



## Management Discussion and Analysis

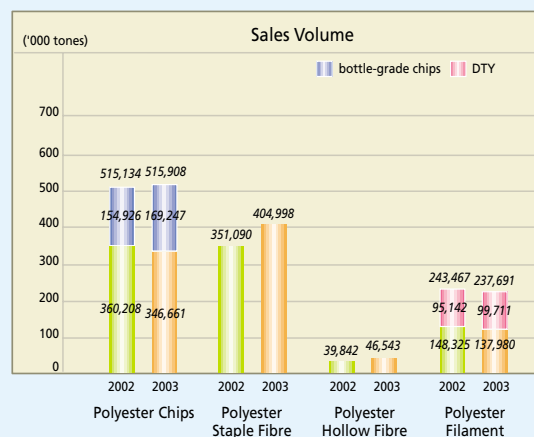
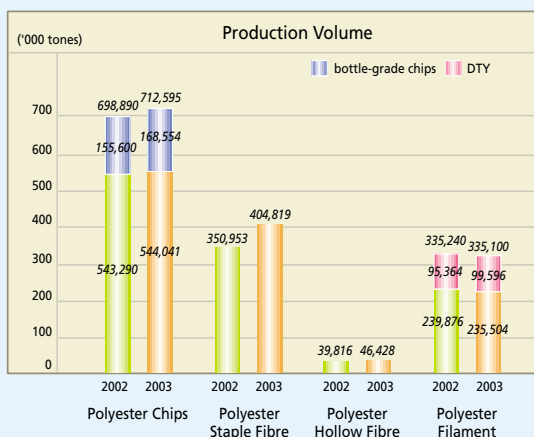


Mr. Xu Zheng-ning, Managing Director

The information set out below does not constitute part of the financial statements audited by KPMG or KPMG Huazhen, as set out on pages 59 to 91 and pages 92 to 132, respectively, of this Annual Report, and is included for information purpose. This discussion and analysis should be read in conjunction with the information contained in the Consolidated Financial Statements and Notes thereto (the "Financial Statements") presented in this Annual Report. Financial figures, where applicable, except for specifically noted, contained herein have been extracted from the financial statements prepared in accordance with the IFRS.

### 1. Results of Operations

In 2003, by overcoming the negative impacts from the war in Iraq and SARS and grasping the opportunities during the recovery of polyester industry in the second half of 2003, the Group took great efforts to increase production volume and sales volume and further reduced costs and expenses. As a result, the Group's consolidated turnover exceeded Rmb10 billion in its history and the Group achieved the best operating results in the recent three years.





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### (1) Turnover

In 2003, the Group's total production volume of polyester products increased to 1,498,762 tonnes, representing an increase of 5.2 per cent as compared with that of 1,424,899 tonnes for last year. Of which, the total production volumes of bottle-grade polyester chips, polyester staple fibre and polyester hollow fibre increased by 8.3 per cent, 15.4 per cent and 16.2 per cent respectively. Increase was mainly due to the SSP project with an annual capacity of 100,000 tonnes completed in February 2002 achieving full operation in 2003 and the commencement of operation of its other structural improvement and expansion projects, such as the staple fibre project with an annual capacity of 90,000 tonnes and improvement project of No.5K production line. Owing to its efforts in its product structure adjustment, the total production volumes of differential and specialized products increased, while the proportion of fibre-grade polyester chips and polyester filament to total products decreased. The average capacity utilization rate reached 102.0 per cent (2002: 101.5 per cent). The total production volume of PTA amounted to 719,828 tonnes, an increase of 110.2 per cent as compared with that of 342,474 tonnes of last year. Increase was mainly due to the commencement of operation of the PTA project with an annual capacity of 450,000 tonnes.

