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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. CORPORATE INFORMATION

Weiqiao Textile Company Limited (the "Company") was incorporated as a joint stock company with limited liability in Zouping County, Shandong Province, the People's Republic of China (the "PRC") on 6 December 1999 under the original name of Shandong Weiqiao Textile Company Limited. Upon completion of the reorganisation (the "Reorganisation") undertaken in preparation for the listing of the Company's H shares on the Main Board of The Stock Exchange of Hong Kong Limited (the "HKSE"), the Company became the holding company of the Group. A summary of the transactions undertaken by the Company relating to the Reorganisation is set out below:

(1) In May 2001, the Company acquired from its immediate holding company, Shandong Weiqiao Chuangye Group Company Limited ("Holding Company", formerly known as Shandong Weiqiao Textile Group Company Limited), the operating assets and related liabilities of the four fabric weaving factories located in the First Production Area for a total sum of approximately Renminbi ("RMB") 267 million, satisfied by assumption of short term bank loans of approximately RMB237 million and cash settlement of approximately RMB30 million.

(2) In July 2001, the Company established Weihai Weiqiao Textile Company Limited ("Weihai Weiqiao") with Weihai Civil Aviation Industrial Company Limited ("WCAI"). The registered capital of Weihai Weiqiao is RMB148,000,000 and is owned as to about 87.2% and about 12.8% by the Company and WCAI, respectively.

(3) Pursuant to a shareholders' resolution dated 15 July 2002, the registered capital of the Company was increased to RMB530,770,000, comprising 530,770,000 domestic shares of RMB1.00 each. 328,730,000 domestic shares of RMB1.00 each were issued to Holding Company, credited as fully paid in consideration for the transfer of the relevant assets and liabilities of the Second Production Area and Third Production Area by Holding Company on 30 September 2002. The net assets injected by Holding Company amounted to RMB785,667,466, according to the valuation performed by Shandong Zheng Yuan He Xin Certified Public Accountants Ltd., certified public accountants registered in the PRC, as described in its valuation report dated 28 June 2002.

(4) In September 2002, Holding Company, Itochu Corporation, a company incorporated in Japan, and Profit Rich Company, a company registered in Hong Kong, entered into a Sino-foreign equity joint venture contract to jointly establish Shandong Luteng Textile Company Limited ("Luteng Textile") with a registered capital of US$9,790,000. According to the joint venture contract, Holding Company was to contribute US$7,340,000 in the form of plant and machinery, accounting for 75% of the registered capital of Luteng Textile, whilst Itochu Corporation and Profit Rich Company were to contribute cash of US$1,000,000 and technology rights of US$1,450,000, respectively, into Luteng Textile, representing 10.2% and 14.8% of the registered capital of Luteng Textile, respectively.

Prior to the agreed time when the parties were to make their respective contributions in accordance with the joint venture contract, Holding Company transferred all of its rights and obligations under the joint venture contract to the Company. Such transfer had obtained the approval and consent of the board of Luteng Textile and the Foreign Economic and Trade Cooperation Bureau of Binzhou City of Shandong Province. By 20 October 2002, the Company, Itochu Corporation and Profit Rich Company had each made their respective contributions towards the registered capital of Luteng Textile in accordance with the provisions of the joint venture contract.

1. CORPORATE INFORMATION (continued)

(5) On 18 November 2002, the Company acquired from Holding Company and Binzhou Weiqiao Textile Company Limited (renamed as Binzhou Weiqiao Property Company Limited on 2 June 2003) ("Binzhou Weiqiao"), a related company of the Company, 90% and 1% of equity interests, respectively, in Binzhou Weiqiao Technology Industrial Park Company Limited ("Binzhou Industrial Park") at the respective consideration of RMB90,000,000 and RMB1,000,000.

(6) On 31 March 2003, the Company increased its equity interests in Binzhou Industrial Park from 91% to 97% by the injection of fixed assets amounting to RMB223,443,780, according to the valuation performed by Shandong Huanghe Certified Public Accountants Co., Ltd., certified public accountants registered in the PRC, as described in its valuation report dated 11 April 2003. Of this fixed asset injection, an amount of RMB200,000,000 was credited by Binzhou Industrial Park as new capital injection by the Company and RMB23,443,780 was credited by Binzhou Industrial Park as an amount due to the Company.

The Group is principally engaged in the production and sale of cotton yarns, grey fabrics and denims in the PRC and overseas. The Company changed to its present name, Weiqiao Textile Company Limited, on 19 February 2003.

The registered office of the Company is located at No. 34, Qidong Road, Weiqiao Town, Zouping County, Shandong Province, the PRC. In the opinion of the directors, the ultimate holding company is Zouping County Supply and Marketing Cooperation Union ("ZCSU"), which is a collectively-owned enterprise established in the PRC.

2. IMPACT OF NEW AND REVISED STATEMENTS OF STANDARD ACCOUNTING PRACTICE ("SSAPS")

The following new and revised SSAPs are effective for the first time for the current year's financial statements:

- SSAP 12 (Revised): "Income taxes"
- SSAP 35: "Accounting for government grants and disclosure of government assistance"

These SSAPs prescribe new accounting measurement and disclosure practices. The major effects on the Group's accounting policies and on the amounts disclosed in these financial statements of adopting these SSAPs are summarized as follows:

SSAP12 prescribes the accounting for income taxes payable or recoverable, arising from the taxable profit or loss for the current period (current tax); and income taxes payable or recoverable in future periods, principally arising from taxable and deductible temporary differences and the carryforward of unused tax losses (deferred tax).

The SSAP has no significant impact for these financial statements on the amounts recorded for income taxes. However, the related note disclosures are now more extensive than previously required. These are detailed in note 11 to the financial statements and include a reconciliation between the accounting profit and the tax expense for the year.

SSAP 35 prescribes the accounting for government grants and other forms of government assistance.

The adoption of this SSAP has had no significant impact for these financial statements on the amounts recorded for government grants, however, additional disclosures are now required and are detailed in note 3 to the financial statements.

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of preparation

These financial statements have been prepared in accordance with Hong Kong Statements of Standard Accounting Practice, accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. They have been prepared under the historical cost convention.

Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 December 2003. The results of subsidiaries acquired or disposed of during the year are consolidated from or to their effective dates of acquisition or disposal, respectively. All significant intercompany transactions and balances within the Group are eliminated on consolidation.

Minority interests represent the interests of outside shareholders in the results and net assets of the Company's subsidiaries.

Subsidiaries

A subsidiary is a company whose financial and operating policies the Company controls, directly or indirectly, so as to obtain benefits from its activities.

The results of subsidiaries are included in the Company's profit and loss account to the extent of dividends received and receivable. The Company's interests in subsidiaries are stated at cost less any impairment losses.

Joint venture companies

A joint venture company is a company set up by contractual arrangement, whereby the Group and other parties undertake an economic activity. The joint venture company operates as a separate entity in which the Group and the other parties have an interest.

The joint venture agreement between the venturers stipulates the capital contributions of the joint venture parties, the duration of the joint venture and the basis on which the assets are to be realised upon its dissolution. The profits and losses from the joint venture company's operations and any distributions of surplus assets are shared by the venturers, either in proportion to their respective capital contributions, or in accordance with the terms of the joint venture agreement. A joint venture company is treated as:

(i) a subsidiary, if the Company has unilateral control, directly or indirectly, over the joint venture company;

(ii) a jointly-controlled entity, if the Company does not have unilateral control, but has joint control, directly or indirectly, over the joint venture company;

(iii) an associate, if the Company does not have unilateral or joint control, but holds, directly or indirectly, generally not less than 20% of the joint venture company's registered capital and is in a position to exercise significant influence over the joint venture company; or

(iv) a long term investment, if the Company holds, directly or indirectly, less than 20% of the joint venture company's registered capital and has neither joint control of, nor is in a position to exercise significant influence over, the joint venture company.

