

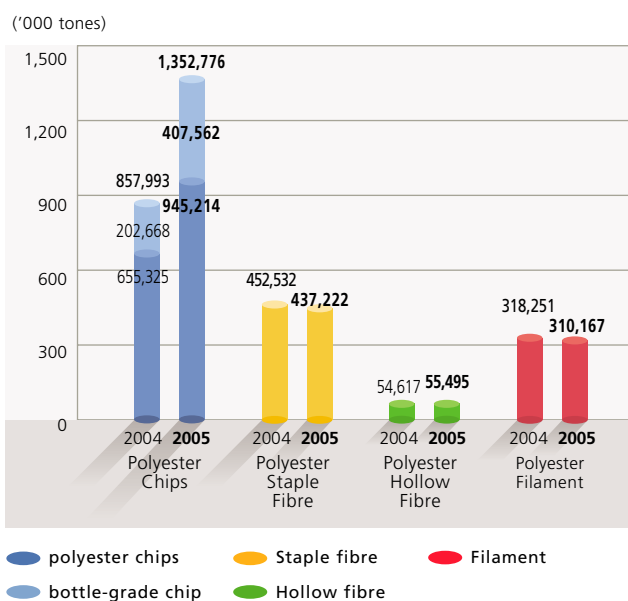
Management Discussion and Analysis

The information set forth below does not constitute part of the financial statements audited by KPMG or KPMG Huazhen, as set forth on pages 54 to 102 and pages 103 to 149, 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 for specifically noted, contained herein have been extracted from the financial statements prepared in accordance with IFRS

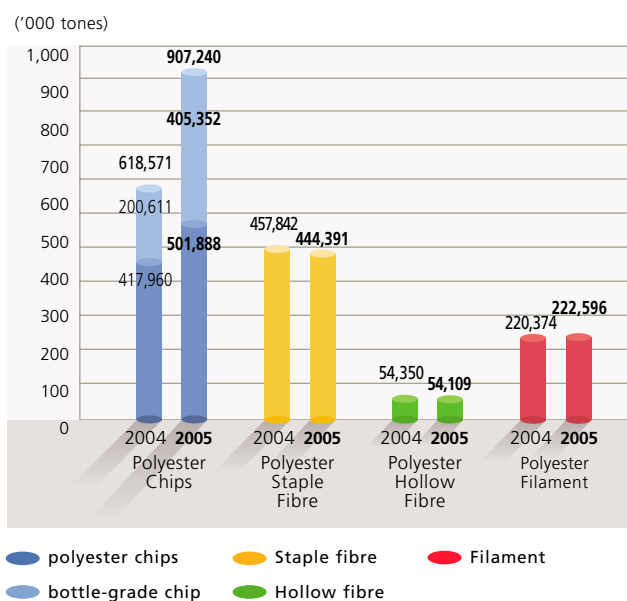
1. Results of Operations

In 2005, under the severe market condition, the Group put great efforts in speeding up reform adjustment, strengthening internal management, optimising production and operations and further reducing costs and expenses. As a result, the Group achieved positive development in various fields.

Production Volume



Sales Volume



Management Discussion and Analysis

(1) Turnover

In 2005, the Group's total production volume of polyester products increased to 2,155,660 tonnes, representing an increase of 28.1 percent as compared with that of 1,683,393 tonnes for last year. Of this, the total production volumes of bottle-grade polyester chips increased by 101.1 percent. Increase was mainly due to the full operation of the co-polymer ("CP") and SSP project with an annual capacity of 200,000 tonnes completed in November 2004. Due to adjusting products mix and capacity utilisation rate according to market changes, profit and cost, the total production volumes of polyester staple fibre and polyester filament decreased by 3.4 percent and 2.5 percent respectively as compared with last year. The average 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 that of 933,363 tonnes of last year. Increase was mainly due to the stable and full operation of PTA line that was successfully increased the capacity in April 2005.

