

Report of the Directors

PRINCIPAL ACTIVITIES

The Group is principally engaged in the manufacture and sale of refrigerators and air-conditioners.

FINAL DIVIDENDS

The Group recorded a profit of RMB48,478,000 for the year ended 2006. The Board resolved not to pay any dividend for the year ended 2006 and not to capitalize any reserve funds (no dividend was paid by the Group for the year ended 31 December 2005).

LIQUIDITY AND SOURCES OF FUNDS

Net cash generated from operating activities was approximately RMB767,913,000 (2005: net cash used in of approximately RMB817,936,000) for the year ended 31 December 2006.

As at 31 December 2006, the Company had bank deposits and cash (including pledged bank balances) amounting to approximately RMB390,504,000 (2005: RMB287,098,000), and bank loans amounting to approximately RMB1,556,702,000 (2005: RMB2,160,523,000).

Total capital expenditures for the year ended 2006 amounted to approximately RMB142,652,000 (2005: RMB336,836,000).

HUMAN RESOURCES AND EMPLOYEES' REMUNERATION

As at 31 December 2006, the Group had approximately 11,359 employees, mainly comprising 1,260 technical staff, 4,609 sales representatives, 421 financial staff, 461 administrative staff and 3,981 production staff. Three of the Company's employees hold a doctorate degree while 106 and 2,326 Company's employees hold a master degree and a bachelor degree, respectively. There were 421 employees with an official title of middle rank or above. In addition, the Company currently has 56 resigned or retired staff. Staff costs for the year ended 31 December 2006 amounted to approximately RMB538,066,000 (2005: RMB587,296,000).

CHARGES ON THE GROUP'S FIXED ASSETS

As at 31 December 2006, the Group's property, plant and equipment (including self-used leasehold land) of approximately RMB821,523,000 (2005: RMB999,795,000) were pledged as security for the Group's bank borrowings.

EXPOSURE TO EXCHANGE RATE FLUCTUATION

Since substantially the Group's purchase and overseas sales in the Reporting Period were denominated in foreign currency, the Group had some extent of exposure to exchange rate fluctuation and financial instruments such as discounted export bills, import/export bills, and hedging were used to hedge exchange rate risk.

PUBLIC FLOAT

As at 26 April 2007, the Directors acknowledge that based on publicly available information and within the knowledge of the Directors, 25% or above of the total issued share capital of the Company are held by the public. Therefore, the public float of the Company satisfies the requirements stipulated under the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the "Listing Rules").

CONTINGENT LIABILITIES

During the reporting period, the Group was involved in a number of material litigations with estimated contingent liabilities of RMB4,212,000.

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MATERIAL LITIGATION

Up to 26 April 2007, the Company and its subsidiaries were involved in 25 litigations which, in each case involved an amount over RMB10 million, the total amount involved was RMB1,044,168,100.

AUDIT COMMITTEE

The sixth audit committee of the Company has reviewed the final result announcement and report for the year ended 31 December 2006.

CAPITAL EXPENDITURE

The Group expects that the capital expenditure for 2007 to be approximately RMB155,223,600.

TRUST DEPOSITS

As at 31 December 2006, the Company did not own any trust deposit in any financial institution in the PRC. All of the Company's deposits are placed with the commercial banks in the PRC and Hong Kong.

LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

As at 31 December 2006, the Group had long-term bank borrowings of RMB nil (2005: RMB nil) and cash and cash equivalents of RMB142,247,000 (2005: RMB184,284,000), of which over 74% are denominated in Renminbi.

RATIO OF TOTAL ASSETS TO TOTAL LIABILITIES

As at 31 December 2006, the ratio of total assets to total liabilities of the Group was 86.30%.

PROPERTY, PLANT AND EQUIPMENT

During the year, the Group spent approximately RMB140 million on acquisition of property, plant and equipment. The details of the movements in property, plant and equipment of the Group during the year are set out in note 15 to the financial statements.

PENSION SCHEMES

Details of the Group's pension schemes for the year ended 31 December 2006 are set out in note 34 to the financial statements.

RESERVES

Details of movements in reserves of the Group and the Company during the year 2006 are set out in statement of changes in equity on page 49 of the financial statements.

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DISTRIBUTABLE RESERVES

There was no distributable reserves of the Company as at 31 December 2006.

INDEPENDENCE OF THE INDEPENDENT NON-EXECUTIVE DIRECTORS

The sixth Board have received written confirmations from all of the independent non-executive Directors in respect of their independence in accordance with the requirements provided under Rule 3.13 of the Listing Rules, and consider that all the independent non-executive Directors of the sixth Board are in compliance with the relevant guidelines under Rule 3.13 of the Listing Rules and are still independent persons.

INTERESTS IN CONTRACTS OF DIRECTORS AND SUPERVISORS

No service contract has been entered into with any Directors of the sixth Board or any supervisors of the sixth Supervisory Committee.

The directors and supervisors of the sixth Board of the Company have not directly or indirectly held any material interests in any material contracts.

INDEPENDENT NON-EXECUTIVE DIRECTORS' REVIEWS OF CONTINUING CONNECTED TRANSACTIONS

The independent non-executive Directors of the sixth Board have reviewed the continuing connected transactions of the Company for the year 2006 ended and confirmed that these transactions were conducted in the ordinary course of business of the Company on normal commercial terms which were fair and reasonable and in the interest of the shareholders of the Company as a whole.

MODEL CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers ("Model Code") as set out in the Listing Rules as its code for securities transaction by Directors. After specific enquiries made to the Directors of the sixth Board, Mr. Tang Ye Guo, Mr. Yang Yun Duo, Mr. Wang Shi Lei, Ms. Yu Shu Min, Mr. Lin Lan, Mr. Xiao Jian Lin, Mr. Zhang Sheng Ping, Mr. Lu Qing and Mr. Cheung Yui Kai, Warren and former directors Mr. Su Yu Tao and Mr. Zhang Ming confirmed that they have complied with the Model Code during their terms of office.

