

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 2001.

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:

	2001 RMB'000	2000 RMB'000
Sales of refrigerators (Note i)	2,164,254	2,149,213
Sales of air-conditioners (Note ii)	2,177,207	1,574,493
Others	40,155	145,797
	4,381,616	3,869,503

Note i: A breakdown of the 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:

	2001 RMB'000	2000 RMB'000
Domestic sales in the PRC:		
Northwestern region	238,147	218,922
Northeastern region	235,841	229,185
Northern region	376,533	370,727
Eastern region	345,250	303,210
Midsouthern region	238,434	196,677
Southwestern region	220,594	198,553
Southern region	265,205	572,444
Total domestic sales	1,920,004	2,089,718
Export sales outside the PRC	244,250	59,495
Total	2,164,254	2,149,213

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

	2001	2000
	RMB'000	RMB'000
Domestic sales in the PRC:		
Northwestern region	118,397	87,258
Northeastern region	51,333	53,639
Northern region	362,665	318,466
Eastern region	513,975	329,546
Midsouthern region	236,231	190,996
Southwestern region	152,788	92,095
Southern region	381,135	362,073
Total domestic sales	1,816,524	1,434,073
Export sales outside the PRC	360,683	140,420
Total	2,177,207	1,574,493

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 the line of business for the year ended 31 December 2001 is summarised as follows:

	Refrigerators	Air-conditioners
	business	business
	RMB'000	RMB'000
Turnover	2,164,254	2,177,207
Loss from operations	(654,776)	(826,632)
Loss after tax	(689,913)	(828,616)
Minority interests	(9,329)	—
Net loss	(680,584)	(828,616)

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Details of the Group's results for the year ended 31 December 2001 are set out in the consolidated income statement on page 17 of the accompanying financial statements.

The directors resolved not to pay any dividend for the year ended 31 December 2001 (the Group did not pay any dividend for the year ended 31 December 2000), and recommended that the accumulated losses of approximately RMB1,446,804,000 as of 31 December 2001 be carried forward.

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 18 of the accompanying financial statements.

FINANCIAL SUMMARY

A financial summary of the Group for each of the five years ended 31 December 2001 is set out on page 12 of the report.

MAJOR CUSTOMERS AND SUPPLIERS

For the year ended 31 December 2001, the five largest customers of the Group accounted for approximately 14% (2000 - 16.8%) of the Group's turnover in aggregate, with the largest customer accounted for approximately 5.24% (2000 - 6.4%) of the Group's turnover. The five largest suppliers accounted for approximately 13.3% (2000 - 13.4%) of the Group's total purchases, with the largest supplier accounted for approximately 5.6% (2000 - 4.0%) of the Group's purchases.

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.

SHARE CAPITAL

Details of share capital are set out in Note 20 to the accompanying financial statements.

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SUBSTANTIAL SHAREHOLDERS

As of 31 December 2001, 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:

Percentage of Name	Number of issued shares	shareholding
Guangdong Kelon (Rongsheng) Group Company Limited ("GKG")	337,915,755 (Domestic shares)	34.06% *
HKSCC Nominees Limited	417,421,305 (H shares)	42.07%

* GKG and Greencool Enterprise Development Company Limited ("Greencool") entered into a sale and purchase agreement on 29 October 2001 (and such agreement was amended on 5 March 2002) under which GKG agreed to sell to Greencool 204,775,755 legal person shares of RMB1.00 each in the Company representing approximately 20.64% of the existing issued share capital of the Company. The transfer procedures in respect of the 204,775,755 legal person shares were completed by GKG and Greencool on 18 April 2002.

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 2001.

LIQUIDITY AND CAPITAL RESOURCES

Net cash outflow for operating activities was approximately RMB111,631,000 (2000 - net cash inflow of approximately RMB1,378,813,000) for the year ended 31 December 2001.

As of 31 December 2001, the Group had cash and bank deposits amounting to approximately RMB778,191,000 (2000 - RMB838,710,000), of which approximately RMB97,231,000 (2000 - RMB192,314,000) was denominated in foreign currencies, and bank loans amounting to approximately RMB1,558,230,000 (2000 - RMB694,783,000), of which approximately RMB60,530,000 (2000 - RMB57,083,000) was denominated in foreign currencies.

Total capital expenditures for the year ended 31 December 2001 amounted to approximately RMB218,306,000 (2000 - RMB305,809,000) 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.

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PURCHASE, SALE OR REDEMPTION OF SHARES

During the year ended 31 December 2001, neither the Company nor any of its subsidiaries had purchased, sold or redeemed any of the Company's listed shares.

