Chapter VII Directors' Report

Section I Operation Review of the Company during the Reporting Period

1. Overall Operation Review of the Company during the Reporting Period

The Company is one of the largest textile machinery manufacturers in the PRC , and the only enterprise group capable of research and development as well as manufacturing of complete sets of cotton weaving equipment with integrated business in scientific research, industrial and trading. It is principally engaged in the development, manufacture and sales of textile machinery and components and parts thereof and recognised a high and new technology enterprise. Its predecessor is the former Jingwei Textile Machinery Factory with over 50 years of history. As the flagship in the textile machinery industry in the PRC, the Company is dedicated to the development of textile industry in the PRC with a full range of textile machinery to satisfy various customers' needs. The Company's major products consist of the equipment for the whole process of cotton weaving including cotton-clearing machines, carding machines, clearing-carding machines, combing machines, doubling machines, roving machines, spinning machines, air-jet yarn weaving machines, automatic winding machines, common winding machines, high-speed warping machines, water-jet weaving machines, air-jet weaving machines, rapier weaving machines, warp knitting machines, circular weft knitting machines, and components and parts of textile machinery. Major products contribute to half of the market share in the textile machinery market in the PRC and are sold in various regions of the country and exported to over 40 countries and regions. Its products enjoy brilliant reputation in the PRC textile and textile machinery industry as well as important influence in international textile and textile machinery industry. The Company is recognized as a specialized textile machinery enterprise with excellent quality and high reputation.

2006 is the initial year of implementation of the '11th Five-Year Plan' by the State. By seizing the excellent market opportunities in a constantly growing textile industry, the Company increased its efforts to develop the domestic and international markets with a business strategy focusing on 'greater innovational efforts, enhanced competitiveness' under a favourable environment where the PRC textile industry has been speeding up the process of industry enhancement during the period of '11th Five-Year Plan'. The Company maintained rapid growth with sound operating results by introducing series of predominant brands of cotton textile in complete sets, strengthening technological innovation and management innovation, accelerating products structural adjustments, promoting in-depth resources consolidation, smoothly implementing Share Segregation Reform, consolidating internal enterprise management and further improving competitiveness. During the year, the Company was awarded with the 'Advanced Organization in National Textile Industry' by the State Ministry of Personnel and China Textile Industry Association, the "Advanced Organization as National State-Owned Enterprise with 'Quaternion Excellence'" by the Organization Department of the Chinese Communist Party and Party Committee of the State-owned Assets Supervision and Administration Commission of the State Council, the 'Top 100 Enterprises of Sales Revenue in the PRC Machinery Industry for year 2005' by the China Mechanical Industry Federation and the Industrial Traffic Statistic Department of the National Statistic Bureau; the 'Selected Enterprise in the Top 500 Enterprises for Enterprise Informatization in China for year 2005' by the CECA National Informatiztion Evaluation Center; the 'Top 500 Manufacturing Enterprises in Year 2006' by the State Statistic Bureau of the PRC; the 'Chinese Textile Brands Cultural Innovation Award' by China Textile Industry Association, the Association for Development of Textile Enterprise Culture in China and the 'Top 100 Beijing Enterprises' by the Beijing Enterprise Federation and Beijing Entrepreneurs Association etc.

Financial performance based on HKFRS financial information

For the year ended 31st December 2006 and as stated in the financial report prepared in accordance with the HKFRS, revenue and profit attributable to equityholders of the Group amounted to RMB4,609,322,000 and RMB187,442,000 respectively, representing an increase of 8.66% and 22.49% from that of last year respectively. As at 31st December 2006, the Group's carrying amount of bank balances was RMB905,281,000, short-term bank loans was RMB522,787,000, of which borrowings in US dollars amounted to US$20,000,000 (equivalent to RMB156,174,000), and the balance were borrowings in Renminbi. The interest rates were in the range of 5.31% to 6.36% per annum. The Group had long-term borrowings RMB200,000,000. The gearing ratio (long-term borrowing divided by net asset value) was 7.02%.

As at 31st December 2006, bank and cash balances of RMB7,891,000 (2005: RMB4,656,000) were pledged as collateral for the Group's short-term bank loan.

As at 31st December 2006, no fixed assets of the Group (2005: Nil) were pledged as security for the Group's bank loans.

As at 31st December 2006, none of the short-term investments of the Group (2005: Nil) were pledged as security for the Group's bank loans.

Financial performance based on PRC GAAP financial information

For the year ended 31st December 2006 and as stated in the financial report prepared in accordance with the PRC GAAP, revenue from principal activities of the Group amounted to RMB4,609,322,000, representing an increase of 8.66% from that of last year. Profit from the principal activities was RMB784,797,000, representing an increase of 13.85% from that of last year. Net profit was RMB183,631,000, representing an increase of 34.78% over the previous year.

Among which:

Revenue from principal activities of the Company was RMB3,073,736,000, representing an increase of 2.97% over the previous year while its profit from principal activities was RMB255,136,000, representing an increase of 3.66% over the previous year.

Section I Operation Review of the Company during the Reporting Period (continued)

1. Overall Operation Review of the Company during the Reporting Period (continued)

Subsidiaries: Revenue from principal activities of Qingdao Hongda Textile Machinery Company Limited was RMB1,134,682,000 while profit from its principal activities was RMB99,260,000.

Revenue from principal activities of Shenyang Hongda Textile Machinery Company Limited was RMB250,369,000 while profit from its principal activities was RMB28,628,000.

Revenue from principal activities of Tianjin New Type Textile Machinery Company Limited was RMB 195,133,000, while profit from its principal activities was RMB 37,143,000.

Revenue from principal activities of Tianjin Hongda Textile Machinery Company Limited was RMB319,801,000 while profit from its principal activities was RMB42,678,000.

Revenue from principal activities of Changde Textile Machinery Company Limited was RMB460,442,000 while profit from its principal activities was RMB126,260,000.

Revenue from principal activities of Beijing Jingwei Textile New Technology Company Limited was RMB62,517,000 while profit from its principal activities was RMB20,352,000.

Revenue from principal activities of Shanghai Jingwei Dongxing Blowing Carding Machinery Company Limited was RMB137,400,000 while profit from its principal activities was RMB24,609,000.

