

# Business Review and Prospects

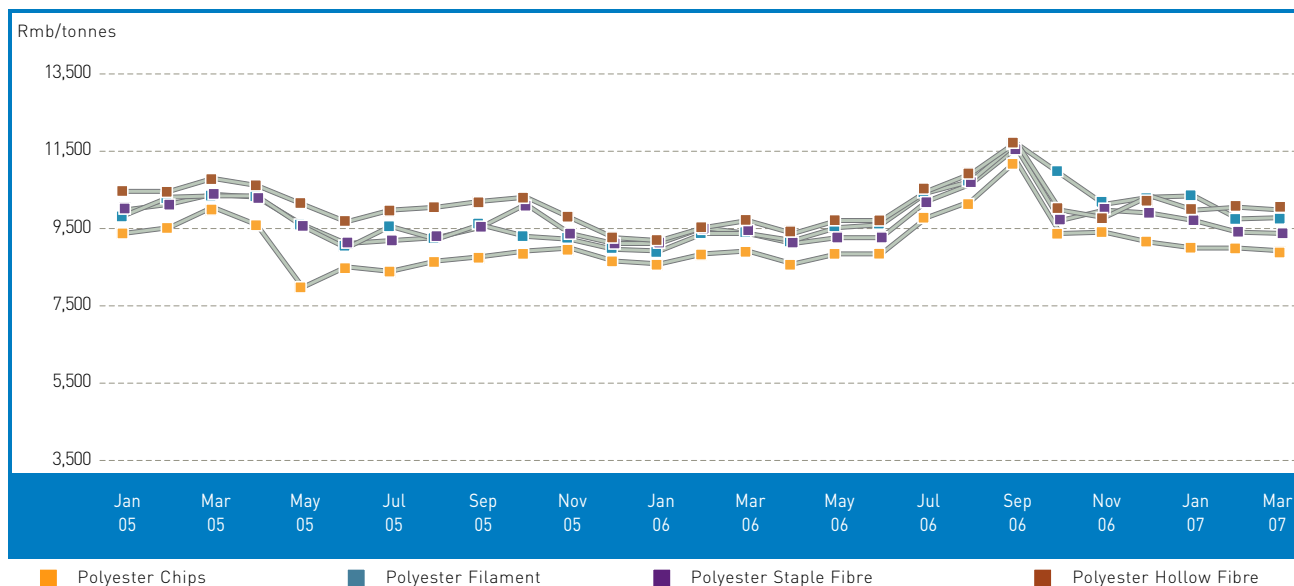
Financial figures, where applicable, contained herein have been extracted from the financial statements prepared in accordance with IFRSs.

In 2006, faced with a difficult operating environment, the Group continued to extend reform adjustments and expand its market. By exerting efforts to strengthen internal management, reduce costs and expenses and optimise product structure, positive progress was achieved in various fields concerning production and operations. Meanwhile, the Group successfully erased the deficits and earned surpluses in its operational results.