SHARE CAPITAL STRUCTURE

As at 31 December 2006, the share capital structure of the Company was as follows:

	Number of shares	Percentage of total issued share capital (%)
Domestic Shares	337,915,755	34.06
H Shares	459,589,808	46.33
A Shares	194,501,000	19.61
Total	992,006,563	100.00

Report of the Directors

TOP TEN/SUBSTANTIAL SHAREHOLDERS

- (1) As at 31 December 2006, the Company has a total of 50,137 shareholders in total, of which the top ten/substantial shareholders were as follows:

Shareholdings of the top ten shareholders

Name of Shareholder	Nature of Shareholder	Percentage of the total issued shares capital of the Company	Percentage of the relevant class of issued shares of the Company	No. of Shares Held	No. of Unlisted Shares Held	No. of Pledged or Frozen Shares
Qingdao Hisense Air-conditioning Company Limited	Domestic legal person shares	26.43%	77.60%	262,212,194	262,212,194	0
Shunde Economic Consultancy Company	Domestic legal person shares	6.92%	20.32%	68,666,667	68,666,667	0
Shenyin Wanguo Securities (H.K.) Limited	Foreign Shareholder	5.53%	11.93%	54,851,000	0	Unknown
The Hongkong and Shanghai Banking Corporation Limited	Foreign Shareholder	5.17%	11.16%	51,295,925	0	Unknown
Bank of China (Hong Kong) Limited	Foreign Shareholder	4.94%	10.66%	48,981,000	0	Unknown
Guotai Junan Securities (Hong Kong) Limited	Foreign Shareholder	4.12%	8.90%	40,920,000	0	Unknown
HSBC Nominees (Hong Kong) Limited	Foreign Shareholder	4.04%	8.73%	40,106,904	0	Unknown
First Shanghai Securities Limited	Foreign Shareholder	2.61%	5.63%	25,868,000	0	Unknown
Hang Seng Securities Limited	Foreign Shareholder	2.04%	4.40%	20,235,000	0	Unknown
Standard Chartered Bank (HK) Ltd.	Foreign Shareholder	1.07%	2.31%	10,614,500	0	Unknown

Note: As at 31 December 2006, as shown in the register of substantial shareholders kept according to Section 336 under the Securities and Futures Ordinance under the Laws of Hong Kong (the "SFO"), the above top eight shareholders among the top 10 shareholders maintained short positions in the issued share capital of the Company.

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Shareholdings of top ten tradable Shareholders

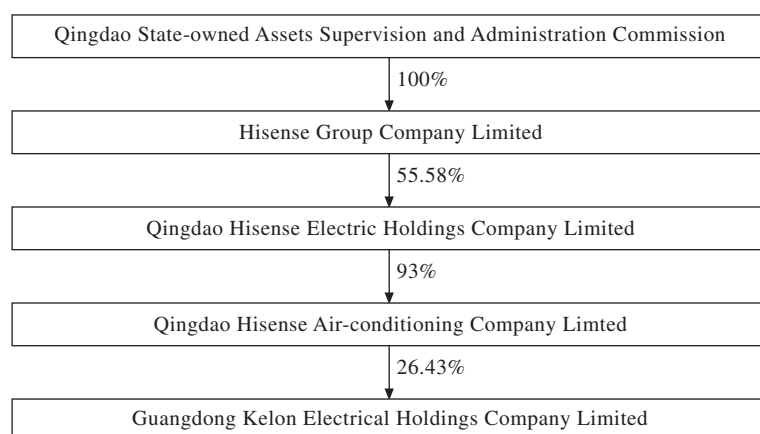
Name of Shareholder	Number of listed Shares Held	Class of Shares
Shenyin Wanguo Securities (H.K.) Limited	54,851,000	Overseas listed foreign shares
The Hongkong and Shanghai Banking Corporation Limited	51,295,925	Overseas listed foreign shares
Bank of China (Hong Kong) Limited	48,981,000	Overseas listed foreign shares
Guotai Junan Securities (Hong Kong) Limited	40,920,000	Overseas listed foreign shares
HSBC Nominees (Hong Kong) Limited	40,106,904	Overseas listed foreign shares
First Shanghai Securities Limited	25,868,000	Overseas listed foreign shares
Hang Seng Securities Limited	20,235,000	Overseas listed foreign shares
Standard Chartered Bank (HK) Ltd.	10,614,500	Overseas listed foreign shares
BOCI Securities Limited	8,034,000	Overseas listed foreign shares
Sun Hung Kai Investment Services Limited	7,859,000	Overseas listed foreign shares

Remarks on the connected relationship or action in concert of the above shareholders

The Company does not know whether any one of the top ten holders of listed shares is connected with each other or any one of them is a party acting in concert with any of the other nine shareholders as defined in Administrative Measures for Information Disclosure of the Shareholders of Listed Companies.

(2) Brief introduction about the controlling shareholder of the Company

1. Qingdao Hisense Air-Conditioning Co., Ltd., the single largest shareholder of the Company, was incorporated on 17 November 1995 with a registered capital of RMB674.79 million. Its registered address is Changsha Road, Hi-tech Zone, Qingdao, the PRC and the legal representative is Mr. Tang Ye Guo. It is primarily engaged in researching and manufacturing of air-conditioners, injection moulds and provision of after-sale repairing services for its products.
2. Relationship between the Company and its Beneficial Controlling Shareholds



The actual beneficial controller of the Company is Qingdao State-owned Assets Supervision and Administration commission.

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3. The transfer procedure of 26.43% legal person shares of the Company held by Guangdong Greencool was completed on 13 December 2006. Following the share transfer, Hisense Air-Conditioning held 262,212,194 shares of the Company, representing 26.43% of total issued shares of the Company.

As at 29 March 2007, the share reform plan of the Company is implemented, the percentage of shares held by Hisense Air-Conditioning to shares of the Company changed to 24.08% accordingly.

INTERESTS OF DIRECTORS, SUPERVISORS AND CHIEF EXECUTIVES IN THE SHARES

As at 31 December 2006, none of the sixth Board, supervisors and the chief executive of the Company and any of their associates held any interests or short positions in any shares, underlying shares and debentures of the Company and its associated corporations, as recorded in the register maintained by the Company pursuant to Section 352 of the SFO.

MAJOR CUSTOMERS AND SUPPLIERS

During the year ended 31 December 2006, the aggregate amount of the Company's purchases from the top five suppliers was RMB747,000,000, representing 15.14% of total purchase amount of the Company for the year and the aggregate sales amount of the top five customers was RMB2,140,000,000, representing 32.60% of total sales amount of the Company for the year. Among them the largest customer is Hisense Marketing, which accounted for 23.96% of the Company's total sales. As at 31 December 2006, none of the Directors, associates of the Directors or shareholders of the Company, who to the knowledge of the Company hold 5% or more of the shares in the Company, have any interest in the above suppliers or customers.

PURCHASE, SALE OR REDEMPTION OF SHARES

During the year ended 31 December 2006, neither the company nor any of its subsidiaries has purchased, sold, redeemed any of the Company's listed shares.

PRE-EMPTIVE RIGHTS

There is no provision for pre-emptive rights under the Articles of Association of the Company.

TAX RELIEF AND EXEMPTION

The Company is not aware of any particulars of tax relief and exemption available to shareholders by reason of their holding of the Company's H shares.

AUDITORS

The reappointment of Shenzhen Dahua Tiancheng Certified Public Accountants and BDO McCabe Lo Limited as the Company's local and foreign auditors respectively was reviewed and approved by the 2005 AGM of the Company.

Note: The financial information contained in the Report of the Directors is calculated in accordance with the PRC GAAP).