Revenue from principal activities of Wuxi Jingwei Textile Technology Testing Company Limited was RMB102,151,000 while profit from its principal activities was RMB8,281,000.

Revenue from principal activities of Shanxi Jingwei Heli Machinery Manufacture Company Limited was RMB480,259,000 while profit from principal activities was RMB50,404,000.

Revenue from principal activities of Wuxi Hongda Textile Machinery and Special Parts Company Limited was RMB 102,189,000, while profit from its principal activities was RMB 28,549,000.

The main operating activities of the Group in 2006 were as follows:

(1) Seize market opportunities, and introduce a series of predominant brands

Driven by the textile industrial restructuring and products upgrading, there is a growing demand for technological reform in textile enterprises, some enterprises achieve prosperous production and sales through faster and consistent expansion of equipment, new technology and new techniques. The subsidiaries of the Company seized the valuable market opportunities to strengthen market development, focus on key customers and engage in delicate production arrangement, in order to maximize the satisfaction of market demand. Therefore, another historical breakthrough in terms of production capacity of the mainsteam products can be achieved again. In the meantime, the headquarters of the Company emphases more on the introducing of a series of predominant brands of cotton textile in complete sets. The Company focused on managing key customers and aimed at getting large projects from customers. The Company effectively promoted product sales, increased its market shares, strengthened its market positioning and continuous leading position in domestic market through tracking large domestic clients and large projects, fully capitalizing advantages in terms of complete sets, brands, networks and financing and adopting various flexible marketing initiatives. During the year, the Company and Siemens jointly introduced the digitized cotton-weaving system in complete sets and competitive advantages in respect of cotton-weaving equipment in complete sets were thereby substantially enhanced.

(2) New breakthrough in technology research and development, further refinement of product structure

With the use of the Product Development Guideline of the '11th Five-Year Plan' as reference, the Company's work on technology research and development speeded up the process and succeeded in building an enterprise based and market oriented innovational technology system, which can consolidate the functions of production, learning and research. Centering around the pioneering textile technological trends, it enhanced the caliber in creativity and innovation on a full scale, helped master core technology and critical technology. Therefore fruitful results from technology research and development can be achieved and positive progress in technological cooperation can be made. Management was constantly strengthened and the Company's product structure was further restructured and refined by the process of technology research and development. As a result, new products made more contribution to the increase in sales revenue and profit.

Section I Operations Review of the Company during the Reporting Period (continued)

1. Overall Operation Review of the Company during the Reporting Period (continued)

(2) New breakthrough in technology research and development, further refinement of product structure (continued)

In 2006, the Company's new product development plan comprised 53 projects in total, of which 39 were major equipment and 17 items were exhibited in the 10th China International Expo of Textile Machinery, of which 11 were awarded with 'Showpiece of Excellence' by China Textile Machinery (Group) Company Limited. All of the 28 exhibited sets of equipment have attained leading domestic technological level. Meanwhile, further enhancing the function of the headquarters as a technology center, the Company increased technology input and the use of talents to strengthen technological management. It actively attempted to enroll projects including the jet looms, automatic winding machines, compact spinning machines and warp knitting machines as specific projects sponsored by a special state fund, and obtained the approval of sponsorship of RMB 10,000,000 for these projects. The Company received the subsidy in February 2007, amounting to RMB 5,000,000. Meanwhile, in order to have an equal market competitive status for its imported whole-set equipment, import duties on ring spinning machines condensators was reduced from 6% to nil upon continuous application, thereby creating a fair competitive environment with foreign textile machinery enterprises from the policy perspective. The Company also strengthened protection on intellectual property and applied for 31 patents and 31 patents were approved for the year.

In 2006, the Company set up 252 technological reform projects, and the completed major technological reform projects include: the relocation of the entire workshop of Shenyang Hongda Textile Machinery Company Limited; the construction of new final assembly workshop for warp knitting weaving of Changde Textile Machinery Company Limited and assembly workshop for automatic winding machines of Qingdao Hongda Textile Machinery Company Limited, which effectively promoted the upgrading of the technological equipment of the enterprise.

In 2006, the Headquarter Technology Center and Tianjin Hongda Textile Machinery Company Limited also passed the accreditation as provincial technology centers, which laid solid foundation to upgrade Headquarter Technology Center as a national technology center.

In terms of technique improvements, technological equipment reform and enhancement of product quality, the Company conducted various exchanges on techniques in 2006, and organized to amend the relevant standards. Various enterprises also made great efforts on specific equipment, items and proprietary technologies through effective measures, which enhanced the technological level in these enterprises, built up delicate production lines and consistently improved product quality and corporate market competitiveness. A thread rolling machine solely made by the Yuci branch company as a replacement for imported ones, has a production efficiency approximating these of leading international standards upon various technological modifications.

(3) Consolidation of resources with further results in integrated operations

In recent years, the Company has consistently driven resources consolidation with positive progress and has achieved outstanding performance by adopting integrated operations, which further promoted the overall operating efficiency and composite competitiveness of the Company.

Consolidation of international trade is gradually exhibiting different new patterns. Having built an international marketing network in an accelerated manner in 2006, the Company established another overseas technology service center in India, the world's second largest cotton weaving country, after having set up a technology service center in Pakistan. These technology service centers are staffed directly by various enterprises in the hope to implement the internationalized marketing strategy of 'going out'. At the same time, the range and variety of export products are continuously extended. In 2006, the Group participated in the international textile machinery exhibitions in Pakistan, Indonesia, Turkey, India and Egypt, conducted a number of surveys, client visits and market promotions, which further reinforced the efforts to develop the key international markets. The Company's cotton weaving equipment in complete sets had growing international brand impact as a result of in-depth comprehension on international market demands, better expansion and service to the international markets as well as successful export of whole-set projects.

Consolidation of supply chains gives positive results. With the introduction and sophisication of the centralized procurement of bulk purchase of materials, the Company's Headquarters set up a management platform featuring a centralized procurement of bulk purchase of materials with price cross-comparison functions, which combines the advantages of centralized procurement and structural control. Meanwhile, with new products development and refinement, the Company tightened the strategic cooperation with suppliers and chose suppliers with potential as long-term strategic partners through maximizing its external and internal enterprise advantages. These will materially reduce the cost of imported equipment in complete sets and therefore helped generate more profits.

