



Continue to expand market shares

INDUSTRY REVIEW

In 2006, China's economy maintained relative healthy development trend while exports continued to increase. Of these, exports of textile and clothing reached US\$147.085 billion, representing a growth of 25.14% as compared with the previous year. During the year, the trade tension between China and US & Europe was gradually eased after these regions implemented the agreed safeguards which had limited the growth rate of China's exports of clothing and textiles to US and Europe. Such changes created relatively stable operating environment to the textile industry in the PRC, at the same time provided good opportunities in the continued exploration and industrial upgrading of the textile industry.

On the other hand, the continued expansion in the domestic demands of China has become the key accelerator in driving the rapid growth of the textile industry. According to the statistics of China Cotton Textile Association, total revenue for the country's cotton textile industry in 2006 was about RMB574.693 billion, representing an increase of 23.24% as compared with 2005. Profit before tax was RMB19.548 billion, representing an increase of 31.59% as compared with 2005. Domestic sales accounted for 86.82% of the revenue of the cotton textile industry, representing an increase of 1.79 percentage points as compared with the previous year.

Recently, global supply and demand for cotton are basically balanced. According to the forecast of United States Department of Agriculture (USDA), the world's cotton production in the Year 2006/2007 is anticipated to reach 24.9 million tons, only an increase of 190,000 tons over the previous year. In respect of the PRC, due to the substantial increase in cotton production, gap between cotton supply and demands in China is diminishing. In 2006, the average cotton A Index in China was approximately RMB14,261.98 per ton, representing an increase of approximately 5.11% compared with 2005. Relatively stable cotton price has enabled a better control on the core cost in the industry.



MANAGEMENT DISCUSSION AND ANALYSIS



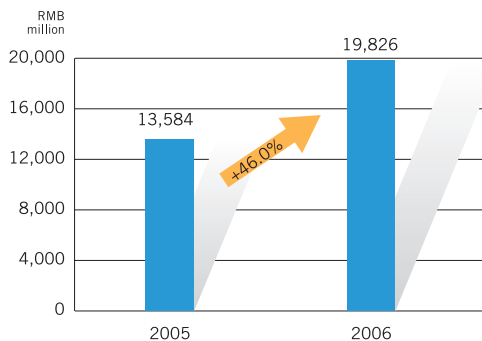
BUSINESS REVIEW

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.

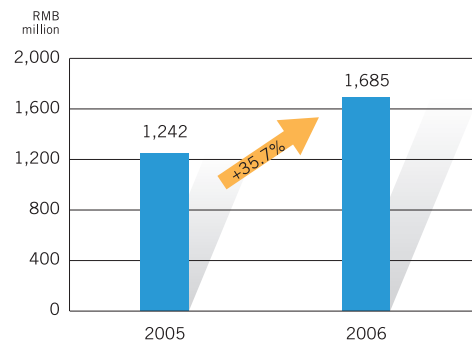
In 2006, leveraging on its leading position and scale of operations, Weiqiao Textile had acquired more market share in both international and domestic markets, and at the same time continued to maintain its high gross profit margin level through industrial enhancement. According to the statistics of China Chamber of Commerce for Imports & Exports of Textiles, Weiqiao Textile ranked number 1 in terms of the aggregate export values of yarn and fabric in the PRC in 2006.

For the year ended 31 December 2006, Weiqiao Textile obtained remarkable growth in both revenue and net profit attributable to shareholders of the Company as compared with the corresponding period of 2005.

Revenue



Net profit attributable to shareholders of the Company

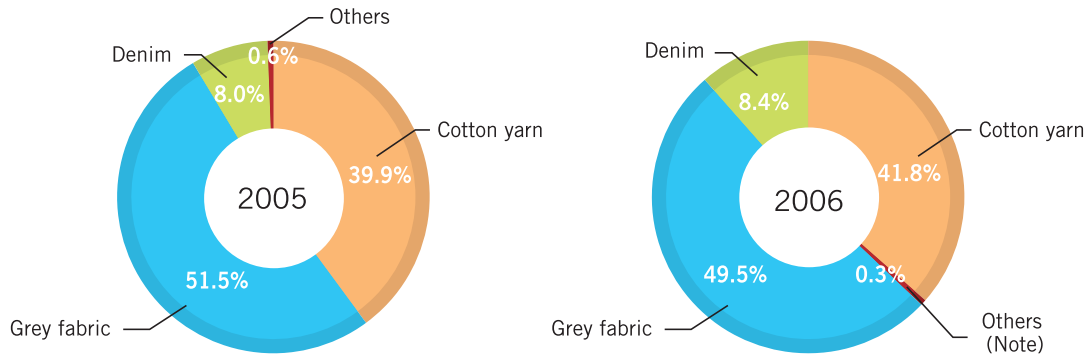


For the twelve months ended 31 December 2006, the revenue of Weiqiao Textile and the net profit attributable to shareholders of the Company had a significant growth compared with 2005. This was mainly attributable to the Group's enhancement in market sales, further enhancement of utilization rate of production, and more high value-added products to satisfy market demands by continuous improvement on the standard of production equipment and technology.

