



## Business Review and Prospects

Financial figures, where applicable, contained herein have been extracted from the financial statements prepared in accordance with the IFRS.

In 2003, the Group made considerable efforts and progress in its operations and reforms to overcome all the negative factors and grasped the opportunities during the recovery of polyester industry in the second half of 2003, and achieved the best operating results in the recent three years. In 2003, the Group achieved consolidated profit attributable to shareholders of Rmb259,131,000. Of which, Yizheng Chemical Fibre Foshan Polyester Company Limited (“**Foshan Polyester**”) and Foshan Chemical Fibre Company Limited (“**Foshan Chemical**”) (collectively “**Foshan Group**”) sustained a loss of Rmb8,947,000 as a result of the payment of employee reduction expenses of Rmb13,970,000 during the year, while Yihua Kangqi Chemical Fibre Company Limited (“**Kangqi Company**”) and its subsidiaries (“**Kangqi Group**”) made a profit of Rmb13,503,000.

### 1. Market Review

In 2003, the global economy gradually recovered, and the PRC economy continued to maintain a rapid growth, with the GDP growth rate of 9.1 per cent. The per capita GDP in the PRC exceeded US\$1,000. The average income of urban and rural residents generally increased. The export growth of the PRC textile products and clothes increased rapidly, and the export volume reached US\$80.48 billion, an increase of 27.7 per cent as compared with last year. Of which, the export volume of chemical fibre textile products and clothes reached US\$27.90 billion, an increase of 32.1 per cent as compared with last year. In respect of the domestic needs, total domestic resident consumption on clothes increased by 9.2 per cent as compared with last year, while the consumption of household and industrial textile products significantly increased by 10 per cent and 13 per cent respectively.

In 2003, total domestic supply of polyester products grew rapidly in pace with the total consumption of polyester products. The total polyester production capacity increased by 3,000,000 tonnes during the year. Total domestic supply of polyester fibre amounted to 10,326,300 tonnes, an increase of 16.0 per cent as compared with last year, of which, the domestic production volume increased by 18.3 per cent and the import volume increased by 6.4 per cent as compared with last year. Meanwhile, as a result of the increase of 14.3 per cent in the domestic textile fibre processing volume, the total domestic consumption of polyester fibre increased to 9,959,500 tonnes, an increase of 15.9 per cent as compared with last year.

