



INDUSTRY OVERVIEW

Domestic demand constitutes the major driving force of the textile industry in the PRC. With rapid economic development and improving living standards of its 1.3 billion population, high value-added textile products enjoy immense market potential. The textile industry is a major industry in the PRC, significantly contributing to labour employment and economic growth. The historical development of economic systems and administrative regions led to separate business investment and a fragmented market with no dominant market leader in the PRC textile industry. Increasing market demand for quality textile products and the continuous enhancement of management levels and operation models marked the beginning of the stage of resources consolidation, in which state-owned enterprises with lower technological levels and manufacturers with smaller production scales are expected to be eliminated. Meanwhile, large-scale textile enterprises with higher economies of scale become more competitive. During the expected further market consolidation, opportunities for mergers and acquisitions will continue to emerge, providing ample room for the further development of large-scale textile enterprises with advanced operation models.

To cater for the ever-changing textile market, textile enterprises have to equip themselves with sustainable innovation to enhance product value so as to gain market acceptance. Textile products using spandex as raw material have been well-received by the market in recent years. The unique stretching property of spandex and its flexibility for innovation allow it to be widely applied in the production of various clothing, such as shirts, trousers and leisure clothing. As spandex has become a popular textile material, global spandex production has increased considerably. In 2003, the global annual production of spandex reached 270,000 tonnes, representing a compound annual growth rate of 12.3% from 1990 to 2003. It is expected that market demand for spandex stretch textile products will gradually increase.

As the "world's factory", the PRC is the global industrial production base for textiles, which, as one of the major industries in the PRC, demonstrates unique edges against the international market. With the recent abolition of the quota system, the PRC textile enterprises are likely to leverage their cost advantages to increase export volume and explore overseas markets. According to the 2004 World Trade Organization's report headed "The Global Textile and Clothing Industry Post the Agreement on



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Textiles and Clothing”, upon the abolition of the quota system, the proportion of garments imported from the PRC by the US is expected to gradually increase from 16% in 2002 to 50%. Garment manufacturers will continue to significantly increase their production capacity in order to capture upcoming business opportunities and stimulate the demand for upstream textile products such as yarns and grey fabrics, which are favourable to the development and expansion of the upstream textile industry.

With the view of maintaining the textile industry’s overall efficiency and enhancing the competitiveness of exported textile products in the international market, the PRC government imposed export tariffs on domestic textile products after the abolition of the quota system to encourage the increase in production of high value-added quality textile products. As a result, the demand for upstream textile products with higher quality is expected to increase, creating a broader market for enterprises possessing the capability to produce high value-added upstream textile products.

BUSINESS REVIEW

Since its establishment in 1997, the Group has expanded its production capacity by acquiring

textile production facilities from the state owned enterprises at a relatively low cost and by organic expansion, successfully propelling the Group’s rapid development and robust growth. By focusing on the production of spandex stretch textile products and continuously developing new products, the Group has become one of the largest cotton textile manufacturers in the PRC. As at 31 December 2004, the Group had a total of eight production bases, located in Xuzhou, Taizhou and Nantong in Jiangsu Province and Jinhua in Zhejiang Province respectively.

The Group’s major products include spandex stretch yarns, spandex stretch grey fabrics and garment fabrics. During the year under review, market demand for the Group’s products continued to grow, contributing to the increases in the sales of yarns and grey fabrics to 24,465 tonnes and 80.13 million meters respectively, representing increases of 31.8% and 2.5% when compared with the previous year. In 2004, the Group’s high value-added spandex stretch yarns and spandex stretch grey fabrics were well received by the market, sales volume reached 18,922 tonnes and 63.73 million meters respectively, representing increases of 51.5% and 15.4% when compared with the previous year. Sales volume of garment fabrics increased by 68.3% to 9.93 million meters from last year.



