

Business Review and Prospects

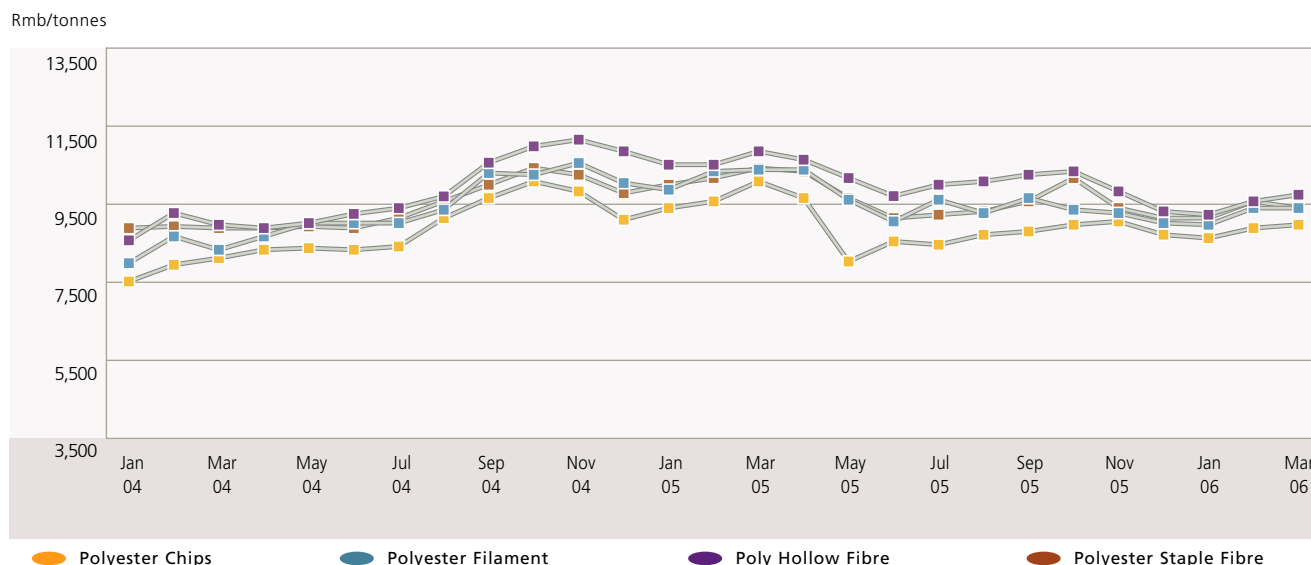
Financial figures, where applicable, contained herein have been extracted from the financial statements prepared in accordance with IFRS.

In 2005, faced with a difficult operating environment, the Group accelerated reform adjustments and sought to expand operations. By strengthening internal management and reducing cost and expenses, the Group achieved improvements to production and operation functions. Asset structure and organisational structure were also upgraded.