The Company has unilateral control over the Group's only joint venture company, Luteng Textile, since its incorporation on 12 September 2002.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Negative goodwill

Negative goodwill arising on the acquisition of subsidiaries, associates and jointly-controlled entities represents the excess of the Group's share of the fair values of the identifiable assets and liabilities acquired as at the date of acquisition, over the cost of the acquisition.

To the extent that negative goodwill relates to expectations of future losses and expenses that are identified in the acquisition plan and that can be measured reliably, but which do not represent identifiable liabilities as at the date of acquisition, that portion of negative goodwill is recognised as income in the consolidated profit and loss account when the future losses and expenses are recognised.

To the extent that negative goodwill does not relate to identifiable expected future losses and expenses as at the date of acquisition, negative goodwill is recognised in the consolidated profit and loss account on a systematic basis over the remaining average useful life (10 years) of the acquired depreciable/amortisable assets. The amount of any negative goodwill in excess of the fair values of the acquired non-monetary assets is recognised as income immediately.

In the case of associates and jointly-controlled entities, any negative goodwill not yet recognised in the consolidated profit and loss account is included in the carrying amount thereof, rather than as a separately identified item on the consolidated balance sheet.

On disposal of subsidiaries, associates or jointly-controlled entities, the gain or loss on disposal is calculated by reference to the net assets at the date of disposal, including the attributable amount of negative goodwill which has not been recognised in the consolidated profit and loss account and any relevant reserves as appropriate.

Related parties

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities.

Impairment of assets

An assessment is made at each balance sheet date of whether there is any indication of impairment of any asset, or whether there is any indication that an impairment loss previously recognised for an asset in prior years may no longer exist or may have decreased. If any such indication exists, the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's value in use or its net selling price.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. An impairment loss is charged to the profit and loss account in the period in which it arises.

A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the recoverable amount of an asset, however not to an amount higher than the carrying amount that would have been determined (net of any depreciation/amortisation), had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is credited to the profit and loss account in the period in which it arises.

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Fixed assets and depreciation

Fixed assets, other than construction in progress, are stated at cost less accumulated depreciation and any impairment losses. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after fixed assets have been put into operation, such as repairs and maintenance, is normally charged to the profit and loss account in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the fixed asset, the expenditure is capitalised as an additional cost of that asset.

Depreciation is calculated on the straight-line basis to write off the cost of each asset over its estimated useful life. The estimated useful lives of fixed assets and their principal annual rates for this purpose, after taking into consideration the estimated residual value of not more than 5% of cost, are as follows:

	Estimated useful life	Yearly depreciation rate
Land and buildings	20-50 years	2.0-4.8%
Machinery and equipment	6-14 years	6.8-15.8%
Motor vehicles	6-10 years	9.5-15.8%

The gain or loss on disposal or retirement of a fixed asset recognised in profit and loss account is the difference between the net sales proceeds and the carrying amount of the relevant asset.

Construction in progress represents plant and properties under construction, which is stated at cost less any impairment losses, and is not depreciated. Cost comprises the direct costs of construction and capitalised borrowing costs on related borrowed funds during the period of construction. Construction in progress is reclassified to the appropriate category of fixed assets when completed and ready for use.

Leased assets

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Where the Group is the lessee, rentals payable under such operating leases are charged to the profit and loss account on the straight-line basis over the lease terms.

Intangible assets

Technology rights are stated at cost less any impairment losses and are amortised on the straight-line basis over their estimated useful lives of 10 years.

Research and development costs

All research costs are charged to the profit and loss account as incurred.

Expenditure incurred on projects to develop new products is capitalised and deferred only when the projects are clearly defined; the expenditure is separately identifiable and can be measured reliably; there is reasonable certainty that the projects are technically feasible; and the products have commercial value. Product development expenditure which does not meet these criteria is expensed when incurred.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined on the weighted average basis and, in the case of work in progress, semi-finished goods (which principally comprise cotton yarns) and finished goods, comprises direct materials, direct labour and an appropriate proportion of overheads. Net realisable value is based on the estimated selling prices less any estimated costs to be incurred to completion and disposal.

Cash and cash equivalents

For the purpose of the consolidated cash flow statement, cash and cash equivalents comprise cash on hand and demand deposits, and short term highly liquid investments which are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, and have a short maturity of generally within three months when acquired, less bank overdrafts which are repayable on demand and form an integral part of the Group's cash management.

For the purpose of the balance sheet, cash and cash equivalents comprise cash on hand and at banks, including term deposits, which are not restricted as to use.

Provisions

A provision is recognised when a present obligation (legal or constructive) has arisen as a result of a past event and it is probable that a future outflow of resources will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation.

When the effect of discounting is material, the amount recognised for a provision is the present value at the balance sheet date of the future expenditures expected to be required to settle the obligation. The increase in the discounted present value amount arising from the passage of time is included in finance costs in the profit and loss account.

Income tax

Income tax comprises current and deferred tax. Income tax is recognised in the profit and loss account or in equity if it relates to items that are recognised in the same or a different period, directly in equity.

Deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences:

- except where the deferred tax liability arises from goodwill or the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Income tax (continued)

- in respect of taxable temporary differences associated with investments in subsidiaries and interests in joint ventures, except where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, carryforward of unused tax assets and used tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carryforward of unused tax assets and unused tax losses can be utilised:

- except where the deferred tax asset relating to the deductible temporary differences arises from negative goodwill or the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- in respect of deductible temporary differences associated with investments in subsidiaries and interests in joint ventures, deferred tax assets are only recognised to the extent that it is probable that temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Conversely, previously unrecognised deferred tax assets are recognised to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Revenue recognition

Revenue is recognised when it is probable that the economic benefits will flow to the Group and when the revenue can be measured reliably, on the following bases:

- from the sale of goods, where the significant risks and rewards of ownership have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold; and

- interest income, on a time proportion basis taking into account the principal outstanding and the effective interest rate applicable.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Government grants

Government grants are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. When the grant relates to an expense item, it is recognised as income over the periods necessary to match the grant on a systematic basis to the costs that it is intended to compensate. Where the grant relates to an asset, the fair value is credited to a deferred income account and is released to the profit and loss account over the expected useful life of the relevant asset by equal annual instalments.

Retirement benefits scheme

The Company and its subsidiaries participate in defined contribution retirement schemes organised by the local government authorities in the PRC. Employees holding city and township residency are entitled to an annual pension equivalent to a fixed portion of their basic salaries at their retirement dates. The Company and its subsidiaries are required to make contributions to the retirement schemes at a rate of 20% of the total salary of those employees and have no further obligation for post-retirement benefits. The contributions are charged to the profit and loss account of the Group as they become payable in accordance with the rules of the scheme.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, i.e., assets that necessarily take a substantial period of time to get ready for their intended use or sale, are capitalised as part of the cost of those assets. The capitalisation of such borrowing costs ceases when the assets are substantially ready for their intended use or sale. Where funds have been borrowed generally, and used for the purpose of obtaining qualifying assets, a capitalisation rate based on the weighted average of the borrowing costs applicable to the borrowings of the company that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining qualifying assets, is applied to the expenditure on the individual assets.

Dividends

Final dividends proposed by the directors are classified as a separate allocation of retained profits within the capital and reserves section of the balance sheet, until they have been approved by the shareholders in a general meeting. When these dividends have been approved by the shareholders and declared, they are recognised as a liability.

Interim dividends are simultaneously proposed and declared, because the Company's articles of association grants the directors the authority to declare interim dividends. Consequently, interim dividends are recognised immediately as a liability when they are proposed and declared.

Foreign currency transactions

The companies now comprising the Group are domiciled in the PRC and maintain their books and records in RMB. Foreign currency transactions are recorded at the applicable exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated into RMB at the applicable exchange rates ruling at that date. Exchange differences are dealt with in the profit and loss account.