The Group has fully embraced its operation strategy of the continual launch and development of new products. During the year under review, the Group launched numerous new products, including low-drawing cotton stretch yarns, cotton bi-stretch grey fabrics, top-grade cotton stretch satin, stretch dobby fabrics and top-grade linen/cotton casual fabrics. Together with the development of various kinds of products that are not yet in mass production, the Group has further enhanced its product varieties and product reserves. During the year under review, the Group focused on the production of spandex stretch products. Its major products include carded cotton stretch yarns, combed cotton stretch yarns, polyester and rayon blended stretch yarns, rayon stretch yarns, low-drawing cotton stretch yarns, cotton stretch grey fabrics, cotton bi-stretch grey fabrics, polyester and rayon blended stretch grey fabrics, as well as various types of garment fabrics.

In order to maintain high production efficiency, the Group's production facilities operate round-the-clock every day. In 2004, the average utilization rate of the Group's production facilities reached 90%. In addition, the Group implemented stringent quality control measures to ensure product quality. Its yarn products were produced at an Uster Statistics of 25-5% and its grey fabric products were produced according to the Four Points System of the United States. The Group's persistence in stringent quality control received international recognition. During the period under review, the production facilities of the Group's member, Taizhou Century Texhong Textile Co., Ltd., were accredited with the ISO9001:2000 Quality Management System Certificate and the ISO14001:1996 Environmental Management System Certificate, establishing a solid foundation for the production of more high quality products.



Net Profit in 2004
increased
by **61.1%**
over the previous year.

PROSPECTS

With the abolition of the quota system, the US and Europe may initiate anti-dumping legislation or impose import restrictions on the PRC's textile products. However, the Group believes that these possible measures will only target at certain types of textile products. As an upstream textile enterprise in the PRC, the Group will stay abreast of market development trends and

continue to optimize its customer portfolio and actively expand its customer base and sales channels, such as direct sales to local and overseas renowned fashion brands and distributors, and gradually tap into regions with strong demand, such as regions outside Zhejiang Province and Jiangsu Province while exploring markets in Asia and other countries with no restriction on the PRC's textile products, strengthening its revenue base.

Optimization of the product mix will be a crucial step for the Group to explore domestic and overseas markets. The Group will continue to focus on production of more high quality textile products through application of innovative textile materials. The Group is poised to maintain its leading market position and develop future industrial trends.

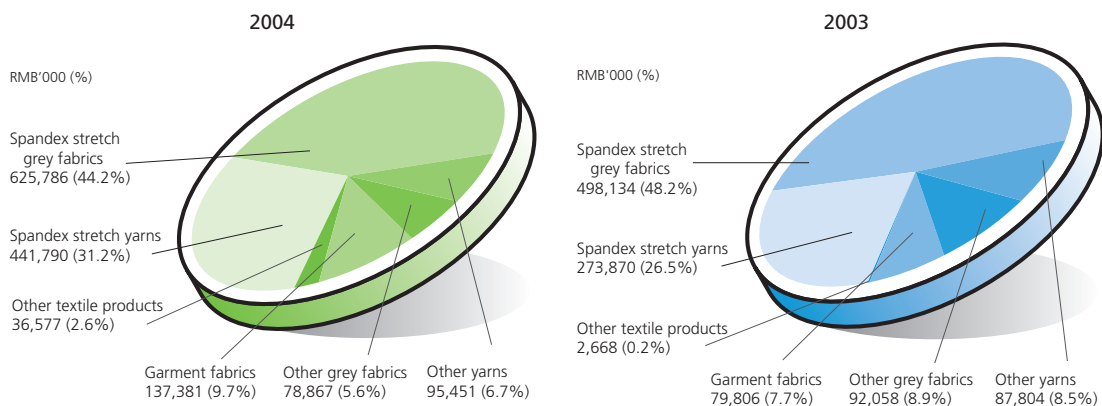
The Group will strengthen internal management to minimize operating costs. Furthermore, the Group will endeavour to facilitate information exchange related to management, business operation and accounting, to smoothen administration and to enhance operational efficiency through the installation of a management information system.