Report of the Directors

I. CHANGES IN SHAREHOLDERS' INTEREST DURING THE REPORTING PERIOD AND DESCRIPTION

In RMB

Item	Share capital	Capital reserve	Surplus reserve	Undistributed profits	Conversion difference on foreign exchange returns	Total shareholders' interests
At the beginning of the period	992,006,563	1,581,099,649	114,580,901	(3,800,717,444)	4,954,275	(1,108,076,056)
Increase for the period	-	27,002,478	-	24,120,753	10,024,118	61,147,349
Decrease for the period	-	-	-	-	-	-
At the end of the period	992,006,563	1,608,102,127	114,580,901	(3,776,596,691)	14,978,393	(1,046,928,707)

Reasons for changes: Of the increase of capital reserve for the period, the increase of provision for equity investment for the year amounting to RMB11,009,933 represents the increase of the capital reserve of the subsidiaries of the Company which is the share attributable to the Company and the settlement of debts of RMB15,992,545. The increase of undistributed profit for the period of RMB24,120,753 represents the net profit for the period. The increase of exchange difference on foreign currency translation of RMB10,024,118 represents the fluctuation of exchange rates.

II. INVESTMENTS OF THE COMPANY DURING THE REPORTING PERIOD

- 1 During the Reporting Period, the Company did not raise any capital and no capital raised during any prior Reporting Period were used during the Reporting Period.
- 2 During the Reporting Period, there were no major investments funded by internal capital and thus there are no reports on the progress and income received from such investments.

III. THE AUDITOR'S REPORT ISSUED BY SHENZHEN DAHUA TIANCHENG CERTIFIED PUBLIC ACCOUNTANTS FOR THE COMPANY CONTAINING QUALIFIED OPINION. THE BOARD EXPLAINED THE MATTERS RELATING TO THE QUALIFIED AUDITORS' OPINION IN DETAIL AS FOLLOWS:

Reserved Matter 1: "As described in Notes 6.3, 6.4, and 7 to the financial statements, a series of related parties' transactions and unusual cash flows occurred between the Company and its former largest shareholder, Guangdong Greencool Enterprise Development Limited and its related parties (the "Greencool Companies") during the period from October 2001 to July 2005. In addition, the Greencool Companies, through certain specified third party companies such as Tianjin Lixin Commercial Trading Development Company Limited, involved in a series of unusual cash flows with the Company in the same period. Such transactions and unusual cash flows as well as the suspected fund embezzlement have been reported to the relevant authority, and are pending for judgement. Such reported matters involve the accounts receivables and payables between the Company and the Greencool Companies as well as the specified third party companies mentioned above. As at 31 December 2006, the balance of the accounts receivables of the Company from the Greencool Companies and the above specified third party companies amounted to RMB651 million. The Company has made a provision of RMB364 million in respect of the accounts receivables from Greencool Companies and the above specified third party companies. We were unable to adopt appropriate audit procedures to obtain sufficient and appropriate audit evidence to ascertain whether the estimated provision for bad debts is reasonable and the assessment and calculation of the receivables is reasonable.

As the Company and its former single largest shareholder, Guangdong Greencool Enterprise Development Company Limited, and its related parties or through its third party companies had a series of related parties' transactions and irregular cash inflow/outflow during the period from 2001 to 2005. The aforesaid transactions, irregular cash inflow/outflow and suspected funds embezzlement have been formally investigated by relevant authorities. As at 31 December 2006, the balance of the accounts receivables of the Company from Greencool Companies and the aforesaid specified third party companies amounted to RMB651,000,000.

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Since the court has not yet made its judgment, the Company can only estimate, based on the available information about the cases at present, the recoverable amount of accounts receivables due from Greencool Companies and specified third party companies, meanwhile the Company has made a provision of RMB364 million. The bases of the estimate include : the information regarding the properties of Greencool Companies sealed and frozen by the Court as applied by the Company, and the initial analysis report on the aforesaid fund embezzlement prepared by the lawyer of the Company. As analyzed by the lawyer, the properties of Greencool Companies available for settlement amounted to approximately RMB1,000,000,000, and the total claim amount against Greencool Companies by the creditors to the court amounted to approximately RMB2,400,000,000. The amount claimed by the Company for the fund embezzlement of Greencool Companies amounted to RMB792,000,000. There is possibility that the credit balance be settled based on the proportion of property to the debts. Based on the estimated settlement proportion, and that the case is still in the progress, the court has not yet acknowledged the amount of the Company's claim of the debts, the Board of the Company estimated the recoverable amount and made a provision of RMB364,000,000 for bad debts.

Meanwhile, the law firm to this case declared that, apart from the case handled by them, they cannot guarantee the accuracy of the information and data related to other relevant cases nor the results of those cases. Further, whether the relevant subsidiaries of the Company are qualified to participate in the property appropriation of Greencool Companies is dependent on the decision of the Court.

The Board considers that the provision for bad debts is an accounting estimate. The handling method of this accounts receivable does not contravene any relevant requirements of the Accounting System for Business Enterprises, and since there is no material difference between the level of judgment on the recoverability of the accounts receivables made in 2006 and that in 2005, the qualified opinions to this item will not affect the impartiality on the preparation of the income statement for the year ended 2006.

After the court has made its judgment and the settlement proportion, the Company will, pursuant to the determined recoverable proportion, adjust retrospectively the 2005 financial statements (balance sheet and income statement), and the relevant items in the balance sheet as at 31 December 2006. The Company has taken measures to sequester the properties of Greencool Companies which are available for settlement. The Company will also pay attention to the progress of the case and make its best efforts to ensure its rights as a creditor.

Reserved Matter 2: As described in Note 6.26 "Revenues and Costs of Principal Operations" to the financial statements, in 2005 the Company adopted a method of calculating the inventory at year-end based on the result of stock take at year-end and weighted purchase unit prices, upon which the costs of principal operations in 2005 was back-calculated. Even though such method will not have any impact on the audit of the balance of inventory by the end of 2005, however, due to unreliability of the control system prior to 2005, we were unable to perform satisfactory audit procedures to determine whether the cost of principal operations back-calculated all attributable to 2005. In our audit on the income statement in 2005, we have expressed a qualified opinion on the cost of principal operations . In the year 2006, the management of the Company could not take appropriate measures to rectify such accounting error and make retrospective adjustments to the cost of the principal operations in 2005. The reserved matters above will not impose any impact on the acknowledgment of the income statement of 2006 and the cash flow statement of 2006.

This is a reserved matter on the cost of principal operations in 2005. The Company was unable to make retrospective adjustments for the cost of principal operations in 2005 due to the restrictions of conditions; however, the calculation and audit of the costs of principal operations in 2006 resumed normal as the Company made improvement in its stock control system and costs calculation and audit system. Such reserved matter will have no impact on the income statement of 2006 and the cash flow statement of 2006.