#### Domestic supply and demand of polyester fibre

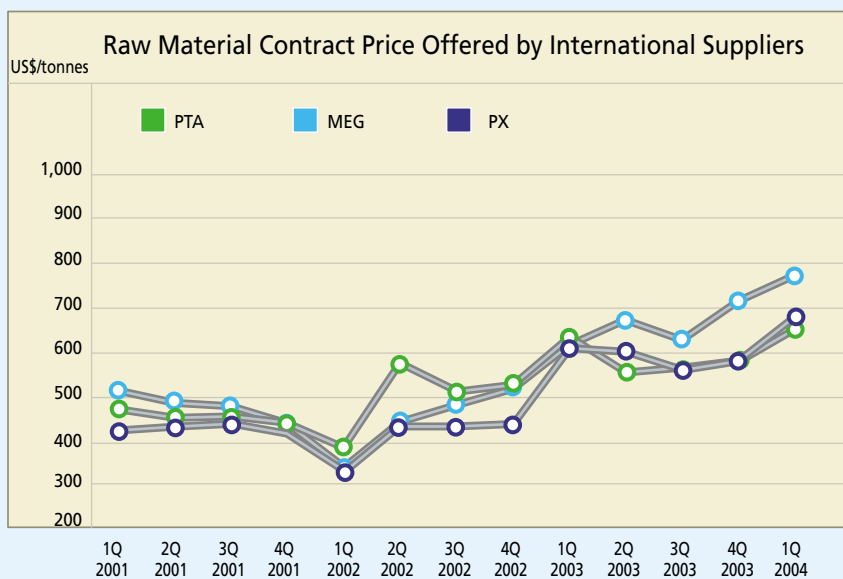
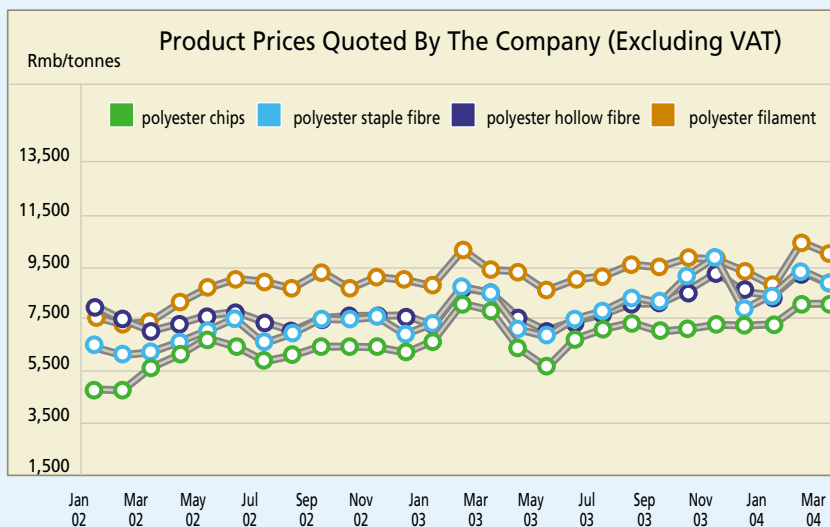
	Polyester filament			Polyester staple fibre			Polyester fibre		
	2003 '000 tonnes	2002 '000 tonnes	+/- (%)	2003 '000 tonnes	2002 '000 tonnes	+/- (%)	2003 '000 tonnes	2002 '000 tonnes	+/- (%)
Production	<b>5,642.2</b>	4,770.4	18.3	<b>3,491.3</b>	2,951.2	18.3	<b>9,133.5</b>	7,721.6	18.3
Import	<b>407.7</b>	325.6	25.2	<b>577.1</b>	600.2	-3.8	<b>984.8</b>	925.8	6.4
Export	<b>43.6</b>	29.4	48.3	<b>115.9</b>	71.6	61.9	<b>159.5</b>	101.0	57.9
Net import	<b>364.1</b>	296.2	22.9	<b>461.2</b>	528.6	-12.8	<b>825.3</b>	824.8	0.1
Inventories at the beginning of the year	<b>131.6</b>	187.0	-29.6	<b>76.4</b>	69.0	10.7	<b>208.0</b>	256.0	-18.8
Inventories at the end of the year	<b>145.5</b>	131.6	10.6	<b>61.8</b>	76.4	-19.1	<b>207.3</b>	208.0	-0.3
Total supply	<b>6,181.5</b>	5,283.0	17.0	<b>4,144.8</b>	3,620.4	14.5	<b>10,326.3</b>	8,903.4	16.0
Total consumption	<b>5,992.4</b>	5,122.0	17.0	<b>3,967.1</b>	3,472.4	14.2	<b>9,959.5</b>	8,594.4	15.9

Source: The Chemical Fibre Association of China



## Business Review and Prospects

In the first half of 2003, due to the war in Iraq and the outbreak of SARS, the prices of domestic polyester products and principal polyester raw materials fluctuated significantly, which added a lot of difficulties to the polyester production operations. Starting from June, as a result of the high prices of principal raw materials such as PTA, MEG and PX, the commencement of the peak season for downstream textile industry, and the resurgence in the demand for textile products, the prices of polyester products increased steadily. From October onwards, owing to a sharp rise in cotton price, the prices of polyester fibre, especially for polyester staple fibre, increased significantly. The average price of polyester product (excluding VAT) of the Group increased by 16.5 per cent as compared with last year, while the weighted average purchase prices of principal purchased raw materials of the Group, such as PTA, MEG, and PX, increased by 29.2 per cent as compared with last year.