The chart below is a comparison of the proportion of revenue by products for the years ended 31 December 2005 and 2006:



Proportion of revenue by products



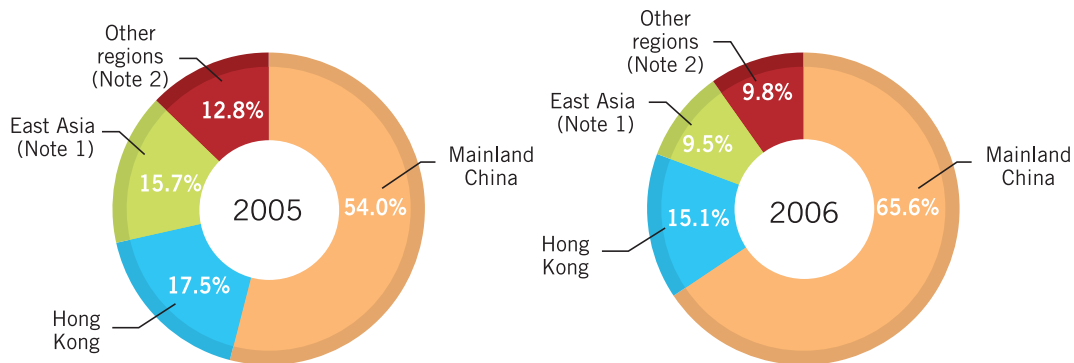
Note: Others include cotton tailings and cotton seeds

Proportion of revenue of the Company's three categories of products to the total revenue remained at the similar level to that in 2005.

MANAGEMENT DISCUSSION AND ANALYSIS

The chart below is a comparison of the Group's revenue in terms of geographical locations for the years ended 31 December 2005 and 2006:

Proportion of revenue by geographical locations



Note 1: East Asia comprises of Japan and South Korea;

Note 2: Others mainly comprise of Taiwan, Thailand, the US and Europe.

For the year ended 31 December 2006, the Group's domestic sales increased substantially. This was mainly due to the strong growth in domestic demands of the PRC during the year. The Group changed its sales strategy, strengthened exploration of domestic market, and expanded its market share in the domestic textile market.

In respect of production, as at 31 December 2006, 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, the Second Industrial Park of Zouping and the Third Industrial Park of Zouping).

All of the above production bases are located in Shandong, the PRC, with a total gross floor area of approximately 3,900,000 sq.m.

In 2006, the Group's production volume of cotton yarn, grey fabric and denim were 882,000 tons, 1,634,000,000 meters and 175,000,000 meters respectively, of which, the growth were about 33.8%, 13.4% and 41.1% respectively as compared with last year. This was mainly attributable to the additional capacities of the First and Second Industrial Parks in the Zouping Production Base, and the Third Industrial Park of Zouping was in operation during the year.

During the year under review, the Group continued to actively expand its market share and explored new market. As at 31 December 2006, the Group had a total of around 7,500 domestic customers and over 720 overseas customers, representing a growth of approximately 29.3% and 20.0% respectively as compared with last year.

ADDITIONAL ISSUE OF H SHARES

Weiqiao Textile has completed the placing of 68,936,500 new H Shares at a placing price of HK\$12.05 per H Share in March 2006, raising net proceeds of approximately HK\$829 million. As at 31 December 2006, the use of proceeds as set out in the announcement dated 2 March 2006 was as follows:

	HK\$ million	
	Planned use	Actual use
Capital investments, thereby expanded the capacity of the existing high value-added products	784	784
General working capital	45	45
Total	829	829

The project was in full operation during the year.

FINANCIAL REVIEW

Revenue, gross profit and gross profit margin

The table below is an analysis of the Group's turnover, gross profit and gross profit margin attributable to its major product categories for the years ended 31 December 2005 and 2006:

Product	For the year ended 31 December 2005			For the year ended 31 December 2006		
	Turnover <i>RMB'000</i>	Gross profit <i>RMB'000</i>	Gross profit margin %	Turnover <i>RMB'000</i>	Gross profit <i>RMB'000</i>	Gross profit margin %
Cotton yarn	5,425,822	1,175,434	21.7	8,291,334	1,126,550	13.6
Grey fabric	6,990,851	837,942	12.0	9,811,971	1,872,157	19.1
Denim	1,080,229	239,963	22.2	1,668,749	311,541	18.7
Others	87,487	(9,209)	(10.5)	54,100	12,842	23.7
Total	13,584,389	2,244,130	16.5	19,826,154	3,323,090	16.8

For the twelve months ended 31 December 2006, the Group's gross profit margin increased to 16.8%. The increase was mainly attributable to the Company's implementation of flexible and effective sales strategies, controls over production costs, market-driven sales mix adjustment, increased sales in high-end grey fabrics while reduced sales of high-end cotton

yarn. As a result, the gross profit margin of cotton yarn was reduced, while gross profit margin of grey fabric was increased. On the other hand, due to unfavorable market environment and low utilization rate of new production capacity, the gross profit margin of denim reduced.