Looking ahead, as one of the leading manufacturers of high value-added spandex stretch textile products in the PRC, the Group will leverage on its competitive edges in the industry, its professional knowledge and extensive experience, especially its experience in successful acquisitions, with the view of catering to the increasing market demand for high-value added textile products. In addition, the Group will capitalize on the opportunities brought forth by system reforms and industrial development in the PRC to enhance its production and operation capabilities through acquisitions as well as organic expansion. The Group is committed in production and sale of more high value-added spandex stretch textile products, and ultimately becoming the leading and influential cotton textile enterprise in the PRC.

FINANCIAL REVIEW

TURNOVER

Turnover Analysis by Products

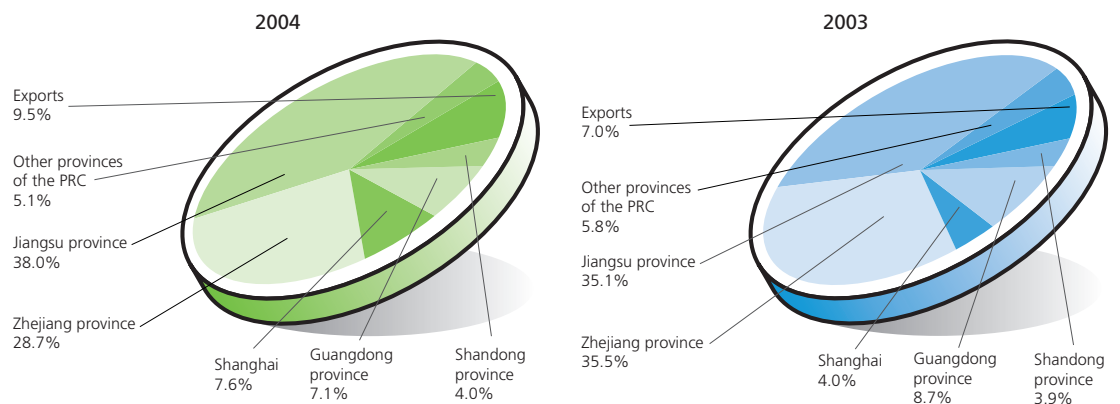


The Group's turnover is primarily generated from the manufacture and sale of high value-added textile products. During the year under review, the Group endeavoured to expand its production of high value-added spandex stretch yarns and spandex stretch grey fabrics. With huge market demand for the Group's textile products and higher selling prices of spandex stretch yarns and spandex stretch grey fabrics, the turnover of the Group increased substantially when compared with the previous year. For the year ended 31 December 2004, the turnover of spandex stretch yarns and spandex stretch grey fabrics increased considerably by 61.3% and

25.6% respectively, accounting for 75.4% of the Group's total turnover compared to 74.7% for the previous year.

During the year under review, the Group increased its production and sales of garment fabrics. The turnover of garment fabrics increased by 72.1% when compared with the previous year, accounting for 9.7% of the Group's total turnover compared to 7.7% for the previous year. The sales of other grey fabrics decreased since the Group further focused on production of spandex stretch grey fabrics.

Turnover Analysis



Since the market demand for high quality textile products continued to grow in the PRC, the Group's sales in the PRC increased substantially by 33.2% from the previous year to RMB1.28 billion, accounting for 90.5% of the Group's sales. During the period, the Group's exports also increased in response to the increase in overseas market demand. The overseas sales amounted to RMB135 million, representing an increase of 85.7% over the previous year and accounted for 9.5% of the Group's total sales.