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 were:

Executive directors

Mr. Gu Chu Jun (Chairman) (Note i)
Mr. Liu Cong Meng (Note i)
Mr. Li Zhen Hua (Note v)
Mr. Yan You Song (Note i)
Mr. Zhang Hong (Note i)
Mr. Fang Zhi Guo (Note i)
Mr. Wang Guo Duan (Note ii)
Mr. Chen Ding Bang (Note ii)
Mr. Chen Tong Xing (Note iii)
Mr. Liang Yuan Ying (Note ii)
Mr. Xu Tie Feng (Note iv)
Mr. Qu Yunbo (Note iv)
Ms. Yu Chor Woon, Carol (Note iv)
Mr. Cai Shier (Note iv)

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Non-executive directors

Mr. Chen Wen Hui (Note i)
 Ms. Yu Xiaoyang (Note i)
 Mr. Chan Pei Cheong, Andy (Note i)
 Mr. Li Kwok Wing, Meocre (Note iv)
 Mr. Li Bao Guo (Note iv)
 The Hon. Dr. Wong Yu Hong, Philip (Note iv)
 Mr. Fan Chor Wah, Vincent (Note iii)

Note i: Appointed on 23 December 2001

Note ii: Resigned on 18 June 2001

Note iii: Resigned on 29 June 2001

Note iv: Resigned on 23 December 2001

Note v: Appointed on 18 June 2001

The aggregate salaries payable to all executive and non-executive directors during the year 2001 are disclosed in Note 27 to the accompanying financial statements.

DIRECTORS', SUPERVISORS' AND CHIEF EXECUTIVE'S INTERESTS IN SHARES

As of 31 December 2001, the directors, supervisors and chief executive of the Company had the following beneficial interests in the Company's PRC domestic shares of RMB1 each, A shares or H shares (within the meaning of the Securities (Disclosure of Interests) Ordinance ("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 Shares
Gu Chu Jun	Director	Corporate Corporate	204,775,755 legal person shares * 3,830,000 H shares **
Li Dai Qiang	Supervisor	Personal/family	105,000 domestic employee shares
He Si	Supervisor	Personal/family	50,000 domestic employee shares

* GKG and Greencool entered into a sale and purchase agreement on 29 October 2001 (and such agreement was amended on 5 March 2002) under which GKG agreed to sell to Greencool 204,775,755 legal person shares of RMB1.00 each in the Company, representing approximately 20.64% of the existing issued share capital of the Company. Mr Gu Chu Jun holds 90% of the total investment of Greencool. The transfer procedures in respect of the 204,775,755 legal person shares in the Company were completed by GKG and Greencool on 18 April 2002.

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** Mr. Gu Chu Jun controls approximately 62.5% of the issued share capital of Greencool Technology Holdings Limited, a company listed on the Growth Enterprise Market of the Stock Exchange of Hong Kong Limited. Two subsidiaries of Greencool Technology Holdings Limited hold 3,830,000 H shares in the Company, representing approximately 0.39% of the issued share capital of the Company.

Save as disclosed above, the Company had no notice of any interests required to be recorded under Section 29 of the SDI Ordinance or pursuant to the Model Code for Securities Transactions by Directors of Listed Companies as of 31 December 2001.

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.

DIRECTORS' AND SUPERVISORS' INTERESTS IN CONTRACTS

Except for the transactions with related parties as disclosed in Note 3 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 27 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.

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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 17% 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 2001, the pension cost relating to these schemes amounting to approximately RMB8,960,000 (2000 - RMB14,724,000) had been charged to the consolidated income statement.

For the period from 1 January 2001 to 31 December 2001, the Group's contributions to the Mandatory Provident Fund scheme for its employees in Hong Kong amounted to approximately HK\$555,000, and the percentage of monthly contribution by the Group was 5% of the employees' relevant income, up to a maximum of HK\$1,000 per month for each employee.

FIXED ASSETS

Details of the movement in fixed assets during the year are set out in Note 9 to the accompanying financial statements.

BANK LOANS

Particulars of bank loans are set out in Notes 15 and 18 to the accompanying financial statements.

TRUST DEPOSITS

As of 31 December 2001, 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

Related party transactions are disclosed in Note 3 to the accompanying financial statements. Those transactions disclosed in Notes 3(a)(i), 3(a)(iii), 3(b)(i)-(iv), 3(b)(vii), 3(b)(xi)-(xii) and 3(c) to the accompanying financial statements constitute connected transactions of the Company under the Rules Governing The Listing of Securities on The Stock Exchange of Hong Kong Limited for the year ended 31 December 2001.

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MATERIAL LITIGATION

Save for the dispute which arose pursuant to the matter disclosed in Note 3(a)(iii)(b) to the accompanying financial statements, the Company had no material litigation or arbitration during the year.

CODE OF BEST PRACTICE

Paragraph 14 of the Code of Best Practice requires the Board of Directors to establish an audit committee. However, since the appointment of the current Board of Directors on 23 December 2001, no audit committee has been appointed.

Save as disclosed above and the matters disclosed in the announcement made by the Company on 29 November 2001 in relation to the Company's Report in respect of the Corrective and Remedial Measures in response to the Inspection by Guangzhou Securities Administration Office of China Securities Regulatory Commission, the Board of Directors considers 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 2001.

AUDITORS

The accompanying financial statements were audited by Messrs Arthur Andersen & Co. A resolution for the appointment of Messrs Deloitte & Touche Tohmatsu and its member firms 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

Gu Chu Jun

Chairman

Shunde, the PRC

24 April 2002