MANAGEMENT DISCUSSION AND ANALYSIS

Selling and distribution expenses

The Group's selling and distribution expenses increased by 4.1% to approximately RMB359,000,000 for the year ended 31 December 2006 from approximately RMB345,000,000 of previous year. In 2006, with an increase of 46.0% in the Group's revenue, the selling and distribution expenses only increased by 4.1%. Following the continuous increase in the Group's transportation volume, the Group conducted tendering on the sea-freight and inland freight charges respectively, thereby significantly reducing the unit prices in transportation. The transportation expenses increased by only 7.4% from approximately RMB256,000,000 in 2005 to approximately RMB275,000,000 in 2006. At the same time, due to the Group's efforts in market development, commission-bearing sales through intermediaries reduced, and ultimately the sales commission paid to intermediaries was decreased by 26.5% from approximately RMB49,000,000 in 2005 to approximately RMB36,000,000.

Administrative expenses

Administrative expenses for the year ended 31 December 2006 amounted to approximately RMB177,000,000, representing an increase of 17.2% as compared with the amount of approximately RMB151,000,000 of previous year. The increase in administrative expenses was mainly due to the increase in the number of administrative staff following the expansion in the Group's production scale, causing the increase in the staff cost and other related expenses. Increase in property taxes derived from the increase in plant area was also another major reason caused the increase in administrative expenses.

Finance costs

Finance costs were to approximately RMB720,000,000. After adding back capitalised interests of approximately RMB13,000,000 and deducting the increase in discounted amount of long-term payables to the immediate holding company of approximately RMB57,000,000, the actual interest expenses for the year ended 31 December 2006 were approximately RMB676,000,000, representing an increase of 54.3% as compared with actual interest expenses of approximately RMB438,000,000 in the corresponding period of previous year. The increase in finance costs was that on the one hand, the Company gradually optimized its capital structure by increasing long-term borrowing and reducing short-term borrowings, causing the effective interest rate to increase. On the other hand, the continued increase in interest rates during the year also gave rise to increase in the finance costs.

Liquidity and financial resources

The cash and cash equivalents of the Group were approximately RMB4,210,000,000 as at 31 December 2006, increased by 32.1% from approximately RMB3,186,000,000 as at 31 December 2005.

For the year ended 31 December 2006, the Group spent approximately RMB2,986,000,000 capital expenditures for constructing the Third Production Area of the First Zouping Industrial Park, the Third Production Area of the Second Zouping Industrial Park, the Third Zouping Industrial Park and the Second Production Area of Weihai Industrial Park and purchasing additional machinery and equipment to enhance the productivity of the Group and to produce high value-added products. The aforementioned capital expenditures were financed by net proceeds of HK\$829 million from issuance of H shares at issue price of HK12.05 per share, and net cash inflow from operating activities of RMB2,973,000,000.

The average turnover of the Group's accounts receivable was approximately 13 days for the year ended 31 December 2006, which decreased from 15 days for the year ended 31 December 2005. The decrease in accounts receivable turnover days was attributable to the successful tightening of the Group's credit policy.

Inventory turnover days decreased from 117 days for the year ended 31 December 2005 to 79 days for the year ended 31 December 2006. Decrease in inventory turnover days was mainly due to the Company's enhancement in sales efforts resulting in rapid increase in revenue, while inventories were basically equaled to the level in the previous year.

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

Net profit attributable to shareholders of the Company was approximately RMB1,685,000,000 for the year ended 31 December 2006, representing an increase of 35.7% as compared with approximately RMB1,242,000,000 of last year.

For the year ended 31 December 2006, the basic earnings per share of the Company were RMB1.43.

Capital structure

The Group continued to maintain an appropriate mix of equity and debt to ensure an efficient capital structure. As at 31 December 2006, the debts of the Group included interest-bearing bank borrowings and long-term payables to the immediate holding company totalling approximately RMB9,867,000,000. Cash and cash equivalents was approximately RMB4,210,000,000 and debt-to-equity ratio was 46.7% (the ratio of total interest-bearing bank borrowings and long-term payables to the immediate holding company, net of cash and cash equivalents to total equity) (2005: 69.8%).