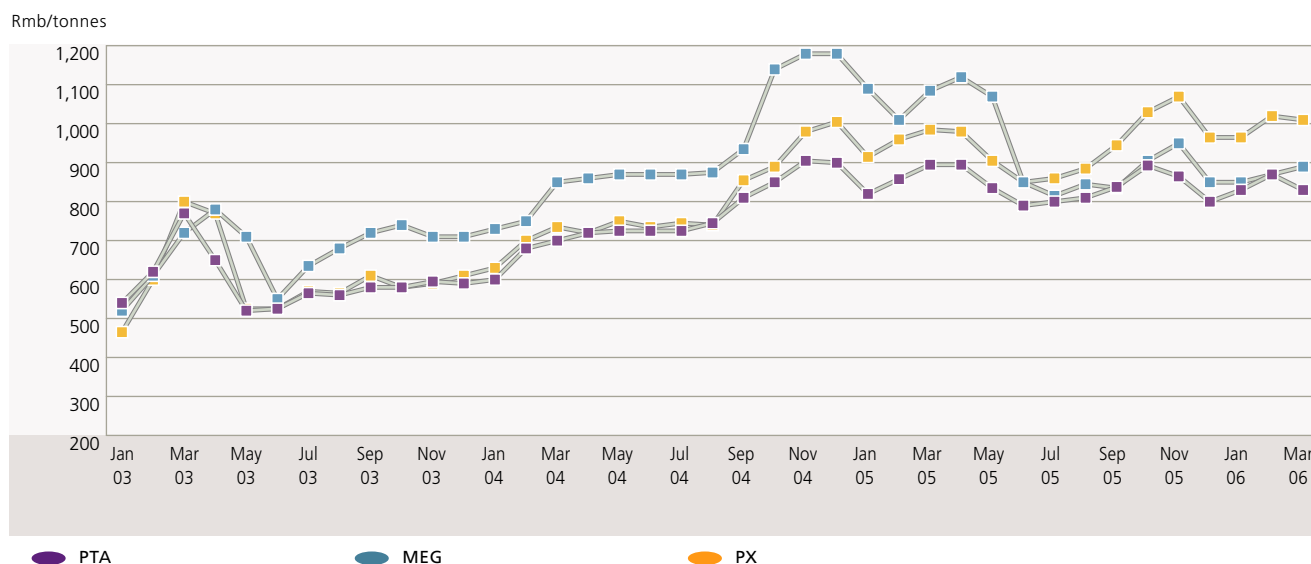
1. Market Review

In 2005, the domestic polyester operating environment was very challenging due to the combined influence of continuing high global oil prices, volatile polyester raw materials prices and more severe position of PRC's textile export. In the first half of 2005, the prices of domestic polyester raw materials and products fluctuated dramatically, and the plant utilisation rates in the polyester industry continually decreased, so the operational risks to the polyester industry became increasingly severe. In the third quarter, the prices of polyester raw materials and products gradually returned to rationality, which may lessen the imbalance between the prices of raw materials and the prices of products. However, in the fourth quarter the price of polyester raw materials and products declined a little owing to reduced PRC textile exports.

Product Prices Quoted by the Company (Excluding VAT)



Raw Material Contract Price Offered by International Supplies



Business Review and Prospects

In 2005, domestic polyester production capacity rapidly increased. The total polyester production capacity amounted to 20.7 million tonnes at the end of 2005, five million tonnes higher than in 2004. The volume of the total domestic supply polyester fibre amounted to 13,649,500 tonnes, an increase of 13.1 percent, over that of 2004; of the total volume, the domestic production volume increased by 15.6 percent and the import volume decreased by 26.6 percent as compared with their respective amounts in 2004. Meanwhile, due to an increase of 20.7 percent in the PRC's textile export, the total domestic consumption volume of polyester fibre amounted to 12,781,700 tonnes, an increase of 11.4 percent over the 2004 amount.

Domestic supply and demand of polyester fibre

	Polyester filament			Polyester staple fibre			Polyester fibre		
	2005 '000 tonnes	2004 '000 tonnes	+/(-) (%)	2005 '000 tonnes	2004 '000 tonnes	+/(-) (%)	2005 '000 tonnes	2004 '000 tonnes	+/(-) (%)
Production volume	7,848.3	6,792.9	15.5	4,853.3	4,198.9	15.6	12,701.6	10,991.8	15.6
Import volume	289.3	361.8	(20.0)	346.2	503.9	(31.3)	635.5	865.7	(26.6)
Export volume	255.1	133.0	91.8	210.4	144.2	45.9	465.5	277.2	68.0
Net import	34.2	228.8	(85.1)	135.8	359.7	(62.3)	170.0	588.5	(71.1)
Inventories at beginning of the year	255.6	145.5	75.7	56.8	61.8	(8.1)	312.4	207.3	50.7
Year-end inventories	323.1	255.6	26.4	79.2	56.8	39.4	402.3	312.4	28.8
Total supply volume	8,393.2	7,300.2	15.0	5,256.3	4,764.6	10.3	13,649.5	12,064.8	13.1
Total consumption volume	7,815.0	6,911.6	13.1	4,966.7	4,563.6	8.8	12,781.7	11,475.2	11.4

Source: The Chemical Fibre Association of China

2. Production and Operation Review

1. Production and Marketing

In 2005, despite low plan utilisation rates in the broader domestic polyester industry, the Group maintained safe and stable operations at its of polyester facilities. The total production volume of polyester products amounted to 2,155,660 tonnes, an increase of 28.1 percent as compared with 1,683,393 tonnes in 2004. The capacity utilisation rate reached 94.8 percent. The total production volume of PTA amounted to 970,507 tonnes, an increase of 4.0 percent as compared with 933,363 tonnes in 2004. The Group closely followed the market trends, persisted in selling all the production produced, and sold at the optimal prices during the period. The Group's total volume of polyester product sales amounted to 1,628,336 tonnes in 2005, an increase of 20.5 percent as compared with 1,351,137 tonnes in 2004. Excluding self-consumption volume and other factors, the ratio of sales to production reached 99.9 percent. In 2005, the Group's export volume of polyester products rose dramatically to 82,142 tonnes, an increase of 63,200 tonnes over the 18,942 tonnes for 2004.