GROSS PROFIT AND GROSS PROFIT MARGIN

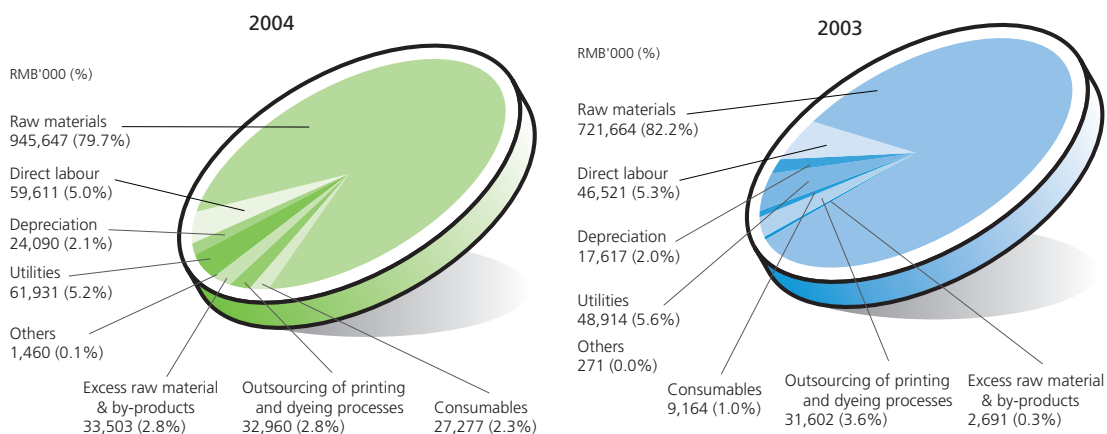
For the year ended 31 December 2004, the increase in the Group's sales, together with the increase in the production of products with higher gross profit margin such as combed stretch yarns, led to the Group's gross profit increased by 47.1% from RMB155.9 million for the previous year to RMB229.4 million. The gross profit margin increased from 15.1% for the previous year to 16.2% for the year under review. Set out below is an analysis of the gross profit margin by products:

	2004	2003
Spandex stretch yarns	16.1%	13.3%
Other yarns	10.5%	9.6%
Spandex stretch grey fabrics	18.2%	17.5%
Other grey fabrics	9.5%	9.8%
Garment fabrics	15.7%	16.5%

COST STRUCTURE

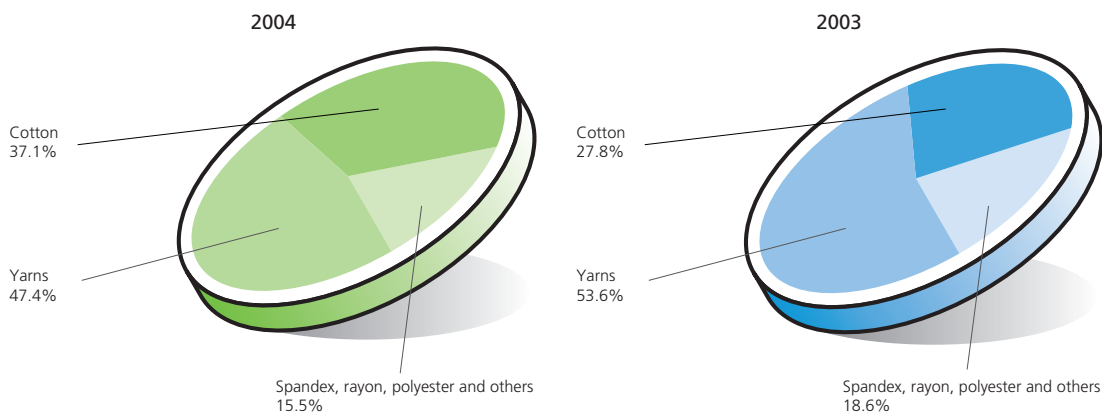
For the year ended 31 December 2004, the Group's cost of sales increased by 35.1% from RMB878.4 million for the previous year to RMB1,186.5 million as a result of the Group's substantial increase in production and sales.

Breakdown of Cost of Sales



COST OF RAW MATERIALS

The Group's raw materials are mainly yarns, cotton, spandex, rayon and polyester, set out below is an analysis of the cost of raw materials:



OTHER REVENUE

For the year ended 31 December 2004, the Group's other revenue amounted to RMB9.4 million, of which RMB8.7 million was discretionary subsidies granted by the PRC government and the remaining RMB0.7 million was interest income from the Group's bank deposits and rental income.