## Business Review and Prospects

### 2. Production operational review

#### (1) Production and Marketing

In 2003, the Group took great efforts to maintain a stable and safe production so as to increase the production volume and sales. On-site management in terms of safety, quality, techniques and facilities were strengthened. Out of the Group's 128 main technological and economic indicators, there were 84 indicators reaching the record high. The total production volume of polyester products amounted to 1,498,762 tonnes, an increase of 5.2 per cent as compared with 1,424,899 tonnes in 2002. The capacity utilization rate reached 102.0 per cent. The total production volume of PTA amounted to 719,828 tonnes, an increase of 110.2 per cent as compared with 342,474 tonnes in 2002. The Group closely followed the market trends, persisted in selling all the products produced, and sold at the optimal prices during the period. Based on good pre-sales work done before the new product launch, the products were quickly launched to the market successfully. The Group's total sales volume of polyester products amounted to 1,205,140 tonnes in 2003, an increase of 4.8 per cent as compared with 1,149,533 tonnes in 2002. Excluding self-consumption volume and other factors, the ratio of sales to production reached 99.9 per cent. A total of 35,767 tonnes of polyester products were exported for the year.

#### (2) Cost control

The year 2003 was the first year for the Group to implement the three-year low cost strategy. The Group put great efforts in reducing costs internally. Overall budget management was implemented to strengthen controls over costs and expenses in the production processes. As a result, the overall energy consumption per unit decreased by 3.7 per cent as compared with last year. Measures were implemented to increase production and sales volume so as to reduce the fixed cost. The unit processing cost was further reduced. Due to the enhanced centralized management of materials purchase, the related risks were prevented. The turnover days of raw materials is 3 days less than that of last year. Due to the increase in R&D expenses and reduced level of the interest capitalisation on long-term loans, the Group's administrative expenses and financial expenses increased by 29.7 per cent and 59.7 per cent respectively as compared with last year. Due to the enhancement of internal management, selling expenses decreased by 0.2 per cent as compared with last year. The proportion of SG&A expenses to turnover decreased slightly.

#### (3) R&D

In 2003, the Group made new achievements in its product and technological development. The profit contributions from differential and specialized products increased further. A total of 14 kinds of new polyester products were developed, of which 12 kinds of new products were launched. A total of 22 kinds of new products were applied for patent, of which 6 patent rights have been obtained. The differential and specialized products, such as film-grade polyester chip, the bottle-grade specialized polyester chips for edible oil, P170/192 – D110/192 polyester filament, polyester filament for automobile decoration and anti-water polyester staple fibre, have been put into production. In particular, the total sales volume of 1.33dtex x 38mm full bright sewing thread type polyester staple fibre, which was in full year operation last year, amounted to 54,000 tonnes. Some positive results were achieved in the development of moisture and perspiration absorbing fibre, spun-laced polyester staple fibre and polylactide ("PLA") fibre. In 2003, the Company's total production volume of specialized polyester chips amounted to 312,000 tonnes and the specialization rate was 62.8 per cent, 6.5 per cent higher than that of last year. The total production volume of differential polyester fibre amounted to 287,000 tonnes and the differential rate of polyester fibre was 45.0 per cent, 4.1 per cent higher than that of last year.



## Business Review and Prospects

### (4) Internal management

In 2003, the Group carried out management innovation persistently, and accelerated internal reforms. The ERP project, which began its single run in July 2003, integrated logistics, cash flow and information flow of the Company. In 2003, the Company received an international certificate of ISO14001 in respect of its environmental management system, and was nominated the National Quality Award and awarded National Quality Management Advanced Enterprise. The Company formulated and had a trial run on its new internal control system, which covers the Group's production and operational cycle and key business sectors. The second phase of the reform on the supply system was implemented, and the centralized management function of the supply system was established. Greater efforts were made to reduce the staff number. The Group entered into voluntary resignation contracts with 912 employees during the year.

### (5) Capital expenditure

In 2003, the Group's structural adjustment projects were completed and in operation consecutively. All these projects rapidly reached the designed requirements and brought profit contributions to the Group. The total capital expenditure paid amounted to Rmb931,308,000. The PTA project with an annual capacity of 450,000 tonnes, the staple fibre project with an annual capacity of 90,000 tonnes, and the improvement project of No. 5K production line were completed and in operation in April, July, July and the specialization polyester chip project with a daily capacity of 450 tonnes was completed and under trial run in October respectively. The CP and SSP projects with an annual capacity of 200,000 tonnes were carried out smoothly at the end of 2003.