Section I Operation Review of the Company during the Reporting Period (continued)

1. Overall Operation Review of the Company during the Reporting Period (continued)

(3) Consolidation of resources with further results in integrated operations (continued)

Domestic marketing network was gradually consolidated. In 2006, the corporate marketing strategy focused on key regions and medium-to-high end market. Marketing efforts were driven by earnest market planning and greater market promotion. The Company tried to maintain market and customer leading position and enhance sales operations by the use of decent of cotton weaving equipment in complete sets and advanced yarn weaving and control technology. Simultaneously, with a focus on 'streamlined management and standardized operation', the Company further consolidated the domestic marketing and sales system and established various administrative and examination mechanisms and reinforced the marketing and sales teams. The company continued to consolidate predominant marketing resources, particularly client resources and provide the Company with scientific evidence for operational decision making by means of enhancing the market information study, analytical, judgment and forecasting capability over the entire market. The Company strives to stand out among intensive market competition by promoting the corporate brand image, and achieve customer satisfaction by undergoing a process that starts and ends at customer needs and customer satisfaction, respectively.

(4) Further strengthening of corporate management with ever increasing integrated management level

Centralized financial management and further improvement on funds utilizing efficiency brought positive effects. In 2006, the Company continued to implement centralized funds management, prioritized funding structure and refined funds utility efficiency and promote centralised management of financial information. The Company further perfected the direct linkage between enterprises and banks and a timely adjustment on balancing surplus and shortage of funds among member enterprises were achieved, which substantially reduced the amount of capital used to secure the operation of the Company. A timely adjustment of debt structure effectively prevented business risks. The cost of capital was greatly reduced by a reasonable use of credit quota. Corporate surplus funds were therefore used reasonably. Inventory risks were effectively reduced with more inventory control and supervision on subordinating enterprises in respect of inventory obsolescence, scrap and slow-moving inventories. Bad debts risk was effectively reduced by tighter management over receivables, close tracking on the settlement efforts of enterprises and debts collection efficiency. In 2006, in an environment featured by macro-economic austerity measures, consistent upward adjustment of interest rate by the central bank and appreciation of US dollar, the financial work effectively ensured that the Company's operations were smoothly conducted and economic efficiency was continuously improved.

A constantly upgrading and improving corporate information platform enhanced corporate operation and management efficiency. In terms of corporate informatization development in 2006, the Company went on to perfect the application of existing system pursuant to the blueprint of building 6 logistics platforms with focus on the composite utilization of information system integration and use of information resources. The implementation of the CRM system indeed effectively combined client resources and market information resources with enterprise production and operation. The upgrading and extended use of headquarter procurement system was proactively implemented. Implementation of a centralized financial system was completed with more stringent administration and analysis on financial data. The headquarters and enterprise base-line databases for various business system applications were used to accelerate the building of enterprise indicator analysis system and enterprise coding systems, so as to satisfy the needs of the Headquarters for business control and support the analysis system for decision making process.

Section I Operation Review of the Company during the Reporting Period (continued)

2. Principal activities of the Company and its operation under PRC GAAP

(1) Analysis of principal activities by product

(Unit: RMB'000)

Item	Revenue from principal activities	Cost of principal activities	Profit margin of principal activities (%)	Increase/decrease of revenue from principal activities compared with last year (%)	Increase or decrease of cost of principal activities compared with last year (%)	Increase or decrease of profit margin of principal activities compared with last year (%)
Natural fibre textile machinery	3,499,926	2,953,504	15.61	4.02	3.71	1.60
Of which being connected transactions	401,392	340,320	15.22	59.91	59.59	1.13
Chemical fibre textile machinery	100,185	72,300	27.83	7.49	(4.97)	51.52
Weaving machinery	479,449	391,962	18.25	19.08	14.50	21.85
Accessories and special parts for weaving machinery	379,579	262,185	30.93	41.14	41.36	(0.35)
Others	150,183	132,381	11.85	33.54	49.43	(44.16)
Total	4,609,322	3,812,332	17.29	8.66	7.68	4.55

During the reporting period, sales of natural fibre textile machinery accounted for 75.93% of the revenue from main operations, which was increased by 4.02% as compared with the same period of last year, and reached RMB3,499,926,000. Of which, combing machines, winding machines and clearing-carding machines accounted for a larger proportion. The profitability of such machines was further increased as sales of medium to high end products increased. As there was increase in sales of horizontal weaving machine and jet weaving machine, sales of which was increased by 19.08% as compared with the same period of last year. Chemical fibre textile machines became the more profitable products for the year with increasing selling price and lower costs. Revenue from textile machinery components and parts increased with contribution from the products by Wuxi Hongda Textile Machinery and Special Parts Company Limited.

(2) Principal activities of the Group by region:

(Unit: RMB'000)

Region	Revenue from principal activities		Change %
	2006	2005	
PRC	4,175,874	3,918,074	6.58
Asia	366,612	275,251	33.19
Africa	40,839	34,238	19.28
Others	25,997	14,349	81.18
Total	4,609,322	4,241,912	8.66

(3) Major suppliers and customers

For the year ended 31st December 2006, the total purchase by the Group from the 5 largest suppliers amounted to RMB782,630,000, representing 20.64% of the total purchases for the year.

For the year ended 31st December 2006, the total sales by the Group to the 5 largest customers amounted to RMB797,075,000, representing 17.29% of the total sales for the year.

