

Chairman's Letter to Shareholders



First of all, please accept my most sincere apologies. Since Kelon commenced business 16 years ago, year 2000 was the first loss-making year and this understandably disappointed our shareholders who have been very supportive throughout the years. As responsible management, we take an open and frank attitude and shall explain in this annual report factors contributed to this year's results. We shall continue to maintain a high level of transparency to our investors.

I strongly believe that reforms will put Kelon back to healthy growth, and would like to express my heartfelt thanks to our shareholders for their continuous support.

Wang Guo Duan
Chairman

Dear Shareholders,

First of all, please accept my most sincere apologies. Since Kelon commenced business 16 years ago, year 2000 was the first loss-making year and this understandably disappointed our shareholders who have been very supportive throughout the years. As responsible management, we take an open and frank attitude and shall explain in this annual report factors contributed to this year's results. We shall continue to maintain a high level of transparency to our investors.

Year 2000 was the most challenging year for Kelon throughout its history of operation. During the year, the Group's results was hit by the most serious blows ever encountered, mainly caused by the emergence of unfavorable internal and external factors.

In recent years, competition in the PRC domestic appliances market has vigorously intensified. With oversupply situation deteriorated, manufacturers were forced to cut prices in order to encourage sales. Kelon was unable to stay away from price wars and such price reductions lowered margins, which directly affected the Group's results.

Besides unfavorable market conditions, we evaluate our own performance and admit the fact that during good times we did not prepare ourselves well enough to tackle difficult times. In the past, we overlooked the critical importance of marketing and hence did not strengthen our marketing and sales systems, to build comprehensive support facilities or to maintain closer relationship with distributors. We were therefore unable to obtain first-hand market intelligence from distribution network and other sales channels, which rendered us incapable in projecting actual sales to consumers. This led to unnecessary accumulation of outdated products, causing blockage in distribution system and even entire sales channels, which in turn prevented sales and promotion of new products to consumers. Moreover, strong business growth in prior years caused the Group's structure to expand substantially, leading to inefficiencies, slow response and wastage of resources. At times when businesses appeared to be fine these problems were not apparent. However, once there was market downturn significance of such issues surfaced.

In early 2000, we reviewed the situation and recognized causes of such problems were not limited to recent market conditions. Unless the Group's internal problems brought forward from the past were resolved, businesses would be adversely affected in the long run. A comprehensive re-engineering program is essential. Early in year 2000, we decisively implemented a number of bold measures, including change in management, establishment of sales and marketing and brand-building strategies, clear-up of our distribution channels, introduction of new product series, streamlining of corporate structure and re-positioning of our business focus.

I am pleased to report the above re-engineering measures made smooth progress since their introduction a year ago. Our new management team is now in place, in particular we added a good number of strong marketing professionals. Since Mr. Qu Yun Bo took up office as Vice President of Sales and Marketing, he led the Group's sales and marketing departments to undergo a series of reforms expeditiously. The Group has transformed from a production-oriented entity to a powerful market-driven corporate. Kelon is now a customer and market focused organization, and moved away from the traditional emphasis on manufacturing. Our product planning and launch of new product series are based on market trends. By matching this with our package of broadcast and promotion tools as well as expanded retail network, the Group successfully stimulates consumer demand for its products. We are pleased to notice that our new product launches in 2001 were well accepted by market.

As part of our new brand-building strategy, we appointed a world-class design house to re-design our corporate image system, which was launched in January 2001 and successfully enhanced our image and promoted sales.

In 2000, we aggressively cleaned up inventory blocked within the distribution channels and the Group's own warehouses, further strengthened and developed 'heart to heart' relationship with our distributors and retailers.

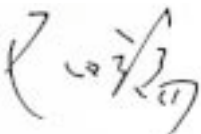
I am pleased to report that, after the successful implementation of the above re-engineering measures, the Group's has re-built its energy and is now back on track with its healthy growth. I would like to emphasize that the Group is good at learning and committed to continue with its growth. The founding of the business was based on nothing but our learning spirit. Our story unfolded since our founders diagnose a refrigerator set to research its production basics and technology. From then on, we came a long way to become the largest manufacturer of refrigerators and air-conditioners in the PRC with numerous achievements. Our two prestigious brands, "Kelon" and "Rongsheng" were valued at a total of more than RMB 15 billion, which came fourth among all brands in China. Our innovative technologies received numerous awards from PRC and international organizations. We are also amongst those public Chinese corporations that received most attention from investors. All these endorsed our commitment to learn and progress. We consider year 2000 as a critical time at which we learned most from the reforms and gained valuable experience which will be treasured by all of us.

As part of the Group's reform, I retired from the post of President in June 2000, and was succeeded by Mr. Xu Tie Feng, who was vested with the important mission to bring Kelon to new highs. Since Mr. Xu took up his new office, the Group has clearly established our business directions. We shall continue to develop the refrigerator and air-conditioner businesses as our core businesses; while remain open to diversification opportunities in areas related to our core businesses and hi-tech industries. Meanwhile, we have also increased our human resources and financial input in international

sales expansion with a projection of high sales growth for the next three years. The small home appliances venture under our parent is now in operation and is expected to become one of the largest operations in five years. Our parent also formed an alliance with the Chinese Academy of Science and a renowned US research institution to establish the "Sino-American Kelon Intelligence Control Research Center" in Beijing, which has achieved success in developing certain technologies. E-das.com (e-domestic-appliances-services), the website the Group invested in, has built a state-of-the-art vertical procurement platform for household appliances in the PRC. We plan to move quickly to secure cooperation with business partners, aiming to establish a comprehensive supply chain system for Kelon in the next two to three years, and eventually becomes a dominant B2B electronic transaction platform for the Chinese household appliance industry.

Our goal in 2001 is to return to profitability. We deeply recognize this is the most important concern of our investors and we are fully committed to achieve this goal to live up to expectations. Nonetheless, with the internal and external challenges we are still facing, we believe it will take a considerable period of time before the Group can enjoy similar robust profit growth it did in the past.

Lastly, I would like to express my most sincere gratitude to our directors and staff who demonstrated a high level of commitment over the past year and contributed to the Group's business development. Also, I would like to thank our shareholders for supporting us through this critical time of change.



Wang Guo Duan

Chairman

Shunde, the PRC

27 April 2001