

## 4. BUSINESS REVIEW AND PROSPECTS

The following financial data, where applicable, are extracted from the Group's unaudited interim financial report prepared in accordance with IAS 34 *Interim Financial Reporting*.

### Interim results

For the six months ended 30 June 2001, the Group reported a consolidated turnover of Rmb3,910,340,000, which represented a decrease of 10.0 per cent as compared with that of Rmb4,346,542,000 for the corresponding period last year. Consolidated profit attributable to shareholders decreased by 67.9 per cent to Rmb121,186,000 as compared with that of Rmb377,525,000 for the corresponding period last year, and basic earnings per share decreased by 67.9 per cent to Rmb0.030 as compared with that of Rmb0.094 for the corresponding period last year.

The Board has resolved not to pay any interim dividend for the year ending 31 December 2001 (Interim dividend for 2000: Nil).

### Market review

In the first half of 2001, the global economic growth witnessed a significant slow-down. Although the PRC reported an economic growth of 7.9 per cent, its foreign trade export volume growth rate decreased by 29.5 per cent. The growth rates of textile products' export volume and profitability also declined, which diminished the growth of demand for polyester products.

In the first half of 2001, the Asian polyester industry was sluggish. Demand and supply of the PRC's polyester products experienced a new round of adjustment caused by a significant increase in new polyester production capacity. Total domestic consumption of polyester fibre reached 3,246,000 tonnes, representing an increase of 16.7 per cent as compared with that of the corresponding period last year. Meanwhile, domestic polyester production capacity increased by approximately 800,000 tonnes, and the total supply of polyester fibre reached 3,590,000 tonnes, representing an increase of 22.0 per cent as compared with that of the corresponding period last year. Because of the significant increase in new polyester production capacity and oversupply, prices of polyester products dropped sharply and profit margins of polyester products shrank drastically. Consequently, some of the domestic polyester product manufacturers incurred losses.

In the first half of 2001, the prices of raw materials in Asia, such as purified terephthalic acid ("PTA"), mono-ethylene glycol ("MEG") and paraxylene ("PX"), were slightly decreased because of the decline in crude oil prices and the under-utilization of polyester manufacturing capacity.

### Business review

In the first half of 2001, in view of the huge pressure brought upon by the sharp decrease in the prices of domestic polyester products, the Group, with the support of all its staff and employees, continued in strengthening management, exploring new markets, lowering costs and expenses, enhancing technological innovations and new product development and accelerating the construction of structural adjustment projects. Meanwhile, the positive effects brought upon by the Group's technological improvement and structural adjustment in recent years were realized. As a result, both the Group's production volume and sales volume reached their records-high, which had partly offset the negative effects of the decrease in product prices and enabled the Group to achieve a consolidated profit attributable to shareholders of Rmb121,186,000.

### *Production and marketing*

In the first half of 2001, despite more overhauls were scheduled, the Group's production and sales volume reached their records-high and the Group was able to maintain safe and stable operations at a high utilization rate. The Group's total production of polyester products was 611,851 tonnes, representing an increase of 10.8 per cent as compared with that of 552,277 tonnes for the corresponding period last year. The capacity utilization rate reached 101.1 per cent. In view of the continuous bearish domestic polyester market, the Group continued to strengthen its communications with other domestic polyester manufacturers, participated actively in two exhibitions and improved its relationship with customers. Built upon the use of the well-established sales network of Yihua Kangqi Chemical Fibre Company Limited and its subsidiaries ("Kangqi Group"), the Group set up a number of new logistic stations, to speed up sales and stabilize its direct sales rate. As a result, the direct sales rate reached 70.3 per cent. The Group's total sales of polyester products reached 522,948 tonnes, representing an increase of 6.0 per cent as compared with that of 493,294 tonnes for the corresponding period last year. The ratio of sales to production reached 98.4 per cent.