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OTHER DISCLOSEABLE MATTERS

I. MATERIAL LITIGATIONS AND ARBITRATIONS OF THE COMPANY

1. Background information on material litigations involving target claim amount over RMB10,000,000

Litigation involving Greencool Companies and the specified third parties

No.	Name of case	Counterparty	Target claim amount	Background information of the case
1	Litigation initiated by Kelon Air-Conditioner against Guangdong Greencool, Gu Chu Jun and Jiangxi Kesheng Industry and Trading Company Limited (“Jiangxi Kesheng”)	Guangdong Greencool, Gu Chu Jun and Jiangxi Kesheng	18,630,000	Under the authorisation by Gu Chu Jun, on 20 February 2005, Kelon Air-conditioner purchased 14.1 tons of refrigerants from Jiangxi Kesheng at a price of RMB18,630,000. However, Kelon Air-conditioner has not received the goods under the contract. The plaintiff considered that Guangdong Greencool has taken benefits from its role as the substantial shareholder to embezzle the capital of the plaintiff and use the name of Jiangxi Kesheng so as to avoid the regulatory restrictions on related parties’ transactions.
2	Litigation initiated by Jiangxi Kelon Industrial Development Co., Ltd. (“Jiangxi Kelon”) against Guangdong Greencool, Gu Chu Jun, Greencool Refrigerant (China) Company Limited (“Tianjin Greencool”), Hainan Greencool Environmental Protection Engineering Co., Ltd. (“Hainan Greencool”) and Jinan San Ai Fu Petrochemical Co., Ltd. (“Jinan San Ai Fu”)	Guangdong Greencool, Gu Chu Jun, Tianjin Greencool, Hainan Greencool and Jinan San Ai Fu	81,600,000	On 20 January 2005, under the direction of Gu Chu Jun and Guangdong Greencool, Tianjin Greencool and Jinan San Ai Fu entered into a sale and purchase contract to sell 700 tons of refrigerant to Jinan San Ai Fu, of which 600 tons were sold by Jinan San Ai Fu to the plaintiff. The plaintiff alleged that the five defendants had embezzled its funds by fraud.
3	Litigation initiated by Shenzhen Kelon Procurement Co Ltd. (“Shenzhen Kelon”), against Guangdong Greencool, Tianjin Lixin Commercial Trading Development Company Limited (“Tianjin Lixin”), Greencool Procurement Centre (Shenzhen) Co., Ltd. (“Shenzhen Greencool”) and Gu Chu Jun	Guangdong Greencool, Shenzhen Greencool and Gu Chu Jun	89,600,300	The plaintiff entered into a sale and purchase contract with Tianjin Lixin to purchase 12,700 tons of steel. The plaintiff made the payments to Tianjin Lixin on 26 April 2005 and 27 April 2005, respectively, and Tianjin Lixin transferred the funds collected to Shenzhen Greencool. The plaintiff has not received any steel supply from Tianjin Lixin. The plaintiff claimed that the four defendants had embezzled its funds by fraud.
4	Litigation initiated by Guangdong Kelon Fittings Co., Ltd against Guangdong Greencool, Tianjin Xiangrun Commercial Trading Development Company Limited (“Tianjin Xiangrun”), Shenzhen Greencool and Gu Chu Jun	Guangdong Greencool, Tianjin Xiangrun, Shenzhen Greencool and Gu Chu Jun	97,412,200	The plaintiff entered into a sale and purchase contract with Tianjin Xiangrun to purchase 8,820 tons of steel from Tianjin Xiangrun. The plaintiff made installments to Tianjin Xiangrun on 26, 27 and 28 April 2005, respectively, but it has not received any steel supply from Tianjin Xiangrun. The plaintiff alleged that the four defendants had embezzled its funds by fraud.

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Litigation involving Greencool Companies and the specified third parties

No.	Name of case	Counterparty	Target claim amount	Background information of the case
5	Litigation initiated by Kelon Air-Conditioner against Guangdong Greencool, Jinan San Ai Fu, Tianjin Greencool, Hainan Greencool and Gu Chu Jun	Guangdong Greencool, Jinan San Ai Fu, Tianjin Greencool, Hainan Greencool and Gu Chu Jun	40,800,000	The plaintiff entered into a sale and purchase contract with Jinan San Ai Fu to purchase 300 tons of environment-friendly refrigerant, and paid a price of RMB40,800,000 on 1 April 2005, but Jinan San Ai Fu failed to deliver the goods. The plaintiff alleged that the five defendants had embezzled its funds by fraud.
6	Litigation initiated by Jiangxi Kelon against Guangdong Greencool	Guangdong Greencool and others	90,000,000	The Company alleged that Aike Enterprises (Tianjin) Co., Ltd. had embezzled its funds and Guangdong Greencool and others have joint liability. The first trial was conducted on 24 July 2006
7	Litigation initiated by Jiangxi Kelon against Guangdong Greencool	Guangdong Greencool and others	75,000,000	The Company alleged that Tianjin Greencool and the others have joint liability. The first trial was conducted on 24 July 2006.
8	Litigation initiated by Yangzhou Kelon against Guangdong Greencool, Gu Chu Jun and Yangzhou Greencool Venture Capital Company Limited (“Yangzhou Greencool”)	Guangdong Greencool, Gu Chu Jun and Yangzhou Greencool	40,000,000	During the course of negotiation conducted in early 2004 by the Company with the management committee of Yangzhou Economic Development Zone (hereinafter referred to as the “Zone”) with respect to the production of “Twin Door Freezers” (also named “Huge Freezers”) in the Zone, Gu Chu Jun deliberately misrepresented the relationship between the Company and Greencool to the management committee of the Zone for the purpose of attracting the large-sized investment projection. As such, the finance bureau of the Zone granted the “Development Encouragement Fund” amounting to RMB40 million, that should have been paid to Yangzhou Kelon as an incentive subsidy on a “levy first and refund later” basis, to Yangzhou Greencool, a private company owned by Gu Chu Jun.
9	Litigation initiated by Jiangxi Kelon against Guangdong Greencool, Gu Chu Jun, Jiangxi Keda Plastic Technology Company Limited (“Jiangxi Keda”) and Greencool Procurement (Shenzhen) Co., Ltd. (“Shenzhen Greencool”)	Guangdong Greencool, Gu Chu Jun, Jiangxi Keda and Shenzhen Greencool	13,000,000	For the purpose of embezzlement of Jiangxi Kelon’s fund, Gu Chu Jun and certain Greencool companies made the Plaintiff transfer a total sum of RMB13 million to Jiangxi Keda on 20 May 2005 and thereafter made Jiangxi Keda transfer such fund immediately to Shenzhen Greencool. The four defendants failed to return such fund to the Plaintiff as at the date hereof. The transfer of such fund from the Plaintiff to Shenzhen Greencool was not substantiated by any genuine transaction and such transfer of fund is an encroachment of the Plaintiff’s fund by the controlling shareholder and its associated companies through Jiangxi Keda.