### Production volume

	For the year ended 31 December			
	2003	Per cent of total production volume (%)	2002	Per cent of total production volume (%)
	Production volume (tonnes)		Production volume (tonnes)	
Polyester products				
Chips	712,595	47.5	698,890	49.0
Of which: bottle-grade polyester chips	168,554	11.2	155,600	10.9
Staple fibre	404,819	27.0	350,953	24.6
Hollow fibre	46,248	3.1	39,816	2.8
Filament	335,100	22.4	335,240	23.6
Of which: draw-twisted yarn ("DTY")	99,596	6.6	95,364	6.7
Total	<u>1,498,762</u>	<u>100.0</u>	<u>1,424,899</u>	<u>100.0</u>

In 2003, due to the increase in production volume and the sales promotion efforts, the Group's total sales volume of the polyester products amounted to 1,205,140 tonnes, representing an increase of 4.8 per cent from 1,149,533 tonnes of 2002. Owing to its efforts in sales promotion of differential and specialized products, the total sales volumes of bottle-grade polyester chips, polyester staple fibre and polyester hollow fibre increased by 9.2 per cent, 15.4 per cent and 16.8 per cent respectively. Export sales of the polyester products amounted to 35,767 tonnes. The ratio of sales to production reached 99.9 per cent. Due to the recognition of high quality and excellent sales services, the selling prices of the Group's products remained high in the domestic market during the year. Due to the impact from SARS in April and May 2003, the prices of polyester products declined to a record low. But owing to the recovery of polyester industry in the second half of 2003, the weighted average prices (excluding VAT) of the Group's polyester products increased from Rmb6,882/tonne to Rmb8,017/tonne, representing a 16.5 per cent increase.



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### Sales volume

	For the year ended 31 December			
	2003		2002	
	Sales volume (tonnes)	Per cent of total sales volume (%)	Sales volume (tonnes)	Per cent of total sales volume (%)
Polyester products				
Polyester chips	<b>515,908</b>	<b>42.8</b>	515,134	44.8
Of which: bottle-grade polyester chips	<b>169,247</b>	<b>14.0</b>	154,926	13.5
Staple fibre	<b>404,998</b>	<b>33.6</b>	351,090	30.5
Hollow fibre	<b>46,543</b>	<b>3.9</b>	39,842	3.5
Filament	<b>237,691</b>	<b>19.7</b>	243,467	21.2
Of which: DTY	<b>99,711</b>	<b>8.3</b>	95,142	8.3
Total	<b><u>1,205,140</u></b>	<b><u>100.0</u></b>	<b><u>1,149,533</u></b>	<b><u>100</u></b>

### Average Prices for products (excluding VAT) (Rmb/tonnes)

	For the year ended 31 December		
	2003	2002	Change (%)
Polyester products			
Polyester chips	<b>7,081</b>	6,036	17.3
Staple fibre	<b>8,172</b>	6,938	17.8
Hollow fibre	<b>8,269</b>	7,556	9.4
Filament	<b>9,737</b>	8,479	14.8
Weighted average price	<b><u>8,017</u></b>	<b><u>6,882</u></b>	<b><u>16.5</u></b>

### Turnover

	For the year ended 31 December			
	2003		2002	
	Turnover Rmb million	Per cent of turnover %	Turnover Rmb million	Per cent of turnover %
Polyester products				
Polyester chips	<b>3,653</b>	<b>35.3</b>	3,109	38.8
Staple fibre	<b>3,310</b>	<b>32.0</b>	2,436	30.4
Hollow fibre	<b>385</b>	<b>3.7</b>	301	3.8
Filament	<b>2,314</b>	<b>22.4</b>	2,065	25.8
Others	<b>682</b>	<b>6.6</b>	99	1.2
Total	<b><u>10,344</u></b>	<b><u>100.0</u></b>	<b><u>8,010</u></b>	<b><u>100.0</u></b>



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In 2003, the Group's turnover amounted to Rmb10,344 million, representing an increase of 29.1 per cent as compared with Rmb8,010 million for last year. The increase was mainly due to the combined efforts of the increase in the product prices and sales volume and the change in sales mix.

