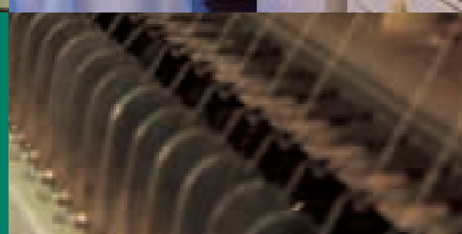
Striving for a better product mix via the **improvement** of production technology.



Management Discussion and Analysis

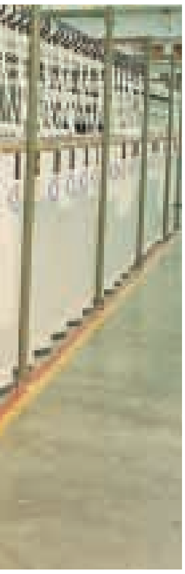
INDUSTRY REVIEW

Commencing from 1 January 2005, the quotas on China's export textile products were abolished and the sales of China's textile products have recorded a significant growth. Cotton textile industry maintained its growth momentum in 2005 and a substantial growth was recorded. In 2005, the production volume of yarn and cotton fabric in China were respectively 14.40 million tons and 19.658 billion meters, representing a growth of 11.5% and 24.01%, respectively as compared with 2004.

The export of textile products had vigorous performance in 2005. According to the statistics of China's Customs, the total export value of textile clothing was approximately US$115.03 billion in 2005, representing a growth of 20.9% as compared with 2004, among which the export value for textile products was approximately US$41.14 billion, a growth of 22.8% as compared with 2004 while the export value for clothing was approximately US$73.89 billion, a growth of 19.9% as compared with 2004. In 2005, China's import value of textile products and clothing was approximately US$17.14 billion, representing a growth of 1.7% as compared with 2004, among which the import value for textile products was approximately US$15.51 billion, a growth of 1.3% as compared with 2004 while the import value for clothing was approximately US$1.62 billion, a growth of 6% as compared with 2004. In view of the complicated and volatile environment in trade and policy, the export for the industry was managed to maintain a stable growth. During the year, an anxiety once prevailing over the trading environment of the region was finally resolved and it is expected that a favourable and stable import and export trading environment can be fostered in future.

Meanwhile, 9.9% growth in China's GDP has largely promoted the domestic consumption in 2005. According to National Bureau of Statistics of China, the total social retail sales in 2005 amounted to RMB6,717.7 billion. The consumers' market in China had a strong demand over the cotton textile products. During the year, the domestic sales of textile enterprises of considerable scales grew by 28.04%, exceeding the growth of export sales. This growth was in line with the "Eleventh Five Year Plan" which stated that efforts would be made to reinforce the domestic demand, and has fully demonstrated the domestic demand is one of the major drivers in promoting the economic growth of the industry.

On the premises that the quotas for textile and clothing have been abolished and the equilibrium attained in the market demand and supply of domestic cotton market and against the backdrop of gradual rise in cotton prices, the profit margin before tax rose to approximately 3.2% in 2005 from approximately 2.3% in 2004 for the cotton textile industry in China as a whole, revamping the excessive low profit margin.



The production volume of cotton in China for the year 2005 was 5.70 million tons, a 9.8% drop as compared with last year. Driven by strong domestic demand, the cotton price rose gradually in 2005 and the highest price recorded in cotton price A index (CNCotton A Index) of the country was approximately RMB14,680/ton. The international cotton price was at the historical low level and the average price of Cotlook A index in the international market was approximately US55.26 cents/lbs. Weiqiao Textile will continue to leverage its edges in costs and to effectively control the costs of cotton through making purchase in the Mainland and abroad.