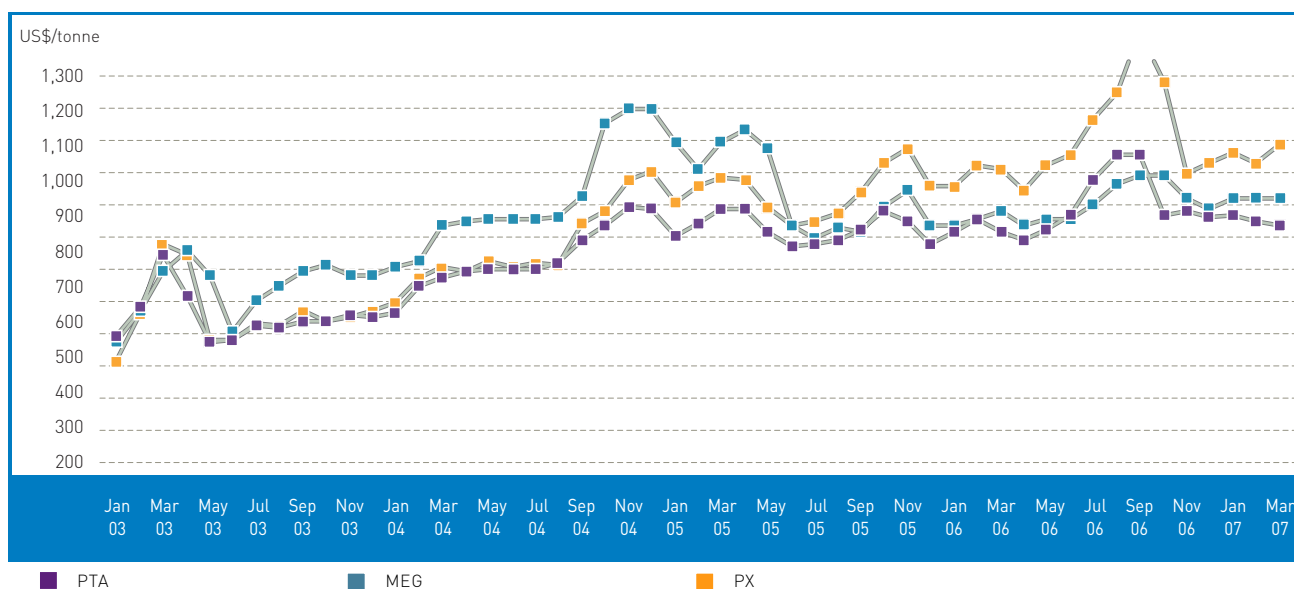
## 1. MARKET REVIEW

In 2006, the domestic polyester industrial chain as a whole surged and then receded. In the first quarter, the prices of domestic polyester raw materials such as PTA, mono-ethylene glycol ("MEG") and polyester products declined owing to the decrease in operation rate of polyester industry and the slowdown in downstream textile demand. From April to August, driven by the costs of crude oil and polyester raw materials and the influence of accelerated downstream textile demand, prices of domestic polyester products continually increased. Entering September, prices of domestic polyester raw materials and polyester products fell precipitously owing to a steep decline in the crude oil price. After the second half of October, the prices of domestic polyester raw materials and polyester products tended to stabilise.

Product Prices Quoted by the Company (Excluding VAT)



Raw Material Contract Price Offered by International Suppliers



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In 2006, the domestic polyester industry continued to expedite structural adjustments and the newly-added polyester production capacity, as shown in the increase of differential and high value-added products. The total polyester production capacity amounted to 21.2 million tonnes at the end of 2006, about one million tonnes higher than in 2005. The volume of the total domestic supply of polyester fibre amounted to 16,953,500 tonnes, an increase of 10.3 per cent over that of 2005, of the total volume, the domestic production volume increased by 11.3 per cent and the import volume decreased by 17.0 per cent as compared with their respective amounts in 2005. Meanwhile, the relatively rapid growth of the PRC's textile and clothes exports drove export volume to 147.09 billion dollars, which was 25.1 per cent higher than in 2005. Total domestic consumption volume of polyester fibre amounted to 15,976,600 tonnes, an increase of 10.0 per cent over the 2005 amount. The domestic demand for polyester fibre continually steady increased.

Domestic supply and demand of polyester fibre

	Polyester filament			Polyester staple fibre			Polyester fibre		
	2006 '000 tonnes	2005 '000 tonnes	+/- (-) [%]	2006 '000 tonnes	2005 '000 tonnes	+/- (-) [%]	2006 '000 tonnes	2005 '000 tonnes	+/- (-) [%]
Production volume	<b>9,913.3</b>	8,902.5	11.4	<b>6,132.8</b>	5,508.7	11.3	<b>16,046.1</b>	14,411.2	11.3
Import volume	<b>264.6</b>	289.3	(8.5)	<b>262.9</b>	346.2	(24.1)	<b>527.5</b>	635.5	(17.0)
Export volume	<b>392.1</b>	255.1	53.7	<b>293.7</b>	210.4	39.6	<b>685.8</b>	465.5	47.3
Net import	<b>(127.5)</b>	34.2	(472.8)	<b>(30.7)</b>	135.8	(122.6)	<b>(158.2)</b>	170.0	(193.1)
Inventories at beginning of the year	<b>323.1</b>	255.6	26.4	<b>56.8</b>	61.8	(8.1)	<b>379.9</b>	317.4	19.7
Year-end inventories	<b>221.1</b>	323.1	(31.6)	<b>70.0</b>	56.8	23.2	<b>291.1</b>	379.9	(23.4)
Total supply volume	<b>10,501.0</b>	9,447.4	11.2	<b>6,452.5</b>	5,916.7	9.1	<b>16,953.5</b>	15,364.1	10.3
Total consumption volume	<b>9,887.8</b>	8,869.2	11.5	<b>6,088.8</b>	5,649.5	7.8	<b>15,976.6</b>	14,518.7	10.0