The Group continued to hold the leading market share in the PRC.

### (2) Cost of sales

In 2003, the Group's cost of sales amounted to Rmb9,320 million, representing 90.1 per cent of the turnover, which decreased by 1.1 per cent as compared with last year. Total costs of raw materials increased by Rmb1,836 million from Rmb5,636 million in 2002 to Rmb7,472 million, which accounted for 80.2 per cent of cost of sales in 2003. The increase was mainly due to the increase in raw materials procurement and the increase in raw material price led by the relatively limited supply. The Group's weighted average purchase price of polyester raw materials increased by 29.2 per cent as compared with last year. Of which, the average purchase costs of PTA, MEG and PX increased by 15.2 per cent, 48.8 per cent and 45.2 per cent respectively as compared with last year. In light of the increase in the price of PTA, the Group increased the production volume of PTA and therefore reduced the purchase volume in 2003, which significantly lowered cost and maximized gross margin for the Group. In addition, the Group took great measures to organize a stable and full operation to increase output and sales and lower cost, and exercised timely and appropriate production of PTA and increased the sales volume of electricity, which helped the Group in achieving a substantial savings in cost of sales.

In 2003, the Group took great measures to lower cost and expenses, which reduced the negative impact of the external factors on the Group. Therefore, the Group's gross profit increased by Rmb319 million as compared with last year, and the gross margin was 9.9 per cent, 1.1 per cent higher than last year (2002: 8.8 per cent). In particular, the Group's gross margin in the second half of 2003 amounted to 13.1 per cent.

### (3) Selling, administrative and financial expenses

	For the year ended 31 December		
	2003 Rmb'000	2002 Rmb'000	Change (%)
Selling expenses	167,269	167,646	(0.2)
Administrative expenses	447,694	345,309	29.7
Financial expenses	54,873	34,360	59.7
Total	<u>669,836</u>	<u>547,315</u>	<u>22.4</u>

In 2003, selling expenses decreased by Rmb0.4 million, mainly due to the effective internal expense control efforts. Administrative expenses increased by Rmb102 million, mainly due to the increase in R&D expense and the additional depreciation expense on the ERP project. Financial expenses increased by Rmb21 million, mainly due to the reduced capitalisation of interest expenses as a result of the completion of the PTA project with an annual capacity of 450,000 tonnes. The total of these three types of expenses increased by 22.4 per cent as compared with last year. The proportion of SG&A expenses to turnover decreased slightly.



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### (4) Profit from operations, profit before taxation, profit attributable to shareholders

	For the year ended 31 December		
	2003 Rmb'000	2002 Rmb'000	Change (%)
Profit from operations	368,271	191,105	92.7
Profit from ordinary activities before taxation	313,398	156,745	99.9
Income tax expense	48,652	7,156	579.9
Profit attributable to shareholders	259,131	144,321	79.6
Earnings per share (in Rmb)	0.065	0.036	79.6

In 2003, the Group's profit from operations and profit from ordinary activities before taxation amounted to Rmb368 million and Rmb313 million respectively, increased by 92.7 per cent and 99.9 per cent respectively as compared with Rmb191 million and Rmb157 million in 2002. It was mainly due to the combined effects of the Group's efforts in grasping the opportunities during the recovery of polyester industry in the second half of 2003, the contribution from new projects completed in 2003 and internal efforts in reducing costs. Profit attributable to shareholders was Rmb259 million, an increase of 79.6 per cent as compared with Rmb144 million last year. The operating profit margin and net profit margin reached 3.6 per cent and 2.5 per cent respectively, representing 1.2 per cent and 0.7 per cent higher than those of last year respectively.

### (5) Statement of the principal operations by products

Polyester products contributed more than 10 per cent of the Group's income from principal operations and profit from principal operations. The following is the statement of principal operations by products for the year ended 31 December 2003 in accordance with the PRC Accounting Rules and Regulations.

