

REPORT OF THE DIRECTORS

The directors of the Company (“Directors”) present their report and the audited financial statements of the Company and the Group for the year ended 31 December 2004.

PRINCIPAL ACTIVITIES

The Group is principally engaged in the production, sale and distribution of cotton yarn, grey fabric and denim. There were no significant changes in the nature of the Group’s principal activities during the year ended 31 December 2004.

RESULTS AND DIVIDENDS

The Group’s operating results for the year ended 31 December 2004 and the financial position of the Group and the Company as at that date are set out in the audited financial statements on pages 40 to 42 and pages 46 to 47.

The Directors recommended the payment of a final dividend of RMB0.25 per share for the year ended 31 December 2004, to shareholders of the Company on the register of members on 30 March 2005. There was no arrangement under which a shareholder of the Company has waived or agreed to waive any dividends. This recommendation has been incorporated in the audited financial statements as an allocation of retained profits within the capital and reserves section of the balance sheet.

SUMMARY FINANCIAL INFORMATION

A summary of the consolidated results, assets and liabilities of the Group for the last five financial years, as extracted from the accountants’ report for the three years ended 31 December 2002 in the Prospectus, and from the audited consolidated financial statements of the Group for the year ended 31 December 2003 and the year ended 31 December 2004 on pages 40 to 42, is set out below:

Results

	Year ended 31 December				2004 RMB'000
	2000 RMB'000	2001 RMB'000	2002 RMB'000	2003 RMB'000	
Turnover	1,559,284	2,353,637	4,380,923	6,560,470	11,088,224
Cost of sales	(1,290,790)	(2,007,486)	(3,729,267)	(5,350,157)	(9,231,047)
Gross profit	268,494	346,151	651,656	1,210,313	1,857,177
Other revenue	2,018	23,748	49,303	74,120	159,022
Selling and distribution costs	(26,165)	(40,794)	(78,565)	(148,375)	(275,899)
Administrative expenses	(9,490)	(27,212)	(40,189)	(89,703)	(143,524)
Other operating expenses	(11,577)	(9,470)	(19,641)	(35,116)	(59,509)
Profit from operating activities	223,280	292,423	562,564	1,011,239	1,537,267
Finance costs	(16,500)	(46,009)	(101,506)	(157,797)	(290,383)
Profit before tax	206,780	246,414	461,058	853,442	1,246,884
Tax	(73,057)	(88,977)	(169,627)	(305,674)	(420,405)
Profit before minority interests	133,723	157,437	291,431	547,768	826,479
Minority interests	—	(3,397)	(3,191)	(6,096)	(944)
Net profit from ordinary activities attributable to shareholders	133,723	154,040	288,240	541,672	825,535

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Assets and liabilities

	31 December				
	2000 RMB'000	2001 RMB'000	2002 RMB'000	2003 RMB'000	2004 RMB'000
Total assets	987,671	2,632,421	5,538,972	11,339,925	16,388,853
Total liabilities	538,995	2,007,308	3,939,219	6,682,539	10,228,695

FIXED ASSETS

Details of movements in the fixed assets of the Company and the Group during the year ended 31 December 2004 are set out in Note 15 to the financial statements.

SHARE CAPITAL AND SHARE OPTION SCHEME

Details of movements in the Company's share capital during the year ended 31 December 2004, together with the reasons therefor, are set out in Note 29 to the financial statements.

Details of placement of H Shares are set out in page 17 of this annual report.

The Company does not have any share option scheme.

PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the Company's articles of association or the Company Law of the PRC which could oblige the Company to offer new shares on a pro rata basis to existing shareholders.

PURCHASE, REDEMPTION OR SALE OF LISTED SECURITIES OF THE COMPANY

Neither the Company, nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities during the year ended 31 December 2004.

RESERVES

Details of movements in the reserves of the Company and the Group during the year ended 31 December 2004 are set out in Note 30 to the financial statements and in the consolidated statement of changes in equity, respectively.

DISTRIBUTABLE RESERVES

As at 31 December 2004, in accordance with the Company Law, an amount of about RMB3,424 million standing to the credit of the Company's capital reserve account, and an amount of about RMB368 million standing to the credit of the Company's statutory reserve funds, as determined in accordance with the PRC accounting standards and regulations, were available for distribution by way of future capitalisation issue. In addition, the Company had retained profits of about RMB1,286 million for distribution as dividend.

MAJOR CUSTOMERS AND SUPPLIERS

During the year ended 31 December 2004, sales to the Group's five largest customers accounted for 15% of the Group's total sales for the year ended 31 December 2004.