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Litigation involving Greencool Companies and the specified third parties

No.	Name of case	Counterparty	Target claim amount	Background information of the case
10	Litigation initiated by the Company's Hubei Branch against Guangdong Greencool, Gu Chu Jun and Wuhan Changrong Electrical Appliance Company Limited ("Wuhan Changrong")	Guangdong Greencool, Gu Chu Jun and Wuhan Changrong	29,843,700	Under the manipulation of Guangdong Greencool and Gu Chu Jun, during the period from 15 December 2004 to 31 December 2004, Wuhan Changrong took delivery of a large number of air-conditioners and other goods from the Plaintiff without making any payment. The defaulted payment of RMB29,843,700 has not yet been settled. The said connected transaction was conducted without going through normal internal approval procedures of the Company and the Plaintiff and no announcement has been issued on it. Therefore it is a sheer collusion between the controlling shareholders, beneficial controllers and Wuhan Changrong against the interest of the Plaintiff.
11	Litigation initiated by Jiangxi Kelon against Guangdong Greencool, Zhuhai City Longjia Refrigerant Co., Ltd. ("Zhuhai Longjia") and Gu Chu Jun	Guangdong Greencool, Zhuhai Longjia and Gu Chu Jun	28,600,000	Under the manipulation of Guangdong Greencool and Gu Chu Jun, Jiangxi Kelon transferred RMB11 million to the bank account of Zhuhai Longjia on 24 December 2003 and further transferred RMB17.6 million on 15 December, 2004. Such transfers of funds were not supported by any transactions and were not recorded in the Plaintiff's accounts. Therefore, it constitutes the embezzlement of the Plaintiff's funds by its controlling shareholder and beneficial controller.
12	Litigation initiated by Jiangxi Kelon against Guangdong Greencool, Gu Chu Jun and Zhuhai Defa Air-conditioner Fittings Company Limited ("Zhuhai Defa")	Guangdong Greencool, Gu Chu Jun and Zhuhai Defa	21,400,000	Under the manipulation of Guangdong Greencool and Gu Chu Jun, Jiangxi Kelon transferred RMB9 million and RMB12.40 million to the bank account of Zhuhai Defa on 24 December 2003 and on 15 December 2004 respectively. Such transfers of funds were not supported by any transactions and were not recorded in the Plaintiff's accounts. Therefore, it constitutes the embezzlement of the Plaintiff's funds by its controlling shareholder and beneficial controller.
13	Litigation initiated by Jiangxi Kelon against Guangdong Greencool, Gu Chu Jun and Wuhan Changrong	Guangdong Greencool, Gu Chu Jun and Wuhan Changrong	20,000,000	Under the manipulation of Guangdong Greencool and Gu Chu Jun, Jiangxi Kelon transferred RMB20 million to the bank account of Wuhan Changrong on 23 December 2003. Such transfer of funds was not supported by any transactions and was not recorded in the Plaintiff's accounts. Therefore, it constitutes the embezzlement of the Plaintiff's funds by the controlling shareholder and the beneficial controller.

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Litigation involving Greencool Companies and the specified third parties

No.	Name of case	Counterparty	Target claim amount	Background information of the case
14	Litigation initiated by the Company and its Anhui Branch against Guangdong Greencool, Gu Chu Jun and Hefei Weixi Home Appliances Co., Ltd. (“Hefei Weixi”)	Guangdong Greencool, Gu Chu Jun and Hefei Weixi	18,694,800	Under the manipulation of Guangdong Greencool and Gu Chu Jun, Hefei Weixi took delivery of a large number of air-conditioners and refrigerators from the Plaintiffs without making any payment during the period from 31 December 2003 to August 2005, and the defaulted payments of RMB16,075,400 and RMB2,619,400 due to the Anhui Branch and the Company, respectively, have not yet been settled. The connected transaction above was conducted without going through normal internal approval procedures of the Company and no announcement has been issued on it, therefore, it is a sheer collusion between the controlling shareholder and beneficial controller together with their associated companies against the interest of the Plaintiffs.
15	Litigation initiated by Kelon Air-Conditioner against Guangdong Greencool, Gu Chu Jun and Hainan Greencool Environmental Protection Engineering Co. Ltd. (“Hainan Greencool”)	Greencool, Gu Chu Jun and Hainan Greencool	12,289,400	Under the manipulation of Guangdong Greencool and Gu Chu Jun, Kelon Air-Conditioner entered into a purchase and sale agreement with Hainan Greencool on 10 March 2005, under which Kelon Air-Conditioner purchased 100 tons of Greencool refrigerant at a unit price of RMB135,000 per ton. After of the above agreement, the Plaintiff made payment of RMB13,437,900 to Hainan Greencool for the refrigerant under the direction of Guangdong Greencool and Gu Chu Jun. However, according to the subsequent investigation and assessment conducted by the plaintiff, the price the refrigerant quoted by Hainan Greencool was about 10 times the normal market price and the refrigerant under the agreement was only value at RMB1,148,500. In other words, Hainan Greencool illegally embezzled the funds of the plaintiff in the amount of RMB12,289,400 by way of connected transaction. The above connected transaction was not subject to the normal approval procedures by the Plaintiff and was not disclosed to the public Therefore, it constitutes an embezzlement of the Plaintiff’s funds by the controlling shareholder and its connected companies.

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Litigation involving Greencool Companies and the specified third parties

No.	Name of case	Counterparty	Target claim amount	Background information of the case
16	Litigation initiated by the Company against Guangdong Greencool, Zhuhai Greencool Refrigeration and Engineering Co., Limited (“Zhuhai Greencool”), Beijing Greencool Refrigerant Replacement Engineering Co., Limited (“Beijing Greencool”), Hainan Greencool and Gu Chu Jun	Guangdong Greencool, Zhuhai Greencool, Beijing Greencool, Hainan Greencool and Gu Chu Jun	13,754,600	During the course of controlling and operating the Plaintiff, Guangdong Greencool and Gu Chu Jun forcibly integrated the businesses of Greencool Companies that of the Company, and took control of the manpower, financial resources and materials for promoting the businesses of Green Group at the Company’s cost. Given that “Greencool Authorized Project Agent” did not make payment to Greencool Companies, Guangdong Greencool manipulated the Company to settle the above-mentioned franchise fees and the payment for purchasing refrigerants on behalf of the “Greencool Authorized Project Agent”. With respect to such payments, the Company was manipulated to pay RMB35,175,000 to Zhuhai Greencool, RMB3,960,000 to Beijing Greencool and RMB2,673,000 to Hainan Greencool. So far, there is an outstanding unrecovered amount of RMB13,754,600 paid by the Company to Greencool Companies under the name of Greencool under manipulation. The above actions conducted by the Defendants were neither approved by the Board and the general meeting under the laws and the articles of association of the Company, nor disclosed to the public.
17	Litigation initiated by Kelon Air-Conditioner against Guangdong Greencool, Gu Chu Jun and Greencool Technology Development (Shenzhen) Company Limited (“Shenzhen Greencool Technology”)	Guangdong Greencool, Gu Chu Jun and Shenzhen Greencool Technology	32,000,000	From 31 March 2003 to 14 April 2003, under the manipulation of Gu Chu Jun and his Greencool Companies name of Greencool, the cumulative payment transferred from Kelon Air-Conditioner to Shenzhen Greencool Technology amounted to RMB32 million, and no repayment has been made to date. As such transfer of funds was not supported by any transactions, the act of the controlling shareholder and its associated companies constitutes an embezzlement of the Company’s funds
18	Litigation initiated by Kelon Air-Conditioner against Guangdong Greencool, Gu Chu Jun and Greencool Technology Environmental Protection Engineering (Shenzhen) Co., Ltd. (“Shenzhen Greencool Environmental”)	Guangdong Greencool, Gu Chu Jun and Shenzhen Greencool Environmental	33,000,000	From 6 May 2003 to 23 June 2003, under the manipulation of Guangdong Greencool and Gu Chu Jun, the total amount transferred from Kelon Air-Conditioner to Shenzhen Greencool Environmental was accumulated to RMB33 million, and no repayment has been made to date. As the funds transferred from the Plaintiff to Shenzhen Greencool Environmental were not based on any transactions, the act of the controlling shareholder and its associated companies constitutes an embezzlement of the Company’s funds

