

MANAGEMENT DISCUSSION AND ANALYSIS

Continue to enlarge its market share



Amidst the steady growth of the domestic cotton textile industry, Weiqiao Textile continued to develop rapidly in 2004. In addition to the construction of the new production base which has further enhanced the production capacity, the Group continued to maintain its leading position in the cotton textile market in the PRC and successfully enlarged its market share.

INDUSTRY REVIEW

China has become the largest cotton production and consumption country in the world. According to the forecast of International Cotton Advisory Committee, cotton production and consumption in the PRC accounted for approximately 24.0% and 35.0% respectively of the world's total market share in the 2003/2004 cotton year. Meanwhile, the growth in the cotton textile industry in the PRC was sustained in 2004. The output of yarn and cotton fabric increased by 18.5% and 21.2% respectively, when compared with that in 2003. In respect of export sales, the PRC remained as one of the major garment exporting countries in the world. In 2004, export of textile and clothing amounted to approximately US\$33.48 billion and US\$61.62 billion, respectively, an increase of 24.3% and 18.7% respectively when compared with 2003.

Strong market demand for cotton textile products was driven by the increase in both domestic and export sales of downstream products in 2004. Domestic apparel sales and export apparel sales grew 21.0% and 19.0% respectively in 2004. It is expected that the global demand for cotton textile products will continue to grow in future which will bring about favourable opportunities to cotton textile enterprises in the PRC.



Cotton prices fluctuated significantly in 2004. In 2003/2004 cotton year, output of cotton in the PRC decreased due to poor harvest, resulting in shortage of cotton supply at the beginning of the Year. CNCotton A Index in domestic market remained at high level in the first half of 2004, with a record of RMB17,845 per ton. Cotlook A Index in the international market also reached its highest of approximately US77.0 cents per pound. In anticipation of a good harvest of domestic cotton and the impact of macro economic austerity measures on cotton demand, CNCotton A Index dropped from the highest in May to approximately RMB11,181 per ton at the end of 2004, while the Cotlook A Index in the international market were approximately US48.3 cents per pound.

As a result of the fluctuation of cotton prices, the macro economic austerity measures implemented by the government of the PRC and shortage of electricity, production costs of small scale manufacturers increased significantly due to their failure in obtaining stable supply of cotton, increase in electricity charges and more stringent credit policies adopted by banks. These small scale manufacturers suspended operations or shifted their production bases, thus accelerating the consolidation of the cotton textile industry. Cotton textile enterprises with a large production scale and better cost structure were benefited from the consolidation.

BUSINESS REVIEW

Weiqiao Textile is principally engaged in the production, sales and distribution of cotton yarn, grey fabric and denim. It is currently the largest cotton textile manufacturer in the PRC. According to the statistics of China Chamber of Commerce for Import and Export of Textiles in 2003, it ranked number one in terms of the aggregate export value of cotton yarn and grey fabric in the PRC.

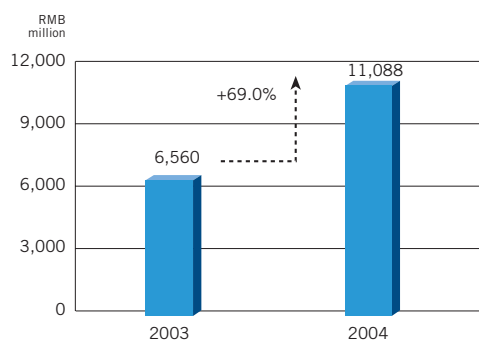
Amidst the steady growth of the domestic cotton textile industry, Weiqiao Textile continued to develop rapidly in 2004. In addition to the construction of the production base which has further enhanced the new production capacity, the Group continued to maintain its leading position in the cotton textile market in the PRC and successfully enlarged its market share.