Business Review and Prospects

2. Cost control

In 2005, the weighted average purchase prices of principal purchased raw materials of the Group, such as PTA, mono-ethylene glycol (“MEG”) and paraxylene (“PX”), increased by 7.9 percent as compared with last year, while the weighted average price of polyester product (excluding VAT) of the Group increased by 0.8 percent as compared with last year. As a result, the Group’s profit margin was significantly compressed. The Group vigorously offset the market’s influence by strengthening internal management and reducing costs and expenses. The overall energy consumption per unit decreased by 4.1 percent from the rate in 2004. In order to reduce raw material costs, the Group increased PTA production volume by ensuring the safe and stable operation of PTA facility. Due primarily to the increases in sales volume, transportation costs and insurance premium, the Group’s selling expenses were 18.7 percent higher than those of 2004. On the other hand, thanks to its efforts in internal management, reducing costs and expenses and reducing interest expenses by lowering bank loans, the Group’s administrative expenses and net financing expenses were respectively 16.4 percent and 26.4 percent lower than those of 2004. The total reduction in selling expenses, administrative expenses and net financing expenses was 8.4 percent from that of 2004.

3. R&D

In 2005, the profit contributed by differential and specialised products increased further. The Group made new achievements in its product development. Development of thirty-three new polyester products was completed successfully. Nine patent rights were obtained. The differential products, such as full-dull polyester chip, specialised chips for industrial filaments, specialised polyester chips for plastic steel band and FDY fine filament, were put into batch production. These products were soon welcomed by market and achieved a relatively good profit. In 2005, the Group’s total production volume of specialised polyester chips amounted to 697,000 tonnes and the specialised rate was 73.7 percent, 11.9 percentage points higher than that of last year. The total volume of differential polyester fibre production amounted to 423,000 tonnes, and the differential rate of polyester fibre was 59.4 percent, 6.4 percentage points higher than that of last year.

4. Internal reform and management

In 2005, the Group’s asset structure adjustment obtained a great breakthrough. In August 2005, the joint venture Yihua UNIFI was established by transferring the assets of Southern area of filament business department (the former Polyester Plant No.5) to UNIFI Asia. The joint venture’s business has since developed smoothly. On 24 March 2006, the Company entered into an agreement with the buyer on the equity transfer of Tianma Chemical Fibre. The establishment of Yihua UNIFI and transfer of Tianma Chemical Fibre will further optimise the Group’s asset structure and make the Group more competitive and profitable in the future. In 2005, the Group continued to advance internal reforms. Among the operational managing staff, the strategy “Compete for Appointment” was carried out, and the number of these employees was reduced by 33.1 percent. Additionally, the Group evaluated and classified all positions, clarifying position responsibilities and business processes. The Group fine-tuned the remuneration system reforms according to market value so as to improve employee morale. In 2005, the number of employees decreased by 1,814 in the form of voluntary resignation contracts or through joint venture investment and system reform (of these, 1,324 jobs will be cut after completing the transfer of Tianma Chemical Fibre’s assets).

5. Capital expenditure

In 2005, the total capital expenditures paid amounted to Rmb 202,564,000. The specialised polyester chips projects with an annual capacity of 160,000 tonnes were completed and put into operation in August 2005. The products were soon welcomed by the market. The project to increase the capacity of PTA line II was successfully completed in April 2005. The Group believes these self-property rights, highly technological and cost effective projects shall further improve products and fixed-assets structure.

Business Review and Prospects

3. Business Prospects and Plan

(1) Market Analysis

According to the 2006 market analysis, the Group has determined:

- (a) firstly, that the global economy and that of the PRC will both enjoy relatively rapid growth, and that foreign and domestic demand for textiles will continue to expand.
- (b) secondly, that the trade memoranda that China signed with the European Union and the US reduced factors of uncertainty pertaining to the PRC's textile export environment, which is prospectively favorable for stable growth in the PRC's textile exports.

As a result of these developments, it is anticipated that the consumption demand for polyester products will steadily increase. At the same time, the excess of supply over demand for domestic polyester production capacity will continue and competitive circumstances will remain challenging for the polyester industry. Meanwhile, the high price of international crude oil and appreciation of the renminbi will intensify operational risks to the domestic polyester industry. From 1 January 2006, the PRC import tariffs on PTA, MEG and PX have remained at 6.5 percent, 5.5 percent and 2 percent, respectively. Furthermore, the new PRC import tariffs on polyester chip have been lowered to 8.6 percent, while the imported tariffs on polyester staple fibre and polyester filament both remain at 5 percent.

