

Management Discussion and Analysis

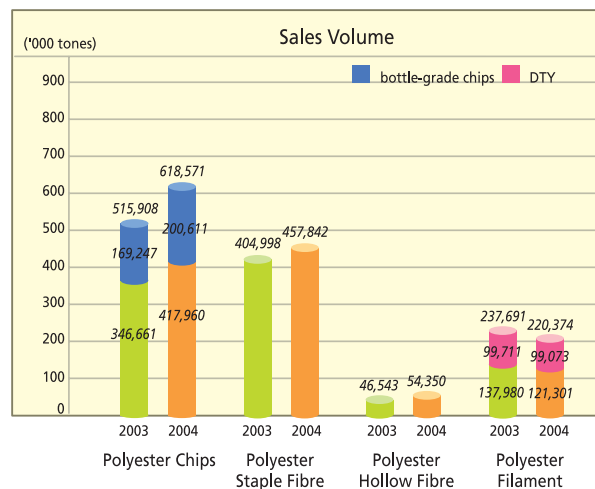
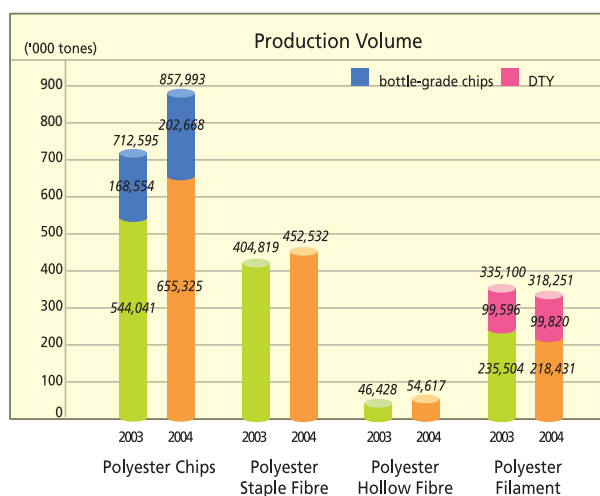


Mr. Xiao Wei-zhen, Managing Director

The information set out below does not constitute part of the financial statements audited by KPMG or KPMG Huazhen, as set out on pages 59 to 92 and pages 93 to 137, respectively, of this Annual Report, and is included for information purpose. This discussion and analysis should be read in conjunction with the information contained in the Consolidated Financial Statements and Notes thereto (the "Financial Statements") presented in this Annual Report. Financial figures, except where specifically noted, contained herein have been extracted from the financial statements prepared in accordance with IFRS.

1. Results of Operations

In 2004, under unfavourable market conditions, the Group put efforts into ensuring the stable and full operation of PTA line I and II to increase the output of PTA, and paid particular attention to improving its operations and lowering costs and expenses. As a result, the Group achieved relatively good profits.



Management Discussion and Analysis

(1) Turnover

In 2004, the Group's total production volume of polyester products increased to 1,683,393 tonnes, representing an increase of 12.3 per cent as compared with that of 1,498,762 tonnes of last year. Of this, the total production volumes of bottle-grade polyester chips, polyester staple fibre and polyester hollow fibre increased by 20.2 per cent, 11.8 per cent and 18.1 per cent respectively. The increase was mainly due to the staple fibre project with an annual capacity of 90,000 tonnes and improvement project of No.5K production line achieving full operation in 2004 and the commencement of operation of the CP and SSP project with an annual capacity of 200,000 tonnes completed in November 2004. Owing to product structure adjustment, the total production volumes of differential and specialized products increased, while the proportion of common products to total products decreased. The average capacity utilization rate reached 100.5 per cent. The total production volume of PTA amounted to 933,363 tonnes, an increase of 29.7 per cent as compared with that of 719,828 tonnes of last year. The increase was mainly due to the stable and full operation of PTA line I and II.

