PROFIRE ENERGY INC
Form 424B3
February 14, 2014

Filed Pursuant to Rule 424(b)(3)
Registration No. 333-193086

Prospectus Supplement No. 3
(to Prospectus dated January 7, 2014)

2,172,405 Shares

PROFIRE ENERGY, INC.

Common Stock

This prospectus supplement supplements the prospectus, dated January 7, 2014, as amended or supplemented (the "Prospectus"), which forms a part of our Registration Statement on Form S-1 (Registration No. 333-193086). This prospectus supplement is being filed to update, amend and supplement the information included or incorporated by reference in the Prospectus with the information contained in our quarterly report on Form 10-Q, filed with the Securities and Exchange Commission (the "Commission") on February 14, 2014 (the "Quarterly Report"). Accordingly, we have attached the Quarterly Report to this prospectus supplement.

The Prospectus and this prospectus supplement relate to the sale or other disposition from time to time of up to 2,172,405 shares of our common stock, which are held by the selling stockholders named in the Prospectus. The shares of common stock covered by the Prospectus and this prospectus supplement were previously issued by us in a private placement. We are not selling any common stock under the Prospectus and this prospectus supplement and will not receive any of the proceeds from the sale or other disposition of shares by the selling stockholders.

This prospectus supplement should be read in conjunction with the Prospectus. This prospectus supplement updates, amends and supplements the information included or incorporated by reference in the Prospectus. If there is any inconsistency between the information in the Prospectus and this prospectus supplement, you should rely on the information in this prospectus supplement.

Our common stock is quoted on the OTCQB and the OTCBB under the symbol "PFIE".

Investing in our common stock involves a high degree of risk. You should review carefully the risks and uncertainties described under the heading "Risk Factors" beginning on page 9 of the Prospectus, and under similar headings in any amendment or supplements to the Prospectus.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of the Prospectus or this prospectus supplement. Any representation to the contrary is a criminal offense.

The date of this prospectus supplement is February 14, 2014

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended December 31, 2013

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Transition Period From ________ to _________

Commission File Number 000-52376

PROFIRE ENERGY, INC.
(Exact name of registrant as specified in its charter)

Nevada (State or other jurisdiction of incorporation or organization)	20-0019425 (I.R.S. Employer Identification No.)
321 South 1250 West, Suite 1 Lindon, Utah (Address of principal executive offices)	84042 (Zip Code)

(801) 796-5127
(Registrant's telephone number, including area code)

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 [X] No [ ]

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

Large accelerated filer [ ]	Accelerated filer [ ]
Non-accelerated filer [ ] (Do not check if a smaller reporting company)	Smaller reporting company [X]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.) Yes [ ]   No [X]

As of February 4, 2013 the registrant had 47,836,428 shares of common stock, par value $0.001, issued and outstanding.

PROFIRE ENERGY, INC.
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PART I. FINANCIAL INFORMATION

Item 1 Financial Info

PROFIRE ENERGY, INC. AND SUBSIDIARY
Condensed Consolidated Balance Sheets

	December 31 2013 (Unaudited)	March 31, 2013
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$5,732,530	$808,772
Accounts receivable, net	8,481,074	5,879,165
Inventories	6,963,230	3,463,614
Prepaid expenses	46,937	1,967
Total Current Assets	21,223,771	10,153,518
PROPERTY AND EQUIPMENT, net	2,543,551	2,232,355
TOTAL ASSETS	$23,767,322	$12,385,873
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$2,050,748	$1,499,330
Accrued liabilities	96,213	189,489
Deferred income tax liability	116,607	72,857
Income taxes payable	1,220,717	161,550
Total Current Liabilities	3,484,285	1,923,226
TOTAL LIABILITIES	3,484,285	1,923,226
STOCKHOLDERS' EQUITY		
Preferred shares: $0.001 par value, 10,000,000 shares authorized: no shares issued and outstanding	-	-
Common shares: $0.001 par value, 100,000,000 shares authorized: 47,836,428 and 45,250,000 shares issued and outstanding, respectively	47,837	45,250
Additional paid-in capital	5,912,516	585,735
Accumulated other comprehensive income/(loss)	(7,351)	371,466
Retained earnings	14,330,035	9,460,196
Total Stockholders' Equity	20,283,037	10,462,647

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$23,767,322	$12,385,873

The accompanying notes are an integral part of these condensed consolidated financial statements.

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PROFIRE ENERGY, INC. AND SUBSIDIARY
Condensed Consolidated Statements of Operations and Other Comprehensive Income (Loss)
(Unaudited)

	For the Three Months Ended December		For the Nine Months Ended December	
	2013	2012	2013	2012
REVENUES				
Sales of goods, net	$8,999,070	$3,176,627	$24,778,093	$10,724,586
Sales of services, net	531,767	364,434	1,276,780	873,341
Total Revenues	9,530,837	3,541,061	26,054,873	11,597,927
COST OF SALES				
Cost of goods sold-product	3,894,002	1,050,966	10,169,122	4,329,037
Cost of goods sold-services	418,594	313,442	919,041	697,474
Total Cost of Goods Sold	4,312,596	1,364,408	11,088,163	5,026,511
GROSS PROFIT	5,218,241	2,176,653	14,966,710	6,571,416
OPERATING EXPENSES				
General and administrative expenses	1,977,911	1,339,676	4,076,226	3,135,668
Research and development	139,691	38,472	390,710	148,865
Payroll expenses	946,878	1,144,024	2,712,947	1,845,679
Depreciation expense	78,685	116,678	205,610	227,604
Total Operating Expenses	3,143,165	2,638,850	7,385,493	5,357,816
INCOME FROM OPERATIONS	2,075,076	(462,197)	7,581,217	1,213,600
OTHER INCOME (EXPENSE)				
Interest expense	-	(4,493)	(10,567)	(13,171)
Gain on disposal of fixed assets	-	-	1,617	-
Rental income	311	-	2,501	-
Interest income	1,544	13,074	9,910	21,389
Total Other Income (Expense)	1,855	8,581	3,461	8,218
NET INCOME BEFORE INCOME TAXES	2,076,931	(453,616)	7,584,678	1,221,818
INCOME TAX EXPENSE	870,625	(127,347)	2,714,839	337,222
NET INCOME	$1,206,306	$(326,269)	$4,869,839	$884,596
FOREIGN CURRENCY TRANSLATION GAIN (LOSS)	$(178,593)	$(449,470)	(378,817)	(229,852)
TOTAL COMPREHENSIVE INCOME	$1,027,713	$(775,739)	$4,491,022	$654,744

BASIC EARNINGS PER SHARE	$0.03	$(0.01)	$0.11	$0.02
FULLY DILUTED EARNINGS PER SHARE	$0.03	$(0.01)	$0.11	$0.02
BASIC WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	46,560,913	45,155,000	45,705,105	45,088,400
FULLY DILUTED WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	46,973,885	45,155,000	46,118,077	45,357,724

The accompanying notes are an integral part of these condensed consolidated financial statements.

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PROFIRE ENERGY, INC. AND SUBSIDIARY
Condensed Consolidated Statements of Cash Flows
(unaudited)

	For the Nine Months Ended December 31	
	2013	2012
OPERATING ACTIVITIES		
Net Income	$4,869,839	$884,596
Adjustments to reconcile net income to		
net cash provided by operating activities:		
Depreciation expense	246,542	225,076
Gain on the disposal of fixed assets	(1,617)	-
Common stock issued for services	28,350	208,750
Bad debt expense	-	69,995
Stock options issued for services	849,531	148,648
Changes in operating assets and liabilities:		
Changes in accounts receivable	(2,749,328)	(642,358)
Changes in inventories	(3,572,120)	(1,493,076)
Changes in prepaid expenses	(44,970)	8,231
Changes in accounts payable and accrued liabilities	519,060	1,031,985
Changes in income taxes payable	1,190,648	(132,932)
Net Cash Provided by Operating Activities	1,335,935	308,915
INVESTING ACTIVITIES		
Proceeds from disposal of equipment	33,910	-
Purchase of fixed assets	(654,057)	(474,381)
Net Cash Used in Investing Activities	(620,147)	(474,381)
FINANCING ACTIVITIES		
Stock issued	4,332,975	-
Stock issued in exercise of stock options	118,512	-
Net Cash Used in Financing Activities	4,451,487	-
Effect of exchange rate changes on cash	(161,257)	(264,802)
NET INCREASE IN CASH	5,006,018	(430,268)
CASH AT BEGINNING OF PERIOD	808,772	1,914,877
CASH AT END OF PERIOD	$5,814,790	$1,484,609

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

CASH PAID FOR:		
Interest	$10,567	$13,171
Income taxes	$1,655,672	$513,245

The accompanying notes are an integral part of these condensed consolidated financial statements.

PROFIRE ENERGY, INC. AND SUBSIDIARY
Notes to the Condensed Consolidated Financial Statements
December 31, 2013 and March 31, 2013

NOTE 1 - CONDENSED FINANCIAL STATEMENTS

The accompanying financial statements have been prepared by the Company without audit. In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position, results of operations and cash flows at December 31, 2013 and for all periods presented have been made.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. It is suggested that these condensed consolidated financial statements be read in conjunction with the financial statements and notes thereto included in the Company's March 31, 2013 audited financial statements. The results of operations for the periods ended December 31, 2013 and 2012 are not necessarily indicative of the operating results for the full years.

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES

Reclassification
Certain balances in previously issued financial statements have been reclassified to be consistent with the current period presentation.

Use of Estimates
The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents
For purposes of the statement of cash flows, cash and cash equivalents include cash and all debt securities with an original maturity of 90 days or less. As of December 31, 2013 and March 31, 2013, bank balances included $5,732,530 and $808,772, respectively, held by the Company’s banks. Of the bank balances, $3,471,361and $0 was not guaranteed by the Province of Alberta, Canada and the FDIC.

Accounts Receivable
Receivables from the sale of goods and services are stated at net realizable value. This value includes an appropriate allowance for estimated uncollectible accounts. The allowance is calculated based on past collectability and customer relationships. The Company recorded an allowance for doubtful accounts of $124,869 and $133,974 as of December 31, 2013 and March 31, 2013, respectively.

PROFIRE ENERGY, INC. AND SUBSIDIARY
Notes to the Condensed Consolidated Financial Statements
December 31, 2013 and March 31, 2013

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (Continued)

Inventory
In accordance with ASC 330, the Company's inventory is valued at the lower of cost (the purchase price, including additional fees) or market based on using the entire value of inventory. Inventories are determined based on the average cost basis. As of December 31, 2013 and March 31, 2013 inventory consisted of the following:

	December 30, 2013	March 31, 2013
Raw materials	$ -	$ -
Finished goods	7,051,138	3,553,140
Work in process	-	-
Subtotal	7,051,138	3,553,140
Reserve for obsolescence	(87,908)	(89,526)
Total	$ 6,963,230	3,463,614

Revenue Recognition
The Company records sales when a firm sales agreement is in place, delivery has occurred or services have been rendered, and collectability of the fixed or determinable sales price is reasonably assured. If customer acceptance of products is not assured, the Company records sales only upon formal customer acceptance.

Income Taxes
The Company is subject to US and Canadian income taxes, respectively, on its US and Canadian income with a credit provided for foreign taxes paid. The combined effective rates of income tax expense (benefit) in the US and Canada are, respectively, 35% and 28% for the nine months ended December 31, 2013 and 2012, respectively.

Basic and Diluted Earnings Per Share
The computation of basic earnings per share of common stock is based on the weighted average number of shares outstanding during the periods presented. The computation of fully diluted earnings per share includes common stock equivalents outstanding at the balance sheet date. The Company had 629,350 and 530,000 stock options included in the fully diluted earnings per share as of December 31, 2013 and 2012, respectively. The Company uses the treasury stock method to calculate the dilutive effects of stock options and warrants.

	For the Nine Months Ended December 31,	
	2013	2012
Net income applicable to common shareholders	$ 4,869,839	$ 884,596
Weighted average shares outstanding	45,705,105	45,088,400
Weighted average fully diluted shares outstanding	46,118,077	45,357,724
Basic earnings per share	$ 0.11	$ 0.02
Fully diluted earnings per share	$ 0.11	$ 0.02

PROFIRE ENERGY, INC. AND SUBSIDIARY
Notes to the Condensed Consolidated Financial Statements
December 31, 2013 and March 31, 2013

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (Continued)

Foreign Currency and Comprehensive Income
The Company's functional currencies are the United States dollar (USD) and the Canadian dollar (CAD), the reporting currency is USD. All transactions initiated in other currencies are translated into the reporting currency in accordance with ASC830-20, "Foreign Currency Matters – Foreign Currency Transactions". The period-end exchange rates of 0.940531 and 0.982898 were used to convert the Company's December 31, 2013 and March 31, 2013 balance sheets, respectively, and the statements of operations used weighted average rates of 0.64101 and 1.02760 for the nine months ended December 31, 2013 and 2012, respectively. All amounts in the financial statements and footnotes are presumed to be stated in USD, unless otherwise identified. Foreign currency translation gains or losses as a result of fluctuations in the exchange rates are reflected in the Statement of Operations and Other Comprehensive Income.

Recent Accounting Pronouncements
The Company has evaluated recent accounting pronouncements and their adoption has not had or is not expected to have a material impact on the Company's financial position, or statements.

Stock-Based Compensation

The Company follows the provisions of ASC 718, "Share-Based Payment's" which requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. The Company uses the Black-Scholes options pricing model for determining the fair value of stock-based compensation.

NOTE 3 – FAIR VALUE MEASUREMENT

The Company measures its cash equivalents and marketable securities at fair value. Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. A three-tier fair value hierarchy is established as a basis for considering such assumptions and for inputs used in the valuation methodologies in measuring fair value:

Level 1 - Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 - Include inputs that are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant inputs are observable in the market or can be derived from observable market data. Where applicable, these models project future cash flows and discount the future amounts to a present value using market-based observable inputs including interest rate curves, foreign exchange rates, and credit ratings.

Level 3 - Unobservable inputs that are supported by little or no market activities.

PROFIRE ENERGY, INC. AND SUBSIDIARY
Notes to the Condensed Consolidated Financial Statements
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NOTE 3 – FAIR VALUE MEASUREMENT (Continued)

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

NOTE 4 – SEGMENT INFORMATION

The Company operates in the United States and Canada. Segment information for these geographic areas is as follows:

	For the Three Months Ended December 31,		For the Nine Moths Ended December 31,	
Sales	2013	2012	2013	2012
Canada	$ 4,288,155	$ 2,386,091	$ 11,492,468	$ 9,940,391
United States	5,242,682	1,154,970	14,562,405	1,657,536
Total	$ 9,530,837	$ 3,541,061	$ 26,054,873	$ 11,597,927

Long-lived assists	December 31, 2013	March 31, 2013
Canada	$ 1,424,129	$ 1,583,613
United States	1,119,422	648,742
Total	$ 2,543,551	$ 2,232,355

NOTE 5 – COMMON STOCK PURCHASE OPTIONS

On October 28, 2009, the Company issued a total of 410,000 stock purchase options exercisable for the purchase of its common stock at $0.40 per share. The options were issued to key employees. The options vest 1/3 each year for 3 years. The Company estimates the fair value of each stock award at the grant date by using the Black-Scholes option pricing model. The following weighted average assumptions used for grants as of October 28, 2009: dividend yield of zero percent; expected volatility of 127%; risk-free interest rates of 1.35% and expected life of 3.0 years. The Company recognized $0 and $18,436 in expense for the fair value of the options vesting during the nine months ending December 31, 2013 and 2012, respectively.