MANAGEMENT DISCUSSION AND ANALYSIS

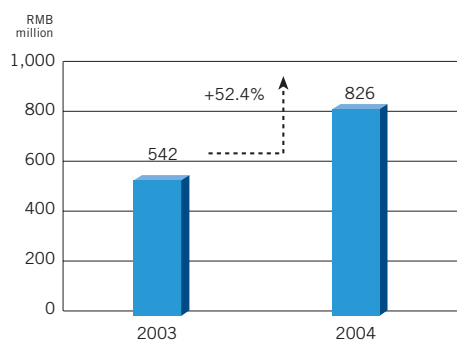


For the year ended 31 December 2004, Weiqiao Textile recorded a significant increase in turnover and net profit attributable to shareholders:

TURNOVER



NET PROFIT ATTRIBUTABLE TO SHAREHOLDERS

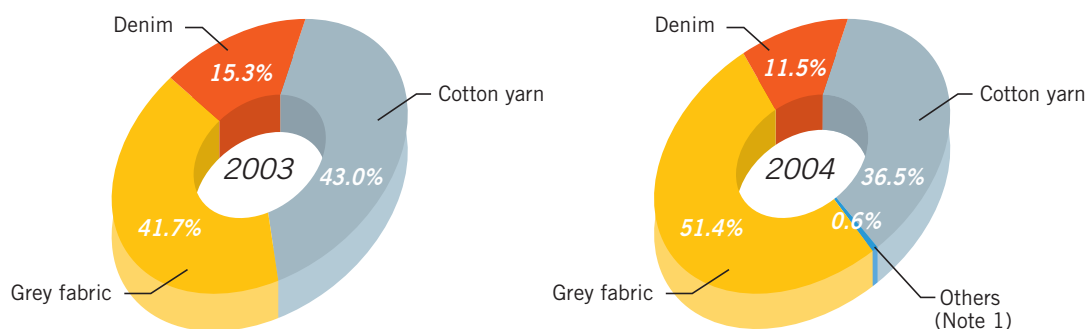


The increase in turnover and net profit attributable to shareholders was mainly due to the full operation of The First Production Area of Binzhou Weiqiao Technology Industrial Park Co., Ltd. (“Binzhou Industrial Park”), the partial operation of The Second Production Area of Binzhou Industrial Park and the full operation of The First Industrial Park of Zouping

and partial operation of The Second Industrial Park of Zouping in Zouping Production Base in 2004. The operation of Binzhou Industrial Park and Zouping Production Base further enhanced the Group’s economies of scale, reduced unit fixed production cost and procurement costs of raw materials.

The charts below are a comparison of the Group's turnover in terms of product categories for the year ended 31 December 2003 and 31 December 2004 and the proportion of the product categories:

A BREAKDOWN OF TURNOVER IN TERMS OF PRODUCT CATEGORIES AND THEIR PROPORTION



Note:

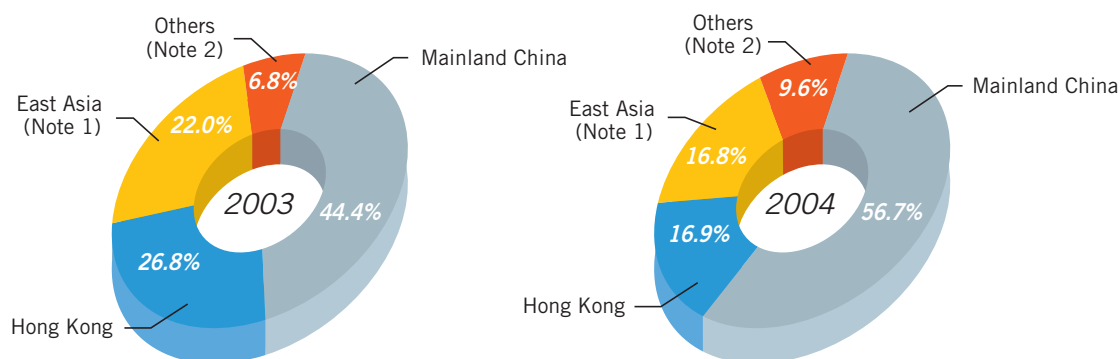
1. Comprising of cotton seeds and by-products

The increase in the proportion of grey fabric was due to the Group's increase in its own usage of cotton yarn for the production and sales of high-end grey fabric, so as to enhance the overall value of its product

mix. Others refer to the sales of cotton seeds and by-products by Shandong Weiqiao Mianye Company Limited (山東魏橋棉業有限公司), the subsidiary of the Company.