Production volume

	For the year ended 31 December			
	2005		2004	
	Production volume (tonnes)	Percent of total production volume (%)	Production volume (tonnes)	Percent of total production volume (%)
<i>Polyester products</i>				
Polyester chips	1,352,776	62.7	857,993	51.0
Of which: bottle-grade polyester chips	407,562	18.9	202,668	12.0
Staple fibre	437,222	20.3	452,532	26.9
Hollow fibre	55,495	2.6	54,617	3.2
Filament	310,167	14.4	318,251	18.9
Total	<u>2,155,660</u>	<u>100.0</u>	<u>1,683,393</u>	<u>100.0</u>

In 2005, the Group's total sales volume of the polyester products amounted to 1,628,336 tonnes, representing an increase of 20.5 percent from 1,351,137 tonnes of 2004. The ratio of sales to production reached 99.9 percent. Owing to the significant increase in the production volume of bottle-grade polyester chips and good sales work for this product, the total sales volumes of bottle-grade polyester chips increased by 102.1 percent. Export sales of the polyester products amounted to 82,142 tonnes, representing an increase of 63,200 tonnes as compared with the 18,942 tonnes for 2004. Due to the drive from the cost of polyester raw materials, the prices of polyester products increased. The weighted average prices (excluding VAT) of the Group's polyester products increased from Rmb 9,467/tonne to Rmb 9,544/tonne during the year, representing a 0.8 percent increase. But the increase in prices of polyester products was obviously less than that of polyester raw material. As a result, the profit margin of polyester products was significantly compressed.

Management Discussion and Analysis

Sales volume

	For the year ended 31 December			
	2005		2004	
	Sales volume (tonnes)	Percent of total sales volume (%)	Sales volume (tonnes)	Percent of total sales volume (%)
Polyester products				
Polyester chips	907,240	55.7	618,571	45.8
Of which: bottle-grade polyester chips	405,352	24.9	200,611	14.8
Staple fibre	444,391	27.3	457,842	33.9
Hollow fibre	54,109	3.3	54,350	4.0
Filament	222,596	13.7	220,374	16.3
Total	<u>1,628,336</u>	<u>100.0</u>	<u>1,351,137</u>	<u>100.0</u>

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

	For the year ended 31 December		
	2005	2004	Change (%)
Polyester products			
Polyester chips	9,067	8,905	1.8
Staple fibre	9,746	9,481	2.8
Hollow fibre	10,316	9,947	3.7
Filament	10,901	10,898	-
Weighted average price	<u>9,544</u>	<u>9,467</u>	<u>0.8</u>

Turnover

	For the year ended 31 December			
	2005		2004	
	Turnover Rmb'000	Percent of turnover %	Turnover Rmb'000	Percent of turnover %
Polyester products				
Polyester chips	8,225,566	52.1	5,508,301	41.3
Staple fibre	4,331,081	27.4	4,340,696	32.5
Hollow fibre	558,197	3.5	540,621	4.1
Filament	2,426,488	15.4	2,401,708	18.0
Others	257,333	1.6	557,145	4.1
Total	<u>15,798,665</u>	<u>100.0</u>	<u>13,348,471</u>	<u>100.0</u>

In 2005, the Group's turnover amounted to Rmb 15,798,665,000, representing an increase of 18.4 percent as compared with Rmb 13,348,471,000 for last year. The increase was mainly due to the increase in sales volume and weighted average prices of polyester products (excluding VAT) by 20.5 percent and 0.8 percent respectively as compared with last year.

Management Discussion and Analysis

(2) Cost of sales

In 2005, the Group's cost of sales amounted to Rmb 15,309,488,000, representing 96.9 percent of the turnover, which increased by 5.4 percentage points as compared with last year. Total costs of raw materials increased by Rmb 2,767,713,000 from Rmb 10,091,288,000 in 2004 to Rmb 12,859,001,000, which accounted for 84.0 percent of cost of sales in 2005. 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 purchase cost of coal and crude oil as compared with last year. The Group's weighted average purchase price of polyester raw materials increased by 7.9 percent as compared with last year. Of which, the average purchase costs of PTA and PX increased by 6.4 percent and 16.9 percent respectively as compared with last year. But the average purchase costs of MEG decreased by 0.3 percent as compared with last year. To ease the increase in the cost of sale, the Group took measures to organise the safe and stable operation of facilities, reduce costs and expenses, increase PTA production volume and save energy consumption.

In 2005, although the turnover increased by 18.4 percent as compared with last year, the Group's gross profit decreased by Rmb 639,361,000 to Rmb 489,177,000 due to the increase in cost of sale by 25.3 percent as compared with last year. The Group's gross margin was 3.1 percent, representing a decrease of 5.4 percentage points as compared with last year.