On February 15, 2011, the Company issued a total of 600,000 stock purchase options exercisable for the purchase of its common stock at $0.30 per share. The options were issued to key employees. The options vest 1/5 each year for 5 years. The Company estimates the fair value of each stock award at the grant date by using the Black-Scholes option pricing model. The following weighted average assumptions used for grants as of February 15, 2011: dividend yield of zero percent; expected volatility of 254%; risk-free interest rates of 2.02% and expected life of 2.5 years. The Company recognized $30,897 and $30,897 in expense for the fair value of the options vesting during nine months ending December 31, 2013 and 2012, respectively.

PROFIRE ENERGY, INC. AND SUBSIDIARY
Notes to the Condensed Consolidated Financial Statements
December 31, 2013 and March 31, 2013

NOTE 5 – COMMON STOCK PURCHASE OPTIONS (CONTINUED)

On March 6, 2012, the Company approved a grant of 820,000 stock purchase options exercisable for the purchase of its common stock at 85% of approval date fair market value. The options were issued to key employees. The options vest 1/5 each year for 5 years. The Company estimates the fair value of each stock award at the grant date by using the Black-Scholes option pricing model. The exercise price was determined as of September 27, 2012, the date the options were executed. The following weighted average assumptions used for grants as of September 27, 2012: dividend yield of zero percent; expected volatility of 191%; risk-free interest rates of 2.37% and expected life of 2.5 years. The Company recognized $216,948 and $1,729 in expense for the fair value of the options vesting during nine months ending December 31, 2013 and 2012, respectively.

On December 17, 2013, the Company changed the strike price per share, of the options approved March 6, 2012, to $1.75, reflecting 100% of the approval date value, as required under applicable tax law. The Company accelerated the terms, to reflect the board approval date, and recognized an extra $58,487 in expense during the three months ended December 31, 2013 and will recognize an additional $59,063 in expense during the three months ending March 31, 2013.

On April 18, 2013, the Company approved a grant of 1,183,000 stock purchase options exercisable for the purchase of its common stock at 85% of approval date fair market value. The options were issued to key employees. The options vest 1/5 each year for 5 years. The Company estimates the fair value of each stock award at the grant date by using the Black-Scholes option pricing model. The exercise price was determined as of August 21, 2013, the date the options were executed. The following weighted average assumptions used for grants as of August 21, 2013: dividend yield of zero percent; expected volatility of 179%; risk-free interest rates of 1.64% and expected life of 2.5 years. The Company recognized $208,454 and $-0- in expense for the fair value of the options vesting during the nine months ended December 31, 2013 and 2012, respectively.

On December 17, 2013, the Company changed the strike price per share, of the options approved April 18, 2013, to $1.37, reflecting 100% of the approval date value, as required under applicable tax law. The Company accelerated the terms, to reflect the board approval date, and recognized an extra $66,398 in three months ended December 31, 2013 and will recognize an additional $68,553 in the three months ending March 31, 2013.

On July 31, 2013, the Company approved a grant of 100,000 stock purchase options exercisable for the purchase of its common stock. The options were issued for director compensation. The options vest 1/2 upon execution and 1/2 after 1 year. The Company estimates the fair value of each stock award at the grant date by using the Black-Scholes option pricing model. The exercise price was determined as of July 31, 2013, the date the options were executed. The following weighted average assumptions used for grants as of August 21, 2013: dividend yield of zero percent; expected volatility of 179%; risk-free interest rates of 1.64% and expected life of 2.5 years. The Company recognized $117,989 and $-0- in expense for the fair value of the options vesting during the nine months ended December 31, 2013 and 2012, respectively.

PROFIRE ENERGY, INC. AND SUBSIDIARY
Notes to the Condensed Consolidated Financial Statements
December 31, 2013 and March 31, 2013

NOTE 5 – COMMON STOCK PURCHASE OPTIONS (CONTINUED)

On December 17, 2013, the Company changed the strike price per share, of the options approved April 18, 2013, to $1.37, reflecting 100% of the approval date value, as required under applicable tax law. The Company accelerated the terms, to reflect the board approval date, and recognized an extra $66,398 in expense during the three months ended December 31, 2013 and will recognize an additional $68,553 in expense during the three months ending March 31, 2013.

A summary of the status of the Company's stock option plans as of December 31, 2013 and 2012 and the changes during the nine months are presented below:

	2013	2012
Unexercised options, beginning of year	1,805,000	1,010,000
Stock options issued during the nine months ended December 31,	1,483,000	820,000
Stock options canceled	(5,000)	(25,000)
Stock options expired	-	-
Stock options exercised	(307,125)	-
Unexercised options, December 31	2,975,875	1,805,000
Exercisable options, December 31	629,375	650,000

The following table summarizes information about the stock options as of December 31, 2013:

Outstanding Options

Range of Exercise Prices	Shares	Wtd. Avg. Remaining Contractual Life (years)	Wtd. Avg. Exercise Price	Aggregate Intrinsic Value
$ 0.40	250,025	0.71	$ 0.40	$ 100,010
0.30	460,000	3.13	0.30	138,000
1.75	785,350	4.18	1.75	1,374,363
1.37	1,180,500	5.30	1.37	1,617,285
1.37	100,000	5.58	1.37	137,000
$ 3.85	200,000	5.85	3.85	770,000
	2,975,875	4.33	$ 1.39	$ 4,136,658

PROFIRE ENERGY, INC. AND SUBSIDIARY
Notes to the Condensed Consolidated Financial Statements
December 31, 2013 and March 31, 2013

NOTE 5 – COMMON STOCK PURCHASE OPTIONS (CONTINUED)

The following table summarizes information about the exercisable stock options as of December 31, 2013:

Range of Exercise Prices	Shares	Remaining Contractual Life (years)	Wtd. Avg. Exercise Price	Aggregate Intrinsic Value
$ 0.40	250,025	0.71	$ 0.40	$ 100,010
0.30	100,000	3.13	0.30	30,000
1.75	129,350	4.18	1.75	226,363
1.37	-	5.30	1.37	-
1.37	50,000	5.58	1.37	68,500
$ 3.85	100,000	5.85	3.85	385,000
	629,375	3.01	$ 1.29	$ 809,873

The following table summarizes information about non-vested options as of the nine months ended December 31, 2013:

	Options	Wtd. Avg. Grant Date Fair Value
Non-vested at March 31, 2013	1,155,000	$ 0.95
Stock options issued during the nine months	1,478,000	1.71
Vest during the nine months ended December 31, 2013	(286,500)	2.42
Non-vested at December 31, 2013	2,346,500	$ 1.42

NOTE 6 – STOCKHOLDERS' EQUITY

On November 18, 2013, the Company completed an equity offering of 2,259,393 shares of restricted Common Stock and received proceeds of $4,332,975, which is net of $592,501 in underwriting discounts, commission and direct costs incurred and paid by the Company in connection with this equity offering.

NOTE 7 – SUBSEQUENT EVENTS

In accordance with ASC 855, the Company's management has evaluated the subsequent events through the date the financial statements were issued and has found no subsequent events to report.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This discussion summarizes the significant factors affecting our consolidated operating results, financial condition, liquidity and capital resources during the three month and nine month periods ended December 31, 2013 and 2012. For a complete understanding, this Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Financial Statements and Notes to the Financial Statements contained in this quarterly report on Form 10-Q and our annual report on Form 10-K for the year ended March 31, 2013.

Forward-Looking Statements

This quarterly report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, (the "Securities Act") and Section 21E of the Securities and Exchange Act of 1934, as amended (the "Exchange Act") that are based on management's beliefs and assumptions and on information currently available to management. For this purpose any statement contained in this report that is that is not a statement of historical fact may be deemed to be forward-looking, including, but not limited to, statements relating to our future actions, intentions, plans, strategies, objective, results of operations, cash flows and the adequacy of or need to seek additional capital resources and liquidity. Without limiting the foregoing, words such as "may", "should", "expect", "project", "plan", "anticipate", "believe", "estimate", "intend", "budget", "forecast", "predict", "potential", "continue", "should", "could" comparable terminology or the negative of such terms are intended to identify forward-looking statements. These statements by their nature involve known and unknown risks and uncertainties and other factors that may cause actual results and outcomes to differ materially depending on a variety of factors, many of which are not within our control. Such factors include, but are not limited to, economic conditions generally and in the industry in which we and our customers participate; competition within our industry; legislative requirements or changes which could render our services less competitive or obsolete; our failure to successfully develop new services and/or products or to anticipate current or prospective customers' needs; price increases or employee limitations; and delays, reductions, or cancellations of contracts we have previously entered into, sufficiency of working capital, capital resources and liquidity and other factors detailed herein and in our other filings with the United States Securities and Exchange Commission (the "SEC" or "Commission"). Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual outcomes may vary materially from those indicated.

Forward-looking statements are predictions and not guarantees of future performance or events. Forward-looking statements are based on current industry, financial and economic information, which we have assessed but which by its nature is dynamic and subject to rapid and possibly abrupt changes. Our actual results could differ materially from those stated or implied by such forward-looking statements due to risks and uncertainties associated with our business. We hereby qualify all our forward-looking statements by these cautionary statements.

These forward-looking statements speak only as of their dates and should not be unduly relied upon. We undertake no obligation to amend this report or revise publicly these forward-looking statements (other than pursuant to reporting obligations imposed on registrants pursuant to the Exchange Act) to reflect subsequent events or circumstances, whether as the result of new information, future events or otherwise.

Throughout this report, unless otherwise indicated by the context, references herein to the “Company”, “we”, “our” or “us” and similar language means Profire Energy, Inc., a Nevada corporation, and its corporate subsidiaries and predecessors.

The following discussion should be read in conjunction with our financial statements and the related notes contained elsewhere in this report and in our other filings with the Securities and Exchange Commission.

Overview

We manufacture, install and service oilfield combustion management technologies and related products (e.g. fuel train components, secondary airplates, etc.). Our products and services aid oil and natural gas producers in the safe and efficient transportation, refinement and production of oil and natural gas. Our primary products are burner management systems.

In the oil and natural gas industry there are numerous demands for heat generation and control. Oilfield vessels of all kinds, including line-heaters, dehydrators, separators, treaters, amine reboilers, free-water knockout systems, etc. require sources of heat to satisfy their various functions, which is provided by a burner flame inside the vessel. This burner flame is integral to the proper function of the oilfield vessel because these vessels use the flame’s heat to help separate, store, transport and purify oil and gas (or even water). The viscosity of the oil and gas is critical to a number of oilfield processes, and is directly affected by the heat provided by the burner flame inside the vessel.

Our products help monitor and manage this burner flame, reducing the need for employee interaction with the burner (e.g. for re-ignition or temperature monitoring), which results in greater operational efficiencies, increased safety, and improved compliance for the oil or gas producer. We believe there is a growing trend in the industry toward automation, including a demand for automation of burner management. In addition to this demand, there is also a need for skilled combustion technicians. Profire also trains and dispatches combustion technicians to address this industry need in Canada. When we believe there is adequate demand for such services in the U.S. and skilled technicians have been trained, we may also begin to market combustion services through our U.S. offices.

Results of Operations

Comparison of the three months ended December 31, 2013 and 2012

Total Revenues

Total revenues during the quarter ended December 31, 2013 increased $5,989,776, or 169%, compared to the quarter ended December 31, 2012. This increase was principally attributable to increased sales of goods, net.

Sales of Goods, Net

We realized an increase of $5,822,443, or 183%, in sales of goods, net during the quarter ended December 31, 2013 compared to the quarter ended December 31, 2012. This increase was primarily due to improved sales execution, the continued development of the U.S. market, the leveraging of now-effective sales people hired in previous quarters, and improved management of the sales team. There have been an increased number of sales through larger customers, which yielded higher revenues during the quarter. We expect that our quarterly revenues will continue to grow year-over-year at approximately historical rates, as our sales team continues to execute on our sales strategy.

Sales of Services, Net

During the three months ended December 31, 2013 we realized an increase of $167,333 or 46%, in sales of services, net. We are beginning to experience increasing service revenues as a result of our continued expansion in the U.S. We anticipate service revenues in our Utah and Texas offices will continue to expand in upcoming quarters. As the sales team proactively looks for equipment sales the opportunity to discuss services, related sales is expected to increase.

Total Cost of Goods Sold

As a percentage of total revenues, total cost of goods sold increased to 45% during the quarter ended December 31, 2013, compared to 39% during the quarter ended December 31, 2012. This increase is due to an increase in Cost of Goods Sold-Products.

Cost of Goods Sold-Products

During the quarter ended December 31, 2013 cost of goods sold-products increased $2,843,036 or 271%, compared to the quarter ended December 31, 2012 as a result of increased sales, and a change in the mix of products sold during the quarter. As a percentage of revenues from product sales, cost of goods sold-products increased from 33% to 43%. This proportional increase is mostly due to a rise in the proportion of sales of lower-margin products (such as component sales) compared to the prior year. Additionally, there was a minor modification in the allocation of overhead costs to cost of goods sold-products. However, the proportion of revenues from product sales represented by cost of goods sold-products for the period is approximately consistent with more recent levels of cost of goods sold-products, or about 40%.

Cost of Goods Sold-Services

Cost of goods sold-services increased $105,152, or 34%, during the quarter ended December 31, 2013 compared to the quarter ended December 31, 2012. As a percentage of service revenues, cost of goods sold-service decreased from 86% to 79%. This decrease was attributable, in part, to logistical efficiencies, derived from serving a larger customer base throughout our service regions (and the installation of personnel in those areas, reducing logistical costs).

Gross Profit

Because the percentage increase in total costs exceeded the percentage-increase in total revenues, gross profit decreased to 55% of total revenues during the quarter ended December 31, 2013 compared to 61% during the quarter ended December 31, 2012.

Total Operating Expenses

Our total operating expenses increased $504,315, or 19%, during the three months ended December 31, 2013 compared to the three months ended December 31, 2012. As a percentage of total revenues, total operating expenses decreased from 75% to 33%. This decrease was largely attributable to a reduction in payroll expenses, general and administrative expenses, and depreciation expenses as a percentage of revenues.

General and Administrative Expenses

During the three months ended December 31, 2013 general and administrative expenses increased by $638,235, or 48%. As a percentage of total operating expense, general and administrative expenses increased from 51% to 63%. This increase was largely due to non-cash stock options expenses for employees and directors (discussed in Note 5)

Research and Development

During the quarter ended December 31, 2013 research and developments expenses were $139,691 compared to $38,472 during the quarter ended December 31, 2012, an increase of 263%. As a percentage of total operating expense, research and development expenses increased from 1% to 4%. We have increased our focus on research and development in order to improve our current products, as well as research the possibility of additional products that could enhance our current product-offering.

Payroll Expenses

We experienced a $197,146, or 17% decrease in payroll expenses in the quarter ended December 31, 2013 compared to quarter ended December 31, 2012. As a percentage of total operating expenses, payroll expenses decreased from 43% to 30%. This decrease was the result of the timing of management bonuses that were paid in the quarter ended December 31, 2012, but were not yet paid as of December 31, 2013.