Section I Operation Review of the Company during the Reporting Period (continued)

3. Change in the assets composition and charges during the Reporting Period

Items	2006 *(RMB'000)*	2005 *(RMB'000)*	Change %	Reasons for change
Cash at bank and on hand	905,281	807,179	12.15	Higher net cash flow generated from operating activities and financing activities
Short term investments	136,886	–	100.00	Entrusted loans and equity investments in primary market
Notes receivable	455,683	567,214	(19.66)	Redemption of matured notes and payment of procurement cost by endorsement
Accounts receivable	417,955	375,452	11.32	Higher receivables and quality warranty sum of new subsidiaries
Other receivable	32,199	230,190	(86.01)	Receipt of payment for share transfer from Shanghai Zhonglian Business Development Co., Ltd.
Advances to suppliers	236,605	300,793	(21.34)	Reduced advances to suppliers for materials
Inventories	1,325,808	1,694,529	(21.76)	Reduced land development cost previously consolidated as Beijing Chen Yu Real Estate Company was not merged at the year end
Prepaid expenses	3,419	2,119	61.35	Increase of heating expenses not yet amortized
Fixed assets, net	1,247,775	1,049,767	18.86	Addition of plant and equipment to increase reproduction capacity and effect on fixed asset due to acquisition of subsidiaries
Construction materials	9,767	14,105	(30.76)	Decrease of prepaid construction and equipment expenses
Construction in progress	106,057	48,073	120.62	Mainly due to the newly added uncompleted production line by associated companies in the year
Intangible assets	262,520	167,050	57.15	Increase of land use rights and impacts of newly acquired subsidiaries
Short term loans	239,624	338,705	(29.25)	Repayment of matured loans
Notes payable	354,762	342,397	3.61	Increase of outstanding commercial papers at the year end
Accounts payable	658,615	954,178	(30.98)	Reduced land development cost previously consolidated as Beijing Chen Yu Real Estate Company was not merged at the year end
Advances from customers	435,429	542,117	(19.68)	Advances from customers in previous years were settled on delivery of contract
Wages payable	13,595	4,609	194.98	Unpaid staff salaries
Taxes payable	23,762	52,537	(54.77)	Value-added tax payable in January 2007 was less than the prior year
Other payables	293,735	311,914	(5.83)	Mainly due to the decrease of payable to related companies
Current portion of long term loans	–	20,000	(100.00)	No matured long-term loans by the year end
Long term loans	200,000	–	100.00	New long-term loans
Capital reserve	1,272,516	1,262,250	0.81	Tax exemption to subsidiaries, refund of land acquisition cost and formation of equity interests to the Company through acquisition of shareholdings in subsidiaries
Surplus reserve	532,084	445,913	19.32	Increase of accumulated surplus reserve
Foreign currency translation difference	(2,115)	(94)	(2,100.5)	Increase in conversion difference in RMB over the previous year in an overseas subsidiary
Profit from principal activities	784,797	689,338	13.85	Higher profitability due to increased profit from principal activities
Profit from other operations	57,321	34,915	64.17	Due to increased sales of raw materials and components
Operating expenses	141,843	106,540	33.14	Mainly due to the increase in expenses in exhibitions and relocating and transportation cost
Administration expenses	491,669	457,623	7.44	Increased number of merged subsidiaries and wage costs
Financial expenses	7,684	1,811	324.19	Mainly due to the increase in net interest income and expenses and expense for notes discount
Investment Income	17,404	10,989	58.38	Mainly due to the increased income from equity investments in primary market
Non-operating expenses	1,897	4,765	(60.20)	Mainly due to the lowered relevant costs to the government by schools for staffs' children
Income tax	22,922	27,391	(16.32)	Mainly due to the higher profit in the new subsidiaries which also enjoy income tax benefit as foreign-invested enterprises

Section I Operation Review of the Company during the Reporting Period (continued)

4. Composition of the Company's cashflow

Net cash inflow from the Group's operating activities in 2006 were RMB131,321,000, which were decreased by RMB155,402,000 from net cash inflow of RMB286,723,000 in 2005. This was mainly due to sales payment in the year was mainly settled by notes, while research and development and production inputs were paid in cash, so operating funds were reduced proportionally. Net cash outflow from investing activities were RMB158,743,000, which were decreased by RMB12,154,000 from net cash outflow of RMB170,897,000 in 2005. This was mainly attributable to the increase in refund from investment in the year. Net cash inflow from financing activities were RMB124,311,000, which were increased against the net outflow in 2005 of RMB316,819,000 by RMB441,130,000. This was mainly attributable to the increase of bank borrowings and lower financing costs.

Items	**2006** (RMB'000)	**2005** (RMB'000)
Cash flows from operating activities	131,321	286,723
Cash flows from investing activities	(158,743)	(170,897)
Cash flows from financing activities	124,311	(316,819)
Effect of foreign exchange rate to cash	(2,022)	(135)
Net increase in cash and cash equivalents	94,867	(201,127)

5. Important information relating to the Company's operation

(1) Current facility utilization of the Group is generally normal. Expansion of production capacity of the Company is primarily achieved through social collaboration and functional divisions.

(2) For the year ended 31st December 2006, new sales contracts signed by the Company for the forthcoming year amounted to RMB2,000,000,000.

(3) The Group prioritizes corporate competitiveness through product development with attractive incentive schemes for technical staff. Therefore, turnover of technical staff is relatively low.

6. Analysis of operation and results of the Company's major controlled subsidiaries and associates

As at 31st December 2006, the Group's major controlled subsidiaries were as follows:

(Unit: RMB'000)

Name of enterprise	Principal activities	Registered capital	Equity interest held by the Group (%)	Net assets	Net profit
Qingdao Hongda Textile Machinery Company Limited	Manufacture, sales, installation, repairing and leasing of special equipment for textile industry, textile machinery and related components	114,000	98	274,116	40,673
Shenyang Hongda Textile Machinery Company Limited	Technological development and manufacture of textile machinery and related components; electronic and electric machinery and equipment, providing technical consultation	71,000	98	126,103	11,026
Tianjin Jingwei New Type Textile Machinery Company Limited	Manufacture and process of textile machinery and special accessories and electronic equipments and economic technological consultancy	16,000	100	41,367	25,345
Tianjin Hongda Textile Machinery Company Limited	Technological development consultation, sales of photocopiers, agriculture processing machinery and related components	78,500	98	141,789	5,012
Changde Textile Machinery Company Limited	Manufacture and sales of textile machinery and other machinery and parts and components, powder metallurgy	42,350	95	189,299	51,596
Beijing Jingwei Textile New Technology Company Limited	Technological development and sale of textile machinery and computer hardware and software, sale of special textile equipment, agricultural machinery, instruments and meters as well as automobile components	100,000	98.40	146,680	13,975
Shanghai Jingwei Dongxing Blowing-Carding Machinery Company Limited	Manufacture and sales of blowing-carding machinery and related components	50,000	73.87	84,063	11,579
Wuxi Textile Technology Testing Company Limited	Manufacture and sales of cotton yarn; research and development in textile machinery and equipment, devices and relevant technologies	49,530	66.55	54,769	2,023
Shanxi Jingwei Heli Machinery Manufacturing Company Limited	Manufacture and sales of textile machinery and equipment	100,000	30	135,712	4,290
Wuxi Hongda Textile Machinery and Special Parts Company Limited	Manufacture of new style textile machinery, other textile machinery and special parts and components as well as machinery and components for general use; sales of its own products.	20,000	35	51,309	13,425

Section I Operation Review of the Company during the Reporting Period (continued)

7. Property, plant and equipment

Details of the movements in property, plant and equipment during the year are set out in note 6 to the financial statements prepared in accordance with the HKFRS.

