

FINANCIAL STATEMENTS

NOTES TO FINANCIAL STATEMENTS

1. CORPORATE INFORMATION

The registered office of Weiqiao Textile Company Limited (the “Company”) is located at No.34, Qidong Road, Weiqiao Town, Zouping County, Shandong Province, the People’s Republic of China (the “PRC”).

The Group is principally engaged in the manufacture and sale of cotton yarns, grey fabrics and denims in the PRC and overseas.

In the opinion of the directors, the immediate holding company and the ultimate holding company are Shandong Weiqiao Chuangye Group Company (“the Holding Company”), a limited liability company established in the PRC, and Zouping County Supply and Marketing Corporation Union (“ZCSU”), a collectively-owned enterprise formed in the PRC, respectively.

2. IMPACT OF RECENTLY ISSUED HONG KONG FINANCIAL REPORTING STANDARDS (“HKFRSs”)

The Hong Kong Institute of Certified Public Accountants has issued a number of new Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards, herein collectively referred to as the new HKFRSs, which are generally effective for accounting periods beginning on or after 1 January 2005. The Group has not early adopted these new HKFRSs in the financial statements for the year ended 31 December 2004. The Group has already commenced an assessment of the impact of these new HKFRSs but is not yet in a position to state whether these new HKFRSs would have a significant impact on its results of operations and financial position.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of preparation

These financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards (which also include Statements of Standard Accounting Practice and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants, accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. They have been prepared under the historical cost convention.

Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 December 2004. The results of subsidiaries acquired or disposed of during the year are consolidated from or to their effective dates of acquisition or disposal, respectively. All significant intercompany transactions and balances within the Group are eliminated on consolidation.

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Subsidiaries

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

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

Negative goodwill

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

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

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

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

Related parties

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

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment of assets

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

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

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

Fixed assets and depreciation

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

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

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

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

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Leased assets

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

Intangible assets

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

Research and development costs

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

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

Inventories

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

Cash and cash equivalents

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

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

Provisions

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

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

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Income tax

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

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

Deferred tax liabilities are recognised for all taxable temporary differences:

- except where the deferred tax liability arises from goodwill or the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries and interests in joint ventures, except where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

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

- except where the deferred tax asset relating to the deductible temporary differences arises from negative goodwill or the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries and interests in joint ventures, deferred tax assets are only recognised to the extent that it is probable that temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

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

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenue recognition

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

- from the sale of goods, where the significant risks and rewards of ownership have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold; and
- interest income, on a time proportion basis taking into account the principal outstanding and the effective interest rate applicable.

Government grants

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

Retirement benefits scheme

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

Borrowing costs

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

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Dividends

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

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

Foreign currency transactions

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

4. SEGMENT INFORMATION

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

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

| | Sales to external customers | Cost of sales | Gross profit |
|----------------|--|----------------------|---------------------|
| | 2004 | 2004 | 2004 |
| | RMB'000 | RMB'000 | RMB'000 |
| Mainland China | 6,291,081 | 4,886,573 | 1,404,508 |
| Hong Kong | 1,869,948 | 1,641,237 | 228,711 |
| East Asia | 1,864,803 | 1,735,844 | 128,959 |
| Others | 1,062,392 | 967,393 | 94,999 |
| Total | 11,088,224 | 9,231,047 | 1,857,177 |

4. SEGMENT INFORMATION (continued)

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

5. TURNOVER AND OTHER REVENUE

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

An analysis of turnover and other revenue is as follows:

| | Group | |
|---|-----------------|-----------------|
| | 2003 RMB'000 | 2004 RMB'000 |
| Turnover | | |
| Sale of goods | 6,560,470 | 11,088,224 |
| Other revenue | | |
| Interest income | 12,048 | 24,154 |
| Gain on sale of raw materials | 27,783 | 61,101 |
| Compensation from suppliers on supply of sub-standard goods | 24,610 | 61,664 |
| Penalty income from employees | 3,853 | 8,036 |
| Negative goodwill recognised | 2,990 | 2,990 |
| Subsidy income | 2,119 | — |
| Other | 717 | 1,077 |
| | 74,120 | 159,022 |

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6. PROFIT FROM OPERATING ACTIVITIES

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

| | Notes | 2003 RMB'000 | 2004 RMB'000 |
|--|-------|-----------------|-----------------|
| Cost of inventories sold | | 5,338,325 | 9,212,247 |
| Staff costs (excluding directors' and supervisors' emoluments (<i>note (8)</i>): | | | |
| Wages, salaries and social security costs | | 607,421 | 1,003,091 |
| Retirement benefit contributions | 7 | 15,756 | 23,653 |
| Loss on disposal of fixed assets | | — | 1,787 |
| Amortisation of intangible assets | 16 | 1,200 | 1,200 |
| Auditors' remuneration | | 2,470 | 3,200 |
| Depreciation | 15 | 287,495 | 499,273 |
| Directors' and supervisors' emoluments | 8 | 1,600 | 4,211 |
| Exchange losses, net | | 7,429 | 9,150 |
| Operating lease expenses | | 4,889 | 9,536 |
| Provision for bad and doubtful debts | | 7,031 | 2,000 |
| Provision against inventories | | 11,832 | 18,800 |
| Negative goodwill recognised as income during the year | 17 | (2,990) | (2,990) |
| Repairs and maintenance | | 160,151 | 264,552 |
| Research and development costs included in: | | | |
| Wages and salaries | | 903 | 3,016 |
| Consumption of consumables | | 3,644 | 5,428 |
| | | 4,547 | 8,444 |

7. RETIREMENT BENEFITS

The aggregate contribution of the Group to retirement benefit scheme were approximately RMB23.7 million for the year ended 31 December 2004 (2003: RMB15.9 million). As at 31 December 2004, the Group had no forfeited contributions available to reduce its contributions to the pension scheme in future years (2003: Nil).