Production volume

	For the year ended 31 December			
	2004		2003	
	Production volume (tonnes)	Per cent of total production volume (%)	Production volume (tonnes)	Per cent of total production volume (%)
Polyester products				
Chips	857,993	51.0	712,595	47.5
Of which: bottle-grade polyester chips	202,668	12.0	168,554	11.2
Staple fibre	452,532	26.9	404,819	27.0
Hollow fibre	54,617	3.2	46,248	3.1
Filament	318,251	18.9	335,100	22.4
Of which: draw-twisted yarn "DTY"	99,820	5.9	99,596	6.6
Total	1,683,393	100.0	1,498,762	100.0

In 2004, the Group's total sales volume of polyester products amounted to 1,351,137 tonnes, an increase of 12.1 per cent from 1,205,140 tonnes of 2003. The ratio of sales to production reached 99.3 per cent. Owing to the sales and promotion of differential and specialized products, the total sales volumes of bottle-grade polyester chips, polyester staple fibre and polyester hollow fibre increased by 18.5 per cent, 13.0 per cent and 16.8 per cent respectively. Export sales of the polyester products amounted to 18,942 tonnes. Due to the drive from the cost of polyester raw material, the prices of polyester products increased. The weighted average prices (excluding VAT) of the Group's polyester products increased from Rmb 8,017/tonne to Rmb 9,467/tonne during the year, a 18.1 per cent increase. But the increase in prices of polyester products was obviously less than that of the principal raw material of polyester. As a result, the profit margin of polyester products was significantly compressed.



Management Discussion and Analysis

Sales volume

	For the year ended 31 December			
	2004		2003	
	Sales volume (tonnes)	Per cent of total sales volume (%)	Sales volume (tonnes)	Per cent of total sales volume (%)
Polyester products				
Polyester chips	618,571	45.8	515,908	42.8
Of which: bottle-grade polyester chips	200,611	14.8	169,247	14.0
Staple fibre	457,842	33.9	404,998	33.6
Hollow fibre	54,350	4.0	46,543	3.9
Filament	220,374	16.3	237,691	19.7
Of which: DTY	99,073	7.3	99,711	8.3
Total	<u>1,351,137</u>	<u>100.0</u>	<u>1,205,140</u>	<u>100</u>

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

	For the year ended 31 December		
	2004	2003	Change (%)
Polyester products			
Polyester chips	8,905	7,081	25.8
Staple fibre	9,481	8,172	16.0
Hollow fibre	9,947	8,269	20.3
Filament	10,898	9,737	11.9
Weighted average price	<u>9,467</u>	<u>8,017</u>	<u>18.1</u>

Turnover

	For the year ended 31 December			
	2004		2003	
	Turnover Rmb million	Per cent of turnover %	Turnover Rmb million	Per cent of turnover %
Polyester products				
Polyester chips	5,508	41.3	3,653	35.3
Staple fibre	4,341	32.5	3,310	32.0
Hollow fibre	540	4.1	385	3.7
Filament	2,402	18.0	2,314	22.4
Others	557	4.1	682	6.6
Total	<u>13,348</u>	<u>100.0</u>	<u>10,344</u>	<u>100.0</u>



Management Discussion and Analysis

In 2004, the Group's turnover amounted to Rmb 13,348 million, an increase of 29.1 per cent as compared with Rmb 10,344 million for last year. The increase was mainly due to the increase in the product prices and sales volume and the change in sales mix.

(2) Cost of sales

In 2004, the Group's cost of sales amounted to Rmb 12,220 million, representing 91.5 per cent of the turnover, which increased by 1.4 percentage points as compared with last year. Total costs of raw materials increased by Rmb 2,619 million from Rmb 7,472 million in 2003 to Rmb 10,091 million, which accounted for 82.6 per cent of cost of sales in 2004. The increase was mainly due to the increase in raw materials procurement and raw material price. Meanwhile, the increase was also due to the increase in the purchase costs of coal and the increase in maintenance expenses as compared with last year. The Group's weighted average purchase price of polyester raw materials increased by 31.8 per cent as compared with last year. Of this, the average purchase costs of PTA, MEG and PX increased by 26.6 per cent, 37.8 per cent and 29.2 per cent respectively as compared with last year. In light of the increase in the price of PTA, the Group increased the production volume of PTA and therefore reduced the purchase volume in 2004, which significantly lowered the cost and maximized the gross margin for the Group.

In 2004, due to the profit contribution of PTA and the effective action in lowering costs and expenses, the Group's gross profit increased by Rmb 105 million as compared with last year. Only after November, due to the rapid changes of polyester market, the Group's gross margin in the fourth quarter amounted to 2.9 per cent, a decrease of 7.8 percentage points as compared with that of the first three quarters of 2004. As a result, the Group's annual gross margin was 8.5 per cent, 1.4 percentage points less than that of last year.

