



Management Discussion and Analysis



Results Review



Under the leadership of the new management team, Kelon has successfully turned around from a loss-making position to a profit-making position within a year and has recorded encouraging results. In 2002, the Group recorded a turnover of RMB4,878,257,000, representing an increase of approximately 11.33% as compared to 2001. Net profit reached RMB84,593,000. Basic earnings per share were RMB0.09.

The Board of Directors does not recommend the payment of dividend in 2002 nor does it recommend the capitalization of any reserve fund (2001: no final dividend declared).

The substantial improvement in the Group's profitability was attributable to three factors. Firstly, the Group places strong emphasis on product quality and continues to improve the technological level of its products, leading to an increase in its products' total added value and brand recognition among consumers. As a result, smaller scales of price cut on "Kelon" refrigerators and air-conditioners as well as "Ronshen" refrigerators were maintained despite increasingly intense competition, ensuring the Group's profit level in 2002. Secondly, overall costs were reduced as the average cost of sales of refrigerators and air-conditioners declined by 13.05% and 8.78% respectively as compared to 2001. Distribution and administrative expenses also declined by 57.75% during the Reporting Period. Thirdly, overall sales revenues recorded an increase of 11.33% as compared to 2001, with the sales revenues from the air-conditioning and refrigeration businesses rising by 7.35% and 4.06% respectively.

Turnover Structure Analysis

Despite intense competition in the domestic appliances market, the domestic sales of air-conditioners recorded increases in the Reporting Period both in terms of sales volumes and revenues, growing by 21.00% and 10.62% respectively as compared to 2001. The sales volumes and revenues of the domestic sales of refrigerators were basically maintained.

The Group's export sales performance maintained its growth momentum. Export sales volumes and revenues for refrigerators increased by 14.80% and 44.50% respectively as compared to 2001. Export sales for air-conditioners increased by 4.60% and 0.40% as compared to 2001.

Healthy Financial Standing

During the Reporting Period, the Group continued to exercise stringent financial management. Riding on its strong foundation from previous years, the Group was able to maintain its sound financial standing. This was reflected in the following areas:

For the year ended 31 December 2002, the Group's total assets reached RMB7,715,793,000, with net assets of RMB2,590,068,000. Bank balances and cash amounted to RMB1,417,085,000. Current assets stood at RMB4,909,479,000.

During the Reporting Period, the Group cleared its old inventories at a discount, basically eliminating all old inventories and greatly improving the liquidity and quality of its total inventory.



Operations Review



High Technology Products

Kelon believes that “leading technology” is the key to continuous corporate development, and thus this approach has been adopted in Kelon’s product development. During the Reporting Period, Kelon launched three major products that led the industry:

Kelon “Shuang Xiao Wang” Cooling and Heating

Air-Conditioner – A pioneer in the domestic air-conditioner industry, it adopts an internationally patented technology, and uses the highly efficient and environmentally-friendly “Greencool Refrigerants” to optimize the performance of its cooling and heating functions. The cooling efficiency of the “Shuang Xiao Wang” Cooling and Heating Air-Conditioner is high at

3.8, which is 65% higher than the national standard and 40% higher than the national energy-saving standard. Its heating efficiency also leads in the industry at a high of 4.2, which is 83% higher than the national standard and 56% higher than national energy-saving standard.



Kelon IMCR (Independent Multi-cycling Refrigeration)

Refrigerator – This refrigerator uses multi-cycling technology for the first time in the world’s refrigeration industry. This revolutionary technology enables individual cooling and freezing operations, bringing the energy savings level of the refrigerators to new highs. IMCR technology not only places Kelon well ahead of the competition, it also opens up more room for higher profitability.



Ronshen Children’s Refrigerator (“I-box”) – This refrigerator pioneers in product categorization by age. It was regarded as a breakthrough in the refrigeration industry in 2002 in terms of



product innovation and market segmentation. The Children’s Refrigerator is tailor-made with 16 patents, providing individual storage for children’s food and eradicating bacteria in food as stored in regular adult refrigerators. This Children’s Refrigerator also adopts durable antibacterial additives as developed by national research organizations, with an antibacterial rate as high as 99.9% and with antibacterial effectiveness lasting for over 10 years. Its antibacterial as well as its freshness preservation capabilities are 30% to 40% higher than regular refrigerators.