During the year ended 31 December 2004, purchases from the Group's five largest suppliers accounted for 46% of the Group's total purchases for the year ended 31 December 2004. During the year ended 31 December 2004, Purchases from the Group's largest supplier accounted for 17% of the Group's total purchases for the year ended 31 December 2004.

The Group has sold and purchased certain products to and from certain companies with the same ultimate controlling shareholder of the Company, details of which are set out in the section headed "Connected Transactions" below.

DIRECTORS' AND SUPERVISORS' SERVICE CONTRACTS AND LETTERS OF APPOINTMENT

Each of the executive Directors and supervisors of the Company (the "Supervisors") (excluding the independent Supervisors) has entered into a service contract with the Company for a term of three years. Each of the non-executive Directors, independent non-executive Directors and independent Supervisors has entered into a letter of appointment with the Company for a term of three years. Pursuant to the Company's articles of association, each Director and Supervisor is eligible for re-election upon expiration of their term of office.

The Directors and Supervisors as at the date of this report and their respective term of office are as follows:

Executive Directors:

Zhang Bo	Until 16 March 2006
Zhang Hongxia	Until 16 March 2006
Qi Xingli	Until 16 March 2006
Zhao Suwen	Until 16 March 2006

Non-executive Directors:

Zhang Shiping	Until 16 March 2006
Wang Zhaoting	Until 16 March 2006

Independent non-executive Directors:

Wang Naixin	Until 16 March 2006
Xu Wenying	Until 26 June 2006
Chan Wing Yau, George	Until 16 March 2006

Supervisors:

Liu Mingping	Until 16 March 2006
Lu Tianfu (<i>Note</i>)	Until 16 March 2006
Wang Wei (<i>Note</i>)	Until 16 March 2006

Note: Independent Supervisor

BIOGRAPHIES OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

Biographical details of the Directors, Supervisors and the senior management of the Company are set out on pages 21 to 24 of this report.

DIRECTORS' AND SUPERVISORS' INTERESTS IN CONTRACTS

Save for those transactions described in the note headed "Related Party Transactions" in Note 33 to the financial statements and the section headed "Connected Transactions" below. None of the Director or Supervisor is or was materially interested, either directly or indirectly, in any contract subsisting during or at the end of 2004 which is significant in relation to the business of the Group.

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CONTRACTS OF SIGNIFICANCE

Save for those transactions described in the note headed “Related Party Transactions” in Note 33 to the financial statements and the section headed “Connected Transactions” below, there is no contract of significance between the Company (or any of its subsidiaries) and its controlling shareholder (or any of its subsidiaries) or by the controlling shareholder of the Company (or any of its subsidiaries) to the Company.

SUBSTANTIAL SHAREHOLDERS

As at 31 December 2004, so far as is known to the Directors, supervisors and the chief executive of the Company, the interests and short positions of every person, other than a Director, supervisor or chief executive of the Company, in the shares and underlying shares of the Company as recorded in the register required to be kept by the Company pursuant to Section 336 of the Securities and Futures Ordinance (“SFO”) were as follows:

Long positions in the domestic shares of the Company (“Domestic Shares”):

	Number of Domestic Shares <i>(note 1)</i>	Approximate percentage of total issued Domestic Share capital <i>(%)</i>	Approximate percentage of total issued share capital <i>(%)</i>
Shangdong Weiqiao Chuangye Group Company Limited (山東魏橋創業集團有限公司) (“Holding Company”)	410,311,100 <i>(note 2)</i>	77.31	46.87
Zouping County Supply and Marketing Cooperation Union (鄒平縣供銷合作社聯合社) (“ZCSU”)	410,311,100 <i>(note 3)</i>	77.31	46.87

Long positions in the H shares of the Company (“H Shares”):

	Number of H Shares <i>(note 4)</i>	Approximate percentage of total issued H Share capital <i>(%)</i>	Approximate percentage of total issued share capital <i>(%)</i>
J.P. Morgan Chase & Co. <i>(note 5)</i>	27,452,001	7.96	3.13
Invesco Asia Limited <i>(note 6)</i>	17,609,000	5.10	2.01
State Street Corporation <i>(note 7)</i>	17,591,208	5.10	2.01
Lloyd George Investment Management (Bermuda) Ltd <i>(note 8)</i>	17,521,000	5.08	2.00

Notes:

1. Unlisted shares.
2. These 410,311,100 domestic shares are directly held by Holding Company.
3. These 410,311,100 domestic shares are deemed corporate interests under the SFO indirectly held through Holding Company, in which ZCSU has a controlling interest.
4. Shares listed on the Main Board of the Stock Exchange.
5. 295,500 H Shares were directly held by J.P. Morgan Chase & Co. 15,859,000 H Shares were held by J.P. Morgan Chase & Co. in its capacity as investment manager and 11,297,501 H Shares in its capacity as custodian/approved lending agent.
6. 17,609,000 H Shares were held by Invesco Asia Limited in its capacity as investment manager.
7. 17,591,208 H Shares were held by State Street Corporation in its capacity as custodian/approved lending agent.
8. 17,521,000 H Shares were held by Lloyd George Investment Management (Bermuda) Ltd as investment manager.

DIRECTORS' AND SUPERVISORS' INTERESTS IN SHARES

As at 31 December 2004, the interests of the Directors, Supervisors or chief executives of the Company in the shares of the Company and its associated corporations (within the meaning of Part XV of the SFO), as recorded in the register required to be kept by the Company pursuant to section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies, were as follows:

Long positions in the Domestic Shares:

	Type of interest	Number of Domestic Shares (note 1)	Approximate percentage of total issued Domestic Share capital (%)	Approximate percentage of total issued share capital (%)
Zhang Hongxia (Executive Director)	Personal	17,700,400	3.34	2.02
Zhang Bo (Executive Director)	Personal	12,932,000	2.44	1.48
Qi Xingli (Executive Director)	Personal	8,052,500	1.52	0.92
Zhang Shiping (Non-Executive Director)	Personal	5,200,000	0.98	0.59

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Long positions in the shares of the Company's associated corporations (within the meaning of Part XV of the SFO):

	Name of associated corporation	Type of interest	Approximate percentage of total issued share capital (%)
Zhang Shiping (Non-executive Director)	Holding Company	Personal	4.53

Note:

1. Unlisted shares

Save as disclosed above, as at 31 December 2004, none of the Directors, Supervisors or the chief executives of the Company had an interest or short position in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which was required to be (a) recorded in the register to be kept by the Company pursuant to Section 352 of the SFO; or (b) notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies.

MANAGEMENT CONTRACTS

No contract concerning the management and administration of the whole or any substantial part of the business of the Company were entered into or existed during the year ended 31 December 2004.

CONNECTED TRANSACTIONS

Details of the connected transactions of the Group for the year ended 31 December 2004 are set out below:

During the year ended 31 December 2004, certain transactions were entered into between the Group and the following connected persons of the Company:

1. Holding Company is one of the promoters and the controlling shareholder of the Company. It therefore constitutes a connected person of the Company under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ("Listing Rules").
2. Weiqiao Bleach is 40% owned by Holding Company. Weilian Print is a 65% owned subsidiary of Holding Company. Weiqiao Dyeing is a 60% owned subsidiary of Holding Company. As each of Weiqiao Bleach, Weilian Print and Weiqiao Dyeing is an associate of a promoter/substantial shareholder of the Company, it constitutes a connected person of the Company under the Listing Rules.
3. Itochu is the holder of 10.2% interests in Luteng Textile, a 75% owned subsidiary of the Company, and 25% interest in Binteng Textile, a 75% owned subsidiary of the Company. Itochu is also the holder of 25% interests in Shandong Binteng Textile Co. Ltd, a 75% subsidiary of the Company. As it is a substantial shareholder of certain subsidiaries of the Company, it constitutes a connected person of the Company under the Listing Rules.

4. Binzhou Industrial Park is a company owned as to 98.5% by the Company and as to 1.5% by Holding Company. Weihai Weiqiao is a company owned as to 87.2% by the Company and as to 12.8% by Weihai Civil Aviation Industrial Company Limited (“WCAI”). Binzhou Industrial Park and Weihai Weiqiao, being non-wholly-owned subsidiaries of the Company, constitute connected persons under the Listing Rules.

All such transactions constituted connected transactions subsequent to the listing of the Company’s H Shares on the Stock Exchange under the Listing Rules.

NON-EXEMPT CONNECTED TRANSACTIONS

Set out below is a summary of the non-exempt connected transactions under the Listing Rules (“Non-Exempt Connected Transactions”):

Supply of cotton by Holding Company to the Group

On 25 August 2003, the Company and Holding Company entered into a supply of products, raw materials and processing services agreement pursuant to which Holding Company agreed to supply cotton (including lint cotton and tailings) to the Group for the production of cotton textile products. The agreement has a term of three years commencing from the date of the agreement. The prices of cotton supplied by Holding Company to the Group were determined by reference to the prices at which comparable types of cotton were supplied by independent third parties under normal commercial terms in the ordinary course of their businesses in the PRC.