The charts below represent the Group's turnover in terms of geographical locations for the year ended 31 December 2003 and 31 December 2004 and the proportion of the geographical locations:

A BREAKDOWN OF TURNOVER IN TERMS OF THE GEOGRAPHICAL LOCATIONS AND THEIR PROPORTION



Notes:

1. Principally comprising of Japan and South Korea
2. Principally comprising of Taiwan, Thailand, US and certain European countries

MANAGEMENT DISCUSSION AND ANALYSIS

In 2004, the Group had an aggregate production volume of about 543,000 tons of cotton yarn, 1,205,000,000 meters of grey fabric and 131,000,000 meters of denim.

As a result of increased domestic demand for cotton textile products and the setting up of production facilities in the PRC by several customers from Asia Pacific, a portion of the Group's export sales has become domestic sales, resulting in an increase in the proportion of domestic sales. In order to capture the opportunities brought by the elimination of quota restrictions on textile products in European Union ("EU") and United States ("US") commencing from 2005, the Company devoted more efforts to expand the markets in EU and US accordingly, which in turn prepared the Group for tapping into the abovementioned markets at an earlier stage. Consequently, the turnover attributable to other regions increased.

The Group has continuously maintained an extensive customer base. Its customers concentrated in the PRC and South Asia, while the EU and the US markets accounted for 9.6% of the Group's turnover in 2004. As at 31 December 2004, the Group had approximately 4,800 customers in over 30 provinces

and municipalities directly under the Central Government in the PRC and approximately 500 overseas customers in over 20 countries and regions. The Group's domestic and overseas customers increased by 20.0% and 25.0% respectively when compared with 2003. The Group's customers included market leaders, namely Fountain Set (Holdings) Limited (福田實業(集團)有限公司), Texwinca Holdings Limited (德永佳集團有限公司) and well-known traders, namely Itochu Corporation ("Itochu"), Nichimen Corporation and Marubeni Corporation. In addition to the increasing number of customers, Weiqiao Textile has developed a closer relationship with its customers. On 9 March 2004, the Company entered into a joint venture agreement with Itochu to establish a sino-foreign equity joint venture company, namely, Shandong Binteng Textile Co., Ltd. (山東濱藤紡織有限公司) ("Shandong Binteng") in order to engage in the production and sale of compact yarns and various types of yarns. Itochu is the holder of 10.2% interests in Shandong Luteng Textile Co., Ltd. (山東魯藤紡織有限公司), a 75% owned subsidiary of the Company. The registered capital of Shandong Binteng is US\$15.43 million, (equivalent to approximately HK\$120.35 million). 75% of the registered capital of Shandong Binteng (i.e. US\$11.57 million, equivalent to approximately HK\$90.25 million) has been contributed by the Company in the form of plant and equipment. The remaining 25% of the registered capital of Shandong Binteng (i.e. US\$3.86 million, equivalent to approximately HK\$30.1 million) has been contributed by Itochu by way of cash. The directors of the Company believe that such joint venture would further enhance the co-operation between the Group and Itochu, strengthen the Group's production technologies and accelerate its response to market demand.

In terms of production, as at 31 December 2004, the Group had a total of four production bases, namely:

1. Weiqiao Production Base (The First, The Second and The Third Production Areas),
2. Binzhou Production Base (Binzhou Industrial Park The First Production Area and The Second Production Area),
3. Weihai Production Base (Weihai Weiqiao Textile Company Limited and Weihai Weiqiao Technology Industrial Park Co., Ltd. (“Weiwei Industrial Park”)),
4. Zouping Production Base (The First Industrial Park of Zouping and The Second Industrial Park of Zouping).

All of the above production bases are located in Shandong, the PRC with a total gross floor area of approximately 2,974,000 sq.m.. Zouping Production Base was newly established in 2004. It is located in Zouping Economic Development Zone in Shandong, the PRC with a total gross floor area of approximately 1,755,000 sq.m.. It is equipped with a full range of textile facilities and has commenced operations since January 2004.