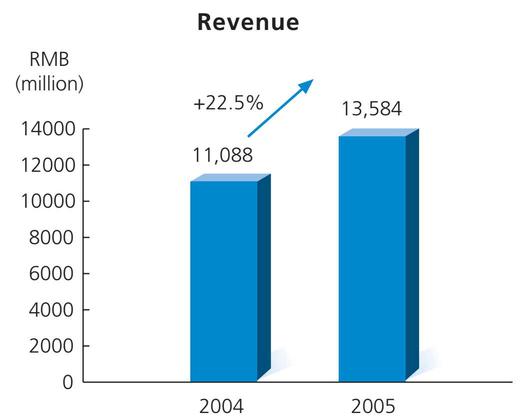
The rise in cotton prices, coupled with the appreciation of RMB and the persistent energy shortage, had seriously impacted small-scale textile enterprises which targeted at low to medium end markets. For large scale enterprises which targeted at medium to high end market and which had stronger bargaining power, they were capable of expanding their scale of operation and reinforcing their edges. The diminishment of the weak and the rise of the strong have enabled the large enterprises to enlarge their market share and offered them the room for expansion. The enterprises that enjoyed the scale of operations and that were well-equipped would be ultimate winner of the market development.

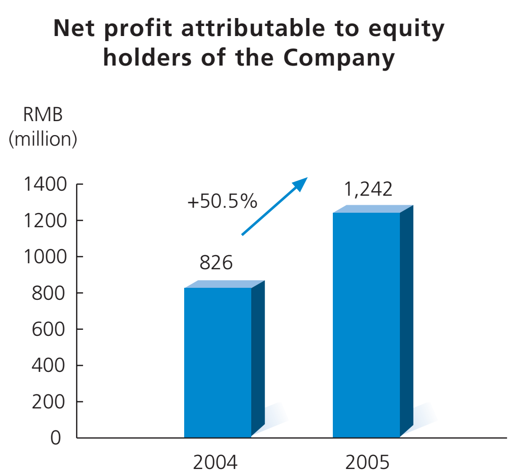
BUSINESS REVIEW

Weiqiao Textile, being the largest cotton textile manufacturer in China in terms of the scale of production and an upstream manufacturer in the production chain, is principally engaged in the production, sale and distribution of cotton yarn, grey fabric and denim. According to the statistics of China Chamber of Commerce for Import and Export of Textiles in 2005, Weiqiao Textile ranked number one in terms of the aggregate export value of yarn and fabric in the PRC.

In 2005, leveraging on its leading position and scale of operations, Weiqiao Textile had acquired more market share in both the international and domestic arenas.

Revenue

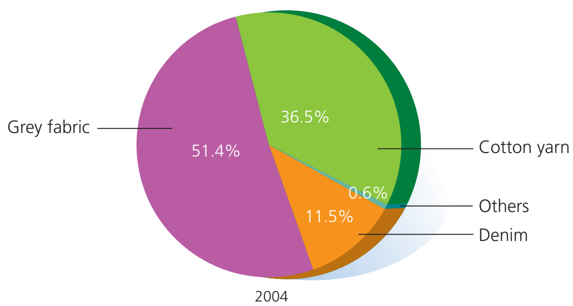


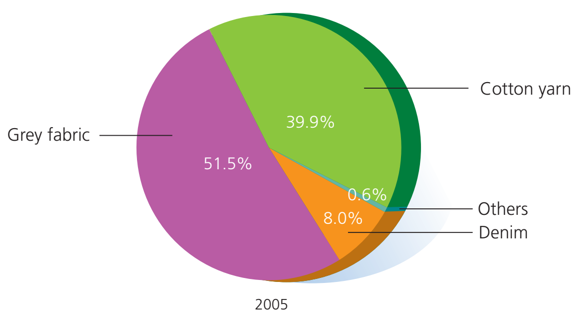


For the year ended 31 December 2005, the revenue of the Group and the net profit attributable to shareholders of the Company had a significant growth and this was mainly attributed to the expansion of production scale, the extended efforts in marketing and the production of more value-added products to satisfy the market needs by continuous improvement on the standard of production equipment and technology. The tax relief the Group obtained is also one of the primary reasons leading to the increase in net profit attributable to shareholders of the Company.

The chart below is a comparison of the Group's revenue in terms of product categories for the years ended 31 December 2004 and 2005:

A breakdown of revenue in terms of product categories:



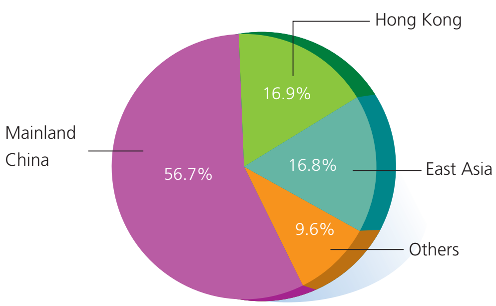


Note: Others include cotton, tailings and cotton seeds.