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4. SEGMENT INFORMATION

The Group has only one business segment, which is the manufacture and sale of cotton yarns, grey fabrics and denims. The Group conducts the majority of its business activities in four geographical areas, namely Mainland China, Hong Kong, East Asia (principally comprising Japan and South Korea) and others. All of the Group's assets are located in Mainland China.

An analysis by geographical segment, as determined by location of the Group's operations, is as follows:

	Sales to external customers 2003 *RMB'000*	**Cost of sales 2003** *RMB'000*	**Gross profit 2003** *RMB'000*
Mainland China	**2,913,976**	**2,124,217**	**789,759**
Hong Kong	**1,759,219**	**1,487,376**	**271,843**
East Asia	**1,446,200**	**1,342,623**	**103,577**
Others	**441,075**	**395,941**	**45,134**
Total	**6,560,470**	**5,350,157**	**1,210,313**

	Sales to external customers 2002 *RMB'000*	Cost of sales 2002 *RMB'000*	Gross profit 2002 *RMB'000*
Mainland China	2,160,011	1,731,733	428,278
Hong Kong	1,189,614	1,011,088	178,526
East Asia	776,493	748,044	28,449
Others	254,805	238,402	16,403
Total	4,380,923	3,729,267	651,656

5. TURNOVER AND OTHER REVENUE

Turnover represents the invoiced value of goods sold, net of trade discounts and returns, and excludes sales taxes and intra-group transactions.

An analysis of turnover and other revenue is as follows:

	Group	
	2002	**2003**
	RMB'000	***RMB'000***
Turnover		
Sale of goods	4,380,923	**6,560,470**
Other revenue		
Interest income	9,340	**12,048**
Gain on sale of raw materials	29,915	**27,783**
Compensation from overseas suppliers on supply of inferior raw materials	3,750	**24,610**
Negative goodwill recognised	374	**2,990**
Subsidy income	4,800	**2,119**
Other	1,124	**4,570**
	49,303	**74,120**

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6. PROFIT FROM OPERATING ACTIVITIES

The Group's profit from operating activities is arrived at after charging/(crediting):

	Notes	2002 *RMB'000*	**2003** ***RMB'000***
Cost of inventories sold		3,714,416	**5,338,325**
Staff costs (excluding directors' and supervisors' emoluments *(note (8))*:			
Wages, salaries and social security costs		325,221	**607,421**
Retirement benefit contributions		6,742	**15,756**
		331,963	**623,177**
Amortisation of intangible assets	17	300	**1,200**
Auditors' remuneration		150	**2,470**
Depreciation	16	121,195	**287,495**
Directors' and supervisors' emoluments	8	212	**1,600**
Exchange losses, net		3,585	**7,429**
Operating lease expenses		37,163	**4,889**
Provision for bad and doubtful debts		4,182	**7,031**
Provision against inventories		14,851	**11,832**
Negative goodwill recognized as income during the year	18	(374)	**(2,990)**
Repairs and maintenance		110,599	**160,151**
Research and development costs included in:			
Wages and salaries		766	**903**
Consumption of consumables		1,104	**3,644**
		1,870	**4,547**

7. RETIREMENT BENEFITS

The aggregate contribution of the Group to retirement benefit scheme were approximately RMB15.9 million for the year ended 31 December 2003 (2002: RMB6.8 million). As at 31 December 2003, the Group had no forfeited contributions available to reduce its contributions to the pension scheme in future years (2002: Nil).

8. DIRECTORS' AND SUPERVISORS' REMUNERATION

Directors' and supervisors' remuneration for the year, as required to be disclosed pursuant to the Listing Rules and Section 161 of the Companies Ordinance, is as follows:

	Group	
	2002	**2003**
	RMB'000	***RMB'000***
Fees	—	**1,269**
Other emoluments:		
Salaries, allowances and benefits in kind	189	**227**
Performance related bonus	—	**—**
Retirement benefit contributions	23	**104**
	212	**1,600**

Fees include approximately RMB385,000 (2002: Nil) payable to the independent non-executive directors. There were no other emoluments payable to the independent non-executive directors during the year (2002: Nil).

The remuneration of each of the directors and supervisors during the year and 2002 fell within the band of nil to HK$1,000,000 (equivalent to approximately RMB1,061,000).

There was no arrangement under which a director or a supervisor waived or agreed to waive any remuneration during the year.

There was no emolument paid by the Group to the directors or supervisors as an inducement to join or upon joining the Group or as compensation for loss of office during the year.

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9. FIVE HIGHEST PAID EMPLOYEES

The five highest paid employees in the Group included five directors for the year ended 31 December 2003 and four directors and one supervisor for the year ended 31 December 2002. The emoluments for these directors and supervisor are included in the analysis set out in note 8.

The emoluments and designated band of the five highest paid individuals (including directors, supervisors and employees) during the year are as follows:

	Group	
	2002 *RMB'000*	**2003** ***RMB'000***
Fees	—	**831**
Other emoluments:		
Salaries, allowances and benefits in kind	146	**224**
Performance related bonus	—	**—**
Retirement benefit contributions	19	**100**
	165	**1,155**

The remuneration of each of the five highest paid employees during the year and 2002 fell within the band of nil to HK$1,000,000 (equivalent to approximately RMB1,061,000).

10. FINANCE COSTS

	Group	
	2002 *RMB'000*	**2003** ***RMB'000***
Interest on bank loans wholly repayable within five years	104,970	**162,597**
Less: Amount reimbursed by the immediate holding company*	(3,464)	**—**
Interest capitalised**	—	**(4,800)**
	101,506	**157,797**

* During 2002, the Company had entered into an arrangement with Holding Company under which the Company agreed to borrow funds from the banks on behalf of Holding Company and Holding Company agreed to reimburse the Company the interest expense thereon on an actual basis. The arrangement was terminated in 2002 when the Company fully settled the related outstanding loan balances with the banks in that year.

** The capitalisation rate adopted for capitalising interests incurred during the year ranged from 4.325% to 6.372% per annum.

11. TAX

Hong Kong profits tax has not been provided as the Group had no assessable profits arising in Hong Kong during the year (2002: Nil).

	Group	
	2002 *RMB'000*	**2003** ***RMB'000***
Current — Hong Kong	—	**—**
— Mainland China	169,627	**305,674**
Total tax charge for the year	169,627	**305,674**

A reconciliation of the tax expense applicable to profit before tax using the statutory rate for the locations in which the Company, its subsidiaries and joint venture are situated to the tax expense at the effective tax rate, and a reconciliation of the applicable rate (i.e. the statutory tax rate) to the effective tax rate, are as follows:

	Group			
	2002		**2003**	
	RMB'000	*%*	***RMB'000***	***%***
Profit before tax	461,058		**853,442**	
At PRC statutory tax rate	152,149	33.0	**281,636**	**33.0**
Expenses not deductible for tax	12,134	2.6	**21,689**	**2.6**
Income not subject to tax	(1,584)	(0.3)	**(699)**	**(0.1)**
Tax exemption	—	—	**(4,150)**	**(0.5)**
Other	6,928	1.5	**7,198**	**0.8**
Tax charge at the Group's effective rate	169,627	36.8	**305,674**	**35.8**

Under PRC income tax law, the companies (except for Luteng Textile) comprising the Group are subject to corporate income tax ("CIT") at a rate of 33% on the taxable income as reported in their statutory accounts, which are prepared in accordance with PRC Accounting Regulations.