Products	Income from principal operations Rmb'000	Cost of principal operations Rmb'000	Gross profit margin (%)	Increase/ (decrease) in income from principal operations as compared to last year (%)	Increase/ (decrease) in cost of principal operations as compared to last year (%)	Gross margin ratio as compared to last year (%)
Polyester products	9,661,964	8,707,405	9.9	22.1	21.4	Increased by 0.5 point
Of which:						
connected transactions	931,214	835,174	10.3	28.0	21.5	Increased by 1.7 point

### (6) Operations of principal subsidiaries in 2003

1. Foshan Group. The Company directly holds 100 per cent of the equity interest of Foshan Chemical. Foshan Chemical's registered capital is Rmb32,933,000. Its principal activity is the provision of management and administration services. The Company directly holds 59 per cent and indirectly holds 41 per cent of the equity interest of Foshan Polyester. Foshan Polyester's registered capital is US\$85,427,000. Its principal activities are the production and



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sales of chemical, chemical fibre, textile and its ancillary raw materials, and after sales services for its products. As at 31 December 2003, the total assets of Foshan Group was Rmb853,439,000. For the year ended 31 December 2003, Foshan Group made a loss of Rmb8,947,000 as a result of the repayment of employee reduction expenses of Rmb13,970,000.

2. Kangqi Group. The Company directly holds 95 per cent and indirectly holds 5 per cent of the equity interest of Kangqi Company. Kangqi Company's registered capital is Rmb60,000,000. Its principal activities are production and operation of polyester fibre business. Kangqi Company, through its 13 subsidiaries in major domestic markets, has established a sales network in the PRC. As at 31 December 2003, the total assets of Kangqi Group was Rmb382,185,000. For the year ended 31 December 2003, Kangqi Group made a net profit of Rmb13,503,000.

### (7) Acquisition, divestment and investment

The Group did not make any material acquisition, divestment and investment in relation to any of its subsidiaries or associates in 2003.

## 2. Financial Analysis

The Group has adopted prudent financial policies, and a risk management control system has been set up in respect of investment, financing and cash management. As a result, a solid and healthy capital structure has been maintained. The Group also adjusted its financial policies in respect of investment, financing and capital structure in response to changes in the external environment, and its internal resource capability, so as to realize sustainable development and maximize shareholders value.

### (1) Current assets and financial resources

	<b>2003</b> <b>Rmb'000</b>	2002 <i>Rmb'000</i>
Net cash flow from operating activities	<b>1,227,703</b>	1,386,258
Net cash flow from investing activities	<b>(863,480)</b>	(1,414,677)
Net cash flow from financing activities	<b>(291,266)</b>	74,046
Net increase in cash and cash equivalents	<b>72,957</b>	45,627
Cash and cash equivalents at the beginning of the year	<b>490,804</b>	445,177
Cash and cash equivalents at the end of the year	<b>563,761</b>	490,804

As at 31 December 2003, the Group's cash and cash equivalents amounted to Rmb564 million, representing an increase of Rmb73 million as compared with Rmb491 million as at 31 December 2002. In 2003, the Group's net cash inflow from operating activities was Rmb1,228 million. In 2003, the Group's net cash flow from investing activities mainly included Rmb931 million of capital expenditure, and the Group's net cash flow from financing activities mainly included Rmb6,184 million of repaying bank loans and Rmb5,957 million of new increasing bank loans respectively. Due to the reasons above, the Group's gearing ratio (the ratio of total liabilities attributable to shareholders equity at the balance sheet date) decreased from 36.3 per cent at 31 December 2002 to 32.3 per cent at 31 December 2003.



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As at 31 December 2003, the Group's bank loans amounted to Rmb1,159 million, as compared with that of Rmb1,386 million in 2002. The decrease was due to the appropriate decrease in short-term loans. Among those bank loans, short-term loans due in 2004 amounted to Rmb719 million, and long-term loans amounted to Rmb440 million, of which Rmb250 million will be due in 2005, Rmb90 million will be due in 2006, and the remaining will be due in 2004. The Group also has access to significant uncommitted short-term borrowing facilities provided by its principal bankers.