Supply of cotton yarn and cotton fabric by the Group to Holding Company, its subsidiaries and associates (“Parent Group”)

On 25 August 2003, the Company and Holding Company entered into a supply of products, raw materials and processing services agreement pursuant to which the Company agreed to supply or procure its subsidiaries to supply cotton yarn and cotton fabric to Parent Group for the production of downstream cotton textile products. The agreement has a term of three years commencing from the date of the agreement. The prices of cotton yarn and cotton fabric supplied by the Group to Parent Group were determined by reference to the prices at which comparable types of cotton yarn and cotton fabric were supplied by the Group to independent third parties under normal commercial terms in the ordinary course of its business in the PRC.

Supply of cotton yarn and cotton fabric by the Group to Itochu

The Group supplied cotton yarn and cotton fabric to Itochu on normal commercial terms in order to maintain a close business relationship with Itochu. The prices at which cotton yarn and cotton fabric were supplied by the Group to Itochu were determined by reference to the prices at which comparable types of cotton yarn and cotton fabric were sold by the Group to independent third parties under normal commercial terms in the ordinary course of its business.

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Supply of electricity and steam by Holding Company to the Group

On 25 August 2003, the Company and Holding Company entered into a supply of electricity and steam agreement pursuant to which Holding Company agreed to supply electricity and steam to the Group for a term of 10 years commencing from the date of the agreement. The Group was therefore able to obtain a stable supply of energy for its operations. The price at which electricity was provided to the Group by Holding Company was the lower of either RMB0.35 per kWh or the market price. The price at which steam was provided to the Group by Holding Company was the lower of either RMB60 per ton or the market price.

Provision of processing services by Parent Group to the Group

On 25 August 2003, the Company and Holding Company entered into a supply of products, raw materials and processing services agreement pursuant to which Holding Company agreed to procure its subsidiaries and/or associates (including but not limited to Weilian Print and Weiqiao Bleach) to provide, cotton yarn and grey fabric downstream processing services (e.g. dyeing, bleaching and printing) to the Group in order to accommodate the side demand from its customers for a term of three years commencing from the date of the agreement. The fees at which processing services were provided by Parent Group to the Group were determined by reference to the fees at which comparable types of processing services were provided by independent third parties under normal commercial terms in the ordinary course of their businesses in the PRC.

Lease of land use rights and building right by Holding Company to the Company

The Company and Holding Company entered into eight leasing agreements pursuant to which, Holding Company agreed to lease to the Company land use rights and building right in respect of land and building respectively located at No. 34 Qidong Road and west of Xiwaihuan Road, Weiqiao Town, Zouping County, Shandong Province, the PRC for the Company's operations, with a right of renewal exercisable by the Company. The principal terms of the agreements are 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.
- (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) 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.
- (vi) 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.
- (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 RMB994,100 for the land relating to the Zouping Industrial Park Area.
- (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 RMB2,000,000 for the land relating to the Zouping Industrial Park Area.

The rent changeable by Holding Company to the Company was determined by reference to the market rent, namely the rent payable for leasing land use rights/building right in respect of similar properties from independent third parties under normal commercial terms in the normal course of their business in Zouping County, Shandong Province, the PRC.

Establishment of Shandong Binteng Textile Co., Ltd.

On 9 March 2004, the Company entered into a joint venture agreement with Itochu to establish sino-foreign equity joint venture company, namely, Shandong Binteng Textile Co., Ltd. (“Shandong Binteng”) in order to engage in the production and sale of compact yarns and various types of yarns. 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.

Further details of the Non-Exempt Connected Transactions are set out in the Prospectus and the Company’s announcements dated 17 October 2003 and 10 March 2004.