### *Product and technological development*

The Group achieved new breakthroughs in product and technological development. The know-how of the domestically built polyester facility with an annual capacity of 100,000 tonnes was further improved. The Group set up 7 new research and development teams, which developed 18 kinds of new products. The development of products with high demand such as 1.33 dtex bright thread and functional hollow fibre was given top priority. In the first half of 2001, the differentiation rate of polyester fibre reached 35.8 per cent, representing an increase of 9.2 per cent as compared with that of the corresponding period last year. The differentiation rate of polyester chips reached 37.6 per cent despite the total production volume was more than that of the corresponding period last year.

### *Cost control*

The Group's costs and expenses continue to decrease. On the basis of meeting production needs, the Group grasped every opportunity to put purchasing costs under tighter control. The Group implemented an overall budget programme and expenditure approval policy and all types of expenses were strictly under control. The Group promoted cost verification strategy and called upon all its staff and employees to broaden sources of income and reduce expenditure. In the first half of 2001, the Company's unit consumption of raw materials further decreased. In addition, the Company's unit consumption of comprehensive energy decreased by 5.0 per cent as compared with that of the corresponding period last year. The Group improved the liquidity of its working capital and reduced bank loans. In the first half of 2001, the Group's administrative expenses and financial expenses decreased by 16.9 per cent and 64.4 per cent respectively as compared with that of the corresponding period last year.

### *Internal reform*

In the first half of 2001, the Group continued to implement internal reforms smoothly. According to the pragmatic plan, the Group implemented the "fewer employees, higher efficiency" programme. The Company's policy on on-site workforce was changed from "five shifts of running four" to "four shifts of running three" ("5-to-4") in order to optimize manpower. Meanwhile, the Group has established an incentive mechanism to keep and recruit high calibre personnel.

### *Capital expenditure*

The Group had speeded up its technological development and structural adjustment projects in the first half of 2001. Total capital expenditure amounted to Rmb752,951,000 in the first half of 2001. The Draw-twisted yarn ("DTY") project with an annual capacity of 50,000 tonnes and the direct-melt-spinning polyester filament project with an annual capacity of 75,000 tonnes are running as scheduled. Some of them have already commenced production. The design plans for the PTA project with an annual capacity of 450,000 tonnes have been approved by the relevant authorities and imported facilities have been ordered. The Solid-State-Polymerization ("SSP") project with an annual capacity of 100,000 tonnes is under construction as scheduled.

### **Prospects**

In the second half of 2001, it is expected that the PRC government will take active measures in stimulating domestic demand and export in order to stabilize the economic growth. The opening up of governmental control on domestic cotton prices and stimulation of the textile export will enhance the competitiveness of domestic textile manufacturers. Since 1 July 2001, the VAT rebate rates for both yarn and cloth exported products have been increased from 15 per cent to 17 per cent. If China enters into the World Trade Organization ("WTO") in 2001, the growth of the domestic textile industry will also be enhanced. The steady economic growth and the development of polyester down-stream industries will stimulate the demand for polyester products.

The PRC government will continue with its anti-smuggling efforts and supervision over the re-export trade. Since 3 August 2001, the PRC government has started its anti-dumping investigation into the cases of imported polyester chips and polyester staple fibre from South Korea. Meanwhile, the PRC government will strengthen its supervision over the domestic polyester products in terms of quality, health, and industrial environmental protection, and the domestic market environment is expected to improve.

Prices of polyester products are expected to have chances to rebound, but there will be limited room to increase given the present demand-supply situation.

Prices of polyester raw materials such as PTA, MEG and PX are expected to remain stable due to sufficient supply, under-utilization of polyester production capacity and the relative stability in crude oil prices within the region.

In view of the direct competition from big foreign companies after China's entry into WTO, the Group will concentrate on issues such as quality, product mix, costs, profit and substitutes to imported products, enhance its core competitiveness and optimize and integrate management of production, overhaul and construction. All these will help to maximize the Group's comprehensive benefits. Meanwhile, as the leading enterprise in the domestic polyester industry and with the supports from Sinopec, the Group will cooperate with relevant government authorities in creating a better environment for the domestic polyester industry.