8. DIRECTORS' AND SUPERVISORS' REMUNERATION

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

| | Group | |
|---|------------------------|------------------------|
| | 2003 <i>RMB'000</i> | 2004 <i>RMB'000</i> |
| Fees | 1,269 | 3,996 |
| Other emoluments: | | |
| Salaries, allowances and benefits in kind | 227 | 179 |
| Retirement benefit contributions | 104 | 36 |
| | 1,600 | 4,211 |

Fees include approximately RMB806,000 (2003: RMB385,000) payable to the independent non-executive directors. There were no other emoluments payable to the independent non-executive directors during the year (2003: Nil).

The remuneration of each of the directors and supervisors during the year and 2003 fell within the band of nil to HK\$1,000,000 (equivalent to approximately RMB1,061,000).

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

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

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9. FIVE HIGHEST PAID EMPLOYEES

The five highest paid employees in the Group included five directors (2003: five), details of whose remuneration are included in the analysis set out in note 8 above.

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

| | Group | |
|---|-----------------|-----------------|
| | 2003 RMB'000 | 2004 RMB'000 |
| Fees | 831 | 2,980 |
| Other emoluments: | | |
| Salaries, allowances and benefits in kind | 224 | 179 |
| Retirement benefit contributions | 100 | 36 |
| | 1,155 | 3,195 |

The remuneration of each of the five highest paid employees during 2004 and 2003 fell within the band of nil to HK\$1,000,000 (equivalent to approximately RMB1,061,000).

10. FINANCE COSTS

| | Group | |
|---|-----------------|-----------------|
| | 2003 RMB'000 | 2004 RMB'000 |
| Interest on bank loans wholly repayable within five years | 162,597 | 316,383 |
| Less: Interest capitalised* | (4,800) | (26,000) |
| | 157,797 | 290,383 |

* The capitalisation rate adopted for capitalising interests incurred during the year ranged from 3.336% to 7.254% per annum. (2003: 4.325% to 6.732%)

11. TAX

Hong Kong profits tax has not been provided as the Group had no assessable profits arising in Hong Kong during the year (2003: Nil).

| | Group | |
|-------------------------------|-----------------|-----------------|
| | 2003 RMB'000 | 2004 RMB'000 |
| Current — Hong Kong | — | — |
| — Mainland China | 305,674 | 420,405 |
| Total tax charge for the year | 305,674 | 420,405 |

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

| | 2003 | | 2004 | |
|--|---------|-------|-----------|-------|
| | RMB'000 | % | RMB'000 | % |
| Profit before tax | 853,442 | | 1,246,884 | |
| At PRC statutory tax rate | 281,636 | 33.0 | 411,472 | 33.0 |
| Expenses not deductible for tax | 21,689 | 2.6 | 10,333 | 0.8 |
| Tax loss not recognised | — | — | 5,002 | 0.4 |
| Income not subject to tax | (699) | (0.1) | — | — |
| Tax exemption | (4,150) | (0.5) | (1,913) | (0.1) |
| Others | 7,198 | 0.8 | (4,489) | (0.4) |
| Tax charge at the Group's effective rate | 305,674 | 35.8 | 420,405 | 33.7 |

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

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11. TAX (continued)

Being Sino-foreign joint venture enterprises, Luteng Textile and Binteng Textile are subject to a State CIT rate of 30% and a local CIT rate of 3%. With regard to State CIT, they are entitled to a full exemption for the first two years and a 50% reduction in the next three years, commencing from the first profitable year after offsetting all tax losses carried forward from the previous five years. With regard to local CIT, the local tax authority has granted Luteng Textile and Binteng Textile a full exemption commencing from 2002 and 2004, respectively. Since Luteng Textile and Binteng Textile were both approved to have income tax exemptions in 2004, no provision for CIT has been made by the two companies for the current year.

At 31 December 2004, there is no significant unrecognised deferred tax liability (2003: Nil) for taxes that would be payable on the unremitted earnings of certain of the Group's subsidiaries and joint ventures, as the Group has no liability to additional tax should such amounts be remitted.

The Group did not have any significant unprovided deferred tax in 2004 and 2003.

12. NET PROFIT FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS

The net profit from ordinary activities attributable to shareholders for the year ended 31 December 2004 dealt with in the financial statements of the Company was RMB792 million (2003: RMB472 million).

13. PROFIT APPROPRIATIONS

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

(i) Statutory surplus reserve

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

13. PROFIT APPROPRIATIONS (continued)

(ii) Statutory public welfare fund

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

The directors of respective companies resolved to appropriate 10% of the profit attributable to shareholders, determined in accordance with PRC Accounting Regulations, to each of the statutory surplus reserve and the statutory public welfare fund for the years ended 31 December 2004 and 2003, except for 5% appropriation to statutory welfare fund for the year ended 31 December 2003 in Binzhou Industrial Park.

