

REPORT OF THE DIRECTORS

(Amounts expressed in thousands of Renminbi)

The directors have the pleasure of presenting the directors' report together with the audited financial statements of Guangdong Kelon Electrical Holdings Company Limited (the "Company") and its subsidiaries (hereinafter collectively referred to as the "Group") for the year ended 31 December 2000.

PRINCIPAL ACTIVITIES

The Group is principally engaged in the manufacture and sale of refrigerators and air-conditioners. The Group's turnover by products and by region is summarised as follows:

| | 2000 RMB'000 | 1999 RMB'000 |
|-------------------------------------|-------------------------------|-----------------|
| Sales of refrigerators (Note i) | 2,149,213 | 3,419,731 |
| Sales of air-conditioners (Note ii) | 1,574,493 | 2,155,862 |
| Others | 145,797 | 22,287 |
| | 3,869,503 | 5,597,880 |

Note i: Analysis of sales of refrigerators into domestic sales in the People's Republic of China (the "PRC") by region and export sales outside the PRC is as follows:

| | 2000 RMB'000 | 1999 RMB'000 |
|------------------------------|-------------------------------|-----------------|
| Domestic sales in the PRC: | | |
| Northwestern region | 218,922 | 364,278 |
| Northeastern region | 229,185 | 331,005 |
| Northern region | 370,727 | 569,611 |
| Eastern region | 303,210 | 491,511 |
| Midsouthern region | 196,677 | 344,444 |
| Southwestern region | 198,553 | 310,752 |
| Southern region | 572,444 | 823,693 |
| Total domestic sales | 2,089,718 | 3,235,294 |
| Export sales outside the PRC | 59,495 | 184,437 |
| Total | 2,149,213 | 3,419,731 |

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Note ii: Analysis of sales of air-conditioners into domestic sales in the PRC by region and export sales outside the PRC is as follows:

| | 2000 | 1999 |
|------------------------------|------------------|-----------|
| | RMB'000 | RMB'000 |
| Domestic sales in the PRC: | | |
| Northwestern region | 87,258 | 62,643 |
| Northeastern region | 53,639 | 36,488 |
| Northern region | 318,466 | 419,189 |
| Eastern region | 329,546 | 573,063 |
| Midsouthern region | 190,996 | 236,943 |
| Southwestern region | 92,095 | 171,629 |
| Southern region | 362,073 | 632,075 |
| Total domestic sales | 1,434,073 | 2,132,030 |
| Export sales outside the PRC | 140,420 | 23,832 |
| Total | 1,574,493 | 2,155,862 |

Note iii: Northwestern region includes : Shaanxi, Shanxi, Inner Mongolia, Ningxia, Xinjiang, Gansu, Qinghai and Tibet
 Northeastern region includes : Liaoning, Jilin and Heilongjiang
 Northern region includes : Beijing, Tianjin, Hebei, Shandong and Henan
 Eastern region includes : Shanghai, Jiangsu, Zhejiang and Anhui
 Midsouthern region includes : Jiangxi, Hubei and Hunan
 Southwestern region includes : Sichuan, Yunnan and Guizhou
 Southern region includes : Guangdong, Guangxi, Hainan and Fujian

RESULTS AND APPROPRIATIONS

The results of operations by line of business for the year ended 31 December 2000 is summarised as follows:

| | Refrigerators business RMB'000 | Air-conditioners business RMB'000 |
|----------------------|---|--|
| Turnover | 2,149,213 | 1,574,493 |
| Loss from operations | (159,165) | (828,905) |
| Loss after tax | (204,501) | (846,622) |
| Minority interests | — | 338,649 |
| Net loss | (204,501) | (507,973) |

Details of the Group's results for the year ended 31 December 2000 are set out in the consolidated income statement on page 17 of the accompanying financial statements.

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The directors resolved not to pay any dividend (1999 — RMB212,289,000) for the year ended 31 December 2000, and recommended that the retained earnings of approximately RMB282,349,000 as at 31 December 2000 be carried forward.