Report of the Directors

Litigation involving Greencool Companies and the specified third parties

No.	Name of case	Counterparty	Target claim amount	Background information of the case
19	Litigation initiated by Yangzhou Kelon against Guangdong Greencool, Yangzhou Greencool Venture Capital Company Limited (“Yangzhou Greencool”) and Gu Chu Jun	Guangdong Greencool, Yangzhou Greencool and Gu Chu Jun	35,000,000	In course of investment in Yangzhou Kelon, Gu Chu Jun declared repeatedly to the Management Committee of the Economic Development Zone that Kelon was a subsidiary of Greencool and Greencool was the owner of Kelon during the negotiation and purchase of land. Thus, the Finance Bureau of Economic Development Zone was misled to deposit the incentive fund of RMB35 million to the bank account of Yangzhou Greencool, an associated company of Guangdong Greencool (which was a company solely owned by Gu Chu Jun), instead of Yangzhou Kelon.

Other litigation

No.	Name of case	Counterparty	Target claim amount	Background information of the case
1	Litigation initiated by China Construction Bank Corporation – Nanchang Changbei Branch against Jiangxi Kelon and the Company in relation to the loan contract and guarantee contract	China Construction Bank Corporation – Nanchang Changbei Branch	69,550,000	China Construction Bank Corporation – Nanchang Changbei Branch applied to the court for pre-trial security order on the basis of disputes over the loan contract and guarantee contract with target claim amount of RMB140 million. On 5 August 2005, the High Court of Jiangxi Province ordered to freeze Jiangxi Kelon’s 80% shareholdings in Shangqiu Kelon. During the freezing period, no such shareholdings shall be pledged or transferred without the court’s prior consent. With various negotiations between the parties, So far, Jiangxi Kelon has repaid the Plaintiff an amount of RMB70.45 million.
2	Litigation against the Company initiated by Zhejiang Hangzhou Hangxiao Ganggou Holdings Company Limited (“Hangxiao Ganggou”)	Hangxiao Ganggou	19,853,000	The plaintiff alleged that it had undertaken the construction works of the Company’s plain warehouse factories No. 1 and No. 2 pursuant to a construction contract with the Company and the Company defaulted in payment of RMB1,193,000 of construction fees. The plaintiff filed proceeding against the Company for the payment of RMB1,193,000 in construction fees and RMB17,660,000 in default penalties and the cost of legal proceedings. The proceeding was resumed in March 2007. Hangxiao Ganggou has amended the claim for construction fees to RMB1,170,000.
3	Litigation against Jiangxi Kelon and Kaifeng Kelon Air-Conditioner Co., Ltd. (“Kaifeng Kelon”) by Technology Development to joint venture contract	Henan Province Kaifeng Economic Technology Development	27,160,000	The plaintiff applied for a pre-trial security order from the court to attach properties worth of RMB18,000,000 of Jiangxi Kelon and Kaifeng Kelon. The plaintiff applied for a security order from the court during the proceeding and the court ordered to attach the equipments, factory and the land use right of Kaifeng Kelon worth or RMB9,160,000.

Report of the Directors

Other litigation

No.	Name of case	Counterparty	Target claim amount	Background information of the case
4	Litigation initiated by CAN/MC Appliance Corporation against the Company and Kelon International Incorporation	Can International. inc./MC Appliance Corporation	USD 13,750,719.19	The plaintiff alleged that it entered into a contract with the defendant on 29 December 2003 to purchase 108,108 units of MCBR1000W refrigerators, but the defendant failed to perform its obligations as set out in the contract on a timely basis and that the goods delivered were defective.
5	Litigation initiated by Jinlin Commercial Bank Jiangbei Branch against Jilin Kelon Electric Co., Ltd (“Jilin Kelon”) and the Company	Jinlin Commercial Bank Jiangbei Branch	18,057,900	The plaintiff claimed for loan principal and related interest.
6	Litigation initiated by the company against Hangxiao Ganggou	Hangxiao Ganggou	11,547,000	The Company alleged that Hangxiao Ganggou failed to complete the construction works according to the term of the contract and has to pay default compensation.

2. General status of the litigations

As at 26 April 2007, the Company and its subsidiaries were involved in 65 litigations with a total claim amount of RMB1,080,595,200 and the use rights of a land of 629,003.22 square metres.

Among the aforementioned litigations involving the Company and its subsidiaries, the Company and its subsidiaries acted as plaintiffs in 28 litigations with a total claim amount of RMB819,090,800 and as defendants in 37 litigations involving an amount of RMB261,504,400 and the use rights of a land of 629,003.22 square metres.

Among the litigations involving the Company and its subsidiaries, save for the 25 material litigations and arbitrations as disclosed above involving an amount exceeding RMB10,000,000 each (with a total amount of RMB1,044,168,100), the remaining 40 litigations with target claim amount less than RMB10,000,000 each (with a total amount of RMB36,427,100 and the use rights of a land of 629,003.22 square metres).

Report of the Directors

II. PARTICULARS ON THE DISPOSAL OF ASSETS, TAKEOVER AND MERGER DURING THE REPORTING PERIOD

1. Acquisition of assets, takeovers and mergers by the Company during the Reporting Period

No acquisition of assets, takeovers and mergers were made by the Company during the Reporting Period.