It is expected that global crude oil price will continue to fluctuate immoderately at a high level in 2006. With new polyester raw material facilities to be put in operation, the mismatch of supply and demand for domestic polyester raw materials will likely be resolved. However, the prices of raw materials such as PTA, MEG and PX will remain high owing to the relative high cost of global crude oil. Because the excess of supply over demand in polyester production capacity will remain, the outlook for polyester products' profit margins is not optimistic. The Group still faced with a difficult operating environment.

(2) Business strategy

In 2006, the Group will adapt to the developing trend of market competition, stand by the market-oriented reform adjustments, strengthen internal management and accelerate technology innovation so as to build up the enterprise's competitiveness. The following will be set as priorities in 2006:

I. Stick to market orientation and strengthen raw material purchase and market so as to expand profit margins

The Group will maintain its market orientation and take profit maximisation as its principle. By strengthening swing of product selling and raw material purchase and measures of stock and price, the profit margin will be expanded. The Group will expand the proportion of direct selling and sell all the produced products at optimal time prices. The Group will fully explore the international market and multiply exports of all kinds of polyester products. Meanwhile, the Group will strengthen negotiations with suppliers and give full play to its negotiating position with respect to raw material purchases so as to improve its influence on quoted prices. As a result, it is expected that purchasing costs will be reduced. To meet the target sales-to-production ratio of 100 percent, the planned volume of polyester product sales is 1,697,000 tonnes.

II. Strengthen production management and meticulously maintain safe and stable operation of production facilities

The Group will continue to strengthen safety and environment management; further enact its safety responsibility system; strengthen specialty and spot management so as to reduce unexpected production interruptions; and maintain safe, stable, high grade and low energy-consumption operations. Meanwhile, to realise efficient operation of facilities, the Group will dynamically adjust the product mix and capacity utilisation rate according to market changes, costs and profits. The planned volume of polyester product production is 2,224,000 tonnes, of which the planned self-consumption volume is 527,000 tonnes. The planned production volume of PTA is 970,000 tonnes.

Business Review and Prospects

III. Excavate potential thoroughly to improve efficiency and reduce costs and expenses comprehensively

The Group will take active and effective measures to realise the aim set at the beginning of 2006 of reducing costs and improving efficiency. The first section of these measures is the production section. The facility operation will be optimised and the volume of PTA and polyester product production will be increased. Activities will be rigorously developed to reduce consumption of energy and raw materials. The Group will strive to decrease the overall energy consumption per unit by 3.0 percent from last year's consumption rate. The second section is strengthening the operation and circulation. The Group will exert more effort in new product development and market exploration. The third section is to strengthen management. The Group will strengthen the centralised control management and reduce capital costs and financial expenses. In addition, the percentage of the facility maintained by the Group itself will be increased and the repairing costs will be reduced. The fourth section is technology advancement and reconstruction. The Group organises the project using heavy oil to replace fuel oil so as to reduce the consumption of coal-generating electricity.

IV. Strictly manage internal affairs and improve management level constantly

The Group will continually implement overall budget management and strictly manage unplanned expenses so as to realise the target of reducing expenses. The Group will consummate internal control system, improve its enforcement and make it normative. Financial management will be strengthened so as to improve the efficiency of capital use and lower financial expenses. The Group will strengthen investment management and strictly control non-productive investments. Performance evaluation will be enhanced and motivation and obligation mechanisms will be improved aiming to mobilise employees' enthusiasm and creativity.

V. Strengthen product development and technology improvement surrounding the aim of polishing superior main business operation

Closely surrounding market and profit, the Group will actively establish product development and service teams, seek to effectively execute market promotion work, and increase the profit contributions of new products. Meanwhile, based on the advantage of complete set equipment, the Group will develop a series of differential or specialised products by market differentiation according to market demand and product characteristics so as to raise additional product value. There are 29 items planned for new development. The Group's projected production volume of differential fibre and specialised polyester chips products for 2006 will be 423,000 tonnes and 784,000 tonnes respectively, while differential rate and specialised rate are expected to be 63.1 percent and 76.3 percent.

VI. Speed up the internal market operation reform by catching opportunities and increasing degree.

The Group will continually advance restructuring based on department specialisation, further optimise operating processes and the division of labor to improve management efficiency. The employment and remuneration system reform will be fine-tuned and the strategy "Compete for Appointment" will be carried out for operations and service positions to meet staff reduction and capital allocation requirements. The Group will accelerate reform of particular items and non-core business separation. The overhaul and maintenance center will further modify its internal mechanisms to meet the requirement of market-independent operations, which will settle a foundation for reform and business reorganisation.