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Figures for the year ended 31 December 2004

Below is a table setting out the aggregate value for each of the Non-Exempt Connected Transactions for the year ended 31 December 2004:

Transaction nature	Aggregate value for the year ended 31 December 2004 <i>(RMB million)</i>
1. Supply of cotton yarn and cotton fabric	
(a) by the Group to Parent Group	252
(b) by the Group to Itochu	351
2. Supply of electricity and steam by Holding Company to the Group	554
3. Lease of land use rights and building right by Holding Company to the Company	10

Confirmation by the independent non-executive Directors

The independent non-executive Directors have reviewed the Non-Exempt Connected Transactions and confirmed that each of the Non-Exempt Connected Transactions was:

- (i) entered into in the ordinary and usual course of business of the Group;
- (ii) conducted either on normal commercial terms or, if there were not sufficient comparable transactions to judge whether it was on normal commercial terms, on terms that were fair and reasonable so far as the shareholders of the Company are concerned;
- (iii) entered into either in accordance with the relevant agreement governing such transactions or where there were no such agreements, on terms no less favourable than those available to or from independent third parties, as applicable; and
- (iv) was within the relevant annual cap which had been agreed with the Stock Exchange.

OTHER CONNECTED TRANSACTIONS

Granting of financial assistance by the Company and Holding Company to Binzhou Industrial Park

During the year ended 31 December 2004, there are no guarantees given by the Company and Holding Company to Binzhou Industrial Park were in force.

Granting of financial assistance by the Company to Weihai Weiqiao

During the year ended 31 December 2004, the following guarantees given by the Company and WCAI to Weihai Weiqiao were in force. Pursuant to such guarantees, the Company and WCAI agreed to guarantee, 87.2% and 12.8% respectively, of the obligations of Weihai Weiqiao in respect of certain banking facilities for working capital purposes. Each of the guarantees is for a period of two years commencing on the day when the relevant banking facilities are due. The principal terms of the guarantees are as follows:

Lender	Effective date of banking facilities	Expiry date of banking facilities	Date of guarantee	Principal amount of banking facilities (RMB million)
Agricultural Bank of China	31 July 2002	30 July 2005	14 July 2003	40
Agricultural Bank of China	16 August 2002	15 August 2005	14 July 2003	6
Bank of Communications	10 October 2002	9 October 2005	14 July 2003	30
Agricultural Bank of China	20 November 2002	19 November 2005	14 July 2003	30
Agricultural Bank of China	15 January 2003	14 January 2006	14 July 2003	20
Agricultural Bank of China	25 February 2003	24 February 2006	14 July 2003	30
Agricultural Bank of China	28 February 2003	27 February 2006	14 July 2003	4
Bank of Communications	28 August 2002	28 August 2005	15 October 2003	10
Bank of Communications	9 August 2004	8 August 2005	9 August 2004	20
Bank of Communications	31 May 2004	26 May 2005	31 May 2004	10
Agricultural Bank of China	11 June 2004	10 June 2005	11 June 2004	14
Agricultural Bank of China	21 December 2004	20 December 2005	21 December 2004	8.25
Agricultural Bank of China	16 July 2004	15 July 2005	16 July 2004	20
Agricultural Bank of China	8 December 2004	7 December 2005	8 December 2004	20
Agricultural Bank of China	17 December 2004	16 December 2005	17 December 2004	20
Agricultural Bank of China	24 December 2004	23 December 2005	24 December 2004	20
Weihai City Commercial Bank	15 December 2004	14 December 2005	16 December 2004	20

RETIREMENT SCHEME

Details of the retirement scheme of the Group are set out in Note 7 to the financial statements.

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COMPLIANCE WITH THE CODE OF BEST PRACTICE

To the best knowledge of the Directors, the Company has complied with the Code of Best Practice (“Code of Best Practice”), as set out in Appendix 14 of the Listing Rules, throughout the year ended 31 December 2004.

CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS

The Company has not adopted a code for securities transactions on terms no less exacting than the required standard of the Model Code for Securities Transactions by Directors of Listed Issuers (the “Model Code”) as set out in Appendix 10 of the Listing Rules.

Following specific enquiry made with the Directors, the Company has confirmed that each of the Directors complied with the required standard set out in the Model Code regarding securities transactions by the Directors.

AUDIT COMMITTEE

The Company has established an audit committee (“Audit Committee”) in accordance with the requirements of the Code of Best Practice for the purposes of reviewing and providing supervision over the Group’s financial reporting process and internal controls. The Audit Committee is composed of the three independent non-executive Directors. An audit committee meeting was held on 28 February 2005 to review the Group’s annual report and provide advice and recommendations to the board of directors of the Company.

INTERNATIONAL AUDITORS

Ernst & Young was the Company’s international auditors for the year ended 31 December 2004. A resolution for the reappointment of Ernst & Young as international auditors of the Company will be proposed at the forthcoming annual general meeting.

On Behalf of the Board of Directors

Zhang Bo
Chairman

Shandong, the PRC
28 February 2005