For the year ended 31 December 2000, the directors resolved not to appropriate any retained earnings to statutory reserve.

RESERVES

Movements in reserves of the Group and the Company during the year are set out in the statement of changes in equity on page 20 of the accompanying financial statements.

FINANCIAL SUMMARY

A financial summary of the Group for each of the five years ended 31 December 2000 is set out on page 14 of the report.

MAJOR CUSTOMERS AND SUPPLIERS

For the year ended 31 December 2000, the five largest customers of the Group accounted for approximately 16.8% (1999 — 17.8%) of the Group's turnover in aggregate, with the largest customer accounted for approximately 6.4% (1999 — 8.7%) of the Group's turnover. The five largest suppliers accounted for approximately 13.4% (1999 — 12.4%) of the Group's total purchases, with the largest supplier accounted for approximately 4.0% (1999 — 3.5%) of the Group's purchases.

As of 31 December 2000, Guangdong Kelon (Rongsheng) Group Company Limited ("GKG"), a shareholder of the Company, has beneficial interest in one of the Group's five largest customers. This transaction has been disclosed in Note 4 to the accompanying financial statement.

Except as disclosed above, none of the directors, their associates, or any shareholders (who, to the knowledge of the directors, owned more than 5% of the Company's share capital) had a beneficial interest in the Group's five largest customers or five largest suppliers.

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SHARE CAPITAL

Details of share capital are set out in Note 29 to the accompanying financial statements.

SUBSTANTIAL SHAREHOLDERS

As of 31 December 2000, the following parties (not being a director, supervisor or chief executive of the Company) had registered an interest in 10% or more of the issued share capital of the Company:

| Name | Number of issued shares | Percentage of shareholding |
|------------------------|-------------------------------|----------------------------|
| GKG | 337,915,755 (Domestic shares) | 34.1% |
| HKSCC Nominees Limited | 418,394,105 (H shares) | 42.2% |

Save as disclosed above, the Company had no notice of any interests required to be recorded under Section 16(1) of the Securities (Disclosure of Interests) Ordinance (the "SDI Ordinance") as of 31 December 2000.

LIQUIDITY AND CAPITAL RESOURCES

Net cash inflow for operating activities was approximately RMB1,109,437,000 (1999 — outflow of approximately RMB433,616,000) for the year ended 31 December 2000.

As of 31 December 2000, the Group had cash and bank deposits amounting to approximately RMB838,710,000 (1999 — RMB753,140,000), of which approximately RMB192,314,000 (1999 — RMB66,543,000) was denominated in foreign currencies, and bank loans amounting to approximately RMB694,783,000 (1999 — RMB1,118,263,000), of which approximately RMB57,083,000 (1999 — RMB108,063,000) was denominated in foreign currencies.

Total capital expenditures for the year ended 31 December 2000 amounted to approximately RMB305,808,729 (1999 — 859,205,000) and the major expenditure item was the purchase of new equipment for operating purpose and fixtures for promotion purpose. The capital expenditures were funded by the working capital of the Group.

PURCHASE, SALE OR REDEMPTION OF SHARES

During the year ended 31 December 2000, neither the Company nor any of its subsidiaries had purchased, sold or redeemed any of the Company's listed shares.

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PRE-EMPTIVE RIGHTS

According to the Articles of Association of the Company and the laws of the PRC, there are no provisions for pre-emptive rights requiring the Company to offer new shares to the existing shareholders in proportion to their shareholdings.