8. Retirement benefit scheme

Details of the retirement benefit scheme of the Group are set out in note 32 to the financial statements prepared in accordance with the HKFRS.

9. Donations

Donations made by the Group during the year amounted to RMB403,000 (2005: RMB341,000).

Section II Prospects for the future development of the Company

1. Development trend of the textile machinery industry and market competition faced by the Company

China is going through a crucial period in its overall construction of a well-off and harmonious socialist society. The national economy has entered into a new era of constantly stable and rapid growth, which offers a favourable external environment for the overall corporate operation. As a result of China's entry into the WTO, the constantly flourishing development and industry improvement in the textile industry will continue to drive the demand for textile machinery. Series of measures implemented by the state government for the purposes of boosting the development of the machinery manufacturing industry and encouraging technological innovation will also facilitate the acceleration of structural reorganization of the textile machinery industry and technological improvement. The rapid growth in the textile industry of Southeast Asia, especially India, has provided a sizable overseas market for the export of textile machinery. Contrary to the development opportunities for the Company as noted above, the Company will also continue to face some uncertain factors, such as price fluctuation in energy and raw materials, the appreciation of value of RMB, the effect of gap between cotton prices and those prevailing in the international market, the reduction in value-added tax refund for export of textile products and trade disputes.

2. Future development strategies of the Company

Facing the competition and challenges brought about by economic globalization in the 21st century, the Company chooses to be based in China, the largest textile industry market in the world. With a good vision of "A friend of the global textile industry and the pride of the manufacturing industry of China" and the mission of "providing our customers with full-flow digital solutions", the Company will adhere closely to the business direction of "satisfying customers' needs and securing corporate growth" and develop core competitiveness, so as to establish itself as a diversified, internationalized and modernized conglomerate with international competitiveness. It is expected that the Company will become one of the top three global textile machinery enterprise within three to five years.

3. The operation plan for 2007

(1) To accelerate the transformation of technological research and development mechanisms and promote the creation of proprietary intellectual property rights

The Company will

1. speed up the research and development of new products and explore new products, markets and set projects;
2. strengthen the research of technique in complete sets and establish core technologies for our products through the application of informatization;
3. reinforce technological innovation, strengthen the protection of intellectual property rights, apply for patents proactively and achieve breakthrough in proprietary intellectual property rights and patent;
4. constantly consummate the construction of the research and development system of the headquarters and other enterprises, strive for policy support and project assistance from the state government and develop a technological innovation system of enterprise;
5. enhance the incentive mechanism for the technological team, so as to truly stimulate the initiatives and creativity of the technological personnel;
6. ensure the proper implementation of projects supported by State's special project fund and carry out technological reform with focus on dedicated machines, assembling, key technological breakthrough and application of new technology and materials.

Section II Prospects in the future development of the Company (continued)

3. The operation plan for 2007 (continued)

(2) To enhance the marketing of products in complete sets and further enlarge the market share in the international market

The Company will

1. strengthen its marketing innovation and develop meticulous marketing philosophy. Special attention will be paid to VIP customers. Interviews and communication will be made with large customers on a regular basis;
2. The Company will reinforce the management of the marketing and sales network and build up good network of after-sales services. Spare parts service centers in key areas will be improved; The Company will increase the marketing effort by carrying out product launch and propaganda in different forms according to the key products and areas;
3. The Company will increase its marketing efforts in the sales of equipment in complete sets and will fully utilise the advantage of equipment in complete sets as reflected by spinning quality indicator and the use of digital data collection system;
4. enhance the promotion efforts through advertisement and various network media;
5. Publicity will be made for the Company and its products through a number of channels and means. In addition, products will be promoted by use of the website of the Company;
6. market analysis and statistics should be carried out properly to further understand the industry trend at the domestic and global level as well as information about our competitors. Statement of data and statistics analysis of all entities shall be normalized to notify them of the market information in timely manner.

(3) To reinforce the management of corporate economic operation and improve the quality of economic operation

1. the Company will develop an enterprise resource plan that guides the full-year operation by itemizing the general indicators reasonably;
2. strengthen the coordination of problems arising from the corporate production operation to ensure stable development of corporate economic operation. With particular regard to certain stages of the production, the Company shall make a good effort on the resolution of bottleneck problems, optimization of flows and efficiency enhancement;
3. reinforce the plans assessment, including assessment of the implementation of enterprise resource plan and
4. focus on the management of production safety and prevent any potential risks to ensure safe production.

(4) To further implement centralized financial management and improve the efficiency of use of capital

1. the Company will reinforce the financial budget management, further consummate and implement flexible budgeting and prepare a budget plan for the year 2007 on a reasonable basis;
2. the Company will further carry out computerized financial management by utilising the standardized auditing platform, the Company will be able to monitor its accounting information on a real time basis; to provide a basis for the corporate economic operation and decision-making,
3. the Company will strengthen the preparation and analysis of financial reports and prepare quarterly, interim and annual financial analysis reports to the best of its ability; the Company will keep updated with the new accounting standards and carry out transformation, comparison, restatement and disclosure of financial reports following the replacement of old standards by new ones.
4. moreover, the Company will strengthen its guidance on the actual application by each subsidiary of the new standards and standardized training after changing the reporting system and auditing items, thus realizing the complete transition of accounting audit;
5. the Company will also strengthen capital management by tightening fixed capital management and reasonably adjusting and allocating funds, so as to minimize potential risks and improve capital gains;
6. the Company will continue to establish and consummate an internal accounting control system. As a result, the corporate management will be strengthened and the operating risk will be minimized.