SELLING AND DISTRIBUTION EXPENSES

For the year ended 31 December 2004, the Group's distribution expenses amounted to RMB29.8 million, representing an increase of 33.6% when compared with the previous year. The increase in distribution expenses was mainly due to the increase in transportation and salary expenses associated with the increase in business volume and market expansion.

GENERAL AND ADMINISTRATIVE EXPENSES

During the year under review, the administrative expenses increased by 33.7% from RMB36.4 million for the previous year to RMB48.6 million, accounting for 3.4% of the Group's turnover. The increase in general and administrative expenses was mainly due to the increase in employees in relation to administration and management, and the increase in salaries, bonuses, and social welfare of existing employees in response to the rapid expansion of the Group's businesses.

FINANCE COSTS

The Group's finance costs for the year under review amounted to RMB13.2 million, representing an increase of 48.4% when compared with RMB8.9 million for the previous year. The increase in finance costs was due to the increase in average bank borrowings and bank interest rates.

NET PROFIT MARGIN

For the year ended 31 December 2004, the Group's net profit margin rose to 9.7% from 8.2% for the previous year. The increase in net profit margin was mainly due to the increase in gross profit margin and the effective cost control measures implemented by the Group so that

the percentage of selling expenses, general and administrative expenses and finance costs to turnover were similar to that of the previous year. Furthermore, the increase in other revenues had positive impact on the Group's net profit margin.

BORROWINGS

As at 31 December 2004, the Group had outstanding short-term bank loans of RMB227.9 million (2003: RMB235.9 million). The short-term bank loans were raised mainly for working capital purpose and business expansion in prior years. All of the short-term bank loans were denominated in Renminbi and bearing interest at rates ranging from 5.0% to 8.0% per annum (2003: 1.7% to 6.4% per annum). The loan period ranged from 6 months to 1 year.

Of the total short-term bank loans, RMB119.4 million (2003: RMB119.4 million) was unsecured and the remaining balance was secured.

The secured assets as at 31 December 2004 were summarized below:

- Certain land and buildings and machinery and equipment with an aggregated net book value of RMB174 million (2003: RMB108.1 million);
- Bank balance of RMB7.1 million (2003: Nil);
- Bills receivable of RMB2 million (2003: Nil).

In addition, certain subsidiaries of the Company provided corporate guarantees totalling RMB109.5 million (2003: RMB117.3 million) for the bank borrowings as at 31 December 2004.

The net debt to equity ratio, being borrowings net of cash and cash equivalents divided by equity, was zero as at 31 December 2004 as compared to 0.68 as at 31 December 2003.

All non-trade debts due to or from related parties were settled and all trade-related debts due to or from related parties will be settled according to normal and usual commercial terms.

FOREIGN EXCHANGE RISK

In the opinion of the Board, since the majority of the sales, purchases and expenses of the Group are mainly denominated in Renminbi, the exposure to fluctuations in foreign currency exchange rates is minimal. As a result, the Group was not involved in any hedging activities during the year under review.

CONTINGENT LIABILITIES

As at 31 December 2004, the Group had contingent liabilities of RMB21.9 million. Such amount represented government grants obtained

from the Management Committee of Taizhou Economic Development Zone in connection with the Group's purchase of a piece of land in Taizhou, Jiangsu Province, the PRC.

LIQUIDITY AND FINANCIAL RESOURCES

The Group expect to finance its working capital needs and expansion principally by internally generated cash, bank borrowings, funds raised through issuance of equity securities or a combination of them. As at 31 December 2004, the Group had credit facilities of RMB273 million, of which RMB212.9 million had been utilized.