(3) Selling, administrative and financial expenses

	For the year ended 31 December		
	2005 Rmb'000	2004 Rmb'000	Change (%)
Selling expenses	210,503	177,406	18.7
Administrative expenses	365,543	437,415	(16.4)
Financial expenses	53,087	72,176	(26.4)
Total	<u>629,133</u>	<u>686,997</u>	<u>(8.4)</u>

In 2005, due to the increase in sales volume, transportation cost and insurance premium, selling expenses increased by Rmb 33,097,000 as compared with last year. Administrative expenses and net financing expenses decreased by Rmb 71,872,000 and Rmb 19,089,000 respectively as compared with last year. These saving are attributed to improvements to the internal management, reductions in costs and expenses, and decreases in interest expenses as a result of lowering bank loan. The total decrease in selling expenses, administrative expenses and net financing expenses was 8.4 percent as compared with last year.

(4) Operating (loss)/profit, (loss)/profit before taxation, (loss)/profit attributable to equity shareholders of the Company

	For the year ended 31 December		
	2005 Rmb'000	2004 Rmb'000	Change (%)
Operating (loss)/profit	(956,249)	348,968	(374.0)
(Loss)/profit before taxation	(1,009,336)	276,792	(464.7)
Income tax expense	(41,343)	33,860	(222.1)
(Loss)/profit attributable to equity shareholders of the Company	(967,508)	240,383	(502.5)
(Loss)/earnings per share (in Rmb)	<u>(0.242)</u>	<u>0.060</u>	<u>(502.5)</u>

Management Discussion and Analysis

In 2005, despite the Group's enhanced efforts in uplifting production volume and sales volume and exercising better control over costs and expenses, the increase in polyester raw material prices was higher than in polyester products prices. As a result, the profit margin of polyester products was significantly compressed. Meanwhile, the Group recorded a non-cash impairment charge of Rmb 783,621,000 due to establishing a joint venture with UNIFI Asia by injecting the assets of the former Polyester Plant No. 5 and the equity transfer of Tianma Fibre. Owing to the above factors, the Group's operating loss and loss before tax amounted to Rmb 956,249,000 and Rmb 1,009,336,000 respectively, representing a decrease of 374.0 percent and 464.7 percent as compared with last year respectively. Loss attributable to equity shareholders of the Company amounted to Rmb 967,508,000, representing a decrease of 502.5 percent as compared with last year.

(5) Statement of the principal operations by products

Polyester products contributed more than 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 2005 in accordance with the PRC Accounting Rules and Regulations.

Products	Income from principal operations <i>Rmb'000</i>	Cost of principal operations <i>Rmb'000</i>	Gross profit margin %	Increase/ (decrease) in income from principal operations as compared to last year %	Increase/ (decrease) in cost of principal operations as compared to last year %	Gross margin ratio as compared to last year %
Polyester products	15,541,332	14,939,902	3.9	21.5	27.9	Decreased by 4.8 percentage points
Of which: connected transactions	320,317	308,579	3.7	(42.4)	(39.3)	Decreased by 4.9 percentage points

During 2005, the Company didn't sell any products to its controlling shareholder and its subsidiaries.

Management Discussion and Analysis

(6) Operations of principal subsidiaries and a jointly controlled entity in 2005

1. Tianma Chemical Fibre (former Yizheng Chemical Fibre Foshan Polyester Company Limited) and Foshan Chemical Fibre United Company Limited (“**Foshan Chemical**”) (collectively “**Foshan Group**”). The Company directly holds 90 percent and indirectly holds 10 percent 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 Tianma Chemical Fibre. Tianma Chemical Fibre’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 provision of after sales services for its products. As at 31 December 2005, the total assets of Foshan Group was Rmb 254,972,000. For the year ended 31 December 2005, Foshan Group made a loss of Rmb 461,520,000.
2. Yihua Kangqi Chemical Fibre Company Limited (“**Kangqi Company**”) and its subsidiaries (“**Kangqi Group**”). The Company holds 95 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 2005, the total assets of Kangqi Group was Rmb 357,347,000. For the year ended 31 December 2005, Kangqi Group made a loss of Rmb 1,499,000.
3. Yihua UNIFI. The Company and UNIFI Asia holds 50 percent of the equity interest of Yihua UNIFI respectively. Yihua UNIFI’s registered capital is USD 30,000,000 and is a joint venture. Its principal activities are the production and sales of differential polyester filament and relevant products, performing research and development of polyester and textile products, and providing after sales services for its products. As at 31 December 2005, the total assets of Yihua UNIFI was Rmb 626,161,000. For the year ended 31 December 2005, Yihua UNIFI made a loss of Rmb 22,962,000.