2. Disposal of assets

Unit: RMB ten thousand

Transaction counterpart	Disposed assets	Date of disposal	Price of disposal	Net profit attributable to the disposed asset from the beginning of the year to the date of disposal	Gain on disposal	Connected transaction or not	Basis of pricing	Completion of transfer of relevant assets title	Completion of transfer of relevant indebtedness
佛山市汽車運輸有限公司	Travell Equipment	October 2006	209.56	–	30.99	No	Tender	Yes	Yes
佛山市名勝投資有限公司	Land	November 2006	12,720.73	–	3,636.04	No	Tender	No	Yes
Personel	House and construction	October 2006	995.14	–	271.79	No	Tender	No	Yes
Personel	House and construction	November 2006	1,386.13	–	572.03	No	Tender	No	Yes
Personel	House and construction	December 2006	2,422.89	–	627.15	No	Tender	Yes	Yes
Personel	Delivery Equipment	December 2006	71.90	–	7.24	No	Tender	Yes	Yes
China Resources Group (華潤集團)	Land	June 2006	714.67	–	66.49	No	Auction	Yes	Yes

Note: Disposal mainly consisted of idle assets and posed no impact on the continuity of operation and stability of the management of the Company.

Report of the Directors

III. PARTICULARS OF THE COMPANY'S MATERIAL RELATED PARTIES' TRANSACTIONS DURING THE REPORTING PERIOD

1. Related parties' transactions related to ordinary operation

During the Reporting Period, the Company and Hisense Group Company Limited ("Hisense Group") and its relevant subsidiaries and Huayi Compressor Holdings Company Limited ("Huayi Compressor") and its subsidiaries, entered into certain ordinary related parties' transactions, details of which are as follows:

Unit: RMB ten thousand

No.	Related parties	Subject of the related parties' transaction	Pricing policy	Transaction amount	Percentage of total amount of similar transactions
1	Huayi Compressor and its subsidiaries	Purchase of compressor	Market price	12,797.77	2.60%
2	Hisense Group and its subsidiaries	Sales of Productions	Market price	157,269.51	23.95%
3	Hisense Group and its subsidiaries	Sales of components	Market price	780.46	0.12%
4	Hisense Group and its subsidiaries	Sales of fixed assets	Market price	30.02	0.00%
5	Hisense Group and its subsidiaries	Purchase of components	Agreement price	736.70	0.15%
6	Hisense Group and its subsidiaries	Purchase of Air-conditioners	Agreement price	6,985.41	1.5%
7	Hisense Group and its subsidiaries	Sale of moulds	Market price	320.30	0.05%
8	Hisense Group and its subsidiaries	Buy back by Hisense	Original agreed price	20,972.93	4.25%

2. Related parties' transactions related to transfers of assets and equity interest During the Reporting Period, the Company, Chengdu Engine (Group) Co., Ltd. (成都發動機(集團)有限公司), Chengdu Kelon Refrigerator Co., Ltd. (成都科龍冰箱有限公司) ("Chengdu Kelon") and Chengdu Xinxing Electrical Appliance Co., Ltd. (成都新星電器股份有限公司) entered into the equity transfer memorandum of understanding on 31 October 2006. Pursuant to which, the Company proposed to acquire 30% of the shares of Chengdu Kelon which were held by Chengdu Engine (Group) Co.,Ltd. at a price of RMB81 million based on the assets and current financial condition of Chengdu Kelon.

Report of the Directors

IV. MATERIAL CONTRACTS AND THEIR PERFORMANCE

1. External guarantees

Unit: ten thousand

Particulars of external guarantees provided by the Company (not including guarantees provided for subsidiaries of the Company)

Name of guaranteed entity	Inception date (Date of agreement)	Amount of guarantee	Type of guarantee	Guarantee period	Discharged or not	Given to related parties or not
Nil						
Total amount of guarantees incurred during the Reporting Period						0
Total balance of guarantees as at the end of the Reporting Period						0
Particulars of guarantees provided for subsidiaries by the Company						
Total amount of guarantees provided for subsidiaries during the Reporting Period						316,969.93
Total balance of guarantees as at the end of the Reporting Period						133,021.74
Particulars of the total amount of guarantees provided by the Company (including guarantees provided for subsidiaries)						
Total amount of guarantees						133,021.74
Percentage of total guarantees to the absolute value of net assets of the Company						127.06%
where:						
Amount of guarantees provided for shareholders, beneficial owners and their related parties						0
Amount of loan guarantees provided, directly or indirectly, for secured parties having a gearing ratio of more than 70%						123,352.66
Amount of guarantees in excess 50% of the absolute value of net assets						80,675.31
Total amount of guarantees of above 3 items						133,021.74

Report of the Directors

V. FUNDS EMBEZZLED FOR NON-OPERATING PURPOSES AND THEIR SETTLEMENT PROGRESS

1. Amount of funds embezzled for non-operating purpose at the beginning and at the end of the Reporting Period

Outstanding Amount of funds of the listed company appropriated by the former controlling shareholder, its subsidiaries, specified third parties and other related parties for non-operating purposes (in RMB)		Total amount recovered during the reporting period (in RMB)	Settlement method	Amount recovered (in RMB)	Time of Settlement (month)
1 January 2006	31 December 2006				
718,607,200	689,219,900	29,387,300	By litigation and by way of settling with assets	12,678,300	The fund amounting to RMB12,678,300 was embezzled by Zhongshan Dongyue Electrical Company Limited at the beginning of the period. As such, raw materials were received for settling the debt during the period. Currently, Zhongshan Dongyue Electrical Company Limited has become a normal material supplier.
			Adjustment made in line with the verification of accounts	16,709,000 (note)	December 2006

Note: During the Reporting Period, the Company recovered part of the embezzled funds of RMB12,678,300 through litigations and by way of settling debts with assets. The Company also adjusted the amount embezzled for non-operating purpose according to the updated information available to the Company after conducting further investigation and verification. Therefore, the total embezzled amount was reduced by RMB16,709,000 as compared with that as disclosed in the Company's annual report for the year ended 2005 (the "Annual Report 2005").

At the end of Reporting Period, the funds embezzled by the former controlling shareholder of the Company, its subsidiaries, specified third parties and other related parties for non-operating purposes amounted to RMB689,219,900 in aggregate, of which, a total amount of RMB650,694,100 was appropriated by the former controlling shareholder (Guangdong Greencool) and its associated companies (Greencool Companies), specified third parties for non-operating purposes, while the remaining balance of RMB38,525,800 was embezzled by other related parties.

2. Illustration on the embezzlement of funds of the listed company by the former controlling shareholder for non-operating purposes and the status of settlement

For details of the embezzlement of funds, please refer to "specific explanation on the embezzlement of funds by the controlling shareholder of the Company and other related parties by Shenzhen Dahua Tiancheng Certified Public Accountants".