CASHFLOW

	2004 <i>RMB'000</i>	2003 <i>RMB'000</i>
Net cash inflow from operating activities	180,124	5,550
Net cash outflow from investing activities	81,219	23,600
Net cash inflow from financing activities	110,263	35,517
Cash and cash equivalents at 31 December	247,245	38,077

For the year ended 31 December 2004, net cash inflow generated from operating activities amounted to RMB180.1 million. The increase in net cash inflow from operating activities was mainly due to the increase in the Group's profit and the decrease in deposits for purchase of cotton attributable to the drop in cotton price.

During the year under review, the net cash outflow from investing activities amounted to RMB81.2 million, which was mainly used for the expansion of the production capacity of our plants in Xuzhou, the PRC and the acquisition of the assets of Feng County Textile Factory.

For the year ended 31 December 2004, the net cash inflow from financing activities amounted to RMB110.3 million. The amount increased when compared to the previous year was as a result of the net proceeds of about RMB194 million raised from the issue of new shares of the Company in December 2004 and the net dividends paid out of RMB64.7 million before the listing of the Company on HKSE.

INVENTORY TURNOVER DAYS

For the year ended 31 December 2004, the inventory turnover days of the Group decreased from 55 days in 2003 to 51 days. The decrease in inventory turnover days was mainly due to the increase in the Group's production and delivery efficiency, the effective control of inventories and the decrease in the price of cotton when compared to the previous year.

ACCOUNT RECEIVABLE TURNOVER DAYS

For the year ended 31 December 2004, the Group's account receivable turnover days decreased from 37 days for the previous year to 34 days as a result of the Group's stringent review of customers' creditability and its efforts in optimizing its customer base.

DIVIDEND POLICY

The declaration of dividends will be subject to the discretion of the Directors, depending on the Group's operation results, working capital, cash positions and capital requirements. The Group's members in the PRC may only distribute its after-tax profits after it has made allocations or allowances for the recovery of accumulated losses, allocations to the statutory common reserve fund, the statutory welfare fund and the discretionary common reserve fund as may be approved by the shareholders. Subject to the availability of the Company's cash and distributable reserves, the Group's investment requirement, the cash flow and working capital requirements, it is the current intention of the Directors to recommend annually the distribution of not less than 30% of the Group's annual net profit as dividends to shareholders of the Company in the foreseeable future.

USE OF PROCEEDS

The net proceeds from the issue of the Company's new shares in December 2004 amounted to approximately RMB194 million. For the year ended 31 December 2004, approximately RMB17 million and RMB10 million had been used for working capital purpose and for the expansion of yarn production capacity respectively. The remaining balance of approximately RMB167 million had been placed as short-term deposits with licensed banks in Hong Kong and is expected to be applied as stated in the Prospectus as follows:

- as to approximately RMB145 million for the expansion of the Group's yarn production operations;
- as to approximately RMB18 million for the installation of a management information system;
- as to approximately RMB2 million for enhancing the Group's product development capability; and
- as to approximately RMB2 million will be used as general working capital of the Group.

The actual and intended applications of the net proceeds referred to the above are consistent with the plans as set out in the Prospectus.

CAPITAL EXPENDITURE

For the year ended 31 December 2004, the capital expenditure of the Group amounted to RMB81.6 million was used for the purchase of plants and machinery.

HUMAN RESOURCES

As at 31 December 2004, the Group had 6,634 full-time employees, representing an increase of 1,469 when compared with the previous year. New employees were recruited to cater for the Group's business expansion during the year. The Group pays retirement, medical, casualty, unemployment and maternity insurance for its employees in accordance with the relevant PRC rules and regulations.

SHARE OPTIONS

The Company has adopted a share option scheme and a Pre-IPO share option scheme on 21 November 2004 for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. The Directors may, at their discretion, invite any employees or Directors of the Group and other selected participants as set out in the share option scheme, to subscribe for shares in the Company. As at 31 December 2004, share options for the subscription of an aggregate of 4,342,000 shares of the Company had been granted to 4 senior management of the Group under the Pre-IPO share option scheme and no share option had been granted under the share option scheme. Further particulars of which are set out in the paragraph headed "Share Options" under the section headed "Report of the Directors" in this report.