(3) Selling, administrative and financial expenses

	For the year ended 31 December		
	2004 Rmb'000	2003 Rmb'000	Change (%)
Selling expenses	177,406	167,269	6.1
Administrative expenses	437,415	447,694	(2.3)
Financial expenses	72,176	54,873	31.5
Total	<u>686,997</u>	<u>669,836</u>	<u>2.6</u>

In 2004, selling expenses increased by Rmb 10 million, mainly due to the increase in sales volume and transportation costs. Administrative expenses decreased by Rmb 10 million, mainly due to the efforts in compressing internal management and lowering costs and expenses. Financial expenses increased by Rmb 17 million, mainly due to the decrease in interest capitalized and the increase in interest expenses on bills discounted. The total of these three types of expenses increased by 2.6 per cent as compared with last year. The proportion of these expenses to turnover decreased by 1.3 percentage points as compared with last year.



Management Discussion and Analysis

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

	For the year ended 31 December		
	2004	2003	Change
	Rmb'000	Rmb'000	(%)
Profit from operations	348,968	368,271	(5.2)
Profit from ordinary activities before taxation	276,792	313,398	(11.7)
Income tax expense	33,860	48,652	(30.4)
Profit attributable to shareholders	240,383	259,131	(7.2)
Earnings per share (in Rmb)	0.060	0.065	(7.2)

In 2004, due to the loss on the disposal of fixed assets and impairment losses of fixed assets, the Group's profit from ordinary activities before taxation amounted to Rmb 277 million, decreased by 11.7 per cent as compared with Rmb 313 million in 2003. Profit attributable to shareholders was Rmb 240 million, a decrease of 7.2 per cent as compared with Rmb 259 million last year. The operating profit margin and net profit margin reached 2.6 per cent and 1.8 per cent respectively, representing 1.0 percentage points and 0.8 percentage points less than that of last year respectively.

(5) Statement of the principal operations by products

Polyester products contributed over 10 percent of the Group's income from principal operations and profit from principal operations. The following is the statement of principal operations by products for the year ended 31 December 2004 in accordance with the PRC Accounting Rules and Regulations.

Products	Income from principal operations Rmb'000	Cost of principal operations Rmb'000	Gross profit margin (%)	Increase/ (decrease) in	Increase/ (decrease) in	Gross margin ratio as compared to last year (%)
				income from principal operations as compared to last year (%)	cost of principal operations as compared to last year (%)	
Polyester products	12,791,326	11,678,381	8.7	32.4	34.1	Decreased by 1.2 percentage points
Of which:						
connected transactions	556,464	508,504	8.6	(40.2)	(39.1)	Decreased by 1.7 percentage points

During 2004, the Company did not sell any products to its controlling shareholders and their subsidiaries.



Management Discussion and Analysis

(6) Operations of principal subsidiaries in 2004

1. Yizheng Chemical Fibre Foshan Polyester Company Limited (“**Foshan Polyester**”) and Foshan Chemical Fibre Company Limited (“**Foshan Chemical**”) (collectively “**Foshan Group**”). The Company directly holds 90 per cent and indirectly holds 10 per cent of the equity interest of Foshan Chemical. Foshan Chemical’s registered capital is Rmb 32,933,000. Its principal activity is the provision of management and administration services. The Company directly holds 59 percent and indirectly holds 41 percent of the equity interest of Foshan Polyester. Foshan Polyester’s registered capital is USD 85,427,000. Its principal activities are the production and sales of chemical, chemical fibre, textile and its ancillary raw materials, and after sales services for its products. As at 31 December 2004, the total assets of Foshan Group was Rmb 798,627,000. For the year ended 31 December 2004, Foshan Group made a loss of Rmb 14,952,000.
2. Yihua Kangqi Chemical Fibre Company Limited (“**Kangqi Company**”) and its subsidiaries (“**Kangqi Group**”). The Company directly holds 95 per cent and indirectly holds 5 percent of the equity interest of Kangqi Company. Kangqi Company’s registered capital is Rmb 60,000,000. Kangqi Company, through its 13 subsidiaries in major domestic markets, has established a sales network in the PRC. Kangqi Group’s principal activities are sales of polyester fibre. As at 31 December 2004, the total assets of Kangqi Group was Rmb 386,934,000. For the year ended 31 December 2004, Kangqi Group made a net profit of Rmb 7,676,000.

