp.). Because we cannot freely sell our fuel products to take advantage of opportunities for higher prices we may not be able to fully cover increases in crude oil prices by increases in the sale prices of our products, which has had and will continue to have a material adverse effect on our financial condition, results of operations and cash flows.

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In addition, the exchange rates between the Renminbi and the U.S. Dollar or other foreign currencies are affected by Chinese government policies. In particular, the value of the Renminbi is only permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies. The Chinese government continues to receive significant international pressure to liberalize its currency policy. Most of our revenue is denominated in Renminbi, and most of our purchase of crude oil and some equipment and certain loan repayments are made in foreign currencies. In general, the trend for appreciation of the Renminbi has been helpful to us since our imported crude oil purchases constitute such a large portion of our total costs. By contrast, any depreciation of the Renminbi would increase our costs and adversely affect our capacity of making profits. In addition, any depreciation of the Renminbi could adversely affect the value of the dividends of our H shares and ADSs, which we pay in foreign currencies. Further appreciation in the value of Renminbi against foreign currencies (including the U.S. Dollar) may cause a decrease in the value of our cash and cash equivalents that are denominated in foreign currencies.

Summary

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

	For the year ended December 31,								
	2010			2011			2012		
	Sales Volume (000 tons)	Net Sales (Millions of RMB)	% of Total Net Sales	Sales Volume (000 tons)	Net Sales (Millions of RMB)	% of Total Net Sales	Sales Volume (000 tons)	Net Sales (Millions of RMB)	% of Total Net Sales
Synthetic fibers	255.9	3,906.6	5.4	250.9	4,150.2	4.6			