Being a Sino-foreign joint venture enterprise, Luteng Textile is subject to State CIT rate at 30% and local CIT rate at 3%. As regards State CIT, it is entitled to full exemption from such tax for the first two years and 50% reduction in the next three years, commencing from the first profitable year after offsetting all tax losses carried forward from previous five years. As regards local CIT, the local tax authority has granted it full exemption from such tax commencing from 2002. No provision for CIT has been made as Luteng Textile incurred an operating loss from its date of establishment (12 September 2002) to 31 December 2002, and was approved to enjoy State CIT exemption in full effective from 1 January 2003.

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11. TAX (continued)

At 31 December 2003, there is no significant unrecognised deferred tax liability (2002: Nil) for taxes that would be payable on the unremitted earnings of certain of the Group's subsidiaries and joint venture, as the Group has no liability to additional tax should such amounts be remitted.

There are no income tax consequences attaching to the payment of dividends by the Company to its shareholders.

12. MINORITY INTERESTS

Pursuant to the minutes of the board of directors' meeting of Weihai Weiqiao dated 2 April 2001, WCAI, which holds a 12.8% equity interest in Weihai Weiqiao, was entitled to a fixed return at a rate of 20% on its capital contribution to Weihai Weiqiao for the two-year period ended 31 December 2002. Accordingly, the net results of operations of Weihai Weiqiao attributable to WCAI for the year ended 31 December 2002 were approximately RMB3.8 million. From 2003 onwards, the net results of operations of Weihai Weiqiao attributable to WCAI are calculated based on the percentage of equity interest in Weihai Weiqiao held by WCAI.

13. NET PROFIT FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS

The net profit from ordinary activities attributable to shareholders for the year ended 31 December 2003 dealt with in the financial statements of the Company was RMB472 million (2002: RMB280 million).

14. PROFIT APPROPRIATIONS

(1) Under the PRC Company Law and the respective companies' articles of association, net profit after tax as determined in accordance with PRC Accounting Regulations can only be distributed as dividends after making up prior years' cumulative losses, if any, and making allowance for the following statutory reserve funds, which cannot be used for purpose other than those for which they are created and are not distributable as cash dividends:

(i) Statutory surplus reserve

In accordance with the PRC Company Law and the respective companies' articles of association, the Company and its subsidiaries, except for Luteng Textile, are required to appropriate 10% of the annual statutory net profit after tax (after offsetting any prior years' losses), determined in accordance with PRC Accounting Regulations, to the statutory surplus reserve. When the balance of such reserve fund reaches 50% of each entity's capital, any further appropriation is optional. The statutory surplus reserve can be utilised to offset prior years' losses or to increase capital. However, such balance of the statutory surplus reserve must be maintained at a minimum of 25% of capital after such usages.

14. PROFIT APPROPRIATIONS (continued)

(ii) Statutory public welfare fund

In accordance with the PRC Company Law and the respective companies' articles of association, the Company and its subsidiaries, except for Luteng Textile, are required to appropriate 5% to 10% of the annual statutory net profit after tax (after offsetting any prior years' losses), determined in accordance with PRC Accounting Regulations, to the statutory public welfare fund, which will be utilised to build or acquire capital items, such as dormitories and other facilities for the employees of the Company and its subsidiaries, and cannot be used to pay for staff welfare expenses. Titles of these capital items will remain with the respective companies now comprising the Group.

The directors of Binzhou Industrial Park resolved to appropriate 10% and 5% of the profit attributable to shareholders for the years ended 31 December 2003 and 2002, determined in accordance with PRC Accounting Regulations, to the statutory surplus reserve and the statutory public welfare fund, respectively.

Except as described above, 10% of the profit attributable to shareholders, determined in accordance with PRC Accounting Regulations, were appropriated to each of the statutory surplus reserve and the statutory public welfare fund as approved in resolutions passed by the board of directors of the respective companies for the years ended 31 December 2003 and 2002.

(iii) General reserve fund, employee's bonus and welfare fund and enterprise expansion fund

In accordance with the PRC Joint Venture Law, dividends can be distributed by Luteng Textile after allowance has been made by offsetting any prior years' losses out of the annual statutory net profit after tax, determined in accordance with PRC Accounting Regulations, and allocations to the statutory reserve funds, comprising a general reserve fund, an employee bonus and welfare fund and an enterprise expansion fund. The amount of transfer to the various statutory reserve funds is determined at the discretion of the board of directors of Luteng Textile.

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14. PROFIT APPROPRIATIONS (continued)

(2) Dividend

	2002 *RMB'000*	**2003** ***RMB'000***
Proposed final RMB0.056 per share (2002: Nil)	—	**45,808**

The proposed final dividend for the year is subject to the approval of the Company's shareholders at the forthcoming annual general meeting. In accordance with the articles of association of the Company, the net profit after tax of the Company for the purpose of profit distribution will be deemed to be the lesser of (i) the net profit determined in accordance with PRC Accounting Regulations and (ii) the net profit determined in accordance with the accounting standards of the overseas place where the Company's shares are listed.

15. EARNINGS PER SHARE

The calculation of basic earnings per share is based on:

	2002 *RMB'000*	**2003** ***RMB'000***
Earnings		
Net profit from ordinary activities attributable to shareholders used in the basic earnings per share calculation	288,240	**541,672**

	Number of shares	
	2002	**2003**
Shares		
Weighted average number of ordinary shares in issue during the year used in the basic earnings per share calculation	284,897,973	**608,061,840**

The weighted average numbers of ordinary shares in issue during the year used in the basic earnings per share calculations for both 2003 and 2002 have been reflected the H shares issued under the initial public offering during 2003 and the domestic shares issued to Holding Company during 2002, respectively.

16. FIXED ASSETS

The Group

	Land and buildings RMB'000	Machinery and equipment RMB'000	Motor vehicles RMB'000	Construction in progress RMB'000	Total RMB'000
Cost:					
At beginning of year	612,084	2,758,390	8,924	295,137	3,674,535
Additions	12,036	601,176	11,481	2,465,751	3,090,444
Acquisition from Holding Company	46,582	—	—	—	46,582
Acquisition from Binzhou Weiqiao	—	16,799	—	—	16,799
Transfers	442,930	1,010,258	—	(1,453,188)	—
Disposals	—	(1,030)	—	—	(1,030)
At 31 December 2003	1,113,632	4,385,593	20,405	1,307,700	6,827,330
Accumulated depreciation:					
At beginning of year	20,082	191,068	889	—	212,039
Provided during the year	14,189	271,775	1,531	—	287,495
Disposals	—	(34)	—	—	(34)
At 31 December 2003	34,271	462,809	2,420	—	499,500
Net book value:					
At 31 December 2003	1,079,361	3,922,784	17,985	1,307,700	6,327,830
At 31 December 2002	592,002	2,567,322	8,035	295,137	3,462,496

Certain of the Group's bank loans amounting to approximately RMB3,471 million were secured by certain of the Group's land and buildings, machinery and equipment, which had an aggregate net book value of approximately RMB5,130 million at 31 December 2003 (2002: RMB2,708 million).

Certain of the Group's bills payable amounting to approximately RMB19 million (note 27) were secured by certain of the Group's fixed assets, representing land use right, with an aggregate carrying amount of approximately RMB48 million as at 31 December 2003 (2002: Nil).

Prior to its transfer to land and buildings, and machinery and equipment, the carrying amount of construction in progress included capitalised interest of approximately RMB4.8 million (2002: Nil).