3. No additional embezzlement occurred during the Reporting Period.

Report of the Directors

4. Illustration from the Board on the failure to resolve the matter of embezzlement completely by the Company at the end of the Reporting Period:

The Company has stepped up its effort to recover the embezzled funds pursuant to the requirements of the “Notice on Expediting the Loan Recovering Process” (Zheng Jian Gong Si Zi [2006] No. 92). At the end of 2006, the Company has recovered RMB12,678,300 from specified third parties and was in the process of reclaiming RMB38,685,800 by way of settling debts with assets, under which relevant actions has been taken to guarantee the collection of the amount. The Company has initiated 21 proceedings against the embezzlers, namely Gu Chu Jun and Guangdong Greencool, as the former controlling shareholder, specified third parties and other related parties, and applied to the courts to seal up or preserve the embezzler’s assets to the maximum extent. Gu Chu Jun is under prosecution and prosecution by the judiciary for his criminal and civil liabilities . The relevant details and the subsequent actions are set out as follows:

The composition of the Board has been changed in June 2006. After the inauguration of the new Board, the Company has set up a special taskforce responsible for recovering the embezzled funds. The taskforce consists of the chairman of the Company (acting as the leader of the taskforce), the vice president who is responsible for the matters relating to securities law (acting as the deputy chief), and key officers in charge of the financial department, the legal department and the securities department of the Company. The Company has engaged two external law firms, namely, King & Wood and Guangdong Guangxin Law Office, responsible to initiate any possible proceedings for the embezzlement of the Company’s funds for the purpose of collecting the embezzled funds to the largest extant:

(1) Recovering arrangement on the funds embezzled by Greencool companies and the specified third parties and its development:

- (i) To initiate every possible proceedings to secure every possible assets of Greencool companies for integrated arrangement and distribution so as to recover the embezzled fund to the maximum extent. (For details of the litigations, please see the section headed “Material litigations and arbitrations of the Company” of this report)

Greencool companies and specified third parties have embezzled RMB651 million of funds from the Company. As the management of Greencool companies have been dissolved and all assets of such companies have been attached or preserved by the relevant authorities, the Company could only recover the funds embezzled by the Greencool companies by way of litigation. In respect of funds which have evidently been transferred to the Greencool Companies or transferred through third parties, the Company has collected relevant evidence and engaged solicitors for further investigation. The Company has taken legal actions where sufficient legal evidence against the Greencool Companies or third parties was present. Meanwhile, in order to safeguard creditor’s rights in the Company and its subsidiaries, Gu Chu Jun was sued as one of the defendants in every litigation, as well as the Greencool Companies which was associated with the business of the Company.

Up to present, the Company has initiated 21 proceedings with the total claim amount of RMB792 million. The above litigations has been accepted by the relevant courts and are now pending for the judicial judgement on Gu Chu Jun and the Greencool companies.

- (ii) To seal up, freeze and preserve all valuable personal assets of the Greencool companies and Gu Chu Jun to the maximum extent. 12 assets were sealed up and frozen, and the funds in their 13 accounts have been preserved as well. (Details of which are disclosed in the 2006 third quarterly report of the Company)
- (iii) Apart from the on-going litigation mentioned above, the Company’s fund of RMB12,678,300 embezzled by 廣東中山東悅電器有限公司 (one of the specified third parties) at the end of 2005, was recovered in July 2006.

(2) Recovering Arrangement on the funds embezzled by other parties and its development

The embezzled funds by other parties amounted to RMB38,525,800, of which RMB34,000,000 was embezzled by a related party, Chengdu Xinxing Electrical Appliance Holdings Company Limited (“Chengdu Xinxing”). The Company has entered into agreements with Chengdu Xinxing and its substantial shareholders, pursuant to which their relevant assets have been pledged to the Company. The relevant approval has been obtained at the Company’s general meeting and the funds will be recovered after completion of the relevant procedures. With respect to the embezzlement of the funds of the Company’s subsidiary Shunde Huaao Electrics Company Limited (“Huaao”) amounting to RMB4,525,800 embezzled by Shunde Yunlong Consultancy Service Company Limited (“Yunlong”), the Company has obtained certain valuable assets from Yunlong. The funds can be recovered after disposal of such assets.

Report of the Directors

(3) Difficulties in settlement process

Firstly, the duration of settlement is unpredictable:

The overall solution scheme for the Greencool Companies is subject to the final decisions of the State Council and the Supreme Court. The embezzled funds will be recovered only after the judicial verdict is made on Greencool Companies' properties for distribution to creditors. However, the time of settlement is unpredictable since litigation and proceedings are subject to several factors.

Secondly, the results of certain litigations remained uncertain:

Litigation was initiated by the Company against the Greencool Companies for their suspected embezzlement of the Company' funds in late 2006. However, the Company fails to collect relevant evidence as no complete accounting records were found for inspection as a result of the dissolution of the management of Greencool Companies and majority of the evidential materials has been taken by the relevant police department for investigation. No criminal trial files are available for inspection before the judicial judgments. Therefore, there are uncertainties in the litigation results.

Thirdly, certain settlement measures may fail to be implemented due to insufficient evidence:

As at 31 December 2005, the Company is payable to Greencool Companies and its associated company in the sum of RMB13,020,000 and is payable to specified third parties in the sum of RMB118,160,000. Since the accounting subjects of the above payables are different from the accounting subjects of the embezzled funds, therefore despite ostensibly the sums can be offset, such sums cannot be offset in accounting treatment temporarily at present. Therefore, such method cannot be used as a method of settlement.

The Company fully understands that the settlement of embezzled funds constitutes an irrevocable obligation of management of Company. The Company will put its greatest effort to recover the funds and reinforce communication with relevant judiciary authorities, gathering more evidence and secure the possible success in litigation to the most extent.

VI. PARTICULARS OF INVESTIGATIONS BY THE CHINA SECURITIES REGULATORY COMMISSION (“CSRC”), ADMINISTRATIVE PUNISHMENT, NOTICE OF CRITICISM, OR PUBLIC CENSURE BY ANY STOCK EXCHANGE ON THE COMPANY, THE BOARD AND ITS DIRECTORS DURING THE REPORTING PERIOD:

- 1 The Company received an investigation notice from the CSRC on 31 May 2006. Since the Company failed to publish its 2005 Annual Report on time, the CSRC commenced an investigation against the Company;
- 2 Since the annual reports for the years 2002, 2003 and 2004 issued by the Company committed such illegal acts as false statement and material omission, the Company received a notice of decision on administrative sanction against the Company from the CSRC (Zheng Jian Fa Zi [2006] No.16) on 4 July 2006;
- 3 Since the Company failed to publish its 2005 Annual Report and its 2006 First Quarterly Report within the statutory periods, and was in breach of the Rules Governing Listing of Stocks on Shenzhen Stock Exchange (as revised on May 2006), the Shenzhen Stock Exchange therefore publicly denounced the Company, the Board, the supervisory committee and the senior management of the Company on 29 May 2006;
- 4 The Company received a notice of decision on administrative sanction against the Company from the CSRC on 18 December 2006. Due to failure to publish its 2005 annual report on time, the Company was in breach of Article 66 of the Securities Law, which constitutes the misconduct as described in Article 193 of the Securities Law of “Failing to Disclose Information in accordance with Requirements”. According to the provision of Article 193 of the Securities Law of the PRC, the CSRC decided to give disciplinary warning to the Company.