The followings will be set as priorities in the second half of 2001:

**(1) To stabilize market and maximize turnover**

The Group will keep monitoring changes in the polyester product market and continue to strengthen communications with other domestic polyester manufacturers, as well as advocating self-discipline within the polyester industry. The Group will actively coordinate with government authorities in the continuous anti-dumping effort of polyester products and in supervising environmental protection for polyester chips production. By doing so, it is expected that the domestic polyester market will be better ordered and product prices will be promoted. The Group will set up strategic relationship with downstream customers who are highly competitive and try to run brand operations so as to develop new markets together. The Group will implement “selling by experts” programme. The Group’s agency sales, product distribution and bank clearing systems will be further improved. The direct sales rate will be stabilized and internet sales will be expanded. Quality of the Group’s sales service will be improved through the optimization of service process for customers and speeding up of reaction to customer’s feedback. Meanwhile, the Group will try to explore the markets for new products. In the second half of 2001, the Group’s planned sales volume of polyester products is 569,000 tonnes.

**(2) To enhance quality management, stabilize operation and increase output**

The Group will further enhance quality management to meet customers’ new requirements for product quality under the new market situation. It will also improve its management of operation and facility to ensure safe and stable operations at a high utilization rate. Meanwhile, the Group will try its best to shorten overhaul time and avoid unscheduled shutdown. Adjustment of product mix and load of facility will be further integrated in order to maximize production volume. In the second half of 2001, the Group’s planned production volume of polyester products is 653,000 tonnes.

**(3) To further reduce costs and expenses**

The Group will strengthen the analysis and calculation of the price trend of raw materials, so as to purchase raw material at lower prices by anticipating the right purchase moments and continuing with its public-bidding programme. The Group will enhance the accuracy and authority of the overall budget management, continue with its austerity programmes and further reduce expenses. Meanwhile, the Group will complete its reform of materials supply system, implement Enterprise Resources Plan (“ERP”), and strengthen its storage management to increase the utilization rate of storage materials. The Group will continue to call on all its staff and employees to broaden sources of income and to reduce expenditure, so as to further reduce the consumption of materials and energy.

**(4) To accelerate technology development and products driven by demand and profit**

In the second half of 2001, the Group will try to meet requirements of different customers with products of high quality, high added-value and low cost. The rewards for the achievements of product development and technological development will be improved. 20 kinds of new polyester products will be developed. The development of functional polyester products will be accelerated. The Group will focus on technological innovation and development in such products as materials for car seats. Meanwhile, the Group will tackle the bottleneck in production and enhance quality control in production lines to further improve product quality.

**(5) To accelerate construction of technology improvement and structural adjustment projects and contribute to the Group as soon as possible**

In addition to ensuring the quality of project construction, the Group will speed up the pace of construction so as to commence production and contribute to the Group as soon as possible. The direct-melt-spinning polyester filament project with an annual capacity of 75,000 tonnes will be completed by the end of September 2001. The DTY project with an annual capacity of 50,000 tonnes will commence production in succession from September 2001 to the beginning of 2002. The SSP project with an annual capacity of 100,000 tonnes and the PTA project with an annual capacity of 450,000 tonnes will be carried out as scheduled. Four technological improvement projects, such as the differential polyester staple fibre facility with an annual capacity of 7,500 tonnes in polyester plant No. 4, will be launched. Meanwhile, quick steps will be taken to plan the projects under the “Tenth Five-Year Plan” which is aimed at enhancing competitiveness.

**(6) To enhance management quality and deepen reforms in human resources management**

In the second half of 2001, the Group will enhance its management quality, integrate and optimize resources in the course of materials supply, production, sales and storage, and improve the economy of scales of production and supplementary utilities facilities. The integration among the Group’s production operations, facilities overhaul and projects construction will be further optimized. In this way, the Group expects to maximize its comprehensive benefit. The Group will continue with its policy on “5-to-4”. The Group will gradually establish its incentive policies such as bidding for job position, special payment and reward for high calibre personnel, in order to maximize the benefits of human resources.