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

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

(2) Dividend

| | 2003 RMB'000 | 2004 RMB'000 |
|---|-----------------|-----------------|
| Proposed final RMB0.25 per share (2003: RMB0.056 per share) | 45,808 | 218,863 |

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

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14. EARNINGS PER SHARE

The calculation of basic earnings per share is based on:

| | 2003 <i>RMB'000</i> | 2004 <i>RMB'000</i> |
|--|------------------------|--------------------------------------|
| Earnings | | |
| Net profit from ordinary activities attributable to shareholders used in the basic earnings per share calculation | 541,672 | 825,535 |
| Shares | | |
| | Number of shares | |
| | 2003 | 2004 |
| Weighted average number of ordinary shares in issue during the year used in the basic earnings per share calculation | 608,061,840 | 851,123,852 |

The weighted average numbers of ordinary shares in issue during the year used in the basic earnings per share calculations for both 2004 and 2003 have been adjusted to reflect the H shares issued by way of placing in 2004 and initial public offering in 2003.

A diluted earnings per share amount for the year ended 31 December 2004 has not been disclosed as no diluting events existed during the year.

15. FIXED ASSETS

The Group

| | Land and buildings <i>RMB'000</i> | Machinery and equipment <i>RMB'000</i> | Motor vehicles <i>RMB'000</i> | Construction in progress <i>RMB'000</i> | Total <i>RMB'000</i> |
|-------------------------------------|---|---|-------------------------------------|---|-------------------------|
| Cost: | | | | | |
| At beginning of year | 1,113,632 | 4,385,593 | 20,405 | 1,307,700 | 6,827,330 |
| Additions | 27,188 | 115,433 | 11,697 | 3,646,494 | 3,800,812 |
| Transfers from/(to) fixed assets | 1,001,298 | 3,156,582 | — | (4,157,880) | — |
| Disposals | — | (7,609) | — | — | (7,609) |
| At 31 December 2004 | 2,142,118 | 7,649,999 | 32,102 | 796,314 | 10,620,533 |
| Accumulated depreciation: | | | | | |
| At beginning of year | 34,271 | 462,809 | 2,420 | — | 499,500 |
| Provided during the year | 43,011 | 452,957 | 3,305 | — | 499,273 |
| Disposals | — | (1,686) | — | — | (1,686) |
| At 31 December 2004 | 77,282 | 914,080 | 5,725 | — | 997,087 |
| Net book value: | | | | | |
| At 31 December 2004 | 2,064,836 | 6,735,919 | 26,377 | 796,314 | 9,623,446 |
| At 31 December 2003 | 1,079,361 | 3,922,784 | 17,985 | 1,307,700 | 6,327,830 |

Prior to its transfer to land and buildings, and machinery and equipment, the carrying amount of construction in progress included capitalised interest of approximately RMB26 million (2003: RMB4.8 million).

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15. FIXED ASSETS (continued)

The Company

| | Land and buildings RMB'000 | Machinery and equipment RMB'000 | Motor vehicles RMB'000 | Construction in progress RMB'000 | Total RMB'000 |
|-------------------------------|----------------------------------|--|------------------------------|--|------------------|
| Cost: | | | | | |
| At beginning of year | 785,602 | 3,192,123 | 13,175 | 1,248,358 | 5,239,258 |
| Additions | 17,353 | 182,029 | 9,771 | 2,273,076 | 2,482,229 |
| Transfers | 611,257 | 2,738,664 | — | (3,349,921) | — |
| Contribution to subsidiaries* | (3,584) | (112,217) | — | (72,622) | (188,423) |
| Disposals | — | (38,479) | — | — | (38,479) |
| At 31 December 2004 | 1,410,628 | 5,962,120 | 22,946 | 98,891 | 7,494,585 |
| Accumulated depreciation: | | | | | |
| At beginning of year | 30,556 | 356,315 | 1,434 | — | 388,305 |
| Provided during the year | 28,489 | 340,998 | 2,204 | — | 371,691 |
| Contribution to subsidiaries* | — | (116) | — | — | (116) |
| Disposals | — | (1,047) | — | — | (1,047) |
| At 31 December 2004 | 59,045 | 696,150 | 3,638 | — | 758,833 |
| Net book value: | | | | | |
| At 31 December 2004 | 1,351,583 | 5,265,970 | 19,308 | 98,891 | 6,735,752 |
| At 31 December 2003 | 755,046 | 2,835,808 | 11,741 | 1,248,358 | 4,850,953 |

* The Company contributed fixed assets with aggregate amount of approximately RMB188 million (approximate to the then carrying amount of such fixed assets) to its subsidiaries in 2004 (2003: RMB208 million).

16. INTANGIBLE ASSETS

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

| | 2003 <i>RMB'000</i> | 2004 <i>RMB'000</i> |
|------------------------------|------------------------|------------------------|
| Cost: | | |
| At beginning and end of year | 12,001 | 12,001 |
| Accumulated amortisation: | | |
| At beginning of year | 300 | 1,500 |
| Provided during the year | 1,200 | 1,200 |
| At closing of year | 1,500 | 2,700 |
| Net book value | 10,501 | 9,301 |

17. NEGATIVE GOODWILL

Negative goodwill recognised in the consolidated balance sheet, arising from the acquisition of Binzhou Weiqiao Technology Industrial Park Company Limited ("Binzhou Industrial Park") in 2002, is as follows:

| | 2003 <i>RMB'000</i> | 2004 <i>RMB'000</i> |
|--------------------------------------|------------------------|------------------------|
| Cost: | | |
| At beginning and end of year | (29,902) | (29,902) |
| Recognition as income: | | |
| At beginning of year | 374 | 3,364 |
| Recognised as income during the year | 2,990 | 2,990 |
| At closing of year | 3,364 | 6,354 |
| Net book value | (26,538) | (23,548) |