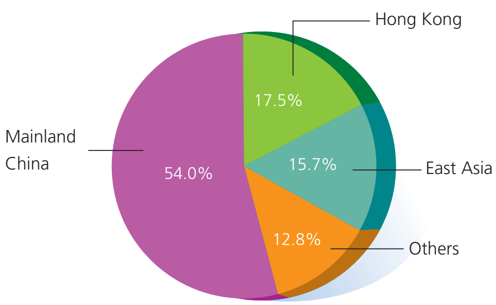
The proportion of grey fabric's revenue to the total revenue remained at the same level as of 2004. The increase in the proportion of cotton yarn's revenue to the total was due to the Group enhancing its production volume and sales of cotton yarn to meet the market demand. The decrease in the proportion of denim's revenue to the total was attributable to the downtrend of denim sales in the low to medium end markets and therefore caused a reduction of production volume of denim by the Group.

The chart below is a comparison of the Group's revenue in terms of geographical locations for the years ended 31 December 2004 and 2005:

A breakdown of revenue in terms of geographical locations:



2004



2005

Note: East Asia comprises of Japan and South Korea; others mainly comprise of Taiwan, Thailand, the US and Europe.

In respect of production, as at 31 December 2005, the Group had a total of four production bases, namely:

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

All of the above production bases are located in Shandong, the PRC, with a total gross floor area of approximately 3,100,000 sq.m.

In 2005, the Group had a production volume of about 659,000 tons of cotton yarn, 1,441,000,000 meters of grey fabric and 124,000,000 meters of denim, of which, the growth in production volume of cotton yarn and grey fabric were about 21.4% and 19.6% respectively as compared with last year and this was mainly attributed to the full operation of Zouping Production Base.

The Group has actively expanded the market share and explored new market in 2005. As at 31 December 2005, the Group had a total of 5,800 domestic customers and over 600 overseas customers, representing a growth of 21% and 20% respectively as compared with last year.

On 13 August 2005, the Company entered into an asset transfer agreement with Holding Company, pursuant to which the Company has agreed to acquire the thermal power assets for an aggregate consideration of RMB3,000,000,000 (equivalent to about HK$2,879,000,000). Such consideration was satisfied as to:

(a) RMB2,710,000,000 (equivalent to about HK$2,601,000,000) by way of allotment and issuance of 250,000,000 domestic shares of the Company at an issue price of RMB10.84 (equivalent to about HK$10.40) per domestic share of the Company, representing the average closing price of the H shares of the Company for the 20 trading days up to 12 August 2005; and

(b) RMB290,000,000 (equivalent to about HK$278,000,000) by two cash instalments payable in 2007.

FINANCIAL REVIEW

Revenue, gross profit and gross profit margin

The table below is an analysis of the Group's revenue, gross profit and gross profit margin attributable to its major product categories for the years ended 31 December 2004 and 2005:

	Year ended 31 December 2004			**Year ended 31 December 2005**		
	Revenue RMB'000	Gross profit RMB'000	Gross profit margin %	**Revenue RMB'000**	**Gross profit/ (loss) RMB'000**	**Gross profit/(loss) margin %**
Product category						
Cotton yarn	4,047,619	694,493	17.2	**5,425,822**	**1,175,434**	**21.7**
Grey fabric	5,700,843	798,863	14.0	**6,990,851**	**837,942**	**12.0**
Denim	1,273,932	341,592	26.8	**1,080,229**	**239,963**	**22.2**
Others	65,830	22,229	33.8	**87,487**	**(9,209)**	**(10.5)**
Total	11,088,224	1,857,177	16.8	**13,584,389**	**2,244,130**	**16.5**

For the year ended 31 December 2005, the Group's gross profit margin decreased to 16.5%. The decrease was mainly attributable to the downtrend of the grey fabric market due to the restrictions on Chinese textile products imposed by the EU and the US. The gross profit of denim also decreased due to the unsatisfactory denim sales at the low to medium end markets.