Section II Prospects in the future development of the Company (continued)

3. The operation plan for 2007 (continued)

(5) To further speed up the application of corporate information integration and the modernise level of management

1. the information development plan for the "Eleventh Five-Year Plan" Period will be publicised and implemented;
2. the Company will further improve the application of all business systems. Measures will be taken to facilitate the application of the indicator analysis system of the headquarters;
3. the Company will put effort on the establishment of the coding system. By initiating the construction of the information coding system in the form of project management, the Company will lay a foundation for the forthcoming overall integration application;
4. the Company will speed up the construction of network safety and a safe environment for information exchange through the intranet.

(6) The Company will intensify strategic procurement, improve the level of the management of supply chain and explore internal potential, so as to continuously reduce the procurement costs.

4. Capital requirement and capital application plans required for achieving future strategic development of the Company and the source of capital

Funds for the Company's day-to-day manufacturing, operations and research and development were mainly from self-generated funds, while the outstanding portion resolved by bank credit facilities. Meanwhile, the Company will actively seek new investment projects to meet its strategic development needs to form new streams of economic growth, such as acquisition of relevant external resources or import of technologies. The amount of funds needed will be determined by reference to the potential projects, while the source of funding may be adopted accordingly including self-generated funds, bank loans or financing on the capital market.

5. Inherent risks and mitigation strategies

While the textile machinery market faces new development opportunities, the pressure of competition in the domestic market will be further intensified. Some foreign textile machinery manufacturers have established their own plants and commenced operation in developed textile regions in Mainland China. They are getting increasingly localized. Meanwhile, private enterprises in the industry are also growing rapidly. With a flexible operating mechanism, such enterprises have exerted pressure on the Company in the sector of cotton-weaving and printing and dyeing equipment. With particular regard to the low end market, the price war is getting increasingly intensified. Such challenges will put increasing pressure and challenges on the development of the Company in the future.

The Company is one of the largest and quality textile machinery enterprises in the PRC. It has good track record of operation in the industry and is with a relatively high standard of management. The production chain is relatively intact. Sales channels are broad. Supported by a highly capable team of specialists, the Company has many competitive advantages. Through its technical cooperation with world-famous textile machinery manufacturers from Germany, Japan, the USA and Italy, the Company has managed to further improve the technical competitiveness of its products. By leveraging on these strengths, the Company will seek to prevent any potential risks and secure the stable growth in the Company, so as to bring better value to the Shareholders.

Section II Prospects in the future development of the Company (continued)

6. Possible changes in the accounting policies and estimates of the Company upon adoption of new corporate accounting standards and its effect on the financial position and operating results of the Company

(1) Analysis on the difference on equity holders' interests from the existing accounting standards and new accounting standards due to first implementation of new standards on 1st January 2007:

According to the Caikuai [2006] 3 "the notice about the issuance of "No. 1 Accounting Standards for Business Enterprises – Notice of 38 Standards Including Inventory Standard"' issued by the Ministry of Finance of the PRC on 15 February 2006, the Company should implement the new accounting standards for business enterprises on 1 January 2007. Differences between the prevailing accounting standards and the new accounting standards which took effect on January 1, 2007 are as follows:

① Difference in long-term equity investments

In 1999, the Company transferred the equity interests by assets with Shenyang Hongda Textile Machinery Company Limited, Tianjin Hongda Textile Machinery Company Limited, Qingdao Hongda Textile Machinery Company Limited and Zhengzhou Hongda New Type Machinery Company Limited, resulting in a credit difference of RMB6,123,559. In 2003, the acquisition of Shanxi Jingwei Heli Machinery Manufacturing Co., Ltd. resulted in a debit difference of RMB3,918,020. In February 2006, the acquisition of equity interests in Wuxi Jingwei Textile Technology and Testing Co., Ltd. resulted in a debit difference of RMB685,414. In July 2006 and February 2006, the acquisition of equity interests in Xianyang Weier Machinery Manufacturing Company Limited and Wuxi Hongda Textile Machinery and Special Parts Company Limited resulted a debit difference of RMB4,411,306 and RMB375,995, respectively. The above transfer of equity interests were all from the controlling shareholder of the Company, China Textile Machinery (Group) Company Limited.

As at 31st December 2006, the amortized net amount for the above equity investments is RMB5,803,545, which shall be entirely eliminated according to the new accounting standards, and therefore reduced retained earnings and equity holders' interest by RMB5,803,545 as at 1st January 2007.

② Financial assets measured by fair value with changes carried through the current profit and loss accounts

In accordance with the new accounting standards, shares held by the Company for recent disposal shall be accounted by fair value with changes carried through the current profit and loss accounts. As at 31st December 2006, the Company held new shares of RMB8,885,556 which was subscribed from the primary market prior to listing, and the impact as at 1st January 2007 was nil as the shares had not been listed.

③ Income tax

In accordance with the new accounting standards, the Company shall calculate its corporate income tax with debt method instead of on a tax payable basis. The deferred tax assets was recognized as RMB32,682,011 calculated according to difference (temporary difference) between the carrying value of the assets and its tax base, resulting an increase of RMB32,682,011 in retained earnings and equity holders' interests as at 1st January 2007.

④ Minority interests

In accordance with the new accounting standards, the balance in minority interests of RMB183,317,433 as at 31st December 2006 shall be credited to equity holders' interests under the new accounting standards, which resulted in an increase of RMB183,317,433 in the equity holders' interests as at 1st January 2007.

(2) Possible changes in accounting policies and changes in accounting estimate after the implementation of new accounting standards and the analysis of their effect on the Company's financial position and operating results:

① In accordance with "No.2 Accounting Standard for Business Enterprises – Long-term Equity Investment", the Company accounts for such investment on cost basis instead of on equity basis used previously, which will affect the current profit and loss of the parent company, but will not affect the operating results of the consolidated financial statements.

② In accordance with "No. 18 Accounting Standard for Business Enterprises – Income Tax", the Company changed the accounting method of tax payment to the debt method which will affect the income tax expenses in future accounting periods, and changes in the net profit and equity holders' interests.

③ In accordance with "No. 33 Accounting Standard for Business Enterprises – Consolidated Financial Statements", the Company will no longer adopt a proportional consolidation on joint venture companies, instead by equity methods, which will affect the operating income and composition of segment assets and liabilities.