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16. FIXED ASSETS (continued)

The Company

	Land and buildings *RMB'000*	Machinery and equipment *RMB'000*	Motor vehicles *RMB'000*	Construction in progress *RMB'000*	Total *RMB'000*
Cost:					
At beginning of year	448,166	2,265,497	5,357	—	2,719,020
Additions	161	590,782	7,818	2,083,832	2,682,593
Acquisition from Holding Company	46,582	—	—	—	46,582
Transfers	290,693	544,781	—	(835,474)	—
Contribution to a subsidiary*	—	(208,022)	—	—	(208,022)
Disposals	—	(915)	—	—	(915)
At 31 December 2003	785,602	3,192,123	13,175	1,248,358	5,239,258
Accumulated depreciation:					
At beginning of year	17,641	148,415	544	—	166,600
Provided during the year	12,915	207,911	890	—	221,716
Disposals	—	(11)	—	—	(11)
At 31 December 2003	30,556	356,315	1,434	—	388,305
Net book value:					
At 31 December 2003	755,046	2,835,808	11,741	1,248,358	4,850,953
At 31 December 2002	430,525	2,117,082	4,813	—	2,552,420

* The Company contributed fixed assets with aggregate amount of approximately RMB208,022,000 (equivalent to the then carrying amount of such fixed assets) to its subsidiary in 2003.

17. INTANGIBLE ASSETS

The intangible assets of the Group represent technology rights of US$1,450,000 (or approximately RMB12 million) injected by a minority shareholder to a subsidiary of the Company as capital contribution in September 2002:

	2002 *RMB'000*	**2003** ***RMB'000***
Cost:		
At beginning of year	—	**12,001**
Additions	12,001	**—**
At closing of year	12,001	**12,001**
Accumulated amortisation:		
At beginning of year	—	**300**
Provided during the year	300	**1,200**
At closing of year	300	**1,500**
Net book value	11,701	**10,501**

18. NEGATIVE GOODWILL

Negative goodwill recognised in the consolidated balance sheet, arising from the acquisition of Binzhou Industrial Park in 2002, is as follows:

	2002 *RMB'000*	**2003** ***RMB'000***
Cost:		
At beginning of year	—	**(29,902)**
Acquisition of a subsidiary (*note 33 (a)*)	(29,902)	**—**
At closing of year	(29,902)	**(29,902)**
Recognition as income:		
At beginning of year	—	**374**
Recognised as income during the year	374	**2,990**
At closing of year	374	**3,364**
Net book value	(29,528)	**(26,538)**

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19. INTERESTS IN SUBSIDIARIES

Details of the interests in subsidiaries of the Company are set out below:

	2002 *RMB'000*	**2003** ***RMB'000***
Unlisted investments, at cost	267,968	**462,235**
Amounts due from subsidiaries	444,655	**727,337**
Amounts due to subsidiaries	(174,418)	**(301,089)**
	538,205	**888,483**

The amounts due from/(to) subsidiaries are unsecured, interest-free and have no fixed repayment terms.

Particulars of the subsidiaries and joint venture of the Company as at 31 December 2003 are as follows:

Company name	Place of incorporation/ establishment and operations	Legal status	Paid-up capital/ registered capital	Percentage of equity interests directly attributable to the Company	Principal activities
Subsidiaries					
Weihai Weiqiao	Weihai, the PRC	Limited liability company	RMB148,000,000	87.2%	Production and sale of cotton yarns and fabrics
Binzhou Industrial Park	Binzhou, the PRC	Limited liability company	RMB300,000,000	97%	Production and sale of cotton yarns and fabrics
Shandong Weiqiao Mianye Company Limited	Zouping, the PRC	Limited liability company	RMB5,000,000	92%	Purchase, processing and sale of raw cotton, cotton seeds and lint cotton
Joint venture					
Luteng Textile	Zouping, the PRC	Sino-foreign equity joint venture	US$9,790,000	75%	Production and sale of polyester yarns and related products

20. OTHER LONG TERM ASSETS

The Group and the Company

	2002 *RMB'000*	**2003** ***RMB'000***
Export VAT refundable	96,250	**—**

21. INVENTORIES

	Group	
	2002 *RMB'000*	**2003** ***RMB'000***
Raw materials	188,876	**934,946**
Work in progress	111,440	**252,462**
Semi-finished goods	101,756	**123,980**
Finished goods	116,573	**226,904**
Consigned materials for processing	58	**316**
Consumables	24,578	**34,064**
Raw materials in transit	206,457	**511,313**
Total	749,738	**2,083,985**

	Company	
	2002 *RMB'000*	**2003** ***RMB'000***
Raw materials	173,077	**745,244**
Work in progress	89,781	**214,192**
Semi-finished goods	89,192	**81,026**
Finished goods	101,807	**183,089**
Consigned materials for processing	57	**316**
Consumables	13,066	**25,263**
Raw materials in transit	206,457	**511,313**
Total	673,437	**1,760,443**

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21. INVENTORIES (continued)

The carrying amounts of inventories of the Group and the Company carried at net realizable value included in the above balances were approximately RMB36 million (2002: RMB27 million) and RMB35 million (2002: RMB27 million), respectively, as at 31 December 2003.

Certain of the Company's raw materials in transit of approximately RMB301 million as at 31 December 2003 were utilised to secure bank loans up to approximately RMB301 million (2002: Nil).

22. TRADE RECEIVABLES

An aged analysis of the trade receivables as at the balance sheet date, based on invoice date, is as follows:

	Group	
	2002 *RMB'000*	**2003** ***RMB'000***
Outstanding balances aged:		
Within 3 months	247,616	**484,610**
3 months to 6 months	3,744	**5,449**
6 months to 1 year	700	**3,453**
1 year to 2 years	2,654	**2,701**
	254,714	**496,213**

	Company	
	2002 *RMB'000*	**2003** ***RMB'000***
Outstanding balances aged:		
Within 3 months	232,434	**420,902**
3 months to 6 months	3,744	**5,449**
6 months to 1 year	700	**3,331**
1 year to 2 years	2,654	**2,701**
	239,532	**432,383**

The Group normally allows a credit period of not more than 45 days to its customers, although an extension of the credit period is not uncommon for customers with a long term relationship. The Group seeks to maintain strict control over its outstanding receivables. Overdue balances are reviewed regularly by senior management.

Certain of the Group's trade receivables of approximately RMB15 million as at 31 December 2003 were utilised to secure bank loans up to approximately RMB12 million (2002: Nil).

23. PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

	Group	
	2002	**2003**
	RMB'000	***RMB'000***
Prepayments to suppliers	35,424	**125,529**
Export VAT refundable	90,000	**75,436**
Other receivables and prepayments	498	**124,711**
Total	125,922	**325,676**

	Company	
	2002	**2003**
	RMB'000	***RMB'000***
Prepayments to suppliers	35,236	**125,192**
Export VAT refundable	90,000	**75,436**
Other receivables and prepayments	100	**116,016**
Total	125,336	**316,644**

Certain of the Company's export VAT refundable of approximately RMB10 million as at 31 December 2003 were utilised to secure bank loans up to approximately RMB10 million (2002: Nil).

24. AMOUNTS DUE FROM/TO THE IMMEDIATE HOLDING COMPANY/ RELATED PARTIES

The balances with the immediate holding company and related parties are unsecured, interest-free and have no fixed repayment terms.

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25. CASH AND CASH EQUIVALENTS AND PLEDGED DEPOSITS

	Group	
	2002 *RMB'000*	**2003** ***RMB'000***
Cash and bank balances	167,635	**1,278,193**
Time deposits	569,313	**576,480**
	736,948	**1,854,673**
Less: Pledged time deposits:		
Pledged for letter of credit facilities	(215,413)	**(292,571)**
Pledged for issuance of bills payable *(note 27)*	(353,900)	**(29,909)**
Cash and cash equivalents	167,635	**1,532,193**

	Company	
	2002 *RMB'000*	**2003** ***RMB'000***
Cash and bank balances	143,464	**1,175,692**
Time deposits	560,913	**528,427**
	704,377	**1,704,119**
Less: Pledged time deposits:		
Pledged for letter of credit facilities	(215,413)	**(274,427)**
Pledged for issuance of bills payable *(note 27)*	(345,500)	**—**
Cash and cash equivalents	143,464	**1,429,692**

Included in the pledged time deposits of the Company for letter of credit facilities as at 31 December 2003, time deposits with a total amount of RMB2 million was utilised to secure bank loans up to approximately RMB2 million (2002: Nil).