(7) Acquisition, divestment and investment

The Group did not make any material acquisition and investment in relation to any of its subsidiaries or associates in 2005. Details of divestment during the year of 2005 are set forth in item 4 of “Significant Events” of the Annual Report.

(8) Profit mix for the year 2005 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 2005, the percentages of profit from principal operations, expenses for the period and net non-operating expenses to total profit showed significant variance as compared with last year. Major reasons for the significant variance were the loss suffered by the Group as a result of the effect of recording the fixed assets impairment and severe domestic polyester market in 2005.

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 2005 Rmb'000	At 31 December 2004 Rmb'000	Changes in amount Rmb'000
Total assets	9,833,113	11,234,701	(1,401,588)
Current assets	2,980,642	2,599,765	380,877
Non-current assets	6,852,471	8,634,936	(1,782,465)
Total liabilities	1,709,196	2,061,850	(352,654)
Current liabilities	1,659,196	1,871,850	(212,654)
Non-Current liabilities	50,000	190,000	(140,000)
Minority interests	52,104	52,529	(425)
Shareholders' equity (excluding minority interests)	8,071,813	9,120,322	(1,048,509)

As at 31 December 2005, the Group's total assets were Rmb 9,833,113,000, total liabilities were Rmb 1,709,196,000, and shareholders' equity (excluding minority interests) were Rmb 8,071,813,000. Compared with the assets and liabilities as at 31 December 2004 (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 9,833,113,000, a decrease of Rmb 1,401,588,000 as compared with the end of last year. Current assets were Rmb 2,980,642,000, an increase of Rmb 380,877,000 as compared with the end of last year. The increase was mainly because bills receivable increased by Rmb 506,889,000 owing to the decrease in bills discount as a result of the rise in net cash inflow. Non-current assets were Rmb 6,852,471,000, a decrease of Rmb 1,782,465,000 as compared with the end of last year, which was mainly because the Group recorded a non-cash impairment charge of Rmb 783,621,000 due to establishing a joint venture with UNIFI Asia by injecting the assets of former Polyester Plant No.5 and the transfer of Tianma Fibre's assets. Meanwhile, such decrease was also due to ordinary depreciation and amortisation.

Total liabilities were Rmb 1,709,196,000, a decrease of Rmb 352,654,000 as compared with the end of last year. Current liabilities were Rmb 1,659,196,000, a decrease of Rmb 212,654,000 as compared with the end of last year, which was mainly due to the decrease of Rmb 262,226,000 and Rmb 110,000,000 in the short-term bank loans and long-term borrowings due within one year respectively under the Group's effort in reducing short-term debts. Non-current liabilities were Rmb 50,000,000, a decrease of Rmb 140,000,000 as compared with the end of last year, which was mainly because the Group repaid a portion of long-term borrowings in advance.

Shareholders' equity (excluding minority interests) was Rmb 8,071,813,000, a decrease of Rmb 1,048,509,000 as compared with the end of last year, mainly due to decrease in retained profits by Rmb 1,048,564,000 as a result of Rmb 967,508,000 for loss attributable to equity shareholders of the Company.

As at 31 December 2005, total liabilities to total assets ratio was 17.4 percent, and 18.4 percent as at 31 December 2004.

Management Discussion and Analysis

(2) Cash flow analysis

At the end of 2005, cash and cash equivalents increased by Rmb 144,383,000, representing an increase from Rmb 228,152,000 as at 31 December 2004 to Rmb 372,535,000 as at 31 December 2005. The following table lists major items in the consolidated cash flow statement of the Group for the year 2005 and 2004.