Depreciation Expense

Depreciation expense decreased $37,993 or 33%, during the quarter ended December 31, 2013 compared to the quarter ended December 31, 2012. As a percentage of total operating expenses, depreciation decreased from 4% to 3%. This decrease in depreciation expense is primarily due to assets meeting their expected lives in our Canada office and to the allocation of depreciation to costs of goods sold.

Total Other Income (Expense)

During the three months ended December 31, 2013 we realized total other income of $1,855 compared to total other income of $8,581 for the three months ended December 31, 2012. During the quarters ended December 31, 2013, we realized interest expense of $0, interest income of $1,544 and rental income of $311. By comparison, during the quarter ended December 31, 2012, we realized interest expense of ($4,493), interest income of $13,074, and rental income of $0.

Net Income Before Income Taxes

The 169% increase we realized in total revenues, the 216% increase in total cost of goods sold and the 19% increase in total operating expenses combined to result in net income before income taxes during the quarter ended December 31, 2013 of $2,076,931 compared to net loss before income taxes of $453,616 during the quarter ended December 31, 2012—an increase of $2,530,547. As a percentage of total revenues, net income before income taxes represented 22% of total revenues, compared to (13%) during the prior year comparable quarter.

Income Tax Expense

We recognized income tax expense of $870,625 during the three months ended December 31, 2013 compared to a benefit of $127,347 during the three months ended December 31, 2012. As a percentage of net income, before income taxes, income tax expense rose from 28% to 42%, which greatly exceeds the Company's historical blended tax rate of about 34%. This proportional increase is largely due to the stock option expenses realized in the quarter, which are not tax-deductible, and resulted in a higher tax-expense that will largely be non-recurring. Additionally, the Company realized a higher proportion of sales in the US market, which has a higher tax rate.

Foreign Currency Translation Gain (Loss)

Our consolidated financial statements are presented in U.S. dollars. Our functional currencies are the United States dollar and the Canadian dollar. Transactions initiated in other currencies are translated to U.S. dollars using year-end exchange rates for the balance sheet and weighted average exchange rates for the statements of operations. Equity transactions were translated using historical rates. Foreign currency translation gains or losses as a result of fluctuations in the exchange rates are reflected in the Statement of Operations and Other Comprehensive Income (Loss).

Therefore, the translation adjustment in our consolidated financial statements represents the translation differences from translation of our financial statements. As a result, the translation adjustment is commonly, but not always, positive if the average exchange rates are lower than exchange rates on the date of the financial statements and negative if the average exchange rates are higher than exchange rates on the date of the financial statements.

During the quarter ended December 31, 2013 we recognized a foreign currency translation loss of $178,593. By comparison, during the quarter ended December 31, 2012 we recognized a foreign currency translation loss of $449,470. These losses were the result of the strengthening of the U.S. dollar against the Canadian dollar.

Total Comprehensive Income (Loss)

For the foregoing reasons, we realized a total comprehensive income of $1,027,713 during the quarter ended December 31, 2013 compared to total comprehensive loss of $775,739 during the quarter ended December 31, 2012.

Comparison of the nine months ended December 31, 2013 and 2012

Total Revenues

Total revenues during the nine months ended December 31, 2013 increased $14,456,946, or 125%, compared to the nine months ended December 31, 2012. This increase was principally attributable to increased sales of goods, net.

Sales of Goods, Net

We realized an increase of $14,053,507, or 131%, in sales of goods, net during the nine months ended December 31, 2013 compared to the nine months ended December 31, 2012. This increase was primarily due to improved sales execution, the leveraging of now-effective sales people hired in previous quarters, and improved management of the sales team. There have been an increased number of sales through larger customers, which yielded higher revenues during the quarter. We expect that our revenues will continue to grow year-over-year at approximately historical rates, as our sales team continues to execute on our sales strategy.

Sales of Services, Net

During the nine months ended December 31, 2013 we realized an increase of $403,439 or 46%, in sales of services, net. We are beginning to experience increasing service revenues as a result of our continued expansion in the U.S. We anticipate service revenues in our Utah and Texas offices will continue to expand in upcoming quarters. As the sales team proactively looks for equipment sales the opportunity to discuss services related sales is expected to increase.

Total Cost of Goods Sold

As a percentage of total revenues, total cost of goods sold remained at 43% during the nine months ended December 31, 2013 (compared to 43% during the nine months ended December 31, 2012). This constancy is due to the similar product mix sold throughout the nine months, although the product mix betw29)......... (22) (1,207) -- (545) (1,774) Less: Amount distributed to Sinopec Group Company in connection with the Acquisition of Petrochemical and Catalyst Assets............. (310) -- -- (745) (1,055) ------ ------ ------ ------- ------- Balance at December 31, 2004........................ 20,308 85,143 11,781 140,290 257,522 ------ ------ ------ ------- ------- NET BOOK VALUE: At December 31, 2004................................ 24,546 88,421 48,752 122,404 284,123 ====== ====== ====== ======= ======= At December 31, 2003................................ 25,753 81,052 37,552 126,374 270,731 ====== ====== ====== ======= ======= As required by the relevant PRC regulations with respect to the Reorganization, the property, plant and equipment of the Group as of September 30, 1999 were valued for each asset class by China United Assets Appraisal Corporation, Beijing Zhong Zheng Appraisal Company, CIECC Assets Appraisal Corporation and Zhong Fa International Properties Valuation Corporation, independent valuers registered in the PRC, on a depreciated replacement cost basis. The value of property, plant and equipment was determined at RMB 159,788. The surplus on revaluation of RMB 32,320, net of amounts allocated to minority interests, was incorporated in the financial statements of the Group at December 31, 1999. In connection with the Acquisition of Sinopec National Star, the property, plant and equipment of Sinopec National Star were revalued at December 31, 2000, by a firm of independent valuers and approved by the Ministry of Finance. The value of property, plant and equipment of Sinopec National Star pursuant to the valuation, based on a depreciated replacement cost basis, was determined at RMB 4,373, resulting in a surplus on revaluation of RMB 1,136, net of amounts allocated to minority interest. In connection with the Acquisition of Ethylene Assets, the property, plant and equipment of Sinopec Maoming were revalued at June 30, 2003, by a firm of independent valuers in accordance with the relevant rules and regulations. The value of property, plant and equipment of Sinopec Maoming pursuant to the valuation, based on a depreciated replacement cost basis, was determined at RMB 5,100, which approximated the net historical carrying value of the assets. F-24 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) In connection with the Acquisition of Refining Assets, the property, plant and equipment of the Refining Assets were revalued at October 31, 2003, by a firm of independent valuers in accordance with the relevant rules and regulations. The value of property, plant and equipment of the Refining Assets pursuant to the valuation, based on a depreciated replacement cost basis, was determined at RMB 461, which approximated the net historical carrying value of the assets. In connection with the Acquisition of Petrochemical and Catalyst Assets, the property, plant and equipment of the Petrochemical and Catalyst Assets were revalued at June 30, 2004, by a firm of independent valuers in accordance with the relevant rules and regulations. The value of property, plant and equipment of the Petrochemical and Catalyst Assets pursuant to the valuation, based on a depreciated replacement cost basis, was determined at RMB 11,895, which approximated the net historical carrying value of the assets. In accordance with IAS 16, subsequent to these revaluations, which was based on depreciated replacement costs, property, plant and equipment are carried at revalued amount, being the fair value at the date of the revaluation less any subsequent accumulated depreciation and impairment losses. Revaluation is performed periodically to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date. Based on a revaluation performed as of December 31, 2004, which was based on depreciated replacement costs, the carrying value of property, plant and equipment did not differ materially from their fair value. 16. CONSTRUCTION IN PROGRESS Exploration Marketing Corporate and and and production Refining distribution Chemicals others Total ---------- -------- ------------ --------- ------ ----- RMB RMB RMB RMB RMB RMB Balance at January 1, 2004..................... 5,535 8,470 7,941 6,957 451 29,354 Additions..................................... 22,808 13,479 15,123 10,711 1,381 63,502 Additions of jointly controlled entities....... 1,323 -- -- 5,178 -- 6,501 Less: Amount distributed to Sinopec Group Company in connection with the Acquisition of Petrochemical and Catalyst Assets..... -- (1) (216) (15) (232) Dry hole costs written off..................... (2,976) -- -- -- -- (2,976) Transferred to property, plant and equipment... (17,428) (13,489) (9,283) (9,460) (304) (49,964) ------- ------- ------- -------- ------- -------- Balance at December 31, 2004................... 9,262 8,459

13,781 13,170 1,513 46,185 ======= ======= ======= ======== ======= ======== The Group's proportionate share of the jointly controlled entities' construction in progress in the E&P and the chemicals segments reflected in the above table were RMB 3,812 and RMB 2,993, respectively, as of December 31, 2003, and RMB 2,053 and RMB 8,171, respectively, as of December 31, 2004. Net changes in capitalized cost of exploratory wells included in the Group's construction in progress in the E&P segment are analyzed as follows: Years ended December 31, ------------------------------ 2002 2003 2004 ------- ------- ------= RMB RMB RMB At beginning of year.. 1,471 2,395 2,438 Additions to capitalized cost of exploratory wells pending the determination of proved reserves................................. 4,134 4,675 4,870 Transferred to oil and gas properties based on the determination of proved reserves.. (1,439) (1,843) (1,434) Dry hole costs written off.. (1,771) (2,789) (2,976) ------- ------- ------= At end of year.. 2,395 2,438 2,898 ======= ======= ====== F-25 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) 17. INVESTMENTS December 31, ----------------- 2003 2004 ----- ----- RMB RMB Unlisted investments, at cost........................... 3,041 2,891 Less: Provision for impairment losses................... (332) (353) ----- ----- 2,709 2,538 ===== ===== Provision for impairment losses is analyzed as follows: Years ended December 31, ------------------------------ 2002 2003 2004 ------ ------ ------ RMB RMB RMB At beginning of year.................................... 545 553 332 Provision for the year.................................. 13 131 96 Written-off.. (5) (62) (14) Less: Amount distributed to Sinopec Group Company in connection with the Acquisition of Ethylene Assets................... -- (290) -- Less: Amount distributed to Sinopec Group Company in connection with the Acquisition of Petrochemical and Catalyst Assets.............................. -- -- (61) ------ ------ ------ At end of year .... 553 332 353 ====== ====== ====== Unlisted investments represent the Group's interests in PRC domiciled enterprises which are mainly engaged in non-oil and gas activities and operations. The Group has no significant investments in marketable securities. 18. INTERESTS IN ASSOCIATES December 31, --------------------- 2003 2004 ----- ------ RMB RMB Share of net assets 8,121 10,222 ----- ------ The Group's investments in associates are with companies primarily engaged in the oil and gas and chemical operations in the PRC. These investments are individually and in the aggregate not material to the Group's financial condition or results of operations for all periods presented. The principal investments in associates, all of which are incorporated in the PRC, are as follows: F-26 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) Percentage Percentage of of equity equity held Form of held by by the business Particulars of issued the Company's Name of company structure and paid up capital Company subsidiaries Principal activities -------------- --------- ------------------- ------- ----------- ------------------- % % Shengli Oil Field Dynamic Incorporated 364,027,608 ordinary 26.33 -- Exploration of crude oil Company Limited ("Dynamic")* shares of RMB 1.00 each and distribution of petrochemical products Sinopec Shandong Taishan Incorporated 480,793,320 ordinary 38.68 -- Trading of petroleum Petroleum Company Limited shares of RMB 1.00 each products and decoration ("Taishan")* of service gas stations Sinopec Finance Company Limited Incorporated Registered capital 32.00 8.22 Provision of non-banking RMB 2,500,000,000 financial services Shanghai Petroleum National Gas Incorporated Registered capital 30.00 -- Exploration and Corporation RMB 900,000,000 production of crude oil and natural gas BASF-YPC Company Limited Incorporated Registered capital 30.00 10.00 Manufacturing and RMB 8,793,000,000 distribution of petrochemical products Shanghai Chemical Industry Park Incorporated Registered capital -- 38.26 Planning, development Development Company Limited RMB 2,372,439,000 and operation of the Chemical Industry Park in Shanghai, the PRC China Shipping & Sinopec Incorporated Registered capital -- 50.00 Transportation of Suppliers Company Limited RMB 876,660,000 petroleum products * Shares of Dynamic and Taishan are listed on the Shenzhen Stock Exchange. Shares held by the Company are domestic state-owned A shares which are not admitted for trading in any stock exchange in the PRC. The market value of the investments in Dynamic based on the quoted market price are RMB 783 and RMB 479 as of December 31, 2003 and 2004, respectively. The market value of the investments in Taishan based on the quoted market price are RMB 1,971 and RMB 1,516 as of December 31, 2003 and 2004, respectively. 19. INTERESTS IN JOINTLY CONTROLLED ENTITIES December 31, ----------------- 2003 2004 ----- ----- RMB RMB Share of net assets................................ 1,043 3,568 ===== ===== The Group's investments in jointly controlled entities are primarily engaged in the oil and gas and chemical operations in the PRC, the principal interests in jointly controlled entities are as follows: Percentage of Percentage equity held Form of Particulars of of equity by the business issued and held by the Company's Name of company structure paid up capital Company subsidiaries Principal activities --------------- --------- --------------- ------- ------------ -------------------- % % Shanghai Secco Petrochemical Incorporated Registered capital 30.00 20.00 Manufacturing and distribution Company Limited USD 901,440,964 of petrochemical products Yueyang Sinopec and Shell Incorporated Registered capital 50.00 - Manufacturing and distribution Coal Gasification USD 45,588,700 of industrial gas Company Limited Block A Oil Field in the Unincorporated - - 43.00 Exploration and production Western Area Chengda of crude oil and natural gas in Bohai Bay The Group's proportionate share of the jointly controlled entities' current and non-current assets, current and non-current liabilities, and operating revenues and expenses is not material to the Group's financial condition or results of operations for all years presented. F-27 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) 20. DEFERRED TAX ASSETS AND LIABILITIES Deferred tax assets and deferred tax liabilities are attributable to the items detailed in the table below: Assets Liabilities Net balance ------ ----------- ----------- December 31, December 31, December 31, --------------- ----------------- ------------------ 2003 2004 2003 2004 2003 2004 ----- ----- ------ ------ ------ ------ RMB RMB RMB RMB RMB RMB Current Provisions, primarily for receivables and inventories 1,446 2,528 -- -- 1,446 2,528 Non-current Property, plant and equipment....................... 272 1,566 (981) (1,704) (709) (138) Accelerated depreciation............................ -- -- (3,618) (3,932) (3,618) (3,932) Tax value of losses carried forward, net of valuation allowance............................. 923 66 -- -- 923 66 Lease prepayment (Note i) .... 373 366 -- -- 373 366 Others... 53 32 -- -- 53 32 ----- ----- ------ ------ ------ ------ Deferred tax assets/(liabilities) .... 3,067 4,558 (4,599) (5,636) (1,532) (1,078) ===== ===== ====== ====== ====== ====== A valuation allowance on deferred tax assets is recorded if it is more likely than not that some portion or all of the deferred tax assets will not be realized through the recovery of taxes previously paid and/or future taxable income. The allowance is subject to ongoing adjustments based on changes in circumstances that affect the Group's assessment of the realizability of the deferred tax assets. The Group has reviewed its deferred tax assets as of December 31, 2002, 2003 and 2004. Based on this review, valuation allowances of RMB 250, RMB 248 and RMB 409 were provided for the years ended December 31, 2002, 2003 and 2004, respectively. The Group determined the valuation allowance based on management's assessment of the probability that taxable profits will be available over the period which the deferred tax assets can be realized or utilized. In assessing the probability, both positive and negative evidence was considered, including whether it is more likely than not that the operations will have future taxable profits over the periods which the deferred tax assets are deductible or utilized and whether the tax losses result from identifiable causes which are unlikely to recur. Based on this assessment, a valuation allowance was provided to reduce the deferred tax asset to the amount that is more likely than not to be realized. The valuation allowance is analyzed as follows: Years ended December 31, ------------------------------ 2002 2003 2004 ------ ------ ------ RMB RMB RMB At beginning of year... 693 943 641 Allowance during the year.. 250 248 409 Less: Amount distributed to Sinopec Group Company in connection with the Acquisition of Ethylene Assets........... -- (550) -- ------ ------ ------- At end of year .... 943 641 1,050 ====== ====== ======= As of December 31, 2004, certain subsidiaries of the Company had tax value of losses carried forward for PRC income tax purpose of RMB 3,382 which were available to offset future PRC taxable income of respective subsidiaries, if any. RMB 264, RMB 561, RMB 567, RMB 751, and RMB 1,239 expire in 2005, 2006, 2007, 2008, and 2009, respectively. F-28 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) Movements in temporary differences between calculations of certain items for accounting and for taxation purposes can be specified as follows: Recognized in Recognized in consolidated Balance at consolidated statements of Balance at January 1, statements of shareholders' December 31, 2002 income equity 2002 ---- ------ ------ ---- RMB RMB RMB RMB Current Provisions, primarily for receivables and inventories.............. 432 (157) -- 275 Non-current Property, plant and equipment..................................... (753) 173 -- (580) Accelerated depreciation.. (2,185) (773) -- (2,958) Tax value of losses carried forward, net of valuation allowance.... 962 16 -- 978 Lease prepayments (Note i).. -- (7) 371 364 Others.. 121 (119) -- 2 ------ ------ ------ ------ Net deferred tax (liabilities)/assets............................. (1,423) (867) 371 (1,919) ====== ====== ====== ====== (Note 10)