Selling and distribution costs

The Group's selling and distribution costs increased by 25.0% to approximately RMB345 million for the year ended 31 December 2005 from approximately RMB276 million of last year. The main reason was that the revenue increased, particularly the 30.3% increase in export sales over 2004, which led to an increase in transportation cost to approximately RMB256 million (2004: approximately RMB187 million) and a proportional increase in sales commission to approximately RMB49 million (2004: approximately RMB30 million).

Administrative expenses

Administrative expenses for the year ended 31 December 2005 amounted to approximately RMB151 million, representing an increase of 4.9% as compared with approximately RMB144 million of last year. With the expansion in production scale of the Group, the administrative expenses increased accordingly. The number of administrative staff grew compared with last year and it caused the increase in staff cost and related expenses.

Finance costs

Finance costs rose to approximately RMB420 million, after capitalizing interests of approximately RMB18 million, for the year ended 31 December 2005, representing an increase of 44.8% as compared with approximately RMB290 million for last year. The increase in finance costs was mainly due to the additional financing for the expansion in production scale and the working capital for additional production capacity.

Liquidity and financial resources

The cash and cash equivalents of the Group were approximately RMB3,186 million as at 31 December 2005, increasing by 41.9% from approximately RMB2,245 million of cash and cash equivalents as at 31 December 2004. In addition, the Group obtained a syndicate term loan facility up to US$125 million on 1 August 2005 which was fully utilised as at 31 December 2005.

For the year ended 31 December 2005, the Group invested approximately RMB5,597 million in capital expenditures, of which RMB3,000 million was related to the acquisition of thermal power assets from the Holding Company, satisfied by the issuance of 250,000,000 domestic shares of the Company at an issue price of RMB10.84 per domestic share, totaling RMB2,710 million, and the payment of RMB290 million by two cash installments payable in 2007. In addition to the above thermal power assets, the Group spent approximately RMB2,597 million in contraction of plant and the purchase of additional machinery and equipment to enhance the productivity of the Group and for the production of high value-added products, which were primarily financed by the net cash inflow from operating activities of RMB1,954 million and the increase in bank borrowings of RMB2,785 million.

The cash and cash equivalents increased by approximately RMB934 million during the year ended 31 December 2005, thereby reducing the net debt-to-equity ratio (the ratio of total bank borrowings, net of cash and cash equivalents, to shareholders' equity) to 0.66 as at 31 December 2005, compared to 0.78 as at 31 December 2004.

The average turnover of the Group's accounts receivable was approximately 15 days for the year ended 31 December 2005, which decreased from 20 days for the year ended 31 December 2004. The decrease in accounts receivable turnover days was attributable to the successful tightening of the Group's credit policy.

Inventory turnover days increased from 106 days for the year ended 31 December 2004 to 117 days for the year ended 31 December 2005. Increase in inventory turnover days was mainly due to the strong demand from the cotton market in the second half of 2005 and the increase of inventory of cotton by the Group.

Net profit attributable to shareholders of the Company and earnings per share

Net profit attributable to shareholders of the Company was approximately RMB1,242 million for the year ended 31 December 2005, representing an increase of 50.5% as compared with approximately RMB826 million of last year.

For the year ended 31 December 2005, the basic earnings per share of the shareholders of the Company were RMB1.35.

Capital structure

The Group continued to maintain an appropriate mix of equity and debt to ensure an efficient capital structure to reduce the costs of capital. As at 31 December 2005, the debts of the Group included bank borrowings and long-term payables to the Holding Company which amounted to approximately RMB10,110 million. Cash and cash equivalents of the Group was approximately RMB3,186 million and gearing ratio (Total debts (including bank loans and long-term payables to the Holding Company)/Total assets) was 40.9%.

Details of the bank borrowings outstanding as at 31 December 2005 were described in Note 29 to the financial statements. As at 31 December 2005, 34.4% of the Group's bank borrowings was subject to fixed interest rates while the remaining 65.6% was subject to floating interest rates.

As at 31 December 2005, the Group's borrowings were denominated in RMB, HK dollars and US dollars, in which 35.9% and 1.2% of the Group's borrowings were denominated in US dollars and HK dollars, respectively. Its cash and cash equivalents were mainly held in RMB and US dollars in which 5.7% of the cash and cash equivalents was held in US dollars.