FINANCIAL STATEMENTS

18. INTERESTS IN SUBSIDIARIES

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

| | 2003 <i>RMB'000</i> | 2004 <i>RMB'000</i> |
|-------------------------------|------------------------|------------------------|
| Unlisted investments, at cost | 462,235 | 1,200,891 |
| Amounts due from subsidiaries | 727,337 | 1,302,996 |
| Amounts due to subsidiaries | (301,089) | (428,250) |
| | 888,483 | 2,075,637 |

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

Particulars of the subsidiaries and joint ventures of the Company as at 31 December 2004 are as follows:

| Company name | Place and date of incorporation/ registration and operations | Legal status | Paid-up capital/ registered capital | Percentage of equity interests directly attributable to the Company | Principal activities |
|---|--|---------------------------|-------------------------------------|---|---|
| <i>Subsidiaries</i> | | | | | |
| Weihai Weiqiao Textile Company Limited (“Weihai Weiqiao”) | Weihai, the PRC 25 July 2001 | Limited liability company | RMB148,000,000 | 87.2 | Production and sale of cotton yarns and fabrics |
| Binzhou Industrial Park (a) | Binzhou, the PRC 26 November 2001 | Limited liability company | RMB600,000,000 | 98.5 | Production and sale of cotton yarns and fabrics |
| Shandong Weiqiao Mianye Company Limited | Zouping, the PRC 30 September 2003 | Limited liability company | RMB5,000,000 | 92 | Purchase, processing and sale of raw cotton, cotton seeds and lint cotton |
| Weihai Weiqiao Technology Industrial Park Company Limited (b) | Weihai, the PRC 30 January 2004 | Limited liability company | RMB260,000,000 | 99.8 | Production and sale of cotton yarns and fabrics |

18. INTERESTS IN SUBSIDIARIES (continued)

| Company name | Place and date of incorporation/ registration and operations | Legal status | Paid-up capital/ registered capital | Percentage of equity interests directly attributable to the Company | Principal activities |
|-----------------------|--|-----------------------------------|--|---|---|
| <i>Joint ventures</i> | | | | | |
| Luteng Textile | Zouping, the PRC 12 September 2002 | Sino-foreign equity joint venture | US\$9,790,000 | 75 | Production and sale of polyester yarns and related products |
| Binteng Textile (c) | Zouping, the PRC 12 March 2004 | Sino-foreign equity joint venture | US\$15,430,000 | 75 | Production and sale of compact yarns and related products |

- (a) During the year, the Company made further capital contribution to Binzhou Industrial Park by capitalising an amount due to the Company by Binzhou Industrial Park. According to the capital verification report issued on 15 January 2004 by Shandong Huanghe Certified Public Accountants Co., Ltd., Certified Public Accountants registered in the PRC, an amount due to the Company by Binzhou Industrial Park of RMB381,107,369 was capitalised into the registered capital and the capital reserve of Binzhou Industrial Park in the respective amount of RMB300,000,000 and RMB81,107,369. Consequently, the equity interests held by the Company in Binzhou Industrial Park increased from 97% on 31 December 2003 to 98.5% on 31 December 2004.
- (b) In January 2004, the Company established Weihai Weiqiao Technology Industrial Park Company Limited ("Weihai Industrial Park") with Mr. Liu Guangmin, an independent third party, in Weihai City with registered capital of RMB260,000,000. The Company contributed cash and fixed assets of RMB160,000,000 and RMB99,480,000, respectively, totalling RMB259,480,000 in capital, accounting for 99.8% of the registered capital of Weihai Industrial Park, whilst Mr. Liu Guangmin contributed cash of RMB520,000, accounting for 0.2% of the registered capital of Weihai Industrial Park.
- (c) In March 2004, the Company and Itochu Corporation ("Itochu") entered into a Sino-foreign equity joint venture contract to jointly establish Binteng Textile with registered capital of US\$15,430,000. According to the joint venture contract, the Company contributed US\$11,570,000 in the form of plant and machinery, accounting for 75% of the registered capital of Binteng Textile, whilst Itochu contributed cash of US\$3,860,000 into Binteng Textile, representing 25% of the registered capital of Binteng Textile.

FINANCIAL STATEMENTS

19. INVENTORIES

| | Group | |
|------------------------------------|------------------------|------------------------|
| | 2003 <i>RMB'000</i> | 2004 <i>RMB'000</i> |
| Raw materials | 934,946 | 606,548 |
| Work in progress | 252,462 | 396,632 |
| Semi-finished goods | 123,980 | 608,871 |
| Finished goods | 226,904 | 807,572 |
| Consigned materials for processing | 316 | — |
| Consumables | 34,064 | 57,322 |
| Raw materials in transit | 511,313 | 196,523 |
| Total | 2,083,985 | 2,673,468 |

| | Company | |
|------------------------------------|------------------------|------------------------|
| | 2003 <i>RMB'000</i> | 2004 <i>RMB'000</i> |
| Raw materials | 745,244 | 429,411 |
| Work in progress | 214,192 | 286,185 |
| Semi-finished goods | 81,026 | 504,896 |
| Finished goods | 183,089 | 650,920 |
| Consigned materials for processing | 316 | 11,716 |
| Consumables | 25,263 | 52,060 |
| Raw materials in transit | 511,313 | 196,523 |
| Total | 1,760,443 | 2,131,711 |

The carrying amounts of inventories of the Group and the Company carried at net realisable value included in the above balances were approximately RMB41 million (2003: RMB36 million) and RMB27 million (2003: RMB35 million), respectively, as at 31 December 2004.