Recognized in Recognized in consolidated Balance at consolidated statements of Balance at January 1, statements of shareholders' December 31, 2003 income equity 2003 ---- ------ ------ ---- RMB RMB RMB RMB Current Provisions, primarily for receivables and inventories. 275 1,171 -- 1,446 Non-current Property, plant and equipment......................... (580) (129) -- (709) Accelerated depreciation.............................. (2,958) (660) -- (3,618) Tax value of losses carried forward, net of valuation allowance... 978 (55) -- 923 Lease prepayments (Note i)............................ 364 (7) 16 373 Others.. 2 51 -- 53 ------ ------ ------ ------ Net deferred tax (liabilities)/assets................. (1,919) 371 16 (1,532) ====== ====== ====== ====== (Note 10) Recognized in Recognized in consolidated Balance at consolidated statements of Balance at January 1, statements of shareholders' December 31, 2004 income equity 2004 ---- ------ ------ ---- RMB RMB RMB RMB Current Provisions, primarily for receivables and inventories. 1,446 1,082 -- 2,528 Non-current Property, plant and equipment......................... (709) 571 -- (138) Accelerated depreciation.............................. (3,618) (314) -- (3,932) Tax value of losses carried forward, net of valuation allowance (Note ii)............................... 923 (591) (266) 66 Lease prepayments (Note i)............................ 373 (7) -- 366 Others.. 53 (21) -- 32 ------ ------ ------ ------ Net deferred tax (liabilities)/assets................. (1,532) 720 (266) (1,078) ====== ====== ====== ====== (Note 10) F-29 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) Note: (i) Land use rights are carried at cost effective January 1, 2002. The effect of this change resulted in a decrease in the revaluation reserve and an increase in other reserves relating to the recognition of the deferred tax asset of RMB 371 as of January 1, 2002. During the year ended December 31, 2003, in connection with the Acquisition of Refining Assets, the land use rights of the Refining Assets were revalued resulting in a surplus of RMB 66 as required by the relevant PRC rules and regulations but were not revalued for financial reporting purposes and, accordingly, deferred tax assets of RMB 16 were created with corresponding increase in other reserves. (ii) As of December 31, 2004, deferred tax assets of RMB 266 were distributed to Sinopec Group Company in connection with the Acquisition of Petrochemical and Catalyst Assets. 21. LONG-TERM PREPAYMENTS AND OTHER ASSETS Long-term prepayments and other assets primarily represent prepaid rental expenses over one year, computer software and catalysts. 22. SHORT-TERM AND LONG-TERM DEBTS AND LOANS FROM SINOPEC GROUP COMPANY AND ITS AFFILIATES Short-term debts represent: December 31, ----------------- 2003 2004 ------ ------ RMB RMB THIRD PARTIES' DEBTS Short-term bank loans.................................. 19,961 20,009 Short-term other loans................................. 29 - ------ ------ 19,990 20,009 Current portion of long-term bank loans................ 7,359 12,177 Current portion of long-term other loans................ 332 121 Current portion of convertible bonds.................... 1,500 - ------ ------ 9,191 12,298 ------ ------ 29,181 32,307 ------ ------ LOANS FROM SINOPEC GROUP COMPANY AND ITS AFFILIATES Short-term loans....................................... 4,046 6,714 Current portion of long-term loans..................... 819 2,000 4,865 8,714 ------ ------ 34,046 41,021 ====== ====== The Group's weighted average interest rates on short-term loans were 3.2% and 3.9% as of December 31, 2003 and 2004, respectively. As of December 31, 2003, the Company had standby credit facilities with several PRC financial institutions which allowed the Company to borrow up to RMB 103,500 on an unsecured basis, at rates ranging from 1.65% to 5.31%. As of December 31, 2003, the Company's outstanding borrowings under these facilities totaling RMB 11,970 which are included in short-term bank loans. These facilities expire at various dates in 2004 and contain no financial covenants. As of December 31, 2004, the Company had standby credit facilities with several PRC financial institutions which allowed the Company to borrow up to RMB 107,000 on an unsecured basis, at rates ranging from 2.95% to 4.54%. As of December 31, 2004, the Company's outstanding borrowings under these facilities totaling RMB 6,203 which are included in short-term bank loans. These facilities expire at various dates in 2005 and contain no financial covenants. F-30 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) Long-term debts comprise: Interest rate and final maturity December 31, --- ------------------------ 2003 2004 ------ ------ RMB RMB THIRD PARTIES' DEBTS LONG-TERM BANK LOANS Renminbi denominated Interest rates ranging from interest free to 6.2% per annum as of December 31, 2004 with maturities through 2013 40,955 52,227 Japanese Yen denominated Interest rates ranging from 2.6% to 5.8% per annum as of December 31, 2004 with maturities through 2024 4,841 4,562 US Dollar denominated Interest rates ranging from interest free to 7.4% per annum as of December 31, 2004 with maturities through 2031 7,563 7,729 Euro denominated Fixed interest rate at 6.7% per annum at December 31, 2004 with maturities through 2010 547 165 Hong Kong Dollar Floating rate at Hong Kong Prime denominated Rate plus 0.3% per annum as of December 31, 2004 with maturities through 2006 7 5 ------ ------ 53,913 64,688 ====== ====== LONG-TERM OTHER LOANS Renminbi denominated Interest rates ranging from interest free to 5.0% per annum as of December 31, 2004 with maturities through 2008 413 359 US Dollar denominated Interest rates ranging from interest free to 4% per annum as of December 31, 2004 with maturities through 2015 151 110 Euro denominated Interest rates ranging from 1.8% to 8.1% per annum as of December 31, 2003 with maturities through 2025; paid off as of December 31, 2004 21 -- ------ ------ 585 469 ====== ====== CONVERTIBLE BONDS Renminbi denominated Interest rate at 2.5% per annum as of December 31, 2003 with maturity in July 2004 (a) 1,500 -- ====== ====== Total long-term banks and other loans carried forward 55,998 65,157 F-31 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) Interest rate and final maturity December 31, -- ------------------------ 2003 2004 ------ ------ RMB RMB Total long-term banks and other loans carried forward 55,998 65,157 CORPORATE BONDS Renminbi denominated Fixed interest rate at 4.61% per annum as of December 31, 2004 with maturity in February 2014 (b) -- 3,500 ------ ------ LONG-TERM BANK LOANS OF JOINTLY CONTROLLED ENTITIES Renminbi denominated Floating rate at 90% of PBOC's base lending rate per annum as of December 31, 2004 with maturities through 2021 705 2,415 US Dollar denominated Floating rate at London Interbank Offer Rate plus 0.7% per annum as of December 31, 2004 with maturities through 2021 745 2,048 ------ ------ 1,450 4,463 ====== ====== TOTAL THIRD PARTIES' LONG-TERM DEBTS 57,448 73,120 Less: Current portion (9,191) (12,298) ------ ------ 48,257 60,822 ====== ====== LONG-TERM LOANS FROM SINOPEC GROUP COMPANY AND ITS AFFILIATES Renminbi denominated Interest free with maturity in 2020 35,561 35,561 Renminbi denominated Interest rates ranging from interest free to 5.2% per annum as of December 31, 2004 with maturities through 2009 4,285 3,204 US Dollar denominated Floating rates at London Interbank Offer Rate plus 1.4% per annum as of December 31, 2003 with maturities through 2005; paid off as of December 31, 2004 12 -- ------ ------ 39,858 38,765 ------ ------ Less: Current portion (819) (2,000) 39,039 36,765 ------ ------ 87,296 97,587 ====== ====== (a) Convertible bonds amounting to RMB 1,500 were issued by a subsidiary on July 28, 1999. Pursuant to the subsidiary's shareholders' approval at the Annual General Meeting held on March 23, 2004, the subsidiary decided not to undergo an initial public offering. The bonds were repaid in July 2004. (b) The Company issued ten years corporate bonds of RMB 3,500 to PRC citizens as well as PRC legal and non-legal persons on February 24, 2004, guaranteed by Sinopec Group Company, with a fixed interest rate at 4.61% per annum. Third parties' loans of RMB 103 and RMB 40 as of December 31, 2003 and 2004, respectively, were secured by certain of the Group's property, plant and equipment. The net book value of property, plant and equipment of the Group pledged as security amounted to RMB 519 and RMB 123 as of December 31, 2003 and 2004, respectively. F-32 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) The aggregate maturities of long-term debts and loans from Sinopec Group Company and its affiliates subsequent to December 31, 2004 are as follows: RMB 2005... 14,298 2006... 15,886 2007... 21,233 2008... 7,832 2009... 6,976 Thereafter... 45,660 111,885 23. TRADE ACCOUNTS PAYABLE Trade accounts payable are analyzed as follows: December 31, ------------------- 2003 2004 ------ ------ RMB RMB Third parties.. 22,122 22,265 Sinopec Group Company and its affiliates................. 1,153 1,527 Associates... 44 -- ------ ------ 23,319 23,792 ====== ====== Amounts due to Sinopec Group Company and its affiliates are repayable in accordance with normal commercial terms. 24. ACCRUED EXPENSES AND OTHER PAYABLES Accrued expenses and other payables represent: December 31, ----------------- 2003 2004 ------ ------ RMB RMB Amounts due to Sinopec Group Company and its affiliates.... 15,072 10,897 Accrued expenditures...................................... 12,208 17,213 Taxes other than income tax............................... 4,327 3,717 Receipts in advance...................................... 5,509 7,387 Advances from third parties............................... 979 1,009 Others... 5,466 5,053 ------ ------ 43,561 45,276 ====== ====== F-33 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) 25. SHARE CAPITAL December 31, ----------------- 2003 2004 ------ ------ RMB RMB REGISTERED, ISSUED AND FULLY PAID 67,121,951,000 domestic state-owned A shares of RMB 1.00 each........ 67,122 67,122 16,780,488,000 overseas listed H shares of RMB 1.00 each............. 16,780 16,780 2,800,000,000 domestic listed A shares of RMB 1.00 each.............. 2,800 2,800 ------ ------ 86,702 86,702 ====== ====== The Company was established on February 25, 2000 with a registered capital of 68.8 billion domestic state-owned shares with a par value of RMB 1.00 each. Such shares were issued to Sinopec Group Company in consideration for the assets and liabilities related to the Predecessor Operations transferred to the Company (Note 1). Pursuant to the resolutions passed at an Extraordinary General Meeting held on July 25, 2000 and approvals from relevant government authorities, the Company is authorized to increase its share capital to a maximum of 88.3 billion shares with a par value of RMB 1.00 each and offer not more than 19.5 billion shares with a par value of RMB 1.00 each to investors outside the PRC. Sinopec Group Company is authorized to offer not more than 3.5 billion shares of its shareholdings in the Company to investors outside the PRC. The shares sold by Sinopec Group Company to investors outside the PRC would be converted into H shares. In October 2000, the Company issued 15,102,439,000 H shares with a par value of RMB 1.00 each, representing 12,521,864,000 H shares and 25,805,750 American Depositary Shares ("ADSs", each representing 100 H shares), at prices of HK$ 1.59 per H share and US$ 20.645 per ADS, respectively, by way of a global initial public offering to Hong Kong and overseas investors. As part of the global initial public offering, 1,678,049,000 domestic state-owned ordinary shares of RMB 1.00 each owned by Sinopec Group Company were converted into H shares and sold to Hong Kong and overseas investors. In July 2001, the Company issued 2.8 billion domestic listed A shares with a par value of RMB 1.00 each at RMB 4.22 by way of a public offering to natural persons and institutional investors in the PRC. All A shares and H shares rank pari passu in all material aspects. F-34 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) 26. RESERVES December 31, ------------------------- 2003 2004 RMB RMB REVALUATION RESERVE At January 1... 31,641 30,341 Revaluation surplus realized... (1,316) (1,891) Revaluation surplus of Refining Assets... 16 -- Revaluation surplus of Petrochemical and Catalyst Assets......................... -- 257 Impairment losses on revalued assets (Note 7).................................. -- (709) ------- ------- At December 31.. 30,341 27,998 ------- ------- CAPITAL RESERVE (Note (a)) At January 1... (18,878) (18,960) Transfer from other reserves... (82) (257) ------- ------- December 31... (18,960) (19,217) ------- ------- SHARE PREMIUM (Note (b)) At January 1 and December 31... 18,072 18,072 ------- ------- STATUTORY SURPLUS RESERVE (Note (c)) At January 1... 4,429 6,330 Appropriation of net income... 1,901 3,228 ------- ------- At December 31.. 6,330 9,558 ------- ------- STATUTORY PUBLIC WELFARE FUND (Note (d)) At January 1... 4,429 6,330 Appropriation of net income... 1,901 3,228 ------- ------- At December 31.. 6,330 9,558 ------- ------- DISCRETIONARY SURPLUS RESERVE (Note (e)) At January 1 and at December 31... 7,000 7,000 ------- ------- OTHER RESERVES At January 1... 12,533 3,868 Deferred tax effect of surplus on land use rights (Note (f) and Note 20).......... 16 -- Realization of deferred tax on land use rights (Note (f))........................ (5) (5) Transfer from retained earnings... 1,157 1,499 Revaluation surplus of Refining Assets... 82 -- Revaluation surplus of Petrochemical and Catalyst Assets......................... -- 257 Consideration for Acquisitions of Ethylene Assets and Refining Assets (Note 1) .. (3,652) -- Consideration for Acquisition of Petrochemical and Catalyst Assets (Note 1)...... -- (3,128) Net assets distributed to Sinopec Group Company (Note (g))...................... (6,263) (2,244) ------- ------- At December 31.. 3,868 247 ------- ------- F-35 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) December 31, -------------------- 2003 2004 RMB RMB RETAINED EARNINGS (Note (h)) At January 1... 20,849 31,832 Final dividend in respect of the previous financial years, approved and paid during the year (Note (i))...................... (5,202) (5,202) Interim dividend (Note (j))... (2,601) (3,468) Net income.. 22,424 36,019 Transfer to statutory surplus reserve................................ (1,901) (3,228) Proposed transfer to statutory public welfare fund.................... (1,901) (3,228) Revaluation surplus realized... 1,316 1,891 Realization of deferred tax on land use rights........................ 5 5 Transfer to other reserves... (1,157) (1,499) ------ ------- At December 31.. 31,832 53,122 ------ ------- 84,813 106,338 ====== ======= Notes: (a) The capital reserve represents (i) the difference between the total amount of the par value of shares issued and the amount of the net assets transferred from Sinopec Group Company in connection with the Reorganization and (ii) the difference between the considerations paid over the amount of the net assets acquired from Sinopec National Star, Sinopec Maoming, Xi'an Petrochemical, Tahe Petrochemical, Tianjin Petrochemical, Luoyang Petrochemical, Zhongyuan Petrochemical, Guangzhou Petrochemical and Catalyst Plants. (b) The application of the share premium account is governed by Sections 178 and 179 of the PRC Company Law. (c) According to the Company's Articles of Association, the Company is required to transfer 10% of its net income, as determined in accordance with the PRC Accounting Rules and Regulations, to statutory surplus reserve until the reserve balance reaches 50% of the registered capital. The transfer to this reserve must be made before distribution of a dividend to shareholders. Statutory surplus reserve can be used to make good previous years' losses, if any, and may be converted into share capital by the issue of new shares to shareholders in proportion to their existing shareholdings or by increasing the par value of the shares currently held by them, provided that the balance after such issue is not less than 25% of the registered capital. During the years ended December 31, 2003 and 2004, the Company transferred RMB 1,901 and RMB 3,228, respectively, being 10% of the current year's net income determined in accordance with the PRC Accounting Rules and Regulations, to this reserve. (d) According to the Company's Articles of Association, the Company is required to transfer 5% to 10% of its net income, as determined in accordance with the PRC Accounting Rules and Regulations, to the statutory public welfare fund. This fund can only be utilized on capital items for the collective benefits of the Company's employees such as the construction of dormitories, canteen and other staff welfare facilities. This fund is non-distributable other than on liquidation. The transfer to this fund must be made before distribution of a dividend to shareholders. Pursuant to the shareholders' approval at the Annual General Meeting on May 18, 2004, the Board of Directors was authorized to determine the amount of the transfer for the six-month period ended June 30, 2004. The directors authorized the transfer of RMB 1,504, being 10% of the net income for the six-month period ended June 30, 2004 determined in accordance with the PRC Accounting Rules and Regulations, to this fund. F-36 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) The directors authorized the transfer of RMB 1,724, subject to shareholders' approval, being 10% of the net income for the six-month period ended December 31, 2004 determined in accordance with the PRC Accounting Rules and Regulations, to this fund. The transfer to this fund for the years ended December 31, 2003 and 2004 were RMB 1,901 and RMB 3,228, respectively. (e) The usage of the discretionary surplus reserve is similar to that of statutory surplus reserve. (f) Effective January 1, 2002, land use rights which are included in lease prepayments are carried at historical cost. Accordingly, the surplus on the revaluation of land use rights credited to revaluation reserve previously, net of minority interests, was eliminated during the year. The effect of this change did not have a material impact on the Group's financial condition and results of operations in the periods prior to the change. As a result of the tax deductibility of the revaluation surplus, a deferred tax asset, net of minority interests, is created with a corresponding increase in other reserves. (g) These represent net assets contributed from and distributed to Sinopec Group Company for no monetary consideration. The net assets distributed to Sinopec Group Company during the year ended December 31, 2003 primarily represent certain assets retained by Sinopec Group Company in connection with the Acquisition of Ethylene Assets and the Acquisition of Refining Assets. The net assets distributed to Sinopec Group Company during the year ended December 31, 2004 primarily represent certain assets retained by Sinopec Group Company in connection with the Acquisition of Petrochemical and Catalyst Assets. These transactions were recorded at historical cost and were reflected as changes in other reserves in the year the acquisitions occurred. (h) According to the Company's Articles of Association, the amount of retained earnings available for distribution to shareholders of the Company is the lower of the amount determined in accordance with the PRC Accounting Rules and Regulations and the amount determined in accordance with IFRS. As of December 31, 2003 and 2004, the amounts of retained earnings available for distribution were RMB 19,732 and RMB 37,124, respectively, being the amount determined in accordance with the PRC Accounting Rules and Regulations. Pursuant to a resolution passed at the Directors' meeting on March 25, 2005, a final dividend in respect of the year ended December 31, 2004 of RMB 0.08 per share totaling RMB 6,936 was proposed for shareholders' approval at the Annual General Meeting. Final dividend of RMB 6,936 in respect of the year ended December 31, 2004 has not been not recognized as a liability as of the balance sheet date. Subject to the relevant provisions of the PRC Company Law and the Company's Articles of Association, Sinopec Group Company may seek to influence the Company's determination of dividends with a view to satisfying Sinopec Group Company's cash flow requirements. (i) Pursuant to the shareholders' approval at the Annual General Meeting on June 10, 2003, a final dividend of RMB 0.06 per share totaling RMB 5,202 in respect of the year ended December 31, 2002 was declared and paid on June 30, 2003. Pursuant to the shareholders' approval at the Annual General Meeting on May 18, 2004, a final dividend of RMB 0.06 per share totaling RMB 5,202 in respect of the year ended December 31, 2003 was declared and paid on June 28, 2004. (j) Pursuant to the shareholders' approval at the Annual General Meeting on June 10, 2003, the Board of Directors was authorized to declare the interim dividends for the year ended December 31, 2003. According to the resolution passed at the Directors' meeting on August 22, 2003, an interim dividend of RMB 0.03 per share totaling RMB 2,601 was declared. Pursuant to the shareholders' approval at the Annual General Meeting on May 18, 2004, the Board of Directors was authorized to declare the interim dividends for the year ended December 31, 2004. According to the resolution passed at the Directors' meeting on August 27, 2004, an interim dividend of RMB 0.04 per share totaling RMB 3,468 was declared. F-37 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) 27. COMMITMENTS AND CONTINGENT LIABILITIES Operating lease commitments The Group leases service stations and other equipment through non-cancellable operating leases. These operating leases do not contain provisions for contingent lease rentals. None of the rental agreements contain escalation provisions that may require higher future rental payments. As of December 31, 2004, the future minimum lease payments under operating leases are as follows: RMB 2005.. 3,452 2006.. 3,343 2007.. 3,278 2008.. 3,245 2009.. 3,225 Thereafter.................................... 97,527 ------- Total minimum lease payments.................. 114,070 ======= The Group's leasing arrangement impose no restrictions on dividends, additional debt and/or further leasing. Capital commitments As of December 31, 2004, the Group had capital commitments as follows: RMB The Group Authorized and contracted for.................. 43,001 Authorized but not contracted for.............. 60,173 ------- 103,174 ======= Jointly controlled entities Authorized and contracted for.................. 3,157 Authorized but not contracted for.............. 2,088 ------- 5,245 ======= These capital commitments relate to oil and gas exploration and development, refining and petrochemical production capacity expansion projects, the construction of service stations and oil depots, and capital contributions to the Group's investments and interests in associates. Exploration and production licenses Exploration licenses for exploration activities are registered with the Ministry of Land and Resources. The maximum term of the Group's exploration licenses is 7 years, and may be renewed twice within 30 days prior to expiration of the original term with each renewal being for a two-year term. The Group is obligated to make progressive annual minimum exploration investment relating to the exploration blocks in respect of which the license is issued. The Ministry of Land and Resources also issues production licenses to the Group on the basis of the reserve reports approved by relevant authorities. The maximum term of a full production license is 30 years unless a special dispensation was given by the State Council. The maximum term of production licenses issued to the Group is 55 years as a special dispensation was given to the Group by the State Council. The Group's production license is renewable upon application by the Group 30 days prior to expiration. F-38 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) The Group is required to make payments of exploration license fees and production right usage fees to the Ministry of Land and Resources annually which are expensed as incurred. Payments incurred were approximately RMB 65, RMB 97 and RMB 189 for the years ended December 31, 2002, 2003 and 2004, respectively. Estimated future annual payments as of December 31, 2004 are as follows: RMB 2005.. 90 2006.. 120 2007.. 75 2008.. 67 2009.. 74 Thereafter.................................... 279 ----- Total payments................................ 705 ===== Contingent liabilities (a) The Company has been advised by its PRC lawyers that, except for liabilities constituting or arising out of or relating to the business assumed by the Company in the Reorganization, no other liabilities were assumed by the Company, and the Company is not jointly and severally liable for other debts and obligations incurred by Sinopec Group Company prior to the Reorganization. (b) As of December 31, 2004, guarantees given to banks in respect of banking facilities granted to the parties below were as follows: RMB Associates..................................... 4,828 ===== As of December 31, 2004, the Company's guarantees were primarily provided to BASF-YPC Company Limited ("BASF-YPC"), an associate. BASF-YPC signed domestic and foreign currencies denominated loan agreements equivalent to RMB 11,700 in March 2003. To enhance the credit standing of BASF-YPC, the Company guarantees the interest payments as well as the repayment of the loans to an amount of RMB 4,680. Payments are due if the Company is notified that BASF-YPC is not able to fulfill its obligations at the maturity date. No collateral secures BASF-YPC's obligation or the Company's guarantee. As of December 31, 2004, it is not probable that the Company will be required to make payments under the guarantee. Thus no liability has been accrued for a loss related to the Company's obligation under this guarantee arrangement. F-39 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) Environmental contingencies To date, the Group has not incurred any significant expenditures for environmental remediation, is currently not involved in any environmental remediation, and has not accrued any amounts for environmental remediation relating to its operations. Under existing legislation, management believes that there are no probable liabilities that will have a material adverse effect on the financial position or operating results of the Group. The PRC government, however, has moved, and may move further towards more rigorous enforcement of applicable laws, and towards the adoption of more stringent environmental standards. Environmental liabilities are subject to considerable uncertainties which affect the Group's ability to estimate the ultimate cost of remediation efforts. These uncertainties include i) the exact nature and extent of the contamination at various sites including, but not limited to refineries, oil fields, service stations, terminals and land development areas, whether operating, closed or sold, ii) the extent of required cleanup efforts, iii) varying costs of alternative remediation strategies, iv) changes in environmental remediation requirements, and v) the identification of new remediation sites. The amount of such future cost is indeterminable due to such factors as the unknown magnitude of possible contamination and the unknown timing and extent of the corrective actions that may be required. Accordingly, the outcome of environmental liabilities under proposed or future environmental legislation cannot reasonably be estimated at present, and could be material. The Group paid normal routine pollutant discharge fees of approximately RMB 287, RMB 245 and RMB 248 for the years ended December 31, 2002, 2003 and 2004, respectively. Legal contingencies The Group is a defendant in certain lawsuits as well as the named party in other proceedings arising in the ordinary course of business. While the outcomes of such contingencies, lawsuits or other proceedings cannot be determined at present, management believes that any resulting liabilities will not have a material adverse effect on the financial position or operating results of the Group. 28. CONCENTRATION OF RISKS Credit risk The carrying amounts of cash and cash equivalents, time deposits with financial institutions, trade accounts and bills receivables, and other current assets, except for prepayments, represent the Group's maximum exposure to credit risk in relation to financial assets. The majority of the Group's trade accounts receivable relate to sales of petroleum and chemical products to related parties and third parties operating in the petroleum and chemical industries. The Group performs ongoing credit evaluations of its customers' financial condition and generally does not require collateral on trade accounts receivable. The Group maintains an allowance for doubtful accounts and actual losses have been within management's expectations. No single customer accounted for greater than 10% of total revenues during the years ended December 31, 2002, 2003 and 2004. No other financial assets carry a significant exposure to credit risk. F-40 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) Concentration of economic risk The Group's operations may be adversely affected by significant political, economic, and social uncertainties in the PRC. In addition, the ability to negotiate and implement specific projects in a timely and favorable manner may be impacted by political considerations unrelated to or beyond the control of the Group. Although the PRC government has been pursuing economic reform policies for the past two decades, no assurance can be given that the PRC government will continue to pursue such policies or that such policies may not be significantly altered. There is also no guarantee that the PRC government's pursuit of economic reforms will be consistent or effective and as a result, changes in the rate or method of taxation, reduction in tariff protection and other import restrictions, and changes in state policies affecting the industries to which the Group sells its products, may have a negative effect on its operating results and financial conditions. Currency risk Substantially all of the revenue-generating operations of the Group are transacted in Renminbi, which is not fully convertible into foreign currencies. On January 1, 1994, the PRC government abolished the dual rate system and introduced a single rate of exchange as quoted by the People's Bank of China. However, the unification of the exchange rate does not imply convertibility of Renminbi into United States dollars or other foreign currencies. All foreign exchange transactions continue to take place either through the People's Bank of China or other banks authorized to buy and sell foreign currencies at the exchange rates quoted by the People's Bank of China. Approval of foreign currency payments by the People's Bank of China or other institutions requires submitting a payment application form together with suppliers' invoices, shipping documents and signed contracts. Business risk The Group conducts its principal operations in China and accordingly is subject to special considerations and significant risks not typically associated with investments in equity securities of the United States and Western European companies. These include risks associated with, among others, the political, economic and legal environment, influence of the State Council over substantially all aspects of its operations and competition in the oil and gas industry. Interest rate risk The interest rates and terms of repayment of short-term and long-term debts of the Group are disclosed in Note 22. Supply risk The Group's largest domestic supplier of crude oil is PetroChina Company Limited. Negotiating another contract with a key supplier at similar terms and costs could have a severe and significant impact on the Group's results of operations. F-41 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) 29. RELATED PARTY TRANSACTIONS Companies are considered to be related if one company has the ability, directly or indirectly, to control the other company or exercise significant influence over the other company in making financial and operating decisions. Companies are also considered to be related if they are subject to common control or common significant influence. The Group is part of a larger group of companies under Sinopec Group Company and has significant transactions and relationships with members of the Sinopec Group. Because of these relationships, it is possible that the terms of these transactions are not the same as those that would result from transactions among wholly unrelated parties. Sinopec Group Company itself is owned by the PRC government. There are also many other enterprises directly or indirectly owned or controlled by the PRC government ("state-owned enterprises"). Under IFRS, state-owned enterprises, other than Sinopec Group Company and its affiliates, are not considered related parties. Related parties refer to enterprises over which Sinopec Group Company is able to exercise significant influence. The Group conducts business with state-owned enterprises. Furthermore, the PRC government itself represents a significant customer of the Group both directly through its numerous authorities and indirectly through its numerous affiliates and other organizations. Sales of certain products to PRC government authorities and affiliates and other state-owned enterprises may be at regulated prices, which differ from market prices. The Group considers that these sales are activities in the ordinary course of business in the PRC and has not disclosed such sales as related party transactions. The principal related party transactions with Sinopec Group Company, which were carried out in the ordinary course of business, are as follows: Years ended December 31, -------------------------- Note 2002 2003 2004 ------- ------- ------- RMB RMB RMB Sales of goods... (i) 28,563 32,134 63,507 Purchases.. (ii) 25,269 31,964 36,828 Transportation and storage................................... (iii) 1,269 1,572 2,003 Exploration and development services......................... (iv) 10,310 13,699 14,446 Production related services.................................. (v) 7,094 8,421 9,036 Ancillary and social services................................ (vi) 1,870 1,783 1,740 Operating lease charges...................................... (vii) 2,523 2,924 3,297 Agency commission income.................................... (viii) 37 41 41 Intellectual property licence fee paid....................... (ix) 10 10 10 Interest received.. (x) 117 114 59 Interest paid.. (xi) 636 583 622 Net deposits (withdrawn from)/placed with related parties..... (xii) (1,758) (1,634) 340 Net loans obtained from/(repaid to) related parties........... (xiii) 1,390 (24) 1,575 The amounts set out in the table above in respect of each of the years in the three-year period ended December 31, 2004 represent the relevant costs to the Group as determined by the corresponding contracts with the related parties. There were no guarantees given to banks by the Group in respect of banking facilities to Sinopec Group Company and its affiliates as of December 31, 2003 and 2004. The directors of the Company are of the opinion that the above transactions with related parties were conducted in the ordinary course of business and on normal commercial terms or in accordance with the agreements governing such transactions, and this has been confirmed by the independent non-executive directors. F-42 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) Notes: (i) Sales of goods represent the sale of crude oil, intermediate petrochemical products, petroleum products and ancillary materials. (ii) Purchases represent the purchase of material and utility supplies directly related to the Group's operations such as the procurement of raw and ancillary materials and related services, supply of water, electricity and gas. (iii) Transportation and storage represent the cost for the use of railway, road and marine transportation services, pipelines, loading, unloading and storage facilities. (iv) Exploration and development services comprise direct costs incurred in the exploration and development such as geophysical, drilling, well testing and well measurement services. (v) Production related services represent ancillary services rendered in relation to the Group's operations such as equipment repair and general maintenance, insurance premium, technical research, communications, fire fighting, security, product quality testing and analysis, information technology, design and engineering, construction which includes the construction of oilfield ground facilities, refineries and chemical plants, manufacture of replacement parts and machinery, installation, project management and environmental protection. (vi) Ancillary and social services represent expenditures for social welfare and support services such as educational facilities, media communication services, sanitation, accommodation, canteens, property maintenance and management services. (vii) Operating lease charges represent the rental paid to Sinopec Group Company for operating leases in respect of land, buildings and service stations. (viii) Agency commission income represents commission earned for acting as an agent in respect of sales of products of and purchase of material for certain entities owned by Sinopec Group Company. (ix) Intellectual property license fee represents reimbursement paid to Sinopec Group Company for fees required to maintain the validity of licenses, trademarks, patents, technology and computer software. (x) Interest received represents interest received from deposits placed with Sinopec Finance Company Limited, a finance company controlled by Sinopec Group Company. The applicable interest rate is determined in accordance with the prevailing saving deposit rate. The balance of deposits as of December 31, 2003 and 2004 were RMB 4,331 and RMB 4,671, respectively. (xi) Interest paid represents interest charges on the loans and advances obtained from Sinopec Group Company and Sinopec Finance Company Limited. (xii) Deposits were withdrawn from/placed with Sinopec Finance Company Limited. (xiii) The Group obtained/repaid loans from/to Sinopec Group Company and Sinopec Finance Company Limited. In connection with the Reorganization, the Company and Sinopec Group Company entered into a number of agreements under which 1) Sinopec Group Company will provide goods and products and a range of ancillary, social and supporting services to the Group and 2) the Group will sell certain goods to Sinopec Group Company. The terms of these agreements are summarized as follows: F-43 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) (a) The Company has entered into a non-exclusive Agreement for Mutual Provision of Products and Ancillary Services ("Mutual Provision Agreement") with Sinopec Group Company effective from January 1, 2000 in which Sinopec Group Company has agreed to provide the Group with certain ancillary production services, construction services, information advisory services, supply services and other services and products. While each of Sinopec Group Company and the Company is permitted to terminate the Mutual Provision Agreement upon at least six months notice, Sinopec Group Company has agreed not to terminate the agreement if the Group is unable to obtain comparable services from a third party. The pricing policy for these services and products provided by Sinopec Group Company to the Group is as follows: o the government-prescribed price; o where there is no government-prescribed price, the government-guidance price; o where there is neither a government-prescribed price nor a government-guidance price, the market price; or where none of the above is applicable, the price to be agreed between the parties, which shall be based on a reasonable cost incurred in providing such services plus a profit margin not exceeding 6%. (b) The Company has entered into a non-exclusive Agreement for Provision of Cultural and Educational, Health Care and Community Services with Sinopec Group Company effective from January 1, 2000 in which Sinopec Group Company has agreed to provide the Group with certain cultural, educational, health care and community services on the same pricing terms and termination conditions as agreed to in the above Mutual Provision Agreement. (c) The Company has entered into a series of lease agreements with Sinopec Group Company to lease certain land and buildings at a rental of approximately RMB 2,447 and RMB 567, respectively, per annum. The Company and Sinopec Group Company can renegotiate the rental amount every three years for land and every year for buildings, such amount not to exceed the market price as determined by an independent third party. The Group has the option to terminate these leases upon six months notice to Sinopec Group Company. (d) The Company has entered into agreements with Sinopec Group Company effective from January 1, 2000 under which the Group has been granted the right to use certain trademarks, patents, technology and computer software developed by Sinopec Group Company.