DIRECTORS AND DIRECTORS' SERVICE CONTRACTS

The directors who held office during the year and up to the date of this report were:

Executive directors

Mr. Wang Guo Duan, *Chairman*

Mr. Chen Ding Bang

Mr. Cai Shi Er

Mr. Liang Yuan Ying

Mr. Chen Tong Xing

Non-executive directors

Mr. Fan Chor Wah, Vincent

Mr. Li Kwok Wing, Meocre

Mr. Li Bao Guo

The Hon. Dr. Wong Yu Wong, Philip

Each executive director has entered into a service agreement with the Company. Particulars of the agreements, except as indicated, are in all material respects identical and are set out below:

- (i) the annual aggregate salaries payable to all the executive directors for the year ended 31 December 2000 amounted to approximately RMB3,399,000. The salaries of the executive directors are subject to an annual increment of not exceeding 25 percent for each subsequent year within the contract term; and
- (ii) each executive director is entitled to a year-end bonus by reference to the annual consolidated profit of the Group after taxation and minority interests (including any extraordinary loss but excluding any extraordinary gain) as decided by the board of directors provided that the aggregate amount of bonus payable to the executive directors may not exceed 2 percent of such profit. All directors are abstained from voting in respect of the resolution regarding the bonus payable to him.

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Each non-executive director was entitled to receive an annual remuneration of RMB30,000.

None of the directors or the supervisors has entered or has proposed to enter into any service contracts with any subsidiaries of the Group which is not terminated within one year without payment of compensation other than statutory compensation.

DIRECTORS' AND SUPERVISORS' INTERESTS IN SHARES

As of 31 December 2000, the directors and supervisors of the Company had the following beneficial interests in the Company's PRC domestic shares of RMB1 each (within the meaning of the SDI Ordinance) as recorded in the Register required to be kept by the Company pursuant to Section 29 of the SDI Ordinance:

| Name | Position | Nature of Interest | Number of Domestic Shares |
|-----------------|------------|--------------------|---------------------------|
| Wang Guo Duan | Director | Personal | 100,000 |
| Chen Ding Bang | Director | Personal | 100,000 |
| Cai Shi Er | Director | Personal/Family | 117,000 |
| Liang Yuan Ying | Director | Personal | 61,500 |
| Chen Tong Xing | Director | Personal | 60,000 |
| Li Di Qiang | Supervisor | Personal/Family | 105,000 |
| He Si | Supervisor | Personal/Family | 50,000 |

Save as disclosed above, the Company had no notice of any interest required to be recorded under Section 29 of the SDI Ordinance or pursuant to the Model Code for Connected Transactions by Directors of listed companies as of 31 December 2000.

DIRECTORS' AND SUPERVISORS' RIGHTS TO ACQUIRE SHARES OR DEBENTURES

At no time during the year was the Company, its subsidiaries, fellow subsidiaries or holding company a party to any arrangements to enable any of the Company's directors, supervisors or members of its management to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate.

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DIRECTORS' AND SUPERVISORS' INTERESTS IN CONTRACTS

Except for the transactions with related parties as disclosed in Note 4 to the accompanying financial statements, no contracts of significance in relation to the Group's business to which the Company or any of its subsidiaries was a party and in which any of the Company's directors, supervisors or members of its management had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

DIRECTORS', SUPERVISORS' AND SENIOR EXECUTIVES' EMOLUMENTS

Details of directors', supervisors' and senior executives' emoluments are set out in Note 10 to the accompanying financial statements.

EMPLOYEE HOUSING SCHEME

Particular of employee housing scheme is set out in Note 22 (i) to the accompanying financial statements.

PENSION SCHEME

The Group manages a defined contribution pension scheme for its employees. The Company makes contributions based on a percentage of the eligible employees' salaries plus a pre-determined amount funded. When an employee leaves the scheme before his/her interest in the employer contributions is fully vested, the ongoing contributions payable by the Company may be reduced by the relevant amount of forfeited contributions.

In addition, pursuant to the PRC laws and regulations, contributions to the basic old age insurance for the Company's local staff are to be made monthly to a government agency based on 16% of the standard salary set by the provincial government, of which 10% is borne by the Company and the remainder is borne by the staff. The government agency is responsible for the pension liabilities relating to such staff on their retirement. The Company accounts for these contributions on an accrual basis.