26. TRADE PAYABLES

An aged analysis of the trade payable as at the balance sheet date, based on the date of the significant risks and rewards of ownership of raw materials and fixed assets having been transferred to the Group, is as follows:

	Group	
	2002	**2003**
	RMB'000	***RMB'000***
Outstanding balances aged:		
Within 90 days	434,058	**1,189,081**
90 days to 3 years	3,258	**59,536**
	437,316	**1,248,617**

	Company	
	2002	**2003**
	RMB'000	***RMB'000***
Outstanding balances aged:		
Within 90 days	403,457	**1,129,841**
90 days to 3 years	3,258	**58,762**
	406,715	**1,188,603**

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27. BILLS PAYABLE

	Group	
	2002	**2003**
	RMB'000	***RMB'000***
Outstanding balances aged:		
Within 90 days	199,540	**19,597**
90 to 180 days	228,000	**60,000**
	427,540	**79,597**

Included in the above Group's balances are bills payable to the Company, the immediate holding company and related parties:

	2002	**2003**
	RMB'000	***RMB'000***
The Company*	—	**79,597**
The immediate holding company	304,000	**—**
Related parties	123,540	**—**
	427,540	**79,597**

* The bills drawn by the subsidiaries of the Company in favor of the Company were discounted with banks by the Company prior to 31 December 2003.

	Company	
	2002	**2003**
	RMB'000	***RMB'000***
Outstanding balances aged:		
Within 90 days	171,540	**—**
90 to 180 days	228,000	**—**
	399,540	**—**

27. BILLS PAYABLE (continued)

Included in the above Company's balances are bills payable to the immediate holding company and related parties:

	2002 *RMB'000*	**2003** ***RMB'000***
The immediate holding company	304,000	—
Related parties	95,540	—
	399,540	—

The Group's and the Company's bills payable were secured by the pledge of certain of the Group's time deposits; details of which are described in note 25 above.

Certain of the Group's bills payable amounting to approximately RMB19 million were secured by certain of the Group's fixed assets with an aggregate carrying amount of approximately RMB48 million (note 16) as at 31 December 2003 (2002: Nil).

28. OTHER PAYABLES AND ACCRUALS

Included in the Group's other payables and accruals as at 31 December 2003 and 31 December 2002 are government grants totalling RMB13 million provided by the Finance Bureau of the Binzhou City to Binzhou Industrial Park for the purpose of providing support for the development of Binzhou Industrial Park.

29. INTEREST-BEARING BANK LOANS

(1) Interest-bearing bank loans, current portion

	Group	
	2002 *RMB'000*	**2003** ***RMB'000***
Current portion of bank loans	496,824	**1,991,369**

	Company	
	2002 *RMB'000*	**2003** ***RMB'000***
Current portion of bank loans	442,824	**1,403,588**

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29. INTEREST-BEARING BANK LOANS (continued)

(2) Interest-bearing bank loans, long term portion

	Group	
	2002	**2003**
	RMB'000	***RMB'000***
Bank loans:		
Secured	2,182,943	**3,793,227**
Unsecured	171,694	**680,481**
	2,354,637	**4,473,708**
Bank loans repayable:		
Within one year or on demand	496,824	**1,991,369**
In the second year	76,500	**946,470**
In the third to fifth years, inclusive	1,781,313	**1,535,869**
	2,354,637	**4,473,708**
Portion classified as current liabilities	(496,824)	**(1,991,369)**
Long term portion	1,857,813	**2,482,339**

	Company	
	2002	**2003**
	RMB'000	***RMB'000***
Bank loans:		
Secured	2,112,943	**3,603,157**
Unsecured	30,694	**82,769**
	2,143,637	**3,685,926**
Bank loans repayable:		
Within one year or on demand	442,824	**1,403,588**
In the second year	76,500	**830,470**
In the third to fifth years, inclusive	1,624,313	**1,451,869**
	2,143,637	**3,685,927**
Portion classified as current liabilities	(442,824)	**(1,403,588)**
Long term portion	1,700,813	**2,282,339**

29. INTEREST-BEARING BANK LOANS (continued)

(2) Interest-bearing bank loans, long term portion (continued)

(i) Other than part of the Group's and the Company's bank loans in the aggregate amount of US$149 million (RMB1,231 million equivalent) as at 31 December 2003 (2002: US$65.3 million or RMB540.1 million equivalent), all of the Group's and the Company's bank loans are denominated in RMB. All of the Group's and the Company's bank loans bear yearly interest rates ranging from 2.16% to 7.254% as at 31 December 2003 (2002: 3.15% to 7.254%).

(ii) Certain of the Group's bank loans amounting to approximately RMB3,471 million were secured by certain of the Group's land and buildings, machinery and equipment, which had an aggregate net book value of approximately RMB5,130 million as at 31 December 2003 (2002: RMB2,708 million).

(iii) Certain of the Company's bank loans were secured by certain of the Company's time deposits, export VAT refundable and raw materials in transit up to approximately RMB2 million (2002: Nil), RMB10 million (2002: Nil) and RMB301 million (2002: Nil) as at 31 December 2003, respectively.

(iv) Certain of the Group's bank loans up to approximately RMB12 million were secured by certain of the Group's accounts receivable of approximately RMB15 million as at 31 December 2003 (2002: Nil).

(v) The Company's immediate holding company has guaranteed certain of the Group's bank loans up to approximately RMB10 million as at 31 December 2003 (2002: RMB142 million).

(vi) WCAI has guaranteed bank loans of Weihai Weiqiao up to about RMB32 million as at 31 December 2003 (2002: RMB34 million).

(vii) The Company has guaranteed bank loans of certain of its subsidiaries up to approximately RMB555 million as at 31 December 2003 (2002: RMB60 million).

(viii) As disclosed in note 10 above, the Company had arranged with the immediate holding company to borrow bank loans on its behalf in 2002.

30. LONG TERM PAYABLE TO THE IMMEDIATE HOLDING COMPANY

The long term payable to the immediate holding company as at 31 December 2003 and 31 December 2002 are unsecured, interest-free and are repayable over three years commencing 2005 by three installments of RMB50,000,000 in 2005, RMB50,000,000 in 2006 and RMB78,927,000 in 2007, respectively.

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31. SHARE CAPITAL

Shares

	2002 *RMB'000*	**2003** ***RMB'000***
Registered, issued and fully paid:		
530,770,000 (2002: 530,770,000) domestic shares of RMB1.00 each	530,770	**530,770**
287,235,500 (2002: Nil) H shares of RMB1.00 each (b)	—	**287,236**
	530,770	**818,006**

The Company does not have any share option scheme.

During the year and 2002, the movements in share capital were as follows:

(a) Pursuant to a shareholders' resolution dated 15 July 2002, the registered capital of the Company was increased to RMB530,770,000, comprising 530,770,000 domestic shares of RMB1.00 each. 328,730,000 domestic shares of RMB1.00 each were issued to Holding Company, credited as fully paid in consideration for the transfer of the relevant assets and liabilities of the Second Production Area and Third Production Area by Holding Company on 30 September 2002. The net assets injected by Holding Company amounted to RMB785,667,466, according to the valuation performed by Shandong Zheng Yuan He Xin Certified Public Accountants Ltd. as described in its valuation report dated 28 June 2002. The increase in registered capital and the issuance of 328,730,000 domestic shares to Holding Company in exchange for the net assets injected were approved by the Office for Restructuring the Economic System of Shandong Province on 28 October 2002.

(b) 249,770,000 H shares of the Company were listed on the Main Board of the HKSE on 24 September 2003 and 37,465,500 additional H shares, issued upon exercise of an over-allotment option, were listed on the Main Board of the HKSE on 30 September 2003. These H shares with a par value of RMB1.00 each were issued to the public by way of placing and public offer at a price of HK$8.5 (equivalent to approximately RMB9.07) per share.