The Group will reimburse Sinopec Group Company for fees required to maintain the validity of these licenses. (e) The Company has entered into agency agreements effective from January 1, 2000 with certain entities owned by Sinopec Group Company under which the Group acts as a sole agent in respect of the sale of all the products of these entities. In exchange for the Group's sales agency services, Sinopec Group Company has agreed to pay the Group a commission of between 0.2% and 1.0% of actual sales receipts depending on the products and to reimburse the Group for reasonable costs incurred in the capacity as its sales agent. (f) The Company has entered into a service stations franchise agreement with Sinopec Group Company effective from January 1, 2000 under which its service stations and retail stores would exclusively sell the refined products supplied by the Group. F-44 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) On December 19, 2002, the Company and Sinopec Group Company entered into an asset swap agreement whereby the Company transferred to Sinopec Group Company certain individual assets and liabilities, consisting principally of, water plants, inspection, maintenance, geology and geophysical assets and related liabilities. The carrying amount of the net assets transferred to Sinopec Group Company approximated the net appraised amount of RMB 1,021. In return, Sinopec Group Company transferred to the Company certain gas stations and oil depot assets. The carrying and appraised amounts of such assets transferred to the Company were RMB 462 and RMB 1,040, respectively. The difference between the appraised amounts of the assets exchanged of RMB 19 was paid in cash by the Company. As discussed in Note 1, the Group acquired the equity interest of Sinopec Maoming from Sinopec Group Company for a consideration of RMB 3.3 billion. As of the valuation date, the carrying amount of the net asset acquired approximated the net appraised amount of RMB 3.3 billion. As discussed in Note 1, the Group acquired the equity interest of Tahe Petrochemical and Xi'an Petrochemical from Sinopec Group Company for a consideration of RMB 356. As of the valuation date, the carrying amount of the net asset acquired approximated the net appraised amount of RMB 356. In December 2003, Sinopec Group Company repaid a bank loan of RMB 962 on behalf of a subsidiary of the Group in exchange for a receivable from that subsidiary. As discussed in Note 1, pursuant to the resolutions passed at the Extraordinary General Meeting held on December 21, 2004, the Group acquired the equity interests of Tianjin Petrochemical, Luoyang Petrochemical, Zhongyuan Petrochemical, Guangzhou Petrochemical and Catalyst Plants from Sinopec Group Company for a total consideration payable of RMB 3,128. In addition, the Group acquired certain individual assets and liabilities from Sinopec Group Company for a total consideration payable of RMB 2,232. In connection with these acquisitions, the Group disposed of certain property, plant and equipment, with net book value of RMB 1,857, and certain other assets and liabilities, related to its oilfield downhole operation (the "Downhole Assets") to Sinopec Group Company for a consideration receivable of RMB 1,712, which approximated the net carrying value of the assets and liabilities, resulting in a net cash consideration of RMB 3,648 payable to Sinopec Group Company. 30. EMPLOYEE BENEFITS PLAN As stipulated by the regulations of the PRC, the Group participates in various defined contribution retirement plans organized by municipal and provincial governments for its staff. The Group is required to make contributions to the retirement plans at rates ranging from 17.0% to 30.0% of the salaries, bonuses and certain allowances of its staff. A member of the plan is entitled to a pension equal to a fixed proportion of the salary prevailing at his or her retirement date. The Group has no other material obligation for the payment of pension benefits associated with these plans beyond the annual contributions described above. The Group's contributions for the years ended December 31, 2002, 2003 and 2004 were RMB 1,726, RMB 1,882 and RMB 2,242, respectively. The Company implemented a plan of share appreciation rights for members of its senior management in order to provide further incentives to these employees. Under this plan, share appreciation rights were granted in units with each unit representing one H share. No shares will be issued under the share appreciation rights plan. Under the plan, all share appreciation rights have an exercise period of five years. A recipient of share appreciation rights may not exercise the rights in the first three years after the date of grant. As of each of the third, fourth and fifth anniversary of the date of grant, the total number of share appreciation rights exercisable may not in aggregate exceed 30%, 70% and 100%, respectively, of the total share appreciation rights granted to such person. During 2003, the Company granted 258.6 million share appreciation right units to eligible employees. F-45 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) The exercise price of share appreciation rights initially granted is the initial public offering price of the Company's H shares. Upon exercise of the share appreciation rights, a recipient will receive, subject to any applicable withholding tax, a cash payment in RMB, translated from the