Major items in cash flow statement	2005 <i>Rmb'000</i>	2004 <i>Rmb'000</i>	Increase/ (Decrease) <i>Rmb'000</i>
Net cash flow from operating activities	577,510	200,569	376,941
Net cash flow from investing activities	86,290	26,391	59,899
Net cash flow from financing activities	(519,417)	(562,569)	43,152
Net (decrease)/increase in cash and cash equivalents	144,383	(335,609)	479,992
Cash and cash equivalents at the beginning of the year	228,152	563,761	(335,609)
Cash and cash equivalents at the end of the year	372,535	228,152	144,383

In 2005, the Group's net cash inflow from operating activities was Rmb 577,510,000, representing an increase of Rmb 376,941,000 as compared with last year. The main reasons were: (1) Owing to enhancing the coordination between production, raw materials procurement and sales, inventories decreased by Rmb 338,628,000, whereas, there was an increase by Rmb 635,849,000 in this regard in 2004. As a result, the net cash flow from operating activities increased by Rmb 974,477,000. (2) Gross profit was Rmb 489,177,000 in 2005, whereas, it was Rmb 1,128,538,000 in 2004. As a result, the net cash flow from operating activities decreased by Rmb 639,361,000.

In 2005, the Group's net cash inflow from investing activities was Rmb 86,290,000, an increase of cash inflow by Rmb 59,899,000 as compared with last year. This was mainly due to: (1) The cash outflow for capital expenditure in 2005 was Rmb 205,993,000, while in 2004 it was Rmb 530,628,000, which increased cash inflows by Rmb 324,635,000. (2) Cash injection by UNIFI Asia for the establishment of Yihua UNIFI and proceeds from disposal of fixed assets in 2005 was Rmb 195,754,000, while in 2004 it was Rmb 8,068,000, which increase cash inflows by Rmb 187,686,000. (3) Time deposits with banks and other financial institutions decreased by Rmb 104,836,000 while the deposits in 2004 decreased by Rmb 534,135,000, which decreased cash inflows by Rmb 429,299,000.

In 2005, the Group's net cash outflow from financing activities was Rmb 519,417,000, a decrease of cash outflow by Rmb 43,152,000 as compared with last year. The main reasons were that the amount of repayment exceeded the borrowing amount by Rmb 416,477,000 in 2005, while the amount of repayment exceeded the borrowing amount by Rmb 459,094,000 in 2004, which resulted in the decrease in the cash outflows by Rmb 42,617,000.

In 2005, the Group's net cash inflow from operating activities was Rmb 577,510,000, while loss attributable to equity shareholders of the Company was Rmb 967,508,000. This significant difference was mainly because the Group recorded a non-cash impairment charge of Rmb 783,621,000. Meanwhile, such difference was also due to ordinary depreciation and amortisation.

(3) Bank borrowings

As at 31 December 2005, the Group's bank borrowings were Rmb 187,500,000, decreased by Rmb 512,226,000 compared with Rmb 699,726,000 as at 31 December 2004. The Group's major bank borrowings were denominated in renminbi 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.

(4) Assets charges

For the year ended 31 December 2005, there were no charges against the Group's assets.

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(5) Management of foreign exchange risk

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

(6) Debt-equity ratio

The debt-equity ratio of the Group was 0.6 percent for 2005 (2004: 2.0 percent). The ratio is computed as long-term borrowings divided by the sum of long-term borrowings and shareholders' equity.

3. Capital Expenditure

In 2005, the Group's capital expenditure amounted to Rmb 202,564,000. The following table provided information on the Group's major construction projects and their actual sales amount in 2005.

Main Projects	Amount	Project status	Information
	invested in		on actual
	2005		sales amount
	Rmb'000		Rmb'000
CP and SSP project with an annual capacity of 200,000 tonnes	15,946	Completed	1,852,200
Specialised polyester chip project with an annual capacity of 160,000 tonnes	68,718	Completed	629,200
The technological improvement project to increase capacity of PTA line II	16,060	Completed	–
Others	101,840	–	–
Total	<u>202,564</u>		<u>2,481,400</u>

The Group's capital expenditure for the year 2006 is expected to be approximately Rmb 537,430,000, of this, Rmb 400,000,000 for the PTA project with an annual capacity of 1,000,000 tonnes. In order to maximise investment contribution, the Group will strengthen investment management in accordance with the prudence principle. The Group will give priority to the projects such as saving energy consumption, safety and environment, and reducing costs and expenses so as to increase profit contribution from existing assets. The planned capital expenditures will be funded from cash generated from operations and bank credit facilities.