As at 31 December 2006, 31.8% of the Group's bank borrowings was subject to fixed interest rates while the remaining 68.2% was subject to floating interest rates.

As at 31 December 2006, the Group's borrowings were denominated in RMB and US dollars, in which 38.9% of the Group's borrowings were denominated in US dollars. Cash and cash equivalents were mainly held in RMB and US dollars in which 2.8% of the cash and cash equivalents was held in US dollars.

Employee and remuneration policy

As at 31 December 2006, the Group had a total of approximately 152,000 employees, representing an increase of approximately 12,000 employees as compared with last year. Increase in the employee was mainly due to the training and recruitment of employees for the need of production capacity expansions and the increase in management for product development. During the year, total staff cost was approximately RMB2,407,000,000, representing 12.1% of the 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.

MANAGEMENT DISCUSSION AND ANALYSIS

PLEDGE OF THE GROUP'S ASSETS

Details are set out in note 28 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. As the Group's revenue and bank deposits which are denominated in US dollars are maintained basically at the same level with the transaction amounts of imported raw materials and foreign currency bank borrowings which are denominated in US dollars. For the year ended 31 December 2006, the Group recognised net foreign exchange gain of RMB109,000,000. 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 Directors believes that the Group will have sufficient foreign exchange to meet its foreign exchange requirements.

CONTINGENT LIABILITIES

As at 31 December 2006, the Group's contingent liabilities not provided for in the financial statements were letter of credit issued amounting of RMB128 million.

Details are set out in Note 35 to the financial statements.

TAXATION

Taxation of the Group increased from approximately RMB187,000,000 for 2005 to approximately RMB617,000,000 for 2006, representing an increase of 229.9%. The reason for the increase was the increase in profit before tax of 60.7% from approximately RMB1,436,000,000 in 2005 to approximately RMB2,308,000,000 in 2006. In addition, in 2005, the Group obtained tax relief of approximately RMB287,000,000 in respect of purchases of domestically produced machinery and equipment required for technological renovations and investment projects. The Group obtained tax relief of approximately RMB163,000,000 in 2006. Pursuant to the prevailing national Tax Laws of the PRC, the Group is entitled to apply for further similar tax relief in future.

POST BALANCE SHEET EVENTS

During the 5th Session of the 10th National People's Congress, which was concluded on 16 March 2007, the PRC Corporate Income Tax Law ("the New Corporate Income Tax Law") was approved and will become effective on 1 January 2008. The New Corporate Income Tax Law introduces a wide range of changes which include, but are not limited to, the unification of the income tax rate for domestic-invested and foreign-invested enterprises at 25%. Since the detailed implementation and administrative rules and regulations have not yet been announced, the financial impact of the New Corporate Income Tax Law to the Group and the Company cannot be reasonably estimated at this stage.

FUTURE OUTLOOK

China's economy in 2007 is still optimistic. As the economic developments are on the rising stage of economic cycle, China's economy will be developing rapidly and steadily. The State has indicated that expansion of domestic demands will be a significant duty of macro control in 2007, and making efforts to expand consumption of residents is the long term policy of the Government going forward. Stable macro control policy and domestic consumption market will definitely increase the consumption level of textiles products, which are favorable environments for the development of the textile industry. Prospects of the growth of the global economy is promising, and economic growth of developed countries will directly promote the growth of consumption and trading, bringing more opportunities for textile exports in the PRC.

Weiqiao Textile will fully capitalize on these favorable development opportunities to further create new approaches of marketing, improve marketing effort, gain more new customers so as to further enhance comprehensive competitiveness in both domestic and overseas markets, strengthen brand awareness, and continue to enhance the awareness and reputation of the Company's products in the market. The Company will focus more on sales of high-end products, and make efforts to enhance market coverage of high-end products further emphasize on the upgrading of technological equipment and innovations of production technology, further optimize technological equipment structure, continue to track the world's cutting-edge technological level, further enhance the management level of the company, maintain and develop the core competitiveness of the company so as to maintain a stable profit margin.

The year of 2007 is an important conversion period of the cotton textile industry in the PRC, and practical conversion of the way of economic growth emphasizing on the conversion from a quantitative drive to a qualitative drive, expediting technological advancements to promote industrial upgrading and self-innovations will still be the main theme of the industrial development. As a textile enterprise with international perceptions and flexible market senses, the Company will on the basis of scale advantage, speed up in self-innovations and industrial upgrading, stressing on new technology, new process and the use of new raw materials, so as to provide high quality services to more customers, consolidate its position in the market and industry, establish a harmoniously developing situation in the employee, enterprise, industry and society, and continue to create more values to shareholders.