For the year ended 31 December 2000, the pension cost relating to these scheme amounting to approximately RMB14,724,000 (1999 — RMB14,707,000) had been charged to the consolidated income statement.

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FIXED ASSETS

Details of the movement in fixed assets during the year are set out in Note 17 to the accompanying financial statements.

BANK LOANS

Particulars of bank loans are set out in Note 26 and 27 to the accompanying financial statements.

TRUST DEPOSITS

As of 31 December 2000, the Company did not have any trust deposits with any financial institutions in the PRC nor any time deposits, which could not be collected upon maturity. All of the Company's deposits have been placed with commercial banks in the PRC and Hong Kong and the Company has not encountered any difficulty in withdrawal.

CONNECTED TRANSACTIONS

For the year ended 31 December 2000, the Group had entered into the following transactions:

- (i) The Company made prepayments amounting to an aggregate sum of RMB34,000,000 indirectly through its subsidiary, Chengdu Kelon Refrigerator Co., Ltd. ("Chengdu Kelon") to Chengdu Xinxing Electrical Appliance Holdings Company Limited ("Chengdu Xinxing"), which is an associate of Chengdu Engine (Group) Company Limited ("Chengdu Engine"), the minority investor of Chengdu Kelon. As consideration for such prepayment, Chengdu Xinxing has agreed to repay Chengdu Kelon by supplying an agreed number of refrigeration parts together with interest payments at an annual rate of approximately 9%. The prepayment was guaranteed by Chengdu Engine and Chengdu Kelon has the right to deduct from any dividends payable to Chengdu Engine the outstanding amount of any payments (in whatever form) due from Chengdu Xinxing directly or indirectly to the Company. As security for Chengdu Engine's performance of its obligations under the above guarantee, Chengdu Engine has charged its entire interests in Chengdu Kelon in favour of the Company.
- (ii) Under the licence agreement ("Licence Agreement") dated 6 July 1996 made between Guangdong Kelon (Rongsheng) Group Company Limited ("GKG"), the holding company of the Group, and the Company, GKG granted to the Company an exclusive right to use the trademarks "Kelon" and "Rongsheng" for no consideration (i) as registered in the PRC and Hong Kong, and/or (ii) as may from time to time be registered and/or in respect of which applications for registration may be made with the trademarks registry of any other territory by GKG and/or (iii) all "Kelon" or "Rongsheng" trademark registrations as may be assigned to GKG from time to time on freezers, refrigerators and other similar or related products and such other products as may be requested by the

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Company from time to time which are not objected by GKG, on a worldwide basis, for a term equivalent to the period of validity of the relevant registration. GKG may use and, with the prior written consent of the Company, allow third party to use, such trademarks on production other than the types of products covered by the Licence Agreement. At present, the Group has used the trademarks of "Kelon" and "Rongsheng" on the refrigerators' products and "Kelon" on the air-conditioners products under the above-mentioned Licence Agreement.

Guangdong Kelon Refrigerator Co., Ltd ("Kelon Refrigerator"), Guangdong Kelon Air-Conditioner Co., Ltd. ("Kelon Air-conditioner") and GKG have an agreement ("Cost Sharing Agreement") whereby GKG agreed to share part of the advertising and promotional costs incurred by Kelon Refrigerator and Kelon Air-conditioner in promoting the brand names of "Kelon" and "Rongsheng". According to the Cost Sharing Agreement, GKG agreed to share advertising costs of RMB93,240,000 and RMB235,000,000 for 1999 and 2000 respectively.

The Group had made payments on behalf of GKG in the settlement of GKG's operating expenses. On the other hand, GKG also made payments on behalf of the Group in the settlement of the Group's purchase of material and other operating expenses.

As of 31 December 2000, a long-term bank loan of RMB200,000,000 of the Company was guaranteed by GKG.