(7) Acquisition, divestment and investment

The Group did not make any material acquisition, divestment or investment in relation to any of its subsidiaries or associates in 2004.

Profit mix for the year 2004 and major reasons for the significant variance in the profit mix as compared with last year (extracted from the financial statements prepared in accordance with the PRC Accounting Rules and Regulations)

In 2004, profit from principal operations was Rmb 1,153 million and 432.5 per cent of total profit, which was increased by 81.8 percentage points as compared with last year. The increase was mainly due to the increase in the Group’s profit from principal operations as a result of the rise in profits contribution from PTA, and the slightly decrease in total profit as a result of the rise in non-operating expenses.

In 2004, net non-operating expenses was Rmb 176 million and 66.1 per cent of total profit, which was increased by 46.8 percentage points as compared with last year. The increase was mainly due to the significant increase in non-operating expenses as a result of loss on disposal of fixed assets and impairment losses of fixed assets.



Management Discussion and Analysis

2. Financial Analysis

The Group's primary sources of funds come from operating activities, short-term and long-term borrowings, and the funds are primarily used for working capital, capital expenditures and repayment of short-term and long-term borrowings.

(1) Assets, liabilities and shareholders' equity analysis

	At 31 December 2004 <i>Rmb million</i>	At 31 December 2003 <i>Rmb million</i>	Changes <i>Rmb million</i>
Total assets	11,235	11,922	(687)
Current assets	2,600	2,801	(201)
Non-current assets	8,635	9,121	(486)
Total liabilities	2,062	2,900	(838)
Current liabilities	1,872	2,560	(688)
Non-Current liabilities	190	340	(150)
Minority interests	53	53	0
Shareholders' equity (excluding minority interests)	9,120	8,969	151

As at 31 December 2004, the Group's total assets were Rmb 11,235 million, total liabilities were Rmb 2,062 million, and shareholders' equity (excluding minority interests) were Rmb 9,120 million. Compared with the assets and liabilities as at 31 December 2003 (hereinafter referred to as "**as compared with the end of last year**"), the variations and main causes of such changes are described as follows:

Total assets were Rmb 11,235 million, a decrease of Rmb 687 million as compared with the end of last year. Current assets were Rmb 2,600 million, a decrease of Rmb 201 million as compared with the end of last year. The decrease was mainly due to the fact that cash at bank and cash in hand decreased by Rmb 336 million owing to the intention to control and reduce interest-bearing liabilities and the repayment of certain bank loans. Non-current assets were Rmb 8,635 million, a decrease of Rmb 486 million as compared with the end of last year, which was mainly due to the increase in ordinary depreciation and amortisation.

Total liabilities were Rmb 2,062 million, a decrease of Rmb 838 million as compared with the end of last year. Current liabilities were Rmb 1,872 million, a decrease of Rmb 688 million as compared with the end of last year, which was mainly due to the decrease of Rmb 409 million in the short-term bank loans under the Group's effort in reducing short-term debts. Non-current liabilities were Rmb 190 million, a decrease of Rmb 150 million as compared with the end of last year because the Group repaid a portion of long-term borrowings in advance, and the reclassification of the portion of long-term borrowings due within one year as current liabilities.

Shareholders' equity (excluding minority interests) was Rmb 9,120 million, an increase of Rmb 151 million as compared with the end of last year, mainly due to the increase in reserves and retained profits by Rmb 57 million and Rmb 94 million respectively.

As at 31 December 2004 and 31 December 2003, the total liabilities to total assets ratio was 18.4 per cent and 24.3 per cent respectively.



Management Discussion and Analysis

(2) Cash flow analysis

At the end of 2004, cash and cash equivalents decreased by Rmb 336 million, representing a decrease from Rmb 564 million as at 31 December 2003 to Rmb 228 million as at 31 December 2004. The following table lists major items in the consolidated cash flow statement of the Group for the year 2004 and 2003.