31. SHARE CAPITAL (continued)

A summary of the transactions during the year with reference to the above movements of the Company's ordinary share capital is as follows:

	Number of shares in issue	Issued share capital *RMB'000*	Capital reserve account *RMB'000*	Total *RMB'000*
At 1 January 2002	202,040,000	202,040	108,791	310,831
Issue of domestic shares (a)	328,730,000	328,730	456,937	785,667
At 1 January 2003	530,770,000	530,770	565,728	1,096,498
Issue of H shares upon listing (b)	287,235,500	287,236	2,317,563	2,604,799
	818,005,500	818,006	2,883,291	3,701,297
Shares issue expenses	—	—	(93,627)	(93,627)
At 31 December 2003	818,005,500	818,006	2,789,664	3,607,670

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32. RESERVES

The Group

The amounts of the Group's reserves and the movements therein for the current and prior year are presented in the consolidated statement of changes in equity on page 39 of the financial statements.

The Company

	Capital reserve *RMB'000*	Statutory surplus reserve *RMB'000*	Statutory public welfare fund *RMB'000*	Proposed final dividend *RMB'000*	Retained profits *RMB'000*	Total *RMB'000*
As at 1 January 2002	108,791	23,766	23,766	131,326	108,749	396,398
Declared final 2001 dividend	—	—	—	(131,326)	—	(131,326)
Capital contribution *(note 31(a))*	456,937	—	—	—	—	456,937
Net profit for the year	—	—	—	—	280,011	280,011
Transfer from/(to) reserves *(note 14 (1))*	—	26,313	26,313	—	(52,626)	—
As at 31 December 2002	565,728	50,079	50,079	—	336,134	1,002,020
Issue of H shares (note 31 (b))	2,317,563	—	—	—	—	2,317,563
Share issue expenses *(note 31 (b))*	(93,627)	—	—	—	—	(93,627)
Net profit for the year	—	—	—	—	472,215	472,215
Transfer from/(to) reserves *(note 14 (1))*	—	54,254	54,254	—	(108,508)	—
Proposed final 2003 dividend	—	—	—	45,808	(45,808)	—
As at 31 December 2003	2,789,664	104,333	104,333	45,808	654,033	3,698,171

33. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

(a) Pursuant to an equity transfer agreement entered into between the Company, the immediate holding company and Binzhou Weiqiao, a related party of the Company, on 18 November 2002, the immediate holding company and Binzhou Weiqiao transferred their equity interests in Binzhou Industrial Park of 90% and 1%, respectively, to the Company for a consideration of RMB90 million and RMB1 million, respectively.

	Year ended 31 December 2002 *RMB'000*
Net assets acquired:	
Fixed assets	723,187
Cash and cash equivalents	13,997
Prepayments, deposits and other receivables	29,210
Inventories	32,235
Short term bank loan	(8,000)
Trade payables	(21,544)
Bills payable	(28,000)
Other payables and accruals	(12,130)
Amount due to the immediate holding company	(494,483)
Amounts due to related parties	(101,613)
Minority interests	(11,957)
	120,902
Negative goodwill arising from acquisition (note 18)	(29,902)
	91,000
Satisfied by:	
Amount due to the immediate holding company	90,000
Amount due to a related party	1,000
	91,000

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33. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT (continued)

(a) (continued)

An analysis of the inflow of cash and cash equivalents in respect of the acquisition of a subsidiary is as follows:

	Year ended 31 December 2002 *RMB'000*
Cash and cash equivalents acquired	13,997
Net cash inflow in respect of the net assets acquired	13,997

(b) Major non-cash transactions

(i) During 2003, Holding Company transferred to the Group all rights and benefits to all of its cotton processing equipment at nil consideration.

(ii) During 2002, the Company's immediate holding company injected the net assets of its wholly-owned Second Production Area and Third Production Area to the Company by way of capital contribution amounting to approximately RMB786 million as follows:

	Year ended 31 December 2002 *RMB'000*
Net assets injected:	
Fixed assets	1,427,001
Inventories	45,769
Amount due to the immediate holding company	(47,828)
Other payables and accruals	(2,941)
Short term bank loans	(368,334)
Long term bank loans	(268,000)
	785,667
Satisfied by:	
Share capital	328,730
Capital reserve	456,937
	785,667

33. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT (continued)

(b) Major non-cash transactions (continued)

(iii) During 2002, the Company acquired plants and buildings for a total sum of approximately RMB179 million from its immediate holding company. The Company has agreed with the immediate holding company to settle this acquisition cost over three years commencing 2005 by three instalments of RMB50,000,000 in 2005, RMB50,000,000 in 2006 and RMB78,927,000 in 2007, respectively (note 30).

(iv) During 2002, a minority shareholder contributed technology rights of approximately RMB12 million (note 17) to a subsidiary of the Company.

34. CONTINGENT LIABILITIES

At the balance sheet date, the Group's and the Company's contingent liabilities not provided for in the financial statements were as follows:

	Group	
	2002 *RMB'000*	**2003** ***RMB'000***
Letters of credit issued	28,890	**191,266**
Bills discounted with recourse	370,000	**—**
Outward letters of credit discounted	7,227	**—**
	406,117	**191,266**

	Company	
	2002 *RMB'000*	**2003** ***RMB'000***
Letters of credit issued	28,890	**191,266**
Bills discounted with recourse	370,000	**—**
Guarantee given to banks in connection with facilities granted to subsidiaries	60,000	**555,471**
Outward letters of credit discounted	7,227	**—**
	466,117	**746,737**

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35. COMMITMENTS

(1) Capital commitments

At the balance sheet date, the Group and the Company had the following capital commitments, principally for the construction and acquisition of fixed assets:

	Group	
	2002	**2003**
	RMB'000	***RMB'000***
Contracted, but not provided for	61,798	**109,197**

	Company	
	2002	**2003**
	RMB'000	***RMB'000***
Contracted, but not provided for	—	**109,197**

(2) Operating lease commitments

At the balance sheet date, the Group and the Company had the following total future minimum lease payments under non-cancelable operating leases in respect of land and buildings:

	Group	
	2002	**2003**
	RMB'000	***RMB'000***
Within one year	2,870	**9,530**
In the second to fifth years, inclusive	10,500	**36,560**
After five years	32,300	**127,190**
	45,670	**173,280**

	Company	
	2002	**2003**
	RMB'000	***RMB'000***
Within one year	2,810	**9,470**
In the second to fifth years, inclusive	10,260	**36,320**
After five years	31,400	**126,360**
	44,470	**172,150**

36. RELATED PARTY TRANSACTIONS

The Group is part of a larger group of companies under ZCSU and has extensive transactions and relationships with members of ZCSU. As such, it is possible that the terms of these transactions are not the same as those that would result from transactions among wholly unrelated parties. Related parties refer to entities in which ZCSU is a shareholder and is able to exercise control or significant influence. The transactions were made on terms agreed between the parties.