In 2004, the Group had an aggregate production volume of about 543,000 tons of cotton yarn, 1,205,000,000 meters of grey fabric and 131,000,000 meters of denim. Due to the full operation of Binzhou Industrial Park The First Production Area, the partial operations of The Second Production Area, the full operation of The First

Industrial Park of Zouping and partial operation of The Second Industrial Park of Zouping in 2004, the aggregate production volume of cotton yarn and grey fabric significantly increased by 68.0% and 106.0%, respectively, compared to 2003. The production volume of denim also grew by 25.0%.

Being a market leader in the cotton textile industry in the PRC, Weiqiao Textile possesses not only scalable production and economies of scale, but also a stable supply of raw materials and electricity. It has successfully capitalised on industry consolidation to increase its market share in the textile industry. During the Year, many domestic cotton textile manufacturers were affected by the fluctuation of cotton prices. Weiqiao Textile adopted a flexible cotton purchasing strategy. The Group had sufficient quotas of imported cotton for production and reasonably purchased domestic cotton. In addition, it was entitled to favourable prices from suppliers due to bulk procurement. It shifted certain impact of increase in cotton prices to its customers to minimise the impact on the Group. For the year ended 31 December 2004, the proportion of the amount of the Group’s imported and purchased lint cotton within the PRC was 65.3% (2003: 57.2%) and 34.7% (2003: 42.8%) respectively. Although the overall manufacturing industries were affected by the shortage of electricity supply throughout the PRC, Weiqiao Textile was able to secure steady electricity supply from Shandong Weiqiao Chuangye Group Company Limited (山東魏橋創業集團有限公司), at a price lower than the market price. As a result, the Group was affected by the shortage in electricity to a lesser extent.

MANAGEMENT DISCUSSION AND ANALYSIS

FINANCIAL REVIEW

Gross profit and gross profit margin

The table below is an analysis of the Group's gross profit and gross profit margins attributable to its major product categories for the years ended 31 December 2004 and 31 December 2003:

Product category	For the year ended 31 December			
	2003		2004	
	Gross profit RMB'000	Gross profit margin %	Gross profit RMB'000	Gross profit margin %
Cotton yarn	605,789	21.5	694,493	17.2
Grey fabric	386,362	14.1	798,863	14.0
Denim	218,162	21.7	341,592	26.8
Others	—	—	22,229	33.8
Total	1,210,313	18.5	1,857,177	16.8

The gross profit margin of the Group decreased to 16.8% in 2004. The decrease in gross profit margins of cotton yarn and grey fabric was attributable to the decrease in cotton prices that commenced in the second half of the Year. Product pricings in turn became unstable, and profit margins were squeezed. The gross profit margin of denim increased due to better denim market and higher selling prices.

Selling and distribution costs

The Group's selling and distribution costs increased by 86.5% to approximately RMB276 million for the year ended 31 December 2004 from approximately RMB148 million for the year ended 31 December 2003. As a result of the increase in sales in 2004, particularly export sales increased by 31.6% compared to 2003, transportation costs increased to approximately RMB187 million (2003: approximately RMB104 million), sales commission increased to approximately RMB30 million (2003: approximately RMB19 million), staff costs increased to approximately RMB42 million (2003: approximately RMB18 million), and other expenses increased to approximately RMB16 million (2003: approximately RMB7 million).

Administrative expenses

Administrative expenses for the year ended 31 December 2004 amounted to approximately RMB144 million, representing an increase of 60.0%, as compared to RMB90 million for the year ended 31 December 2003. Such increase was mainly due to the increase in the number of administrative staff as a result of the expansion in the production scale, the newly establishment of Zouping Production Base, Binzhou Industrial Park The Second Production Area, Weiwei Industrial Park and the establishment of a joint venture with Itochu in 2004. Staff costs and other related expenses increased as a result.