“Project of Perfection”

Kelon’s refrigerators and air-conditioners are the front-runners in China’s domestic appliances industry in terms of technology, quality and product design. To speed up their adaptation to the international market, as well as to confront the challenges of globalization, Kelon implemented its “Project of Perfection” during the Reporting Period. Meticulous design, delicate manufacturing techniques, elegant products and attentive services are the guidelines adhered to enhance Kelon’s competitive edge and raise products to leading international standards. Through this “Project of Perfection”, not only are quality controls and product designs enhanced, wastage in any single production process is minimized and the corporate management process is optimized.

Cost Controls

Kelon turned around from a loss-making position to a profit-making position last year mainly due to the leadership of its visionary management, and their “Profitability Driven” objective, which resulted in stringent cost controls during the Reporting Period.

Kelon implemented an open tender resources procurement system during the Reporting Period, reducing the procurement costs of raw materials and components. The Group also lowered product costs reasonably by optimizing product design. In 2002, Kelon’s production cost for an air-conditioner decreased 13.05% as compared to the previous year, while the production cost for a refrigerator dropped 8.78%. The lower costs allow Kelon to benefit from higher flexibilities in price reductions and in market expansion.

In addition, Kelon optimized the management of its overall sales network and administrative processes, reducing the costs of sales and administration by 8.24% and 86.60% respectively during the Reporting Period.

In July 2002, Kelon adopted a “Cost-Optimization Strategy” by cooperating with China Southern Airlines Company Limited. This cooperation will help Kelon reduce its freight cost by more than 30% annually.

“Total Carefree” Customer Services

“Total Carefree” customer services are among the first batch of domestic appliances service brand names registering its service trademark. Its service scope covers research of consumer needs, product research and manufacturing, as well as a total service package offered during the sales processes. The aim is to achieve 100% customer satisfaction while realizing the service mission to offer total carefree services. Currently, Kelon has over 2,800 service partners, with about 30,000 staff working directly for Kelon’s after-sales services. In the past 3 years, Kelon’s customer satisfaction level has increased by 10%.

Comprehensive Branding Strategies

Kelon's products have been sold under the "Kelon", "Ronshen" and "Huabao" brands for many years. The "Kelon" and "Ronshen" brands are well-known PRC trademarks, targeting the high- to mid-end markets. These brands have been widely applied to a range of product series for air-conditioners, refrigerators, freezers and small home appliances.



The "Combine" brand is a new brand launched by Kelon in 2002 to capture the low-end market and to expand its market share. Riding on Kelon's competitive advantages in terms of professional refrigeration technology, product quality and services, the "Combine" products are priced at the same level as third-tier domestic appliances, filling the gap which exists in the low-end market, and raising overall industry standards in the low-end market. In addition, capitalizing on Kelon's nationwide after-sales service network, customers of these "Combine" products can enjoy "Total Carefree" services support, the same service quality as offered by Kelon for its top-tier brands.

The launch of the "Combine" brand, coupled with the existing "Kelon" and "Ronshen" brands for refrigerators and air-conditioners which are positioned for the high- to mid-end markets, and the "Huabao" brand which targets the mid- to low-end markets, enables Kelon's four brands to complement each other nicely in their market positioning, completely embracing the high-, mid- and low-end product lines. Kelon thus becomes the sole enterprise in the PRC to offer domestic refrigeration appliances under four brands with different market positions, but with one core strategic mission.

Internationalization Strategy

During the Reporting Period, Kelon continued to export products to the international market through OEM and has achieved excellent results. Export volumes increased by 14.30% and the export amount rose 24.75%.

In addition, the Group established an International Cooperation Department during the Reporting Period, led by professionals with extensive overseas experience. They streamlined the internal organization and management, as well as sales channels, to enhance efficiency and strengthen the team, accelerating its adaptation to the international marketplace.