As at 31 December 2003, inventories decreased by Rmb196 million, and trade and other receivables decreased by Rmb53 million. In 2002, there were an increase of Rmb189 million and Rmb40 million respectively. Decrease in inventories was mainly owing to the enhancement in the materials purchase management and the improved turnover day of raw materials. Decrease in trade and other receivables was mainly due to the decrease in bills receivable as a result of the increase in collection at the end of the year. At the end of 2003, the ratio of cash to the total current assets was 43.9 per cent.

### (2) Capital structure

As at 31 December 2003, the Group's shareholders' funds (excluding minority interests) was Rmb8,969 million, total liabilities was Rmb2,900 million, total liabilities to total assets ratio 24.3 per cent as compared with 26.5 per cent of last year.

	At 31 December 2003		At 31 December 2002	
	Amount Rmb'000	Proportion %	Amount Rmb'000	Proportion %
Current liabilities	2,559,673	21.5	2,879,823	24.0
Long-term liabilities	340,000	2.9	300,000	2.5
Shareholders' funds	8,968,853	75.2	8,765,795	73.0
Minority interests	53,455	0.4	57,478	0.5
Total	<u>11,921,981</u>	<u>100.0</u>	<u>12,003,096</u>	<u>100.0</u>

Due to the repayment of bank loans, the Group's current liabilities decreased by 11.1 per cent as compared with last year. Owing to adjustment of short and long-term loans structure, long-term liabilities increased by 13.3 per cent as compared with last year.

As at 31 December 2003, the Group's major bank loans were denominated in Rmb and all of the bank loans were charged at the fixed interest rate. The borrowing requirements of the Group were not subject to seasonal change.

For the year ended 31 December 2003, the Group did not use any financial instruments for hedging purposes.

### (3) Assets charges

For the year ended 31 December 2003, there was no charge on the Group's assets.

### (4) Management of foreign exchange risk

Main receivables and payables items of the Group are denominated in Rmb. Foreign currency used in the Group's operation were mainly denominated in US dollars and were settled immediately under current position. Therefore, there is no material effect on the Group as a result of the fluctuations in foreign exchange rates.



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### (5) Contingent liabilities

The Group's contingent liabilities were set out in note 28 of the financial statements prepared in accordance with the IFRS of the Annual Report.

### 3. Capital Expenditure

In 2003, the Company's capital expenditure amounted to Rmb931 million (excluding Rmb36 million of interest capitalized). The following table provided information on the Group's major construction projects and their actual production volume in 2003.

Main Projects	Amount invested in 2003 (excluding interest capitalised) <i>Rmb'000</i>	Project status	Actual production volume of the main projects <i>(tonnes)</i>
PTA project with an annual capacity of 450,000 tonnes	358	Completed	365,716
Staple fibre project with an annual capacity of 90,000 tonnes	218	Completed	51,047
Differential polyester chip project with a daily capacity of 450 tonnes	86	Under trial run	27,461
Improvement project of No. 5K production line switching from staple fibre production to hollow fibre production	7	Completed	–
CP and SSP project with an annual capacity of 200,000 tonnes	15	Under construction	–
Others	247	–	–
Total	<u>931</u>		<u>444,244</u>

The Company's capital expenditure for the year 2004 is expected to be approximately Rmb1,000 million, including: the CP and SSP project with an annual capacity of 200,000 tonnes, the technological improvement project to increase capacity of the PTA project with an annual capacity of 450,000 tonnes to 600,000 tonnes per year, the staple fibre project with an annual capacity of 100,000 tonnes, and the differential polyester chip with an annual capacity of 160,000 tonnes amounting to Rmb300 million, Rmb60 million, Rmb160 million and Rmb100 million respectively. The planned capital expenditure will be funded from cash generated from operations and bank credit facilities.