



## Chairman's Statement



2004 was a challenging year for Kelon and the entire domestic appliances industry.

The price of raw materials surged sharply in the second half of 2004, and the Group was not able to offset the increased cost entirely by means of raising the market price of new products. Added with the intense competition in both domestic and export markets, the Group's profit margins, which were already narrow, were further cut down, and the Group recorded a decline of its operating results in the fourth quarter as compared with the previous three quarters. In addition, the Group wrote off goodwill of its investment, and made provision for bad debt and inventories, which further affected the profit level of the Group in 2004.

Despite these negative factors and thanks to the strong business foundation built under the leadership of the management and at the hard work of its employees, the Group managed to conclude another year of great achievements. The Group's domestic sales reached RMB5,096,240,000, up 20.8% as compared to 2003, and exports soared 71.5% to a record of RMB3,340,164,000. These translated into an aggregate turnover of RMB8,436,404,000 for the Group, representing an increase of 36.8% over 2003.

Benefiting from our relentless research and development efforts, the Group further strengthened its technological leadership in the industry with the introduction of the environmentally friendly "BCD-209S" refrigerators and the fourth generation of "Shuang Xiao Wang" air-conditioners. In 2004, "Shuang Xiao Wang" air-conditioners broke the world-record with a coefficient of performance of 7.0.

Through our strategic efforts in consolidating and developing our market position in China, the Group's annual production capacity of refrigerators and freezers reached 13 million units, which resulted in Kelon leading the world in its output for refrigerators of 150 liters or below. In addition, our annual capacity for air-conditioners reached 10 million units. The unparalleled economies of scale and the constantly improving industrial designs have greatly helped in absorbing part of the negative effect of the cost increase.

Kelon's comprehensive multi-branding strategy is also one of the keys to its success. In 2004, Kelon successfully expanded its coverage into the second and third-tier markets as well as the villages through well-defined positioning of the "Kelon", "Ronshen", "Huabao" and "Combine" brands, enabling it to precisely cover the high-, mid- and low-end markets. Coupled with the cost advantages, the Group significantly enlarged its market share.

The small home appliances business also experienced stable growth in 2004. Kelon further expanded its business scope into the washing machine industry through forming a joint venture - Guangdong Kelon Weili Electrical Appliances Company Limited ("Kelon Weili Electrical Appliances") in November 2004. Riding on the Group's substantial advantages in technologies, cost, branding, scale and sales channels, we believe the small home appliances business and the newly acquired washing machine business will bring the Group's development into a new stage. We shall also devote our efforts into developing quality energy-saving small home appliances and launching high quality washing machines to capture profits from this huge market.

We have seen the domestic and export selling prices of refrigerators and air-conditioners starting to rebound since late 2004 and the management expects the rising price trend will benefit Kelon's refrigerator and air-conditioner businesses. The Group's competitive advantages will be even more obvious in the domestic market, with the implementation of the Chinese Government's new energy efficiency labeling policy for air-conditioners in March 2005, under which all air-conditioners are required to reach a minimum coefficient of performance level.

In 2004, Guangdong Greencool Enterprise Development Company Limited further increased its stake in the Company to 26.43%, demonstrating the commitment and faith of our single largest shareholder in the future of the Group.

I would like to take this opportunity to express my heartfelt gratitude to all our shareholders, directors, the management and employees. Kelon's respectable results in 2004 testified to the hard work of all our staff. With our leading technological advantages, extensive distribution network, continuous enhancement of economies of scale, as well as stringent cost control, Kelon is set to increase its domestic appliances market share in China and worldwide and will strive for more fruitful results in 2005.

**Gu Chu Jun**

*Chairman of the Board*

China, 28 April 2004