Certain of the Group's and the Company's raw materials in transit of approximately RMB135 million as at 31 December 2004 were utilised to secure bank loans up to approximately RMB135 million (2003: RMB301 million).

20. TRADE RECEIVABLES

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

| | Group | |
|----------------------------|------------------------|------------------------|
| | 2003 <i>RMB'000</i> | 2004 <i>RMB'000</i> |
| Outstanding balances aged: | | |
| Within 3 months | 484,610 | 590,558 |
| 3 months to 6 months | 5,449 | 3,106 |
| 6 months to 1 year | 3,453 | 2,900 |
| 1 year to 2 years | 2,701 | 1,855 |
| | 496,213 | 598,419 |

| | Company | |
|----------------------------|------------------------|------------------------|
| | 2003 <i>RMB'000</i> | 2004 <i>RMB'000</i> |
| Outstanding balances aged: | | |
| Within 3 months | 420,902 | 569,977 |
| 3 months to 6 months | 5,449 | 3,075 |
| 6 months to 1 year | 3,331 | 2,900 |
| 1 year to 2 years | 2,701 | 1,855 |
| | 432,383 | 577,807 |

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

FINANCIAL STATEMENTS

21. PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

| | Group | |
|-----------------------------------|------------------------|------------------------|
| | 2003 <i>RMB'000</i> | 2004 <i>RMB'000</i> |
| Prepayments to suppliers | 125,529 | 363,431 |
| Export value-added tax refundable | 75,436 | — |
| Other receivables and prepayments | 124,711 | 11,356 |
| Total | 325,676 | 374,787 |

| | Company | |
|-----------------------------------|------------------------|------------------------|
| | 2003 <i>RMB'000</i> | 2004 <i>RMB'000</i> |
| Prepayments to suppliers | 125,192 | 362,699 |
| Export value-added tax refundable | 75,436 | — |
| Other receivables and prepayments | 116,016 | 2,270 |
| Total | 316,644 | 364,969 |

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

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

23. CASH AND CASH EQUIVALENTS AND PLEDGED DEPOSITS

| | Group | |
|---|-----------------|-----------------|
| | 2003 RMB'000 | 2004 RMB'000 |
| Cash and bank balances | 1,278,193 | 1,748,717 |
| Time deposits | 576,480 | 1,118,167 |
| | 1,854,673 | 2,866,884 |
| Less: Pledged time deposits: | | |
| Pledged for letter of credit facilities | (292,571) | (229,836) |
| Pledged for issuance of bills payable (note 25) | (29,909) | (67,000) |
| | (322,480) | (296,836) |
| Time deposits over three months | — | (325,400) |
| Cash and cash equivalents | 1,532,193 | 2,244,648 |

| | Company | |
|---|-----------------|-----------------|
| | 2003 RMB'000 | 2004 RMB'000 |
| Cash and bank balances | 1,175,692 | 1,618,216 |
| Time deposits | 528,427 | 1,044,033 |
| | 1,704,119 | 2,662,249 |
| Less: Pledged time deposits for letter of credit facilities | (274,427) | (222,702) |
| Time deposits over three months | — | (325,400) |
| Cash and cash equivalents | 1,429,692 | 2,114,147 |

FINANCIAL STATEMENTS

24. TRADE PAYABLES

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

| | Group | |
|----------------------------|------------------------|------------------------|
| | 2003 <i>RMB'000</i> | 2004 <i>RMB'000</i> |
| Outstanding balances aged: | | |
| Within 90 days | 1,189,081 | 1,292,330 |
| 90 days to 3 years | 59,536 | 37,061 |
| | 1,248,617 | 1,329,391 |

| | Company | |
|----------------------------|------------------------|------------------------|
| | 2003 <i>RMB'000</i> | 2004 <i>RMB'000</i> |
| Outstanding balances aged: | | |
| Within 90 days | 1,129,841 | 1,134,213 |
| 90 days to 3 years | 58,762 | 23,967 |
| | 1,188,603 | 1,158,180 |

25. BILLS PAYABLE

| | Group | |
|----------------------------|------------------------|------------------------|
| | 2003 <i>RMB'000</i> | 2004 <i>RMB'000</i> |
| Outstanding balances aged: | | |
| Within 90 days | 19,597 | 60,000 |
| 90 to 180 days | 60,000 | 160,000 |
| | 79,597 | 220,000 |

The bills payable as at 31 December 2004 were entirely drawn by Weihai Weiqiao in favour of the Company which were discounted with banks by the Company prior to 31 December 2004.

The Group's bills payable were secured by the pledge of certain of the Group's time deposits, details of which are described in note 23 above.

26. OTHER PAYABLES AND ACCRUALS

Included in the Group's other payables and accruals as at 31 December 2004 and 31 December 2003 are government grants totalling RMB70 million and RMB13 million, respectively, mainly provided by the Finance Bureau of the Binzhou City to Binzhou Industrial Park for the purpose of providing support for the development of Binzhou Industrial Park and product development.