Finance costs

Finance costs rose to approximately RMB290 million, after capitalising interests of approximately RMB26 million, for the year ended 31 December 2004, representing an increase of 83.5% as compared to RMB158 million for the year ended 31 December 2003. The increase in bank loans for the year ended 31 December 2004 as compared with the year ended 31 December 2003 was mainly due to the additional financing for the expansion in production scale and the operating capital for additional production capacity.

Liquidity and financial resources

The cash and cash equivalents of the Group were approximately RMB2,245 million as at 31 December 2004, increasing by 46.5% from approximately RMB1,532 million of cash and cash equivalents as at 31 December 2003. In June 2004, the Group completed the placement of 57,447,000 new H shares at a price of HK\$11.6 per H share to raise a total of approximately HK\$653 million. In addition, the Group was granted a dual currency syndicated loan of US\$78 million and RMB183 million on 28 September 2004.

For the year ended 31 December 2004, the Group invested approximately RMB3,614 million in capital expenditures, which was mainly invested in the new Zouping Production Base and increase in the production

of high value-added products. Zouping Production Base has gradually commenced operations since January 2004, whereas new high value-added products have been launched in 2004. The above capital expenditures resulted in a net cash inflow of approximately RMB1,409 million from operating activities and incurred an exchange loss of approximately RMB9 million. These cash outflows were largely offset by:

1. the proceeds from bank loans of approximately RMB2,492 million,
2. net proceeds from the placing of H shares of approximately RMB692 million,
3. a decrease of RMB26 million in secured deposits,
4. an increase of time deposit over 3 months of RMB325 million,
5. an interest income of approximately RMB24 million.

Based on the above reasons, the net debt-to-equity ratio (the ratio of total bank borrowings to shareholders' equity net of cash and cash equivalents) increased to 0.78 as at 31 December 2004 from 0.64 as at 31 December 2003.

As at 31 December 2004, the Group's total borrowings (including bank loans and long-term liabilities payable to the group of companies) amounted to approximately RMB7,145 million, of which there was a dual currency syndicated loan of US\$78 million and RMB183 million entered into with seven banks in September 2004, while the Group's total borrowings amounted to approximately RMB4,653 million as at 31 December 2003, which will become mature within five years. Approximately RMB3,397 million is repayable within one year or on demand, approximately RMB1,277 million is repayable within two years while approximately RMB2,471 million is repayable within three to five years (both years inclusive). It is expected that the Group's daily cash requirement and capital expenditures can be financed by its operating cash. The Group also has considerable short-term credit from its major banks without limitation to the use of credit.

MANAGEMENT DISCUSSION AND ANALYSIS

The average turnover of the Group's accounts receivable was approximately 20 days for the year ended 31 December 2004, which decreased from 28 days for the year ended 31 December 2003. The decrease in accounts receivable turnover days was attributable to the successful tightening of the Group's credit control policy.

Inventory turnover days decreased from 142 days for the year ended 31 December 2003 to 106 days for the year ended 31 December 2004. Decrease in inventory turnover days was mainly due to the strong demand from the market and sufficient supply of cotton, resulting from the stable decrease in cotton prices in the second half of 2004; and the Company lowering the inventory of lint cotton.

For the year ended 31 December 2004, the Group did not use any financial instrument for hedging purposes, and the Group did not have any hedging instrument outstanding as at 31 December 2004.

Net profit attributable to shareholders and earnings per share

Net profit attributable to shareholders of the Group was approximately RMB826 million for the year ended 31 December 2004, representing an increase of 52.4% as compared with RMB542 million in 2003.

For the year ended 31 December 2004, basic earnings per share of the Company was RMB0.97.

Capital structure

It is the intention of the Group to maintain an appropriate mix of equity and debt to ensure an efficient capital structure from time to time. As at 31 December 2004, the liabilities of the Group included bank borrowings and long-term payables to its group of companies which amounted to RMB7,145 million. Cash and cash equivalents of the Group was approximately RMB2,245 million and gearing ratio (Total liabilities (including bank loans and long-term payables to the group of companies)/Total assets) was 43.6%.