Hong Kong dollar amount equal to the product of the number of share appreciation rights exercised and the difference between the exercise price and average market price of the Company's H shares for the exercise period based on the applicable exchange rate between RMB and Hong Kong dollar at the date of the exercise. The Company recognizes compensation expense of the share appreciation rights over the applicable vesting period. For the year ended December 31, 2004, compensation expense recognized was RMB 150. 31. SEGMENTAL REPORTING The Group has five operating segments as follows: (i) Exploration and production, which explores and develops oil fields, produces crude oil and natural gas and sells such products to the refining segment of the Group and external customers. (ii) Refining, which processes and purifies crude oil, which is sourced from the exploration and production segment of the Group and external suppliers, and manufactures and sells petroleum products to the chemicals and marketing and distribution segments of the Group and external customers. (iii) Marketing and distribution, which owns and operates oil depots and service stations in the PRC, and distributes and sells refined petroleum products (mainly gasoline and diesel) in the PRC through wholesale and retail sales networks. (iv) Chemicals, which manufactures and sells petrochemical products, derivative petrochemical products and other chemical products mainly to external customers. (v) Corporate and others, which largely comprise the trading activities of the import and export companies of the Group and research and development undertaken by other subsidiaries. The segments were determined primarily because the Group manages its exploration and production; refining; marketing and distribution; chemicals; and corporate and others businesses separately. The reportable segments are each managed separately because they manufacture and/or distribute distinct products with different production processes and due to their distinct operating and gross margin characteristics. In view of the fact that the Company and its subsidiaries operate mainly in the PRC, no geographical segment information is presented. The Group evaluates the performance and allocates resources to its operating segments on an operating income basis, without considering the effects of finance costs or investment income. The accounting policies of the Group's segments are the same as those described in the principal accounting policies (see Note 2). Corporate administrative costs and assets are not allocated to the operating segments; instead, operating segments are billed for direct corporate services. Inter-segment transfer pricing is based on cost plus an appropriate margin, as specified by the Group's policy. F-46 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) Reportable information on the Group's business segments is as follows: Years ended December 31, ---------------------------------- 2002 2003 2004 -------- ------- ------- RMB RMB RMB SALES OF GOODS Exploration and production External sales...................................... 10,920 14,936 15,970 Inter-segment sales................................. 39,407 47,287 60,053 -------- ------- ------- 50,327 62,223 76,023 Refining External sales...................................... 41,639 51,445 63,388 Inter-segment sales................................. 168,615 217,755 289,699 -------- ------- ------- 210,254 269,200 353,087 Marketing and distribution External sales...................................... 184,378 238,210 342,840 Inter-segment sales................................. 2,329 2,602 2,831 -------- ------- ------- 186,707 240,812 345,671 Chemicals External sales...................................... 72,154 91,964 126,013 Inter-segment sales................................. 7,878 7,415 12,510 -------- ------- ------- 80,032 99,379 138,523 Corporate and others External sales...................................... 24,782 33,394 48,986 Inter-segment sales................................. 20,355 30,371 32,046 -------- ------- ------- 45,137 63,765 81,032 Elimination of inter-segment sales........................ (238,584) (305,430) (397,139) Total sales of goods...................................... 333,873 429,949 597,197 -------- ------- ------- OTHER OPERATING REVENUES Exploration and production............................... 7,305 8,039 9,283 Refining.. 3,074 4,573 5,186 Marketing and distribution............................... 342 548 755 Chemicals.. 4,293 4,461 6,170 Corporate and others..................................... 1,191 1,431 1,192 -------- ------- ------- Total other operating revenues........................... 16,205 19,052 22,586 -------- ------- ------- Total operating revenues.................................. 350,078 449,001 619,783 ========= ======= ======= F-47 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) Years ended December 31, RESULT -------------------------------- 2002 2003 2004 ------ ------- ------- RMB RMB RMB OPERATING INCOME BY SEGMENT - Exploration and production........................ 14,787 19,160 25,614 - Refining.. 6,024 6,073 5,943 - Marketing and distribution........................ 8,401 11,943 14,716 - Chemicals... 1,088 3,543 18,721 - Corporate and others.............................. (999) (1,836) (1,925) ------ ------- ------- Total operating income................................ 29,301 38,883 63,069 ------ ------- -------