Major items in cash flow statement	2004	2003	Increase/ (Decrease)
	Rmb million	Rmb million	Rmb million
Net cash flow from operating activities	201	1,228	(1,027)
Net cash flow from investing activities	26	(864)	890
Net cash flow from financing activities	(563)	(291)	(272)
Net (decrease)/increase in cash and cash equivalents	(336)	73	(409)
Cash and cash equivalents at the beginning of the year	564	491	73
Cash and cash equivalents at the end of the year	228	564	(336)

In 2004, the Group's net cash inflow from operating activities was Rmb 201 million, representing a decrease of Rmb 1,027 million as compared with last year. The main reasons were: (1) Owing to the increase in raw material prices, finished goods prices and production expansion, inventories increased by Rmb 636 million, whereas, there was a decrease by Rmb 196 million in this regard in 2003. As a result, the net cash flow from operating activities decreased by Rmb 832 million. (2) Trade and other receivables increased by Rmb 33 million, whereas, there was a decrease by Rmb 53 million in this regard in 2003. As a result, the net cash flow from operating activities decreased by Rmb 86 million. (3) Trade and other payables decreased by Rmb 374 million, whereas, there was a decrease by Rmb 46 million in this regard in 2003. As a result, the net cash flow from operating activities decreased by Rmb 328 million.

In 2004, the Group's net cash inflow from investing activities was Rmb 26 million, a decrease of cash outflow by Rmb 890 million as compared with last year. This was mainly due to: (1) The cash outflow for capital expenditure in 2004 was Rmb 531 million, while in 2003 it was Rmb 931 million. As a result, the cash outflow from investing activities decreased by Rmb 400 million. (2) Time deposits with banks and other financial institutions decreased by Rmb 534 million while the deposits in 2003 decreased by Rmb 50 million, which decreased cash outflows by Rmb 484 million.

In 2004, the Group's net cash outflow from financing activities was Rmb 563 million, an increase of cash outflow by Rmb 272 million as compared with last year. The main reasons were that the amount of repayment exceeded the borrowing amount by Rmb 459 million in 2004, while the amount of repayment exceeded the borrowing amount by Rmb 227 million in 2003, which resulted in the increase in the cash outflows by Rmb 232 million. Net cash outflow in 2004 for the payment of final dividend for the year 2003 was Rmb 100 million, while net cash outflow in 2003 for the payment of final dividend for the year 2002 was Rmb 60 million, which resulted in the increase in the cash outflows by Rmb 40 million.

(3) Bank borrowings

As at 31 December 2004, the Group's bank borrowings were Rmb 700 million, decreased by Rmb 459 million compared with Rmb 1,159 million as at 31 December 2003. The Group's major bank borrowings were denominated in Rmb and all of the bank borrowings were charged at the fixed interest rate. The borrowing needs of the Group were not subject to seasonal changes.



Management Discussion and Analysis

(4) Assets charges

For the year ended 31 December 2004, except for the time deposits amounting to Rmb 11 million was pledged as a security for short-term bank loans, there was no charge on the Group's assets.

(5) Management of foreign exchange risk

Main receivables and payables items of the Group are dominated in Rmb. Foreign currency used in the Group's operation was dominated in US dollars and settled immediately under current items. Therefore, there is no material effect on the Group resulting from the fluctuations in foreign exchange rates.

(6) Contingent liabilities

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

(7) Debt-equity ratio

The debt-equity ratio of the Group was 2.0 per cent for 2004 (2003:3.7per cent). The ratio is computed as long-term borrowings divided by the sum of long-term borrowings and shareholders' equity.

3. Capital Expenditure

In 2004, the Group's capital expenditure amounted to Rmb 578 million. The following table provided information on the Group's major construction projects and their actual sales amount in 2004.

Main Projects	Amount invested in 2004 Rmb'000	Project status	Information on actual sales amount Rmb'000
CP and SSP project with an annual capacity of 200,000 tonnes	295,789	Completed	135,340
Specialised polyester chip project with an annual capacity of 160,000 tonnes	63,249	Under construction	–
Others	219,066	–	–
Total	578,104		135,340

The Group's capital expenditure for the year 2005 is expected to be approximately Rmb 820 million, including: Rmb 300 million for the PTA project with an annual capacity of 1,000,000 tonnes, Rmb 80 million for the specialised polyester chip project with an annual capacity of 160,000 tonnes and Rmb 150 million for the staple fibre project with an annual capacity of 100,000 tonnes. The planned capital expenditures will be funded from cash generated from operations and bank credit facilities.

