

## Chairman's Statement

The year 2005 has been an extremely challenging year for the Company.

For the domestic appliances industry as a whole, the sky-rocketing prices of raw materials including crude oil, steel and copper tubes have cast a great pressure on the cost to the manufacturers of domestic appliances, and together with the price competition among domestic appliances manufacturers, has resulted in minimal changes in the prices of domestic appliance products. As a result, the gross profit of domestic appliances has decreased further and the profit margins have shrunken further.

Although the Group maintained normal operations in the first quarter of 2005, as a result of Mr. Gu Chu Jun, the former Chairman of the Board, being suspected of having committed economic crimes since May 2005, has greatly hampered the Group's production and operation activities, and adversely affected the confidence of the financial institutions, suppliers and distributors in the Group. Consequently, the Group was forced to suspend operation from May to August 2005 and missed the peak season for production and sales in 2005. In September 2005, the Group obtained support from Hisense Group in the form of funds, marketing, talents and management staff and also engaged new management staff. The operating activities have resumed rapidly. However, the adverse impact of missing the peak sales season resulted in turnover for the year recording only RMB6,978,372,000, representing a decrease of 11.92%. Among which domestic sales was RMB4,154,957,000, representing a decrease of 6.92% while overseas sales was RMB2,823,415,000, representing a decrease of 18.37%.

During the year, the Group strived to reduce turnover of staff and workers and prepared for all-around recovery of production, as such, there was no apparent change in the management expenses of the Company. However, as the financial statements for the year reflected many abnormal situations occurring in 2005 and in prior years, during which the former management performed their duties either poorly or improperly and made overinvestments, the substantial shareholder misappropriated the Group's funds and Mr. Gu Chu Jun, the former Chairman of the Board, has been under investigation by the relevant authority, these factors together had an adverse impact on the Group, consequently, the Group recorded a loss of RMB3,702,172,000 for the year.

Despite the extremely difficult operating environment, the Group still followed its operational guideline of "Leading in Technology" and further enhanced the core competitiveness of our refrigerator products. In view of the general insufficiency of power supplies in the PRC, the Group launched a series of refrigerators which can continuously function during periods of power shortage. This has secured the Group's leading position in energy-saving technology of refrigerator and led to a remarkable increase in the market share of our products. On 16 September 2005, Mr. Tang Ye Guo was appointed as president of the Company, and Mr. Xiao Jian Lin, Mr. Su Yu Tao, Mr. Shi Yong Chang and Mr. Luo Jun were appointed as vice presidents of the Company, who together with Mr. Lin Lan, a vice president, formed the new management of the Company. The new management of the Company has, since its inauguration, adopted effective measures, including accelerating capital turnover, disposing of idle assets and reducing cost and expenses in order to adjust the Group's internal mechanism and strengthen the Group's internal management. The new management of the Company has also implemented measures to restore the confidence of financial institutions, distributors and suppliers in the Group's prospects. Such measures have improved the Group's external operating environment, as a result of which the Group's production and operation have been rapidly restored normal. The Group recorded remarkable growth in production and sales in the fourth quarter of the reporting period.

Guangdong Greencool Enterprise Development Company Limited ("Guangdong Greencool"), the current sole substantial shareholder of the Company and Qingdao Hisense Air-Conditioner Company Limited ("Hisense Air-Conditioner") entered into the "Transfer Agreement between Guangdong Greencool and Hisense Air-Conditioner in relation to the transfer of shares in Guangdong Kelon Electrical Holdings Company Limited", its "Supplemental Agreement" and "Second Supplemental Agreement" on 9 September 2005, 28 September 2005 and 15 April 2006 respectively. As of this date, the equity transfer is still in process.

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Meanwhile, in an effort to protect the interests of the Group and its shareholders as a whole, the Group proactively investigated, and assisted the investigation of regulatory and judicial authorities on, the Company's interests embezzled by Mr. Gu Chu Jun and his connected companies (including but not limited to Guangdong Greencool) and the possible effect to the Company's outstanding liabilities. Based on the results of the investigation, the Group has taken necessary legal actions against Mr. Gu Chu Jun and his connected companies for compensation, so as to protect the interests of the shareholders of the Company as a whole. In 2006, the Board and the management of the Group will continue to seek to recover the Company's embezzled funds through various means.

On behalf of Kelon, I would like to take this opportunity to express my sincerest gratitude to all our shareholders, Directors, management personnel and employees. It is their support and strenuous efforts that have carried Kelon through this exceptionally difficult year of 2005. In 2006, the Group will use its best endeavours to operate under the operational guidelines of "optimising internal systems, improving cash flow, continuing high-end innovation and maintaining operational efficiency". The Group will solidify its foundation, strengthen its management, further leverage on its competitive edge of technical innovation and continuously pursue the stable and efficient operation. For maximizing the interest of shareholders as a whole, the Group will use its best endeavours to fully overcome the difficulties as quickly as possible and achieve a stable advance and healthy development in the near future.

**Tang Ye Guo**

*Chairman of the Board*

China, 11 August 2006