In addition to the Reorganisation, further details of which are set out in note 1 to these financial statements, and transactions and balances disclosed in note 10, note 24, note 26, note 28, note 29 and note 33 to these financial statements during the year, the Group had the following material transactions with the following related parties:

Name of related parties	Relationship with the Company	Nature of transactions	2002 RMB'000	2003 RMB'000
Holding Company	The immediate holding company	Purchase of lint cotton and tailings	224,260	**164,600**
		Expenses on provision of electricity and steam	145,684	**229,194**
		Sale of cotton yarns, grey fabrics and denims	449,458	**8,829**
		Sale of ancillary materials and spare parts	85,719	**598**
		Sale of lint cotton and tailings	410,127	**—**
		Purchase of cotton yarns, grey fabrics and denims	1,110,732	**60,131**
		Purchase of fixed assets	47,843	**46,582**
		Purchase of ancillary materials and spare parts	23,542	**6,575**
		Expenses on equipment and property leasing	37,163	**4,889**
		Expenses on provision of processing services	1,669	**—**
Shandong Weiqiao Dyeing and Weaving Co., Ltd.	A fellow subsidiary	Sale of cotton yarns	99,324	**107,325**
		Sale of grey fabrics and denims	70,377	**—**
		Purchase of corduroy	11,169	**34,227**
		Expenses on provision of processing services	129	**2,997**
Shandong Weilian Printing and Dyeing Co., Ltd.	A fellow subsidiary	Sale of grey fabrics	15,425	**96,012**
		Expenses on provision of processing services	3,186	**8,242**
		Purchase of coloured fabrics	881	**15,172**
Shandong Weiqiao Bleaching-Dyeing Co.,Ltd.	An associate of Holding Company	Sale of cotton yarns	4,047	**6,105**
Binzhou Industrial Park	A fellow subsidiary (before becoming a subsidiary of the Company in November 2002)	Sale of lint cotton and tailings	21,938	**—**
		Purchase of cotton yarns and grey fabrics	25,321	**—**
		Purchase of tailings	1,121	**—**
Binzhou Weiqiao	A fellow subsidiary	Sale of lint cotton and tailings	41,539	**—**
		Sale of cotton yarns and grey fabrics	26,563	**—**
		Sale of ancillary materials and spare parts	1,793	**—**
		Purchase of cotton yarns and grey fabrics	156,210	**—**
		Purchase of lint cotton and tailings	3,740	**—**
		Purchase of ancillary materials and spare parts	2,731	**—**
		Purchase of fixed assets	—	**16,799**

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36. RELATED PARTY TRANSACTIONS (continued)

Name of related parties	Relationship with the Company	Nature of transactions	2002 RMB'000	2003 RMB'000
No. 1 Oil and Cotton Co., Ltd	A fellow subsidiary of Holding Company	Purchase of lint cotton	5,570	374
No. 2 Oil and Cotton Co., Ltd	A fellow subsidiary of Holding Company	Purchase of lint cotton	3,226	2,251
No. 6 Oil and Cotton Co., Ltd	A fellow subsidiary of Holding Company	Purchase of lint cotton	30,401	12,307
Zouping Fuhai Oil Industrial Co., Ltd	A fellow subsidiary of Holding Company	Purchase of lint cotton	17,803	299
Pozhuang Cotton Co., Ltd.	A fellow subsidiary of Holding Company	Purchase of lint cotton	12,925	5,147
Zouping Cotton and Hemp Fibre Co., Ltd.	A fellow subsidiary of Holding Company	Purchase of lint cotton	18,249	627
Zouping Cotton and Hemp Fibre Co.	A fellow subsidiary of Holding Company	Purchase of lint cotton	5,164	—

In addition to the above, Holding Company transferred to the Group all rights and benefits to all of its cotton processing equipment at nil consideration in 2003.

In the opinion of the directors, the above transactions were conducted in the usual course of business.

Pursuant to an agreement entered into between the Company and Holding Company dated 10 May 2000 and a supplementary agreement dated 1 July 2002, commencing from 1 January 2002, Holding Company provided electricity and steam to the Company at a billing rate of RMB0.35/kwh and RMB60/ton, respectively. Each of Binzhou Industrial park and Luteng Textile entered into an agreement with Holding Company on 1 September 2002. Pursuant to the agreements, Holding Company provided electricity and steam to these two companies at a billing rate of RMB0.35/kwh and RMB60/ton, respectively, commencing from 1 September 2002.

In connection with the Reorganisation, the above agreements were terminated on 25 August 2003 and on the same date, the Company and Holding Company entered into a supply of electricity and steam agreement. Pursuant to the agreement, Holding Company agreed to supply electricity and steam to the Group at a rate of the lower of the market price and RMB0.35/kwh for electricity, and at a rate of the lower of the market price and RMB60/ton for steam.

Also, in connection with the Reorganisation, on 25 August 2003, the Company entered into several agreements with Holding Company and its subsidiaries other than the companies now comprising the Group (collectively, the "Holding Group") which govern the supply of cotton by Holding Company, the supply of cotton yarns and grey fabrics to and the provision of processing services by the Holding Group.

Up to 31 December 2003, the Group has entered into nine property lease agreements with Holding Company, with a right of renewal exercisable by the Group. The significant terms of such agreements are summarized as follows:

(i) Land use rights lease agreement dated 27 December 2000 with the commencement date and expiry date on 27 December 2000 and 27 December 2020, respectively, at an annual rental expense of RMB454,900 for the land relating to the First Production Area.

(ii) Land use rights lease agreement dated 10 May 2001 with the commencement date and expiry date on 10 May 2001 and 10 May 2021, respectively, at an annual rental expense of RMB868,000 for the land relating to the First Production Area.

36. RELATED PARTY TRANSACTIONS (continued)

(iii) Land use rights lease agreement dated 30 September 2002 with the commencement date and expiry date on 30 September 2002 and 30 September 2022, respectively, at an annual rental expense of RMB888,700 for the land relating to the Second Production Area.

(iv) Land use rights lease agreement dated 14 May 2003 with the commencement date and expiry date on 14 May 2003 and 14 May 2023, respectively, at an annual rental expense of RMB1,503,000 for the land relating to the Third Production Area.

(v) Land use rights lease agreement dated 13 September 2002 with the commencement date and expiry date on 13 September 2002 and 13 September 2022, respectively, at an annual rental expense of RMB60,700 for the land relating to the Second Production Area.

(vi) Operating lease agreement for a building dated 10 May 2000 with the commencement date and expiry date on 10 May 2000 and 10 May 2006, respectively, at an annual rental expense of RMB600,000 for a building located at No. 34 Qidong Road, Weiqiao Town, Zouping County, Shandong Province, the PRC.

(vii) Land use rights lease agreement dated 17 October 2003 with the commencement date and expiry date on 17 October 2003 and 17 October 2023, respectively, at an annual rental expense of RMB2,167,000 for the land relating to the Zouping Industrial Park Area, a new production area established during the year.

(viii) Land use rights lease agreement dated 17 October 2003 with the commencement date and expiry date on 17 October 2003 and 17 October 2023, respectively, at an annual rental expense of RMB994,100 for the land relating to the Zouping Industrial Park Area.

(ix) Land use rights lease agreement dated 17 October 2003 with the commencement date and expiry date on 17 October 2003 and 17 October 2023, respectively, at an annual rental expense of RMB2,000,000 for the land relating to the Zouping Industrial Park Area.

In addition, during the year ended 31 December 2003, the Group received bills receivable aggregating approximately RMB76 million (2002: RMB1,363 million) from Holding Company. All of the bills were discounted with banks, none of which remained outstanding with recourse as at 31 December 2003 (note 34). According to the arrangement with Holding Company, discounting charges were borne by Holding Company. During the year ended 31 December 2003, discounting charges of approximately RMB1 million (2002: RMB21 million) were borne by Holding Company.

During the year ended 31 December 2003, the Group issued bills payable aggregating approximately RMB617 million (2002: RMB578 million) to the subsidiaries (including Holding Company) of ZCSU (the “ZCSU Group”). All of the bills were discounted with banks and the related discounting charges were borne by the ZCSU Group.

37. POST BALANCE SHEET EVENT

In January 2004, the Company established a subsidiary, Weihai Weiqiao Industrial Park Company Limited (“Weihai Industrial Park”) with a registered capital of RMB260,000,000. Weihai Industrial Park is owned as to 99.8% and 0.2% by the Company and Mr. Liu Guangmin, an independent third party, respectively.

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38. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors of the Company on 27 February 2004.