27. INTEREST-BEARING BANK LOANS

(1) Interest-bearing bank loans, current portion

| | Group | |
|-------------------------------|-----------------|-----------------|
| | 2003 RMB'000 | 2004 RMB'000 |
| Current portion of bank loans | 1,991,369 | 3,347,144 |

| | Company | |
|-------------------------------|-----------------|-----------------|
| | 2003 RMB'000 | 2004 RMB'000 |
| Current portion of bank loans | 1,403,588 | 2,652,789 |

FINANCIAL STATEMENTS

27. INTEREST-BEARING BANK LOANS (continued)

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

| | Group | |
|---|-----------------|-----------------|
| | 2003 RMB'000 | 2004 RMB'000 |
| Bank loans: | | |
| Secured | 3,793,227 | 5,470,823 |
| Unsecured | 680,481 | 1,495,107 |
| | 4,473,708 | 6,965,930 |
| Bank loans repayable: | | |
| Within one year or on demand | 1,991,369 | 3,347,144 |
| In the second year | 946,470 | 1,226,904 |
| In the third to fifth years, inclusive | 1,535,869 | 2,391,882 |
| | 4,473,708 | 6,965,930 |
| Portion classified as current liabilities | (1,991,369) | (3,347,144) |
| Long term portion | 2,482,339 | 3,618,786 |

| | Company | |
|---|-----------------|-----------------|
| | 2003 RMB'000 | 2004 RMB'000 |
| Bank loans: | | |
| Secured | 3,603,157 | 4,692,468 |
| Unsecured | 82,769 | 1,495,107 |
| | 3,685,926 | 6,187,575 |
| Bank loans repayable: | | |
| Within one year or on demand | 1,403,588 | 2,652,789 |
| In the second year | 830,470 | 1,142,904 |
| In the third to fifth years, inclusive | 1,451,869 | 2,391,882 |
| | 3,685,927 | 6,187,575 |
| Portion classified as current liabilities | (1,403,588) | (2,652,789) |
| Long term portion | 2,282,339 | 3,534,786 |

27. INTEREST-BEARING BANK LOANS (continued)

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

- (i) On 8 September 2004, the Company entered into a master agreement relating to a dual currency term loan facility (the "Agreement") with a syndicate of banks. The facility provides that the Company may borrow up to US\$78 million and RMB183 million, which were fully utilised as at 31 December 2004. The Agreement contained certain undertakings and financial covenants, including but not limited to maximum level of dividend payment, minimum level of consolidated tangible net worth, maximum level of consolidated total debts and consolidated total secured debts, maintenance of net consolidated current assets and certain financial ratios.
- (ii) Other than part of the Group's and the Company's bank loans in the aggregate amount of US\$297 million (equivalent to RMB2,462 million) as at 31 December 2004 (2003: US\$149 million or equivalent to RMB1,231 million), all of the Group's and the Company's bank loans are denominated in RMB. All of the Group's and the Company's bank loans bear yearly interest rates ranging from 3.2% to 7.254% as at 31 December 2004 (2003: 2.16% to 7.254%).
- (iii) Certain of the Group's bank loans amounting to approximately RMB4,879 million were secured by certain of the Group's land and buildings, machinery and equipment, which had an aggregate net book value of approximately RMB7,202 million as at 31 December 2004 (2003: RMB5,130 million).
- (iv) Certain of the Group's bank loans of RMB135 million were secured by certain of the Group's export value-added tax refundable of RMB72 million (2003: RMB10 million) and accounts receivable of RMB144 million (2003: RMB15 million). The export value-added tax refundable and accounts receivable were received by the Group and included in the Group's cash and cash equivalents prior to 31 December 2004.
- (v) Certain of the Group's bank loans up to approximately RMB135 million (2003: RMB301 million) were secured by certain of the Group's raw materials in transit of approximately RMB135 million (2003: RMB301 million) as at 31 December 2004.
- (vi) Weihai Civil Aviation Industrial Company Limited, a minority shareholder of Weihai Weiqiao, has guaranteed bank loans of Weihai Weiqiao up to about RMB41 million as at 31 December 2004 (2003: RMB32 million).
- (vii) The Company has guaranteed bank loans of certain of its subsidiaries up to approximately RMB281 million as at 31 December 2004 (2003: RMB555 million).

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28. LONG TERM PAYABLE TO THE IMMEDIATE HOLDING COMPANY

The long term payable to the immediate holding company as at 31 December 2004 and 31 December 2003 are unsecured, interest-free and are repayable over three years commencing 2005 by three instalments of RMB50,000,000 in 2005, RMB50,000,000 in 2006 and RMB78,927,000 in 2007, respectively.

| | The Group and the Company | |
|---|---------------------------|-----------------|
| | 2003 RMB'000 | 2004 RMB'000 |
| Amount repayable: | | |
| Within one year | — | 50,000 |
| In the second year | 50,000 | 50,000 |
| In the third to fifth years, inclusive | 128,927 | 78,927 |
| | 178,927 | 178,927 |
| Portion classification as current liabilities | — | (50,000) |
| Long term portion | 178,927 | 128,927 |

29. SHARE CAPITAL

| | 2003 RMB'000 | 2004 RMB'000 |
|--|-----------------|-----------------|
| Registered, issued and fully paid: | | |
| 530,770,000 (2003: 530,770,000) domestic shares of RMB1.00 each | 530,770 | 530,770 |
| 344,682,500 (2003: 287,235,500) H shares of RMB1.00 each (b) | 287,236 | 344,683 |
| | 818,006 | 875,453 |

The Company does not have any share option scheme.