INCOME/(LOSS) FROM ASSOCIATES - Exploration and production........................ 152 293 447 - Refining... 1 (1) 58 - Marketing and distribution........................ 63 43 302 - Chemicals... 24 (41) (164) - Corporate and others.............................. 84 102 154 ------ ------- ------- Aggregate income from associates .... 324 396 797 ------ ------- ------- FINANCE COSTS Interest expense.................................. (4,932) (4,365) (4,583) Interest income................................... 351 322 374 Foreign exchange losses........................... (427) (450) (223) Foreign exchange gains............................ 60 30 61 ------ ------- ------- NET FINANCE COSTS..................................... (4,948) (4,463) (4,371) Gain from issuance of shares by a subsidiary............ -- 136 -- Investment income...................................... 239 89 111 ------ ------- ------- INCOME BEFORE INCOME TAX AND MINORITY INTERESTS......... 24,916 35,041 59,606 Income tax... (7,491) (10,645) (17,815) ------ ------- ------- INCOME BEFORE MINORITY INTERESTS....................... 17,425 24,396 41,791 Minority interests.................................... (1,129) (1,972) (5,772) ------ ------- ------- NET INCOME.. 16,296 22,424 36,019 ====== ======= ======= Assets and liabilities dedicated to a particular segment's operations are included in that segment's total assets and liabilities. Assets which benefit more than one segment or are considered to be corporate assets are not allocated. "Unallocated assets" consists primarily of cash and cash equivalents, time deposits with financial institutions, investments and deferred tax assets. "Unallocated liabilities" consists primarily of short-term and long-term debts, loans from Sinopec Group Company and its affiliates, income tax payable, deferred tax liabilities and other liabilities. Interests in and income from associates are included in the segments in which the associates operate. Information on associates is included in Note 18. Additions to long-lived assets by operating segment are included in Notes 15 and 16. F-48 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) December 31, ----------------------------- 2002 2003 2004 ------- ------- ------- RMB RMB RMB ASSETS Segment assets - Exploration and production.......................... 90,983 101,303 110,509 - Refining... 90,704 96,839 111,878 - Marketing and distribution.......................... 71,516 73,942 93,722 - Chemicals.. 101,667 101,130 105,032 - Corporate and others................................ 18,610 14,445 17,574 ------- ------- ------- TOTAL SEGMENT ASSETS..................................... 373,480 387,659 438,715 ------- ------- ------- Interests in associates - Exploration and production.......................... 1,583 1,233 1,396 - Refining... 147 136 314 - Marketing and distribution.......................... 1,435 1,815 2,410 - Chemicals.. 3,624 3,517 4,315 - Corporate and others................................ 1,275 1,420 1,787 ------- ------- ------- AGGREGATE INTERESTS IN ASSOCIATES........................ 8,064 8,121 10,222 ------- ------- ------- Unallocated assets....................................... 25,734 24,404 25,657 ------- ------- ------- TOTAL ASSETS.. 407,278 420,184 474,594 ======= ======= ======= LIABILITIES Segment liabilities - Exploration and production.......................... 16,126 15,733 16,241 - Refining... 22,235 25,729 28,130 - Marketing and distribution.......................... 19,472 21,091 23,419 - Chemicals.. 15,458 18,951 16,528 - Corporate and others................................ 9,046 10,022 15,547 ------- ------- ------- TOTAL SEGMENT LIABILITIES................................ 82,337 91,526 99,865 ------- ------- ------- Unallocated liabilities.................................. 135,015 131,092 150,643 ------- ------- ------- TOTAL LIABILITIES....................................... 217,352 222,618 250,508 ======= ======= ======= F-49 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) Segment capital expenditure is the total cost incurred during the year to acquire segment assets that are expected to be used for more than one year. Years ended December 31, ------------------------------ 2002 2003 2004 ------ ------ ------ RMB RMB RMB CAPITAL EXPENDITURE Exploration and production... 20,228 20,628 21,234 Refining.. 6,698 9,788 14,272 Marketing and distribution.. 6,982 6,826 16,678 Chemicals.. 7,769 7,680 11,025 Corporate and others.. 816 518 1,550 ------ ------ ------ 42,493 45,440 64,759 ====== ====== ====== CAPITAL EXPENDITURE OF JOINTLY CONTROLLED ENTITIES Exploration and production.. -- 1,200 1,323 Chemicals... -- 2,993 5,178 ------ ------ ------ -- 4,193 6,501 ------ ------ ------ DEPRECIATION, DEPLETION AND AMORTIZATION Exploration and production...