- (iii) The Group engaged Kelon Advertising Company ("Kelon Advertising") as one of its advertising agents. Kelon Advertising Company is a wholly-owned subsidiary of GKG. For the year ended 31 December 2000, the Group made payment of RMB88,065,000 (1999 — RMB18,723,000) to Kelon Advertising in connection with advertising activities of Kelon brands.
- (iv) Shunde Kelon Household Electrical Appliance Company Limited ("Shunde Kelon") is a company which is 75% and 25% held by GKG and the Company, respectively. During the year ended 31 December 2000, Shunde Kelon purchased refrigerators and air-conditioners from the Group and sold them in the market. During the year ended 31 December 2000, the total sale amount of the Group to Shunde Kelon amounted to approximately RMB2,096,000.
- (v) The Group sold goods amounting to RMB5,716,000 to Shunde Huao Electrical Company Limited ("Shunde Huao"), which is a subsidiary of GKG.
- (vi) The Group has advanced money to certain related parties of GKG. The advances outstanding from these related parties as of 31 December 2000 amounted to approximately RMB28,551,000 (1999 — RMB18,111,000). All of these advances are guaranteed by GKG.

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- (vii) Kelon Air-Conditioner is a 60% owned subsidiary of the Company. The minority shareholder of Kelon Air-Conditioner is Grand Moment Investments Holdings Limited, a company incorporated in the British Virgin Islands, which is 37.5% held by GKG.
- (viii) Kelon Development Company Limited (“KDC”), a subsidiary of the Company, had entered into an agreement with Qin Jia Yuan Shares Company Limited (“QJY”) on 23 September 2000 regarding the subscription of shares by KDC in Communication and You Holdings Company Limited (“C&Y”) as well as setting out the respective rights and obligations of QJY and KDC as shareholders of C&Y and setting out the basis on which the business and affairs of C&Y would be managed and controlled.

C&Y is principally engaged in the media advertising and marketing business, including but not limited to:

- (a) the provision of production support on audio-visual program;
- (b) marketing of shows to overseas broadcasting entities;
- (c) provision of promotion, public relations, advertising consultancy services to advertisers and factory owners;
- (d) production of special audio-visual programmes for advertisers and factory owners; and
- (e) obtaining advertising air time from various media and selling such air time to advertising clients.

In accordance with the agreement, KDC subscribed for 25 shares in C&Y at a consideration of HK\$12,000,000 and QJY subscribed for 73 shares in C&Y at a consideration of HK\$2,000,000 and the assignment of certain advertising and business contracts to C&Y. QJY also acquired 1 share in C&Y from each of C&Y’s initial subscribers, for cash at par.

KDC also agreed with C&Y to purchase HK\$20,000,000 worth of advertisement and/or sponsorship air-time. As of 31 December 2000, no payment has been made to C&Y on the advertising fee.

As the sole shareholder of QJY is the spouse of Dr. Philip Yu Hong Wong, a non-executive director of the Company, QJY is a connected person of the Company under the Rules Governing The Listing of Securities on The Stock Exchange of Hong Kong Limited (the “Listing Rules”).

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All of the above transactions constitute connected transactions of the Company under the Listing Rules.

The directors (including the independent non-executive directors) have reviewed the above-mentioned transactions and confirmed that the above transactions (other than transactions (ii) and (vi)) were entered into on normal commercial terms in the ordinary course of business of the Group and in accordance with the agreements governing these transactions. The amounts involved in the above transactions are set out in Note 4 to the accompanying financial statements.

MATERIAL LITIGATION

The Company had no material litigation or arbitration during the year.

CODE OF BEST PRACTICE

The Board of Directors confirm that the Company has complied with the Code of Best Practice as set out in Appendix 14 of the Listing Rules throughout the year ended 31 December 2000.

AUDITORS

The accompanying financial statements were audited by Messrs. Arthur Andersen & Co. A resolution for the re-appointment of Messrs. Arthur Andersen & Co as the Company's auditors for the ensuing year is to be proposed at the forthcoming annual general meeting.

On behalf of the Board of Directors

WANG GUO DUAN

Chairman

Shunde, the PRC
27 April 2001