## 3. Business prospects and arrangement

### (1) Market Analysis

According to the 2004 market analysis, the Group considers: Firstly, the global economy has been recovering at a faster pace with continuous increase in the international trade. The price of international crude oil is expected to remain high, and the global petrochemical industry is in the upswing of the business cycle. The outlook for the PRC's economy is promising, with the ability to maintain an annual GDP growth rate of 7 per cent or above. There will be continuous high demand for both petrochemical and polyester products, which will stimulate a continuous increase in demand for the polyester and textile industry. Secondly, the PRC Government will continue to strengthen macro-economic controls over the polyester industry, measures will be taken to reduce bank credit and to implement a strict approval process concerning land and environment. In addition, the domestic supply of electricity and transportation will become tight, which will restrain the increase in the production capacity of polyester industry. With the polyester industry's initiatives on technical improvement, structural adjustment and product upgrade, the competitive environment is expected to improve, and there is a very good prospect and development room for product differentiation, specialization and non-fibre polyester products. At the same time, with the quick development of the domestic polyester industry, the problem of shortages in polyester raw materials such as PX, MEG and PTA in the PRC is becoming more acute, which may become an important bottle-neck to the operations and development of polyester business in 2004. In addition, with the rise in the prices of textile raw materials such as cotton, the decrease in the VAT rebates of textile export and the intensified international trade wars and protectionism, there will be more uncertainties for the development of the downstream textile industry, which in turn may affect the demand for and the price of polyester products.



## Business Review and Prospects

Since 1 January 2004, the PRC import tariffs on PTA, MEG and PX have been lowered to 7 per cent, 5.5 per cent and 3 per cent respectively. Also, the PRC import tariffs on polyester chip, polyester staple fibre and polyester filament have been lowered to 10.7 per cent, 5 per cent and 8 per cent respectively. Since 1 January 2004, the PRC's VAT rebates of textile export have been lowered about 4 per cent. In December 2003, the USA Government imposed a 7.5 per cent quota on three types of textile products from the PRC, and it will remain effective for one more year.

On the whole, the Group will face a more favorable operating environment in 2004. It is expected that the prices of polyester products will, on the whole, remain high in 2004 as a result of the increase in demand and polyester raw material prices. Meanwhile, the prices of principal polyester raw materials such as PTA, MEG and PX will continue to stay at a high level because of the high crude oil price and the relatively limited resources, which will pose some pressure to the operation of the Group.

### (2) Business strategy

In 2004, by grasping the favorable business opportunities following the recovery in the polyester industry, taking advantages in its economies of scale and its leading position in technology, the Group will push reform ahead, and take greater measures to increase production and sales and lower costs so as to improve profitability and investment returns. The planned production volume of polyester products is 1,631,000 tonnes, of which, the planned self-consumption volume amounting to 321,000 tonnes. The planned sales volume of polyester products is 1,310,000 tonnes, achieving sales to production ratio of 100 per cent. The planned production of PTA is 876,000 tonnes and 13 new products are planned to be developed for the year. In view of the larger production volume, the Company plans to produce 305,000 tonnes of differential polyester fibre and 345,000 tonnes of specialisation polyester chip, and to realize a differential rate of 46.4 per cent in its polyester fibre and a specialisation rate of 61.0 per cent in its polyester chip.

In 2004, the Group will strive to perform well in the following areas:

#### ***I. Stay close to the market and strengthen operational management to maximise profits***

In 2004, the Group will adhere to its principle of "negative relevance for raw materials and positive relevance for products", and persist in matching supply with production and sales. In light of the new situation in the supply of polyester raw materials, the Group will remain alert to the issues in both domestic and foreign markets, and make meticulous efforts to organize resources so as to ensure a stable supply of raw materials. The Group will closely follow the market trends, maintain a balance between production and sales in order to sell at optimal prices. Emphasis will be put on the sales of differential and specialisation products so as to increase their sales volume and profit contributions. The Group will continue to preserve an optimum combination of domestic sales and export, and make great efforts to explore the overseas market. The Group will also speed up the process of implementing the brand name strategy, strengthening the customer relationship management.