Details of the bank borrowings outstanding as at 31 December 2004 were described in Note 27 to the financial statements. As at 31 December 2004, 88.5% of the Group's bank borrowings was subject to fixed interest rates while 11.5% was subject to floating interest rates. There are no seasonal adjustments with respect to the Group's borrowings.

As at 31 December 2004, the Group's borrowings were primarily denominated in RMB and US dollars, in which 35.3% of the Group's borrowings were denominated in US dollars. Its cash and cash equivalents were mainly held in RMB and US dollars in which 17.8% of the cash and cash equivalents were held in US dollars.

USE OF PROCEEDS FROM THE INITIAL PUBLIC OFFERING (THE “IPO”)

H shares of Weiqiao Textile were listed on the Main Board of the Stock Exchange on 24 September 2003 and net proceeds of about RMB2,511 million (equivalent to about HK\$2,371 million) were raised from the IPO. As at 31 December 2004, the Company applied the proceeds from the IPO for the purposes as set out in the Company's prospectus dated 15 September 2003 as follows:

	<i>HK\$' million</i>	
	Planned	Actual allocation
Expansion of product portfolio to include more high value-added cotton textile products	406	359
Upgrade of the existing production technology	94	94
Establishment of a technology development center	47	—
Upgrade of the information systems	34	3
Repayment of bank loans	566	566
Acquisition relating to the Group's cotton textile manufacturing business	100	—
General working capital	1,124	1,124
Total	2,371	2,146

PLACEMENT OF H SHARES

Weiqiao Textile completed the placement of 57,447,000 new H shares in June 2004 at a price of HK\$11.6 per H share. The net proceeds of the placement was approximately HK\$653 million. As at 31 December 2004, the Company applied the proceeds from the placement for the purposes as set out in the Company's announcement dated 28 May 2004 as follows:

	<i>HK\$' million</i>	
	Planned	Actual allocation
Development and production of high value-added new fabric products	239	239
Increase of production capacity of existing high value-added cotton textile products	192	192
Upgrade of the existing production technology	43	43
General working capital	179	179
Total	653	653

MANAGEMENT DISCUSSION AND ANALYSIS

DETAILS OF THE GROUP'S PLEDGED ASSET

Details are set out in Note 27 to the financial statements.

EXPOSURE TO FOREIGN EXCHANGE RISK

Revenue and most of the expenditures of the Group are denominated in RMB and US dollars. For the year ended 31 December 2004, 43.3% of the Group's revenue and 65.3% of the Group's cost of lint cotton procurement were denominated in US dollars. The Group has not experienced any significant difficulties or impact on its operations or liquidity as a result of fluctuations in currency exchange rates during the year ended 31 December 2004. The Board believes that the Group will have sufficient foreign exchange to meet its foreign exchange requirements.

CONTINGENT LIABILITIES

Details are set out in Note 31 to the financial statements.

TAXATION

Taxation of the Group grew from RMB306 million for 2003 to RMB420 million for 2004, representing an increase of 37.3%. This increase was primarily due to the increase in profit before tax by 46.1% to approximately RMB1,247 million for 2004 from approximately RMB853 million for 2003. Details of the reconciliation of the Group's effective tax rate to the applicable rate are set out in Note 11 to the financial statements.

FUTURE OUTLOOK

As in 2005, quota policies in relation to textile products have been abolished pursuant to the textile product and clothing import and export agreement of the World Trade Organisation. Other members of the World Trade Organisation may impose a 7.5% limit in the increase in import and export of Chinese textile and clothing products until 31 December 2008, western countries may also impose non-quota trade barriers whereas the PRC may take the initiative in imposing export tariffs in order to adjust unnecessary export growth and to control unnecessary capacity expansion in textile industry. In the long term, gradual liberalisation of textile trade will provide more opportunities to the domestic textile industry as well as Weiqiao Textile.

According to China National Textile Industry Council, export of textile and clothing products from the PRC accounted for approximately 30% of the total export of the whole industry, while the remaining 70% was sold domestically. It demonstrates that the development of the PRC textile industry has greatly relied on domestic demand. Given the continuous development of the PRC economy, income per capita will continue to increase, which will further stimulate domestic demand. It is expected that domestic demand will grow at a faster pace, which in turn will provide a more favourable operating environment for Weiqiao Textile.