Source: The Chemical Fibre Association of China

## 2. PRODUCTION AND OPERATION REVIEW

### (1) Production and Marketing

In 2006, despite low plan utilisation rates in the broader domestic polyester industry, the Group maintained safe, stable and capacity operations at its polyester facilities. Owing to the establishment of the joint venture Yihua UNIFI Fibre Industry Company Limited ("Yihua UNIFI") in August 2005 and the completion of equity transfer of Tianma Chemical Fibre in 2006, the total production volume of polyester products amounted to 2,137,191 tonnes, a decrease of 0.9 per cent as compared with 2,155,660 tonnes in 2005. Nevertheless, the Company's production volume of polyester products increased as compared with that of 2005. The capacity utilisation rate reached 93.7 per cent. The total production volume of PTA amounted to 1,003,858 tonnes, an increase of 3.4 per cent as compared with 970,507 tonnes in 2005. Due to strengthening the Group's sales promotion, the Group's total sales volume of polyester products amounted to 1,704,127 tonnes in 2006, an increase of 4.7 per cent as compared with 1,628,336 tonnes in 2005. Excluding self-consumption volume and other factors, the ratio of sales to production reached 100.1 per cent. In 2006, the Group's export volume of polyester products rose dramatically to 120,330 tonnes, an increase of 46.5 per cent over the 82,142 tonnes for 2005.

### (2) Cost control

In 2006, the weighted average price of polyester product (excluding VAT) of the Group increased by 1.7 per cent as compared with last year, while the weighted average purchase prices of principal purchased raw materials of the Group, such as PTA, MEG and PX, increased by 6.7 per cent as compared with last year. The Group vigorously offset the influence of market by reducing costs and expenses and strictly strengthening controls over production processes. Measures drafted at the beginning of 2006 for reducing costs and expenses were conjointly implemented. The consumption of energy and raw materials was further reduced, so that the overall energy consumption per unit decreased by 2.3 per cent as compared with that of 2005. By exerting great efforts to improve the proportion of direct selling, optimise the allocation of transportation resources and reduce intermediate expenses of sales, the Group's selling expenses were 4.6 per cent lower than those of 2005. Administrative expenses and net financing expenses decreased by 21.0 per cent and 105.1 per cent respectively from those of 2005. This occurred for several reasons: improvements to internal management, reductions in costs and expenses, a decrease in fixed assets depreciation as a result of asset structure adjustment and decrease in bank loans and discounted bills. The total reduction in selling expenses, administrative expenses and net finance costs was 22.6 per cent from those figures for 2005.

### (3) R&D

In 2006, The Group adhered to market orientation, take profit as a center, and strengthened product and market development by building its product development team. New progress was achieved in product structural adjustments and technology development. Development of sixteen new polyester products was successfully completed. Seven patent rights were obtained. In 2006, the Group's total production volume of specialised polyester chips amounted to 791,000 tonnes and the specialised rate was 77.9 per cent, 4.2 percentage points higher than that of last year. The total production volume of differential polyester fibre amounted to 453,000 tonnes and the differential rate of polyester fibre was 66.5 per cent, 7.1 percentage points higher than that of last year.

### (4) Internal Reform and Management

In 2006, all reform adjustments advanced smoothly. Restructuring based on department specialisation was further extended, and management processes and the division of labour were optimised. As a result, management efficiency was enhanced. The employment and remuneration system reforms were continually advanced. "Compete for Appointment" was carried out for operations and service positions and the position performance evaluation was extended. The overhaul and maintenance center simulated market-independent operations at the beginning of 2006 and the reform of other particular items also steadily advanced. Great progress was achieved concerning asset structure adjustment. The equity transfer of Tianma Chemical Fibre was successfully completed, which further enhanced asset quality. Through the last two years' reform adjustments, the Group's competitiveness and risk management ability were further strengthened.

### (5) Capital expenditure

In 2006, the Company's total capital expenditure amounted to Rmb 73,600,000. In order to maximise investment contribution, the Company strengthened investment management in accordance with the prudence principle. Projects such as saving energy consumption, safety and environment, and reducing costs and expenses, which increase profit generation from existing assets, were completed in succession.

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## 3. BUSINESS PROSPECTS AND WORK PLAN

### (1) Market Analysis

According to the 2007 market analysis, the Group considers: Firstly, the PRC's economy will still maintain relatively rapid growth and the domestic demand for textiles will continue to expand. Secondly, owing to the competitive advantage of the PRC's textile industry in the international market, the export of PRC's textiles and apparel will continue to steadily increase, which will promote the steady increase in domestic demand for polyester products. At the same time, the excess of supply over demand for domestic polyester production capacity will continue and the profit margin of polyester products will not obviously improve. Meanwhile, some factors such as the adjustment of PRC's VAT rebates policy, Renminbi appreciation and international trade protectionism will increase the uncertainty for PRC's textile and apparel export environment, which in turn will intensify the market risk to the domestic polyester industry. Since 1 January 2007, the PRC import tariffs on PTA, MEG and PX have remained at 6.5 per cent, 5.5 per cent and 2 per cent respectively. The new PRC import tariffs on polyester chip have been lowered to 7.6 per cent, while the import tariffs on polyester staple fibre and polyester filament both remain at 5 per cent.