29. SHARE CAPITAL (continued)

During the year and 2003, the movements in share capital were as follows:

- (a) 249,770,000 H shares of the Company were listed on the Main Board of The Stock Exchange of Hong Kong Limited (the "HKSE") on 24 September 2003 and 37,465,500 additional H shares, issued upon exercise of an over-allotment option, were listed on the Main Board of the HKSE on 30 September 2003. These H shares with a par value of RMB1.00 each were issued to the public by way of placing and public offer at a price of HK\$8.5 (equivalent to approximately RMB9.07) per share.
- (b) On 4 June 2004, 57,447,000 H shares of the Company with a par value of RMB1.00 each were issued to the public by way of placing at a price of HK\$11.6 (equivalent to approximately RMB12.3) per H Share. These H Shares were listed on the HKSE in June 2004.

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

| | Number of shares in issue | Issued share capital RMB'000 | Capital reserve account RMB'000 | Total RMB'000 |
|-----------------------|------------------------------|------------------------------------|---------------------------------------|------------------|
| At 1 January 2003 | 530,770,000 | 530,770 | 565,728 | 1,096,498 |
| Issue of H shares (a) | 287,235,500 | 287,236 | 2,317,563 | 2,604,799 |
| | 818,005,500 | 818,006 | 2,883,291 | 3,701,297 |
| Shares issue expenses | — | — | (93,627) | (93,627) |
| At 1 January 2004 | 818,005,500 | 818,006 | 2,789,664 | 3,607,670 |
| Issue of H shares (b) | 57,447,000 | 57,447 | 649,087 | 706,534 |
| | 875,452,500 | 875,453 | 3,438,751 | 4,314,204 |
| Shares issue expenses | — | — | (14,552) | (14,552) |
| At 31 December 2004 | 875,452,500 | 875,453 | 3,424,199 | 4,299,652 |

FINANCIAL STATEMENTS

30. RESERVES

The Group

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

The Company

| | Capital reserve <i>RMB'000</i> | Statutory surplus reserve <i>RMB'000</i> | Statutory public welfare fund <i>RMB'000</i> | Proposed final dividend <i>RMB'000</i> | Retained profits <i>RMB'000</i> | Total <i>RMB'000</i> |
|---|--------------------------------------|---|---|---|---------------------------------------|-------------------------|
| As at 1 January 2003 | 565,728 | 50,079 | 50,079 | — | 336,134 | 1,002,020 |
| Issue of H shares (<i>note 29</i>) | 2,317,563 | — | — | — | — | 2,317,563 |
| Share issue expenses (<i>note 29</i>) | (93,627) | — | — | — | — | (93,627) |
| Net profit for the year | — | — | — | — | 472,215 | 472,215 |
| Transfer from/(to) reserves (<i>note 13(1)</i>) | — | 54,254 | 54,254 | — | (108,508) | — |
| Proposed final 2003 dividend | — | — | — | 45,808 | (45,808) | — |
| As at 31 December 2003 and 1 January 2004 | 2,789,664 | 104,333 | 104,333 | 45,808 | 654,033 | 3,698,171 |
| Issue of H shares (<i>note 29</i>) | 649,087 | — | — | — | — | 649,087 |
| Share issue expenses (<i>note 29</i>) | (14,552) | — | — | — | — | (14,552) |
| Net profit for the year | — | — | — | — | 791,559 | 791,559 |
| Transfer from/(to) reserves (<i>note 13(1)</i>) | — | 79,749 | 79,749 | — | (159,498) | — |
| Final 2003 dividend declared | — | — | — | (45,808) | — | (45,808) |
| Proposed final 2004 dividend | — | — | — | 218,863 | (218,863) | — |
| As at 31 December 2004 | 3,424,199 | 184,082 | 184,082 | 218,863 | 1,067,231 | 5,078,457 |

31. CONTINGENT LIABILITIES

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

| | Group | |
|--------------------------|------------------------|------------------------|
| | 2003 <i>RMB'000</i> | 2004 <i>RMB'000</i> |
| Letters of credit issued | 191,266 | 172,015 |

| | Company | |
|--|------------------------|------------------------|
| | 2003 <i>RMB'000</i> | 2004 <i>RMB'000</i> |
| Letters of credit issued | 191,266 | 172,015 |
| Bills discounted with recourse | — | 220,000 |
| Guarantee given to banks in connection with facilities granted to a subsidiary | 555,471 | 281,000 |
| | 746,737 | 673,015 |

FINANCIAL STATEMENTS

32. COMMITMENTS

(1) Capital commitments

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

| | The Group and the Company | |
|----------------------------------|---------------------------|-----------------|
| | 2003 RMB'000 | 2004 RMB'000 |
| Contracted, but not provided for | 109,197 | 242,901 |

(2) Operating lease commitments

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

| | Group | |
|---|-----------------|-----------------|
| | 2003 RMB'000 | 2004 RMB'000 |
| Within one year | 9,530 | 9,536 |
| In the second to fifth years, inclusive | 36,560 | 38,196 |
| After five years | 127,190 | 118,228 |
| | 173,280 | 165,960 |

| | Company | |
|---|-----------------|-----------------|
| | 2003 RMB'000 | 2004 RMB'000 |
| Within one year | 9,470 | 9,476 |
| In the second to fifth years, inclusive | 36,320 | 37,953 |
| After five years | 126,360 | 117,457 |
| | 172,150 | 164,886 |