Basic Medical Insurance Scheme for Employees

Since 1 January 2002, according to the Provisional Rules of Basic Medical Insurance in Shunde City (順德市基本醫療保險暫行規定) issued by the People's Government of Shunde City on 2 December 2000, and the relevant accounting requirements of the PRC, the Group has implemented the basic medical insurance policy for its employees. Such amount involved has already been stated as the Group's welfare expenditure.

Significant Events

On 18 April 2002, the share transfer procedures between Greencool Enterprise Development Company Limited ("Greencool") and Guangdong Kelon (Rongsheng) Group Company Limited ("GKG") were completed and Greencool became the single largest shareholder of Kelon, holding 204,775,755 legal person shares, representing 20.64% of Kelon's total issued capital.

On 18 June 2002, the resolution to appoint 德勤華永會計師事務所 and Deloitte Touche Tohmatsu as Kelon's auditors in mainland China and Hong Kong for the year ended 31 December 2002 was approved at the Annual General Meeting.

On 16 August 2002, the resolution to set up an audit committee was approved by Kelon's Board of Directors, and Mr. Chan Pei Cheong, Andy was appointed as the chairman of the audit committee.

On 21 November 2002, Kelon entered into a debt settlement agreement with GKG, its previous single largest shareholder. GKG agreed to transfer the 「科龍」、「容聲」 and 「容升」 trademarks to Kelon to settle the debt owed to Kelon. Concurrently, GKG agreed to procure that a parcel of residential land located at Wai Huan Road, Ronggui District, Shunde City with a total area of 399,614 square metres be transferred by the Land Development Centre, which is owned by the government of the Ronggui Prefecture, to Kelon for settlement of the remaining debt owed by GKG to Kelon. Upon completion of the relevant procedures stipulated in the agreements, the debt owed by GKG to Kelon will be completely settled.



With the reforms in strategy and operations in 2002, Kelon has managed to extricate itself from the unfavourable past. However, anticipating even more intense competition in the domestic appliances market, the Group will take a steady approach in its future development, moving cautiously to obtain success. Kelon's long-term vision is to become a leading international domestic appliances manufacturer, while its short-term strategy is to consolidate its development in China and move on to expand its international markets gradually.

In the future, the Group will continue to implement stringent cost controls by comprehensively and closely monitoring all aspects of its activities, including procurement, production and distribution, with a view to strengthening the Group's profitability. In addition, the Group will expand the applications of its "Shuang Xiao Wang" and IMCR technologies to more product lines to enhance the overall technological benefit of its products, and to achieve a competitive edge in the highly competitive marketplace.

The Group believes that a talented team is the driving force for corporate development. To face globalization and tackle market competition, the Group will continue to recruit and promote top quality, high-tech personnel to build an international team.

Furthermore, with Greencool becoming its single largest shareholder, Kelon has been introduced the international experience and networks of the Greencool Group's management, thereby strengthening the Group's competitive advantages in its internationalization, as it grows into a leading enterprise in the refrigeration industry.

Management Discussion & Analysis

Explanations of the board of directors of the Company in respect of matters under the auditors' opinion:

1. The financial statements of the Group for 2001 were not audited by the current auditors. As the previous auditors were of the view that they were unable to form an audit opinion, this has led to the current auditors not being able to conclude their opinion on whether the financial data for the year ended 31 December 2001 provide a true and fair view. The management of the Company understands the reasons for such decision. The management has not, over the course of more than a year, found any material errors in the year-end balances for 2001. Therefore, they are satisfied with the accuracy of the announced profit figures for 2002. The year-end balances for 2002 have been duly audited and brought forward to the coming year. As such, it is expected that there will be no such qualified opinion for the next results announcement.
2. The audit of an associate of the Group has not yet been completed. Subject to the limitation of the scope of audit, this has resulted in the auditors of the Group being unable to complete the verification of the value of the said associate and a qualified opinion was rendered in respect of the matter. The management of the Group has directly enquired with the said associate as to its financial status for 2002, and has arrived at a preliminary conclusion that the financial status of the associate is not expected to have a material impact on the Group's investment in the associate. However, the final conclusion can be drawn only after the financial statements have been audited.