Even though the abolishment of quota on textile products would not result in direct impact on the Group, it would affect the reorganisation and consolidation of downstream enterprises, which would otherwise benefit the stable development of upstream enterprises, in undertaking more value-added production processes. The management expects that the Group will further benefit from the abolishment of quota on textile products.

In view of the strong demand from the domestic and international markets, the Group will further acquire more advanced equipment to expand its capacity of cotton yarn and grey fabric. In addition, Weiqiao Textile will further improve its technologies and develop more value-added products to enter into the high-end product market and to upgrade the quality of products for its existing customers.

It is anticipated that cotton prices will remain at a relatively high level during the second half of 2005 as a result of the intended reduction in the cultivating area of cotton in 2004/2005 cotton year in the PRC. Weiqiao Textile will continue to take advantage of its strength over cost control and use its cotton quota in a more flexible and effective way. It will also control the cotton cost more effectively through a diversified procurement strategy in the overseas and domestic markets.

Given the strength on its leading position in the global cotton textile industry, production scale, comprehensive product portfolio, renowned brand name, strong customer base and professional management, Weiqiao Textile will fully leverage on the opportunities from industry consolidation, and proactively pursue for acquisitions as appropriate. Weiqiao Textile will keep striving for the best with an aim at becoming the largest cotton textile manufacturer in the world.

CORPORATE GOVERNANCE

Weiqiao Textile understands that investors become more concerned with corporate governance of listed companies. It uses its best endeavours to enhance its corporate governance and place emphasis on a professional and sound business model with integrity. In addition, the Group also devotes to perfecting its internal regulations and strictly complying with the laws so as to further enhance the confidence of investors and the public in the Group.

During the year ended 31 December 2004, the Directors of the Company had complied with the Code of Best Practice as set out in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules").

Board of Directors

As at 31 December 2004, the Board comprises nine Directors, including three independent non-executive Directors who are independent from the Directors, supervisors, chief executive, substantial shareholders (as defined in the Listing Rules) of the Company or its subsidiaries or any of their respective associates (the "Independent Third Parties"). The Company has received from each of its independent non-executive Directors a confirmation of his independence pursuant to Listing Rule 3.13 and the Company considers the independent non-executive Director to be independent. Members of the Board clearly understand their responsibilities and obligations. Eight Board meetings were convened during the Year to review the Group's management accounts, supervise the accounting procedures and internal control system, where the independent non-executive Directors were all present at such meetings.

Supervisory committee

The Company's supervisory committee comprises three supervisors, including two independent supervisors who are the Independent Third Parties. The Company's supervisory committee supervises the operation of the Company with an aim at protecting the Company and its shareholders.

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Transparency

In order to further improve the transparency of the Group, the Group discloses its latest information to media, investors, shareholders and the public on time through various ways, including public announcements, annual reports, interim reports and press releases. In addition, Weiqiao Textile has established an investor relation department to enhance its communication with the investors. The Group closely keeps in touch with the investors through meeting analysts, meeting the investors, inviting the investors to visit the Company's production bases, participating in investment conferences and overseas roadshows, etc.

HUMAN RESOURCES

As at 31 December 2004, the Group had a total of approximately 101,300 employees, representing an increase of 32,300 employees as compared with that as at 31 December 2003. Total staff costs amounted to approximately RMB1,027 million during the Year, representing 9.3% of the Group's turnover. Employees were remunerated based on their performances, experience and prevailing industry practice. The Group's remuneration policies and packages were reviewed by its management on a regular basis. Bonuses and rewards may also be awarded to employees based on performance evaluation, with an aim to encourage and reward staff to achieve better performance.

PUBLIC SHAREHOLDING

As at the date hereof, based on the information that was publicly available to the Company and within the best knowledge of the Directors, 344,682,500 H shares were held by the public, representing 39.37% of the entire share capital, which complied with the minimum requirement of public shareholding under Rule 8.08 of the Listing Rules.