Section III Investments of the Company

1. Use of proceeds

No proceeds from the issue of shares were utilised during the reporting period. As at the end of the reporting period, the unutilised proceeds from the issue of shares amounted to RMB752,000 which was deposited with the bank. The utilisation of accumulated proceeds from the issue of shares is set out in 2003 Annual Report.

2. Use of funds not raised through the issue of shares during the period

The Group's net long-term equity investment at the end of the reporting period was RMB168,966,000, representing a net decrease of RMB16,621,000 or 8.96%, from RMB185,587,000 at the end of the previous year, among which the increase of long-term equity investment for the year was RMB27,959,000.

The major investments were as follows.

(1) In February 2006, the Company acquired 10% equity interest in Wuxi Hongda Textile Machinery and Special Parts Company Limited (無錫宏大紡織機械專件有限公司) ("Wuxi Hongda") held by Wuxi Huaming Automated Technology Co. Ltd. (無錫市華明自動化技術有限公司) at a consideration of RMB4,800,000. Hence, the Company's shareholding reached 35%. From the date of acquisition until the year end, it has contributed a net profit of RMB4,699,000 to the Company. The consideration of the transaction was determined by reference to the carrying value of net assets of Wuxi Hongda as at 31st January 2006. Transfer procedures of the transaction have been completed. Transfers of title of the subject assets and subject debts and liabilities were completed. The transaction was not a connected transaction.

(2) In February 2006, the Company increased its capital injection by RMB57,593,000 into Hong Kong Huaming Co. Limited ("Hong Kong Huaming"), a wholly-owned subsidiary of the Company. Following such injection, the authorised share capital of Hong Kong Huaming increased from US$600,000 to US$7,700,000.

(3) In April 2006, the Company acquired 11.55% equity interest in Wuxi Textile Technology Testing Company Limited (無錫經緯紡織科技試驗有限公司) ("Wuxi Jingwei"), at a consideration of RMB6,911,700 held by Wuxi Engineering Examination Center Co., Ltd., a company controlled by Beijing Jingpeng Investment Management Co., Ltd., a subsidiary of the Company. Hence, the Company's shareholding reached 66.55%. From the date of acquisition until the year end, it has contributed a net profit of RMB1,346,000 to the Company. The consideration of this transaction was determined on the basis of 11.55% of the appraised net asset value of Wuxi Jingwei as at 31st December 2004. Transfer procedures of this transaction have been completed. Transfers of title of the subject assets and subject debts and liabilities were completed. The transaction was not a connected transaction.

(4) In July 2006, the Company acquired 96.68% equity interest in Xianyang Weier Machinery Company Limited (咸陽維爾機械製造有限公司) ("Xianyang Weier") held by Oriental Investment Co., Ltd at a consideration of RMB1,880,000. According to the result of assets evaluation, the net asset value of Xianyang Weier amounted to RMB(2,146,000) on the record date of transfer of equity interest. In light of the initial investment made by the transferror in Xianyang Weier and the resulting accumulation of capital, a transfer price was agreed upon by both parties after consultation. In October 2006, the Company made additional capital injection of RMB60,000,000 into the registered capital of Xianyang Weier.Hence, the Company's shareholding reached 99.334%. From the date of acquisition until the year end, it has contributed a net profit of RMB382,000 to the Company. Transfers of title of the subject assets and subject debts and liabilities were completed. The transaction was not a connected transaction.

(5) In December 2006, the Company and Hong Kong Huaming, a wholly-owned subsidiary of the Company, made capital contribution of RMB15,000,000 and RMB5,000,000 respectively in respect of the establishment of Yichang Jingwei Textile Machinery Company Limited (宜昌經緯紡織機械有限公司) ("Yichang Jingwei"). The registered capital of Yichang Jingwei is RMB20,000,000, held as to 75% and 25% by the Company and Hong Kong Huaming respectively. Yichang Jingwei is principally engaged in the development, manufacturing and sales of textile machinery and special parts and components. No gains were recorded during the reporting period.

(6) In November 2006, Beijing Jingpeng Investment Management Co., Ltd., a wholly owned subsidiary of the Company, transferred its 40% and 20% equity interest in Beijing Chen Yu Tai He Property Development Co., Ltd. (北京農昱泰房地產開發有限公司) to independent individuals and Beijing Jingwei Textile Machinery New Technology Company Limited, a subsidiary of the Company, at a consideration of RMB26,000,000 and RMB13,000,000 respectively.

A loss of RMB2,718,000 resulted from the disposal. From the beginning of the year to the date of disposal, it has contributed a net loss of RMB401,000 to the Company. Transfers of titles of the subject assets and subject debts and liabilities were completed. The transaction was not a connected transaction.

Section IV Routine work of the Board of Directors

1. The Board meetings and the details of resolutions during the reporting period

Details are as follows:

Meeting	Summary of resolutions	Date on which meeting was held	Newspapers for publication of the resolutions	Date of announcement
Extraordinary Board Meeting	Resolved to convene the first Extraordinary General Meeting of 2006 to consider and approve the resolutions on election and replacement of some Directors and Supervisors.	21st February 2006		
Extraordinary Board Meeting	Agreed to continue to provide guarantee for the loan offered to Beijing Hualian Commercial Building Joint Stock Company Limited by Beijing City Bank Joint Stock Company Limited.	27th March 2006	Securities Times, Wen Wei Po and The Standard in Hong Kong	28th March 2006
The Twelfth Meeting of the Fourth Board	Considered and approved the 2005 Annual Report of the Company and its Summary.	18th April 2006	Securities Times, Wen Wei Po and The Standard in Hong Kong	19th April 2006
The Thirteenth Meeting of the Fourth Board	Considered and approved the 2006 First Quarterly Report of the Company.	25th April 2006		
Extraordinary Board meeting	Resolved to convene the 2005 Annual General Meeting, Class Meeting for Holders of A Shares and Class Meeting for Holders of H Shares to be held on 29th June 2006.	11th May 2006		
Extraordinary Board meeting	Agreed to propose an additional resolution in the 2005 Annual General Meeting as resolution No. 7: a resolution in respect of the amendments to the Articles of Association and its appendices.	6th June 2006	Securities Times, Wen Wei Po and The Standard in Hong Kong	7th June 2006
Extraordinary Board meeting	Agreed to provide joint liability guarantee is respect of the composite credit facility to be applied by Tianjin Hongda Textile Machinery Company Limited and Tianjin New Type Textile Machinery Company Limited	9th June 2006	Securities Times, Wen Wei Po and The Standard in Hong Kong	12th June 2006
Extraordinary Board meeting	Considered and approved the form and substance of the Explanatory Statement on the Share Segregation Reform of Jingwei Textile Machinery Company Limited	16th June 2006		
The Fourteenth Meeting of the Fourth Board	Considered and approved the 2006 Interim Report of the Company and its Summary	15th August 2006		