EMPLOYEE AND REMUNERATION POLICY

As at 31 December 2005, the Group had a total of approximately 140,000 employees, representing an increase of approximately 40,000 as compared with last year. The Group employed more manpower and provided with training in order to satisfy the need of production expansion and it also employed more quality control staff, which led to the increase in the number of staff. Total staff costs amounted to approximately RMB1,692 million during the year, representing 12.5% of the Group's revenue. Employees were remunerated based on their performances, experience and prevailing industry practice. The Group's remuneration policies and packages were reviewed by its management on a regular basis. Bonuses and rewards may also be awarded to employees based on performance evaluation, with an aim to encourage and reward staff to achieve better performance.

DETAILS OF THE GROUP's PLEDGED ASSETS

Details are set out in Note 29 to the financial statements.

Exposure to foreign exchange risk

Revenue and most of the expenditure of the Group are denominated in RMB and US dollars. For the year ended 31 December 2005, 46.0% of the Group's revenue and 57.1% of the Group's cost of lint cotton procurement were denominated in US dollars. For the year ended 31 December 2005, the Group has not experienced any significant difficulties or impact on its operations or liquidity as a result of fluctuations in currency exchange rates. The Board believes that the Group will have sufficient foreign exchange to meet its foreign exchange requirements.

CONTINGENT LIABILITIES

Details are set out in Note 36 to the financial statements.

TAXATION

Taxation of the Group reduced from approximately RMB420 million for 2004 to approximately RMB187 million for 2005, representing a decrease of 55.5%. The reason for the decrease is that on 26 September 2005, the Company was awarded a tax relief of approximately RMB273,205,000 in total by the local tax bureau at Zouping for the investment projects undertaken by the Company for the purchases of PRC manufactured machinery and equipment. Binzhou Industrial Park, a non-wholly owned subsidiary of the Company, was also awarded a tax relief of RMB14,484,000 in total by the branch of economic development region under the Binzhou local tax bureau on 15 October 2005 and 16 October 2005. Pursuant to the prevailing tax laws in China, the Group may apply similar tax relief in future.

SUBSEQUENT EVENTS

The Company and Morgan Stanley entered into a placing agreement on 2 March 2006, as a result of which the Company successfully placed a total of 68,936,500 new H shares of the Company at a price of HK$12.05 per share. The net proceeds of the placing amounted to approximately HK$829,237,000. Directors intend to use the proceeds to make investment to increase the productivity of high value-added textile products.

FUTURE OUTLOOK

Weiqiao Textile, being a textile enterprise with world vision and strong market sense, is well aware of the quickening pace of globalization. We expect that the scale of cross-border raw materials purchase, fabric production and outsourcing will be extended. With the focus of world trade negotiation being placed on further market liberalization and reduction of government intervention, the globalized production chain hence emerged will further its role in promoting the interaction among the players in the textile industry.

The year 2006 is the first year for the "Eleventh Five Year Plan" and the growth of China' s economy will be driven more by consumption than by investment. This will be conducive to China's development into a major consumption country, and thereby providing the impetus of persistent growth of both domestic and foreign textile enterprises.

Leveraging on its own strength, Weiqiao Textile will grasp every opportunity to continue to explore overseas market and medium to high end market with a view to becoming the top-pick supplier of international merchandisers when making procurements of cotton textile in China and in the world. In terms of domestic sales, the Group will further its effort in domestic marketing and take the initiative in building up the brand image of "Weiqiao" brand for improving the Group's sales as a whole.

With respect to cost control, the Group strived to control the energy costs and optimized the efficiency of the newly acquired thermal power assets so as to eliminate the bottle-neck in production. The Group will continue to introduce technologies with higher production efficiency and implement efficient production procedures where minimal depletion is expected for reducing the overall production costs and maintaining relatively high gross profit margin.

The Group firmly believes that the competitive edges of Weiqiao Textile will acquire higher market recognition under the trend of pursuing for higher quantity and better quality in the industry. The above strategies, coupled with Weiqiao Textile's edges in technology, scale of operation, services, costs, marketing and marketing network, will enable Weiqiao Textile to grow healthily, consolidate its existing market and seek new business opportunities while exploring new customers and satisfying customers' requirements. We will continue to work closely with other global players and try to reach a new height.