33. RELATED PARTY TRANSACTIONS

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

In addition to the transactions and balances disclosed in note 22, note 27 and note 28 to these financial statements during the year, the Group had the following material transactions with the following related parties:

| Name of related parties | Relationship with the Company | Nature of transactions | 2003 RMB'000 | 2004 RMB'000 |
|--|--|--|---------------------|----------------------|
| Holding Company | the immediate holding company | Purchases of lint cotton and tailings | 164,600 | — |
| | | Expenses on provision of electricity and steam power | 229,194 | 554,140 |
| | | Sale of cotton yarns, grey fabrics and denims | 8,829 | — |
| | | Sale of ancillary materials and spare parts | 598 | — |
| | | Sale of fixed assets | — | 379 |
| | | Purchases of cotton yarns, grey fabrics and denims | 60,131 | — |
| | | Purchases of fixed assets | 46,582 | — |
| | | Purchases of ancillary materials and spare parts | 6,575 | — |
| | | Expenses on equipment and property leasing | 4,889 | 9,536 |
| | | Shandong Weiqiao Dyeing and Weaving Co., Ltd. | a fellow subsidiary | Sale of cotton yarns |
| Purchase of corduroy | 34,227 | | | — |
| Expenses on provision of processing services | 2,997 | | | — |
| Shandong Weilian Printing and Dyeing Co., Ltd. | a fellow subsidiary | Sale of grey fabrics | 96,012 | 116,085 |
| | | Expenses on provision of processing services | 8,242 | — |
| | | Purchases of coloured fabrics | 15,172 | — |
| Shandong Weiqiao Bleaching-Dyeing Co., Ltd. | an associate of Holding Company | Sale of cotton yarns | 6,105 | 7,478 |
| Binzhou Weiqiao Zhiye Co., Ltd. | a fellow subsidiary | Purchases of fixed assets | 16,799 | — |
| Hengfu Knitting Co., Ltd. | a fellow subsidiary | Sale of cotton yarns | — | 7,880 |
| No. 1 Oil and Cotton Co., Ltd. | a fellow subsidiary of Holding Company | Purchase of lint cotton | 374 | — |

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33. RELATED PARTY TRANSACTIONS (continued)

| Name of related parties | Relationship with the Company | Nature of transactions | 2003 RMB'000 | 2004 RMB'000 |
|---|--|-------------------------|-----------------|-----------------|
| No. 2 Oil and Cotton Co., Ltd. | a fellow subsidiary of Holding Company | Purchase of lint cotton | 2,251 | — |
| No. 6 Oil and Cotton Co., Ltd. | a fellow subsidiary of Holding Company | Purchase of lint cotton | 12,307 | — |
| Zouping Fuhai Oil Industrial Co., Ltd. | a fellow subsidiary of Holding Company | Purchase of lint cotton | 299 | — |
| Pozhuang Cotton Co., Ltd. | a fellow subsidiary of Holding Company | Purchase of lint cotton | 5,147 | — |
| Zouping Cotton and Hemp Fibre Co., Ltd. | a fellow subsidiary of Holding Company | Purchase of lint cotton | 627 | — |

The above related party transactions also constitute connected transactions or continuing connected transactions as defined in Chapter 14A of the Listing Rules.

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

In preparation for listing of the Company, the Company and Holding Company entered into a supply of electricity and steam agreement on 25 August 2003. Pursuant to the agreement, the Holding Company agreed to supply electricity and steam to the Group at a rate of the lower of the market price and RMB0.35/kWh for electricity, and at a rate of the lower of the market price and RMB60/ton for steam.

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

In addition, the Group has entered into nine property lease agreements with the Holding Company, with a right of renewal exercisable by the Group. The significant terms of such agreements are summarised 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.

33. RELATED PARTY TRANSACTIONS (continued)

- (iii) Land use rights lease agreement dated 30 September 2002 with the commencement date and expiry date on 30 September 2002 and 30 September 2022, respectively, at an annual rental expense of RMB888,700 for the land relating to the Second Production Area.
- (iv) Land use rights lease agreement dated 14 May 2003 with the commencement date and expiry date on 14 May 2003 and 14 May 2023, respectively, at an annual rental expense of RMB1,503,000 for the land relating to the Third Production Area.
- (v) Land use rights lease agreement dated 13 September 2002 with the commencement date and expiry date on 13 September 2002 and 13 September 2022, respectively, at an annual rental expense of RMB60,700 for the land relating to the Second Production Area.
- (vi) Operating lease agreement for a building dated 10 May 2000 with the commencement date and expiry date on 10 May 2000 and 10 May 2006, respectively, at an annual rental expense of RMB600,000 for a building located at No. 34 Qidong Road, Weiqiao Town, Zouping County, Shandong Province, the PRC.
- (vii) Land use rights lease agreement dated 17 October 2003 with the commencement date and expiry date on 17 October 2003 and 17 October 2023, respectively, at an annual rental expense of RMB2,167,000 for the land relating to the Zouping Industrial Park Area, a new production area established during the year.
- (viii) Land use rights lease agreement dated 17 October 2003 with the commencement date and expiry date on 17 October 2003 and 17 October 2023, respectively, at an annual rental expense of RMB994,100 for the land relating to the Zouping Industrial Park Area.
- (ix) Land use rights lease agreement dated 17 October 2003 with the commencement date and expiry date on 17 October 2003 and 17 October 2023, respectively, at an annual rental expense of RMB2,000,000 for the land relating to the Zouping Industrial Park Area.

34. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors of the Company on 28 February 2005.