9,033 9,413 12,066 Refining... 6,097 6,434 7,730 Marketing and distribution.. 1,968 2,431 2,759 Chemicals... 9,030 9,149 9,325 Corporate and others.. 364 524 462 ------ ------ ------ 26,492 27,951 32,342 ====== ====== ====== IMPAIRMENT LOSSES ON LONG-LIVED ASSETS RECOGNIZED IN STATEMENT OF INCOME Exploration and production.. -- 310 98 Refining... -- 114 14 Marketing and distribution.. -- -- 1,769 Chemicals... -- 453 2,038 ------ ------ ------ -- 877 3,919 ====== ====== ====== IMPAIRMENT LOSSES ON LONG-LIVED ASSETS RECOGNIZED IN SHAREHOLDERS' EQUITY Chemicals... -- -- 709 ====== ====== ====== F-50 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) PRINCIPAL SUBSIDIARIES Details of the Group's principle subsidiaries are as follows: Particulars Type of Percentage of equity of issued legal held by held by Name of company capital entity the Company Subsidiary Principal activities -------------- ------- ------- ----------- --------- ------------------- % % China Petrochemical International RMB1,400 Limited 100.00 -- Trading of crude oil and Company Limited company petrochemical products Sinopec Beijing Yanhua Petrochemical RMB 3,374 Limited 70.01 -- Manufacturing of chemical products Company Limited company Sinopec Sales Company Limited RMB 1,700 Limited 100.00 -- Marketing and distribution of refined company petroleum products Sinopec Shengli Oilfield Company RMB 29,000 Limited 100.00 -- Exploration and production of crude Limited company oil and natural gas Sinopec Fujian Petrochemical RMB 2,253 Limited 50.00 -- Manufacturing of plastics, Company Limited (i) company intermediate petrochemical products and petroleum products Sinopec Qilu Petrochemical Company RMB 1,950 Limited 82.05 -- Manufacturing of intermediate Limited company petrochemical products and petroleum products Sinopec Shanghai Petrochemical RMB 7,200 Limited 55.56 -- Manufacturing of synthetic fibers, Company Limited company resin and plastics, intermediate petrochemical products and petroleum products Sinopec Shijiazhuang Refining- RMB 1,154 Limited 79.73 -- Manufacturing of intermediate Chemical Company Limited company petrochemical products and petroleum products Sinopec Kantonnes Holdings Limited HK$ 104 Limited -- 72.40 Trading of crude oil and petroleum company products Sinopec Wuhan Petroleum Group RMB 147 Limited 46.25 -- Marketing and distribution of refined Company Limited (i) company petroleum products Sinopec Wuhan Phoenix Company RMB 519 Limited 40.72 -- Manufacturing of petrochemical Limited (i) company products and petroleum products Sinopec Yangzi Petrochemical Company RMB 2,330 Limited 84.98 -- Manufacturing of intermediate Limited company petrochemical products and petroleum products Sinopec Yizheng Chemical Fiber RMB 4,000 Limited 42.00 -- Production and sale of polyester Company Limited (i) company chips and polyester fibers Sinopec Zhenhai Refining and RMB 2,524 Limited 71.32 -- Manufacturing of intermediate Chemical Company Limited company petrochemical products and petroleum products Sinopec Zhongyuan Petroleum Company RMB 875 Limited 70.85 -- Exploration and production of crude Limited company oil and natural gas Zhongyuan Petrochemical Company RMB 2,400 Limited 93.51 -- Manufacturing of chemical products Limited company Sinopec Shell (Jiangsu) Petrochemical RMB 455 Limited 60.00 -- Marketing and distribution of refined Marketing Company Limited company petroleum products BP Sinopec (Zhejiang) Petrochemical RMB 647 Limited 60.00 -- Marketing and distribution of refined Company Limited company petroleum products Except for Sinopec Kantons Holdings Limited, which is incorporated in Bermuda, all of the above principal subsidiaries are incorporated in the PRC. (i) The Group consolidated the results of the entity because the Group controlled the board of this entity and had the power to govern its financial and operating policies. F-51 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) 33. FAIR VALUES OF FINANCIAL INSTRUMENTS Financial assets of the Group include cash and cash equivalents, time deposits, investments, trade accounts receivable, bills receivable, amounts due from Sinopec Group Company and its affiliates, advances to third parties, amounts due from associates, and other receivables. Financial liabilities of the Group include bank and other loans, loans from Sinopec Group Company and its affiliates, trade accounts payable, bills payable, amounts due to Sinopec Group Company and its affiliates, receipts in advance, and advances from third parties. The Group has no derivative instruments that are designated and qualified as hedging instruments as of December 31, 2003 and 2004. The disclosures of the fair value estimates, methods and assumptions, set forth below for the Group's financial instruments, are made to comply with the requirements of IAS 32 and IAS 39 and should be read in conjunction with the Group's consolidated financial statements and related notes. The estimated fair value amounts have been determined by the Group using market information and valuation methodologies considered appropriate. However, considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Group could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. The Group has not developed an internal valuation model necessary to make the estimate of the fair value of loans from Sinopec Group Company and its affiliates as it is not considered practicable to estimate their fair value because the cost of obtaining discount and borrowing rates for comparable borrowings would be excessive based on the Reorganization of the Group, its existing capital structure, and the terms of the borrowings. The following table presents the carrying amount and fair value of the Group's long-term indebtedness other than loans from Sinopec Group Company and its affiliates as of December 31, 2003 and 2004: December 31, --------------- 2003 2004 ---- ---- RMB RMB Carrying amount.. 57,448 73,120 Fair value... 57,546 73,263 The fair value of long-term indebtedness is estimated by discounting future cash flows thereon using current market interest rates offered to the Group for debts with substantially the same characteristics and maturities. Investments are unquoted equity interests, and are individually and in the aggregate not material to the Group's financial condition or results of operations for all periods presented. There are no quoted market prices for such interests in the PRC and, accordingly, a reasonable estimate of fair value could not be made without incurring excessive costs. The fair values of all other financial instruments approximate their carrying amounts due to the nature or short-term maturity of these instruments. F-52 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) 34. SIGNIFICANT DIFFERENCES BETWEEN IFRS AND US GAAP The Group's accounting policies conform with IFRS which differ in certain significant respects from US GAAP. Information relating to the nature and effect of such differences are set out below. (a) Foreign exchange gains and losses In accordance with IFRS, foreign exchange differences on funds borrowed for construction are capitalized as property, plant and equipment to the extent that they are regarded as an adjustment to interest costs during the construction period. Under US GAAP, all foreign exchange gains and losses on foreign currency debts are included in current earnings. Accordingly, the US GAAP adjustments represent the amortization effect of such originating adjustments described above. (b) Capitalization of property, plant and equipment In the years prior to those presented herein, certain adjustments arose between IFRS and US GAAP with regard to the capitalization of interest and pre-production results under IFRS that were reversed and expensed under US GAAP. For the years presented herein, there were no adjustments related to the capitalization of interest and pre-production results. Accordingly, the US GAAP adjustments represent the amortization effect of such originating adjustments described above. (c) Revaluation of property, plant and equipment As required by the relevant PRC regulations with respect to the Reorganization, the property, plant and equipment of the Group were revalued as of September 30, 1999. In addition, the property, plant and equipment of Sinopec National Star, Sinopec Maoming, Refining Assets, and Petrochemical and Catalyst Assets were revalued as of December 31, 2000, June 30, 2003, October 31, 2003 and June 30, 2004, respectively, in connection with the Acquisitions of Sinopec National Star, Sinopec Maoming, Refining Assets, and Petrochemical and Catalyst Assets. Under IFRS, such revaluations result in an increase in shareholders' equity with respect to the increase in carrying amount of certain property, plant and equipment above their historical cost bases and a charge to income with respect to the reduction in carrying amount of certain property, plant and equipment below their historical cost bases. Under US GAAP, property, plant and equipment are stated at their historical cost less accumulated depreciation. However, as a result of the tax deductibility of the net revaluation surplus, a deferred tax asset related to the reversal of the revaluation surplus is created under US GAAP with a corresponding increase in shareholders' equity. Under IFRS, effective January 1, 2002, land use rights, which were previously carried at revalued amount, are carried at cost under IFRS. The effect of this change resulted in a decrease to revaluation reserve net of minority interests of RMB 840 as of January 1, 2002. This revaluation reserve was previously included as part of the revaluation reserve of property, plant and equipment. This change under IFRS eliminated the US GAAP difference relating to the revaluation of land use rights. However, as a result of the tax deductibility of the revalued land use rights, the reversal of the revaluation reserve resulted in a deferred tax asset. In addition, under IFRS, on disposal of a revalued asset, the related revaluation surplus is transferred from the revaluation reserve to retained earnings. Under US GAAP, the gain and loss on disposal of an asset is determined with reference to the asset's historical carrying amount and included in current earnings. F-53 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) (d) Exchange of assets As described in Note 29, the Company and Sinopec Group Company entered into an asset swap transaction on December 19, 2002. Under IFRS, the cost of property, plant and equipment acquired in an exchange for a dissimilar item of property, plant and equipment is measured at fair value. Under US GAAP, as the exchange of assets was between entities under common control, the assets received from Sinopec Group Company are measured at historical cost. The difference between the historical cost of the net assets transferred and the net assets received is accounted for as an equity transaction. Accordingly, the US GAAP adjustments represent the amortization effect of such originating adjustments described above. (e) Impairment of long-lived assets Under IFRS, impairment charges are recognized when a long-lived asset's carrying amount exceeds the higher of an asset's net selling price and value in use, which incorporates discounting the asset's estimated future cash flows. Under US GAAP, determination of the recoverability of a long-lived asset is based on an estimate of undiscounted future cash flows resulting from the use of the asset and its eventual disposition. If the sum of the expected future cash flows is less than the carrying amount of the asset, an impairment loss is recognized. Measurement of an impairment loss for a long-lived asset is based on the fair value of the asset. In addition, under IFRS, a subsequent increase in the recoverable amount of an asset is reversed to the consolidated statements of income to the extent that an impairment loss on the same asset was previously recognized as an expense when the circumstances and events that led to the write-down or write-off cease to exist. The reversal is reduced by the amount that would have been recognized as depreciation had the write-off not occurred. Under US GAAP, an impairment loss establishes a new cost basis for the impaired asset and the new cost basis should not be adjusted subsequently other than for further impairment losses. The US GAAP adjustment represents the effect of reversing the recovery of previous impairment charges recorded under IFRS. (f) Capitalized interest on investment in associates Under IFRS, investment accounted for by the equity method is not considered a qualifying asset for which interest is capitalized. Under US GAAP, an investment accounted for by the equity method while the investee has activities in progress necessary to commence its planned principal operations, provided that the investee's activities include the use of funds to acquire qualifying assets for its operations, is a qualifying asset for which interest is capitalized. (g) Goodwill amortization Under IFRS, goodwill and negative goodwill are amortized on a systematic basis over their useful lives. Under US GAAP, with reference to Statement of Financial Accounting Standards No.142, "Goodwill and Other Intangible Assets" ("SFAS No.142"), goodwill is no longer amortized beginning January 1, 2002. Instead, goodwill is reviewed for impairment upon adoption of SFAS No.142 and annually thereafter. F-54 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) (h) Companies included in consolidation Under IFRS, the Group consolidates less than majority owned entities in which the Group has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities, and proportionately consolidates jointly controlled entities in which the Group has joint control with other venturers. However, US GAAP requires that any entity of which the Group owns 20% to 50% of total outstanding voting stock not be consolidated nor proportionately consolidated, but rather be accounted for under the equity method. Accordingly, certain of the Group's subsidiaries, of which the Group owns between 40.72% to 50% of the outstanding voting stock, and the Group's jointly controlled entities are not consolidated nor proportionately consolidated under US GAAP and instead accounted for under the equity method. This exclusion does not affect the net income or shareholders' equity reconciliations between IFRS and US GAAP. Presented below is summarized financial information prepared in accordance with US GAAP of such subsidiaries and jointly controlled entities. Years ended December 31, --------------------------- 2002 2003 2004 ---- ---- ---- RMB RMB RMB Revenues.................................... 16,719 21,735 28,004 Income before income tax..................... 666 1,329 1,373 Net income.................................. 468 1,090 969 Years ended December 31, --------------------------- 2002 2003 2004 ---- ---- ---- RMB RMB RMB Current assets.............................. 5,169 4,986 7,084 Total assets................................ 17,463 27,607 41,213 Current liabilities......................... 4,612 5,902 7,222 Total liabilities........................... 4,992 9,238 16,452 Total equity................................ 12,471 18,369 24,761 (i) Related party transactions Under IFRS, transactions of state-controlled enterprises with other state-controlled enterprises are not required to be disclosed as related party transactions. Furthermore, government departments and agencies are deemed not to be related parties to the extent that such dealings are in the normal course of business. Therefore, related party transactions as disclosed in Note 29 only refers to transactions with enterprises over which Sinopec Group Company is able to exercise significant influence. Under US GAAP, there are no similar exemptions. Although the majority of the Group's activities are with PRC government authorities and affiliates and other PRC state-owned enterprises, the Group believes that it has provided meaningful disclosure of related party transactions in Note 29. F-55 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) (j) Recently issued accounting standards SFAS No. 123R In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-based payment". SFAS No. 123R addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for equity instruments of the enterprise or liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. SFAS No. 123R requires an entity to recognize the grant-date fair-value of stock options and other equity-based compensation issued to employees in the income statement. The revised statement generally requires that an entity account for those transactions using the fair-value-based method, and eliminates an entity's ability to account for share-based compensation transactions using the intrinsic value method of accounting, which was permitted under Statement 123, as originally issued. For the Group, SFAS No. 123R is effective for fiscal years beginning after June 15, 2005. Currently, the Group does not expect the initial application of this statement will have a material impact on its consolidated financial statements. SFAS No. 151 In November 2004, the FASB issued SFAS No. 151, "Inventory costs". SFAS No. 151 clarifies accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). The statement requires that those items be recognized as current period charges. Additionally, SFAS No. 151 requires that allocation of fixed production overheads to the costs of conversion based on normal capacity of the production facilities. For the Group, SFAS No. 151 is effective for fiscal years beginning after June 15, 2005. Currently, the Group does not expect the initial application of this statement will have a material impact on its consolidated financial statements. F-56 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) Reconciliation to US GAAP The effect on net income of significant differences between IFRS and US GAAP for the years ended December 31, 2002, 2003 and 2004 is as follows: Reference Years ended December 31, in note ------------------------------ above 2002 2003 2004 2004 ----- ---- ---- ---- ---- RMB RMB RMB US$ Net income under IFRS.. 16,296 22,424 36,019 4,352 US GAAP adjustments: Foreign exchange gains and losses.......................... (a) 76 76 57 7 Capitalization of property, plant and equipment............ (b) 12 12 12 1 Reversal of deficit on revaluation of property, plant and.. equipment, net of depreciation effect.................... (c) -- 86 (8) (1) Depreciation on revalued property, plant and equipment..... (c) 4,126 3,998 3,825 462 Disposal of property, plant and equipment................. (c) 544 1,316 1,891 228 Exchange of assets.. (d) -- 23 23 3 Reversal of impairment of long-lived assets, net of depreciation effect.............................. (e) 59 47 29 4 Capitalized interest on investment in associates........... (f) 110 141 205 25 Goodwill amortization for the year......................... (g) 6 -- 7 1 Cumulative effect of adopting SFAS No.142.................. (g) 11 -- -- -- Deferred tax effect of US GAAP adjustments................. (1,509) (1,715) (2,085) (252) ------ ------ ------ ----- Net income under US GAAP....................................... 19,731 26,408 39,975 4,830 ====== ====== ====== ===== Basic earnings per share under US GAAP.......................... 0.23 0.30 0.46 0.06 ====== ====== ====== ===== Basic earnings per ADS under US GAAP*........................... 22.76 30.46 46.11 5.57 ====== ====== ====== ===== * Basic net income per ADS is calculated on the basis that one ADS is equivalent to 100 shares. The effect on shareholders' equity of significant differences between IFRS and US GAAP as of December 31, 2003 and 2004 is as follows: Reference Years ended December 31, in note ---------------------------- above 2003 2004 2004 ----- ------- ------- ------ RMB RMB US$ Shareholders' equity under IFRS....................................... 171,515 193,040 23,324 US GAAP adjustments: Foreign exchange gains and losses................................ (a) (352) (295) (36) Capitalization of property, plant and equipment.................. (b) (12) -- -- Revaluation of property, plant and equipment..................... (c) (12,943) (6,783) (820) Deferred tax adjustments on revaluation.......................... (c) 4,004 2,101 254 Exchange of assets.. (d) (555) (532) (64) Reversal of impairment of long-lived assets....................... (e) (561) (532) (64) Capitalized interest on investment in associates................. (f) 321 526 64 Goodwill.. (g) 17 24 3 Deferred tax effect of US GAAP adjustments........................ 398 301 36 ------- ------- ------ Shareholders' equity under US GAAP................................... 161,832 187,850 22,697 ======= ======= ====== F-57 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (All amounts in millions of Renminbi, except share data) 35. SUBSEQUENT EVENT On December 29, 2004, the Group announced its proposal to privatise Sinopec Beijing Yanhua Petrochemical Company Limited ("Beijing Yanhua"), a non-wholly owned subsidiaries in which the Group holds approximately 70% of the equity interests. According to the proposal, the Group will acquire the entire 1,012,000,000 H shares, representing approximately 30% of the issued share capital of Beijing Yanhua at HK$ 3.80 per share. The total consideration required to be paid by the Group was approximately HK$ 3,846 which will be settled in cash. Pursuant to the resolution passed in the Special General Meeting of Beijing Yanhua on March 4, 2005, the shareholders of the H shares in Beijing Yanhua agreed to dispose of and sell their shares in Beijing Yanhua to the Group at the above mentioned price, subject to the approval from the relevant PRC governmental and regulatory bodies. F-58 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES SUPPLEMENTAL INFORMATION ON OIL AND GAS PRODUCING ACTIVITIES (UNAUDITED) (All currency amounts in millions of Renminbi) In accordance with the United States Statement of Financial Accounting Standards No. 69, "Disclosures about Oil and Gas Producing Activities" ("SFAS No. 69"), this section provides supplemental information on oil and gas exploration and producing activities of the Group as of December 31, 2002, 2003 and 2004, and for each of the years in the three-year period ended December 31, 2004 in the following six separate tables. Tables I through III provide historical cost information under US GAAP pertaining to capitalized costs related to oil and gas producing activities; costs incurred in exploration and development; and results of operations related to oil and gas producing activities. Tables IV through VI present information on the Group's estimated net proved reserve quantities; standardized measure of discounted future net cash flows; and changes in the standardized measure of discounted future net cash flows. Table I: Capitalized costs related to oil and gas producing activities Years ended December 31, ------------------------------ 2002 2003 2004 -------- -------- -------- RMB RMB RMB Property cost -- -- -- Wells and related equipment and facilities.......................... 125,790 143,492 158,422 Supporting equipment and facilities................................. 10,809 13,140 12,324 Uncompleted wells, equipment and facilities......................... 4,526 5,535 9,262 ------- ------- ----- Total capitalized costs... 141,125 162,167 180,008 Accumulated depreciation, depletion, amortization and impairment allowances.. (62,397) (70,726) (79,541) ------- ------- ------- Net capitalized costs... 78,728 91,441 100,467 ======= ======= ======= Table II: Cost incurred in exploration and development Years ended December 31, ------------------------------ 2002 2003 2004 -------- -------- -------- RMB RMB RMB Exploration.. 5,798 8,109 8,272 Development.. 18,793 19,852 20,681 ------- ------- ------- Total cost incurred.. 24,591 27,961 28,953 ======= ======= ======= Table III: Results of operations for oil and gas producing activities Years ended December 31, ------------------------------ 2002 2003 2004 -------- -------- -------- RMB RMB RMB Revenues Sales... 8,687 11,850 11,833 Transfers... 39,407 47,287 60,053 ------- ------- ------- 48,094 59,137 71,886 Production costs excluding taxes.................................... (15,174) (16,187) (17,182) Exploration expenses.. (4,363) (6,133) (6,396) Depreciation, depletion, amortization and impairment provisions....... (8,133) (8,684) (11,457) Taxes other than income tax... (860) (970) (1,144) ------- ------- ------- Income before income tax.. 19,564 27,163 35,707 Income tax expense... (6,456) (8,964) (11,783) ------- ------- ------- Results of operations from producing activities..................... 13,108 18,199 23,924 ======= ======= ======= F-59 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES SUPPLEMENTAL INFORMATION ON OIL AND GAS PRODUCING ACTIVITIES (UNAUDITED) - (Continued) (All currency amounts in millions of Renminbi) The results of operations for producing activities for the years ended December 31, 2002, 2003 and 2004 are shown above. Revenues include sales to unaffiliated parties and transfers (essentially at third-party sales prices) to other segments of the Group. All revenues reported in this table do not include royalties to others as there were none. In accordance with SFAS No. 69, income taxes are based on statutory tax rates, reflecting allowable deductions and tax credits. General corporate overhead and interest income and expense are excluded from the results of operations. Table IV: Reserve quantities information The Group's estimated net proved underground oil and gas reserves and changes thereto for the years ended December 31, 2002, 2003 and 2004 are shown in the following table. Proved oil and gas reserves are the estimated quantities of crude oil, natural gas, and natural gas liquids which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions, i.e., prices and costs as of the date the estimate is made. Prices include consideration of changes in existing prices provided only by contractual arrangements, but not on escalations based upon future conditions. Due to the inherent uncertainties and the limited nature of reservoir data, estimates of underground reserves are subject to change as additional information becomes available. Proved reserves do not include additional quantities recoverable beyond the term of the relevant production licenses, or that may result from extensions of currently proved areas, or from application of improved recovery processes not yet tested and determined to be economical. The Group's estimated proved reserves do not include any quantities that are recoverable through application of tertiary recovery techniques. Proved developed reserves are the quantities expected to be recovered through existing wells with existing equipment and operating methods. "Net" reserves exclude royalties and interests owned by others and reflect contractual arrangements in effect at the time of the estimate. F-60 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES SUPPLEMENTAL INFORMATION ON OIL AND GAS PRODUCING ACTIVITIES (UNAUDITED) - (Continued) (All currency amounts in millions of Renminbi) Years ended December 31, ------------------------------ 2002 2003 2004 ------ ------ ------ PROVED DEVELOPED AND UNDEVELOPED RESERVES (OIL) (MILLION BARRELS) Beginning of year.. 3,215 3,320 3,257 Revisions of previous estimates..................................... 119 (81) 23 Improved recovery.. 126 143 127 Extensions and discoveries.. 130 146 134 Production... (270) (271) (274) ----- ----- ----- End of year... 3,320 3,257 3,267 ===== ===== ===== PROVED DEVELOPED RESERVES Beginning of year.. 2,444 2,732 2,786 ===== ===== ===== End of year... 2,732 2,786 2,808 ===== ===== ===== PROVED DEVELOPED AND UNDEVELOPED RESERVES (GAS) (billion cubic feet) Beginning of year.. 3,488 3,329 2,888 Revisions of previous estimates..................................... (133) (649) (95) Extensions and discoveries.. 153 396 447 Production... (179) (188) (207) ----- ----- ----- End of year... 3,329 2,888 3,033 ===== ===== ===== PROVED DEVELOPED RESERVES Beginning of year.. 1,183 1,056 1,249 ===== ===== ===== End of year... 1,056 1,249 1,398 ===== ===== ===== Table V: Standardized measure of discounted future net cash flows The standardized measure of discounted future net cash flows, related to the above proved oil and gas reserves, is calculated in accordance with the requirements of SFAS No. 69. Estimated future cash inflows from production are computed by applying year-end prices for oil and gas to year-end quantities of estimated net proved reserves. Future price changes are limited to those provided by contractual arrangements in existence at the end of each reporting year. Future development and production costs are those estimated future expenditures necessary to develop and produce year-end estimated proved reserves based on year-end cost indices, assuming continuation of year-end economic conditions. Estimated future income taxes are calculated by applying appropriate year-end statutory tax rates to estimated future pre-tax net cash flows, less the tax basis of related assets. Discounted future net cash flows are calculated using 10% midperiod discount factors. This discounting requires a year-by-year estimate of when the future expenditure will be incurred and when the reserves will be produced. The information provided does not represent management's estimate of the Group's expected future cash flows or value of proved oil and gas reserves. Estimates of proved reserve quantities are imprecise and change over time as new information becomes available. Moreover, probable and possible reserves, which may become proved in the future, are excluded from the calculations. The arbitrary valuation prescribed under SFAS No. 69 requires assumptions as to the timing and amount of future development and production costs. The calculations are made for the years ended December 31, 2002, 2003 and 2004 and should not be relied upon as an indication of the Group's future cash flows or value of its oil and gas reserves. F-61 CHINA PETROLEUM & CHEMICAL CORPORATION AND SUBSIDIARIES SUPPLEMENTAL INFORMATION ON OIL AND GAS PRODUCING ACTIVITIES (UNAUDITED) - (Continued) (All currency amounts in millions of Renminbi) Years ended December 31, ------------------------------ 2002 2003 2004 -------- -------- -------- RMB RMB RMB Future cash flows.. 760,468 799,658 1,003,511 Future production costs.. (287,887) (311,568) (350,012) Future development costs... (26,852) (23,838) (25,577) Future income tax expenses... (126,440) (130,224) (174,060) -------- -------- -------- Undiscounted future net cash flows................................. 319,289 334,028 453,862 10% annual discount for estimated timing of cash flows............... (142,450) (146,726) (204,183) -------- -------- -------- Standardized measure of discounted future net cash flows............. 176,839 187,302 249,679 ======== ======== ======== Table VI: Changes in the standardized measure of discounted future net cash flows Years ended December 31, ------------------------------- 2002 2003 2004 -------- -------- -------- RMB RMB RMB RSales and transfers of oil and gas produced, net of production costs. (26,740) (41,802) (46,145) Net changes in prices and production costs........................... 63,625 11,923 69,305 Net change due to extensions, discoveries and improved recoveries.... 23,319 27,721 36,209 Revisions of previous quantity estimates............................ 8,253 (5,951) 2,204 Previously estimated development costs incurred during the year...... 6,935 6,865 7,148 Accretion of discount... 10,323 15,242 16,176 Net change in income taxes.. (27,793) (2,992) (22,733) Others... 164 (543) 213 ------- ------- ------- Net change for the year.. 58,086 10,463 62,377 ======= ======= ======= F-62 SIGNATURE The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf. China Petroleum & Chemical Corporation By /s/ Chen Ge -------------- Name: Chen Ge Title: Secretary to the Board of Directors Date: June 27, 2005 List of Subsidiaries A list of China Petroleum & Chemical Corporation's principal subsidiaries is provide in Note 32 to the consolidated financial statements included in this annual report following Item 19.