## Business Review and Prospects

### **II. Increase and stabilise production and achieve new technological and economic targets**

In 2004, the Group will continue to strengthen safety and environment management, and further enhance its safety responsibility system. Efforts will be put to optimize the operation of key facilities to reduce unplanned cessation of production. The Group will further improve the work on ISO14001 environment management system, speed up the construction of Healthy, Safety and Environmental ("HSE") system to ensure being certified in September, and further integrate ISO9001, ISO14001 and HSE management to strengthen safety, health and environment management. The Group will take great efforts to achieve new technological and economic targets and record the best level. Efforts will also be put into the safe and stable operation of the PTA project with an annual capacity of 450,000 tonnes and the staple fibre project with an annual capacity of 90,000 tonnes, and the specialization polyester chip project with a daily capacity of 450 tonnes. The Group also plans to produce additional output of 180,000 tonnes of PTA, 57,000 tonnes of polyester staple fibre and 140,000 tonnes of specialised polyester chips. The Group will continue to strengthen the product quality management through the launch of "customer satisfaction" program, promote the combination of production, marketing and customer services, implement 6σ management and carry out quality cost activity in the main plants.

### **III. Improve mechanism, increase investment and further promote product development and technological innovation.**

In 2004, the Group will take great efforts in product technological innovation. Firstly, the Group will improve mechanism and system, integrate R&D resources and enrich the team of product technology innovation. Secondly, the Group will make distinct development targets, put out innovation plan and implementation measures and increase investment so as to support the "low cost strategy and high value-added strategy". In 2004, the Group will develop 8 kinds of new products put forward in 2004, 5 kinds of products brought forward from last year and launch 13 kinds of products. Emphasis will be put on the development of film-grade chips, and moisture and perspiration absorbing fibre. The Group also plans to complete the technology improvement project of the SSP project with an annual capacity of 100,000 tonnes and its supporting equipment, and the processing technology on the spinning facility with a daily capacity of 150 tonnes. Moreover, the development of the processing technologies and appraisal systems on film-grade chips, moisturise and perspiration absorbing fibre and sea island filament yarn for fabric will be finished. The Group will continue to promote the technological development of PLA, high strength aramid fibre, polyester chips for beer bottle, and polyester chips for engineering plastic. Finally, the Group will also pay special attention to product contribution, continue to develop and identify know-how technologies so as to form a healthy cycle.

### **IV. Strive to reduce costs and expenses and improve profits**

In 2004, the Group will continue to adopt the low cost strategy to lower costs and expenses further. Measures will be taken to enhance the overall budget management. With the improvement and upgrade in the ERP system, the Group will further improve its cost analysis system. The financial management will be reinforced to ensure efficient use of funds and lower financial expenses accordingly. Investment management and financial audit will also be strengthened. The Group will strengthen the market analysis of polyester raw materials and the pricing negotiation ability to lower the procurement cost. Following the reform in the supply chain management system and the adoption of centralised purchasing, centralised reserves and centralised settlements, the Group will speed up the fund flow and lower the costs.



## Business Review and Prospects

**V. *Focus on projects under construction and start the subsequent projects to increase competitive ability***

The CP and SSP project with an annual capacity of 200,000 tonnes is expected to be completed and commence operations in November 2004. Meticulous measures will be taken to implement the technological improvement project to increase the capacity of the PTA project with an annual capacity of 450,000 tonnes to 600,000 tonnes per year in the third quarter of 2004. The Group will also start the specialization of polyester chips project with an annual capacity of 160,000 tonnes and the staple fibre project with an annual capacity of 100,000 tonnes as soon as possible. Currently, the Group is drafting the projects for the "Eleventh Five-Year Plan" (2006-2010) and future outline for 2020.

**VI. *Promote the separation of core business from the non-core businesses***

In 2004, the Group will advocate the separation of core and non-core businesses, make plan for restructuring of the transportation and maintenance departments. The Group will put equal focus on reform and adjustment, actively promoting the cooperation with big foreign companies and excellent domestic privately-owned companies in the form of joint ventures. In response to the annual economic responsibility assessment, the remuneration policy system will be enhanced and the key factors of performance appraisal will be carefully observed in order to improve efficiency per worker. The Group will fasten the pace of reform in employment, and remuneration system, continue to downsize the staff number, and lay down medium to long-term human resources plan.