It is expected that global crude oil prices will continue to fluctuate immoderately at a high level. With new domestic PTA facilities to be put into operation, the supply of PX will be tighter, which impel its price to remain high. Therefore, polyester industry chain profits will incrementally rise and profit generation by the Group's in-house PTA will be affected. The Group will still be faced with challenging operational conditions.

### (2) Business strategy

In 2007, the Group will actively adapt to developing trends in polyester market competition, continue to extend reform adjustments, vigorously improve management, expedite product structural adjustments and refine the core business of polyester chemical manufacturing so as to enhance competitiveness and profitability. The following will be set as priorities in 2007:

#### ***I. Strengthen product marketing and raw material purchases so as to enhance the ability to respond to the market and to raise profits as the market allows***

The Group will take the market as the base and profit maximisation as the principle. By perfecting the coordination mechanism between production and marketing, the Group will try to realise the change from selling to marketing. The Group will strengthen market analysis so as to actively respond to market change, continue to sell what is produced, and sell at optimal prices. The proportion of direct selling will be increased and intermediate expenses of sales will be reduced. The Group will exert maximum effort to explore the international market and increase exports of all kinds of polyester products. The Group will try to realise the change of raw material purchasing from ensuring supply to anticipating the market so as to further reduce purchasing costs. To meet the target ratio of 100 per cent sales-to-production, the planned volume of polyester products sales is 1,699,000 tonnes.

#### ***II. Comprehensively deploy the safety and environment protection responsibility system to maintain safe and stable operation of facilities***

The Group will continue to strengthen safety and environment management, further put its safety responsibility system into effect, and strengthen spot management so as to reduce unexpected production interruptions and maintain safe, stable, high-grade, and low energy-consumption operations. Meanwhile, to realise the efficient operation of facilities, the Group will dynamically adjust and optimise the product mix and the capacity utilisation rate of facilities according to market changes, costs, and profits. In 2007, the planned volume of polyester product production is 2,129,000 tonnes, of which self-consumption volume is 430,000 tonnes. The planned production volume of PTA is 1,010,000 tonnes.

### **III. Thoroughly mine potential to improve efficiency, conserve energy and raw materials, and substantially reduce costs and expenses**

The Group will take active and effective measures to realise the aim of the cost-and-expense reduction items set at the beginning of 2007. The facility operation will be optimised and the production volume of PTA and polyester products will be increased. Activities will be vigorously developed to reduce consumption of energy and raw materials. The Group will strive to decrease the overall energy consumption per unit by 3.0 per cent from 2005's consumption rate. The Group will seize market opportunities and comprehensively execute tender bid purchasing so as to reduce the purchasing costs of raw and supplementary materials. Capital operation will be strengthened to lower financial expenses. In addition, the proportion of facilities maintained by the Group itself will be increased and the cost of repairs will be reduced. The Group will actively exploit external operation of public engineering in order to increase profits.

### **IV. Further strengthen internal control and constantly improve management**

The Group will establish and strictly enforce its internal control system, actively promote its all-around, entire-staff and whole-process fulfillment, and further normalise it. The Group will strengthen overall budget control and firmly manage unplanned expenses so as to realise its cost reduction targets. The quality of management will be strengthened, and quality standards will be strictly implemented to regulate and improve product quality. The Group will further strengthen facility management and carefully control key facilities and areas to ensure safe and stable operation of production facilities. The Group will strengthen investment management and restrict non-productive investments in order to maximise investment returns.

### **V. Extend product structural adjustments and continually advance technology innovation so as to add value to products**

The Group will extend product structure adjustments, and expand and optimise the production of specialised and differentiated products which have strong profitability. Meanwhile, adhering to the principle of taking market as the base and profit as the center, the Group will strive to develop new products and continually add value by further exerting the integral advantage of product development team. There are 35 product items planned for new development. The Group's projected production volume of differentiated fibre and specialised polyester chips products for 2007 will be 498,000 tonnes and 852,000 tonnes, respectively, while the differential rates for differentiated and specialised products are expected to be 82.6 per cent and 81.5 per cent.

### **VI. Continually extend reform adjustments, actively advance non-core business divestiture, and accelerate the establishment of a market-based employment and remuneration system**

The Group will continue to extend employment and remuneration system reforms. "Compete for appointment" will be carried out for operations and service positions to meet staff reduction and capital allocation requirements. A new round of "Compete for Appointment" will be carried out for management and technology positions. Meanwhile, the Group will extend performance evaluation, and perfect motivation and engagement mechanisms so as to further raise employee morale. The Group will actively advance the course of non-core business divestiture of the overhaul and maintenance centre, and other reforms of particular items; refine the core business, and reduce costs so as to enhance the competitiveness of polyester chemical manufacturing.