Section IV Routine work of the Board of Directors (continued)

1. The Board meetings and the details of resolutions during the reporting period (continued)

Meeting	Summary of resolutions	Date on which meeting was held	Newspapers for publication of the resolutions	Date of announcement
Extraordinary Board meeting	Agreed to provide guarantee with regard to a one-year loan of RMB165 million to be applied by Beijing Hualian Commercial Trading Development Company Limited to the Operation Department of the Headquarter of China Industrial and Commercial Bank.	27th September 2006	Securities Times, Wen Wei Po and the Standard in Hong Kong	28th September 2006
Extraordinary Board Meeting	Agreed to acquire the 96.68% equity interest in shareholding of Xianyang Weier from Oriental Investment Co., Ltd. at a consideration of RMB1.88 million.	10th July 2006		
Extraordinary Board Meeting	Agreed to increase the registered capital of Xianyang Weier by RMB60 million.	10th August 2006		
The Fifteenth Meeting of the Fourth Board	Considered and approved the 2006 Third Quarterly Report of the Company.	20th October 2006		
Extraordinary Board Meeting	Agreed the joint investment by the Company and Hong Kong Huaming Co., Ltd. to establish Yichang Jingwei Textile Machinery Company Limited	10th November 2006		
Extraordinary Board Meeting	Authorized any one of Ye Maoxin, Yao Yuming, Directors and Ye Xuehua, Company Secretary to sign all registration documents regarding the electronic submission system of The Stock Exchange of Hong Kong Limited on behalf of the Board and take all actions he may consider necessary or expedient.	6th December 2006		

2. Implementation of resolutions passed at the general meetings by the Board

The Board of the Company had implemented all the resolutions conscientiously and had paid dividends to the holders of A Shares and H Shares on a timely basis in accordance with the profit distribution proposal approved at the relevant general meetings. The mandate granted at the general meeting to the Directors to exercise general powers to repurchase part of H Shares was not exercised during the reporting period.

Section V Profit distribution proposal for the year

In 2006, the Group realised a net profit of RMB183,631,000 under PRC GAAP, 10% of which amounting to RMB18,363,000 that will be appropriated to the statutory surplus reserve and RMB50,000,000 that will be appropriated to the discretionary surplus reserve in accordance with the articles of association of the Company. Together with the undistributed profit of RMB374,225,000 at the year end, net profit available for the distribution to the shareholders amounted to RMB489,493,000.

For the year 2006, the Board proposed the payment to all shareholders of 2006 final dividend of RMB0.08 per share (tax inclusive), totaling RMB48,304,000 (tax inclusive). The Company's balance of the undistributed profit of RMB441,189,000 will be carried forward to the following year.

Section VI Other reporting items

1. Directors' and Supervisors' interest in contracts

No contracts of significance (except service contracts) in relation to the Group's business to which the Company, its subsidiaries or its jointly controlled entities was a party and in which a Director or Supervisor of the Company had a material interest or is substantially interested, whether directly or indirectly, subsisted at the end of the reporting period or at any time during the reporting period.

2. Directors' and Supervisors' Service Contracts

None of the Directors or Supervisors has entered into a service contract with the Company (or any of its subsidiaries) which is not determinable within one year without payment of compensation, other than statutory compensation.

3. Special illustrations and independent opinions by the independent non-executive Directors regarding external guarantees of the Company

Pursuant to the provisions of the "Notice regarding the Regulations of Certain Issues on the Movements of Funds and External Guarantees of Listed Companies"（"關於規範上市公司與關聯方資金往來及上市公司對外擔保若干問題的通知"）(CSRC [2003]56) and "Notice regarding the Regulation of Certain Issues on External Guarantees of Listed Companies" ("關於規範上市公司對外擔保行為的通知")(CSRC [2005] 120) issued by the China Securities Regulatory Committee, we, as independent non-executive Directors of the Company, have examined thoroughly the decision-making process and circumstances of external guarantees of the Company, and declared those external guarantees of the Company are compliance with provisions of laws, regulations and the Articles of Association, For the year ended on 31st December 2006, the Company had not provided any guarantees, either for the current period or on accumulative basis, to any controlling shareholder, other related parties of the Company with less than 50% shareholding, any non-legal person entities or individuals.

4. Tax Relief and Exemption

The Company is not aware of any tax relief and exemption available to shareholders for reason of their holding of the Company's securities.

5. Purchase, Sale or Redemption of Shares

For the year ended 31st December 2006, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the listed securities of the Company.

6. Pre-emptive Rights

There is no such provisions in the Articles of Association of the Company and the PRC Laws requiring to grant any pre-emptive rights for new shares to its existing shareholders according to their respective shareholding proportions.

7. Management Contract

There were no contracts concerning the management or administration of the whole or substantial part of the business of the Company were entered into or existed during the reporting period.

Section VI Other reporting items (continued)

8. Currency and Interest Rate Risk

As the Group's revenue and expenses are mainly denominated in Renminbi, the Group does not expect that its business operating activities will incur material currency risk.

For its financing activities, for the financial year ended 31 December 2006, the Group's short-term borrowings amounted to RMB522,787,000, of which borrowing of US$20,000,000 (equivalent to RMB156,174,000) were in U.S. dollar, while the remaining balance were in Renminbi under HKFRS. The interest rates were in the range from between 5.31% to 6.36% per annum. The management considers that the Group did not have any material interest rate risk.

9. Connected transactions

Details of connected transactions are set out in Chapter IX – Significant Events of this report.

10. Subsequent events

Details of subsequent events are set out in Note 39 to the financial statements prepared in accordance with HKFRS.

11. Reserves

During the reporting period, significant changes in the amount of reserves of the Group and the Company and the details are set out in Note 20 to the financial statements prepared in accordance with HKFRS.