

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

I. GENERAL

Guangdong Kelon Electrical Holdings Company Limited (hereinafter referred to as the “Company”) is a joint stock limited company incorporated in the PRC on 16 December 1992. The Company’s 459,589,808 overseas listed public shares (the “H Shares”) were listed on The Stock Exchange of Hong Kong Limited on 23 July 1996. In 1998, the Company obtained approval to issue 110,000,000 domestic shares (the “A Shares”), which were listed on the Shenzhen Stock Exchange on 13 July 1999.

In October 2001 and March 2002, the former single largest shareholder of the Company, Guangdong Kelon (Rongsheng) Group Company Limited (hereinafter referred to as “Rongsheng Group”, previously held 34.06% interest in the Company) entered into a share transfer agreement and a supplementary agreement with Shunde Greencool Enterprise Development Company Limited (it was renamed as “Guangdong Greencool Enterprises Development Company Limited in 2004, hereinafter referred to as “Guangdong Greencool”), in connection with the transfer of 20.64% of the total share capital of the Company to Guangdong Greencool. In April 2002, Rongsheng Group transferred its shareholding of 6.92%, 0.71% and 5.79% of the total share capital of the Company to Shunde Economic Consultancy Company, Shunde Dong Heng Development Company Limited and Shunde Xin Hong Enterprise Company Limited, respectively. After the above-mentioned share transfers, Rongsheng Group, the former single largest shareholder of the Company, no longer held any shares of the Company.

On 14 October 2004, Guangdong Greencool, as transferee, had been transferred 5.79% of the total share capital of the Company held by Shunde Xin Hong Enterprise Company. Upon completion of the share transfer, the percentage of total share capital of the Company held by Guangdong Greencool increased to 26.43%.

On 13 December 2006, pursuant to an equity transfer agreement, 26.43% of the total share capital of the Company held by Guangdong Greencool Enterprises Development Company Limited were transferred to Qingdao Hisense Air-Conditioner Company Limited. Upon completion of the transfer, Guangdong Greencool, the former single largest shareholder of the Company, no longer held any share of the Company.

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

II. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS

1. Accounting regulations and standards:

The accounting policies adopted by the Company are in accordance with “Accounting Standards for Business Enterprises” and “Accounting System for Business Enterprises” and the supplementary regulations.

2. Accounting year:

The Company adopts the Gregorian calendar year as its accounting year, i.e. from 1 January to 31 December of each year.

3. Basis of accounting and principle of measurement:

The Company maintains its accounting records on accrual basis. Assets are recorded at historical cost. However, certain fixed assets were restated at assessed value from 1999.

4. Reporting currency:

The reporting currency of the Company is Renminbi (“RMB”).

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

II. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS *(continued)*

5. Foreign exchange translation:

Transactions in foreign currencies are translated into RMB at the applicable rates of exchange (“market exchange rate”) prevailing at the dates of transactions. Monetary assets and liabilities denominated in foreign currencies are translated into RMB at the market exchange rate prevailing at the balance sheet date. Gains and losses arising on exchange are included in financial expenses, except from those arising from the special foreign borrowings for the acquisition and construction of fixed assets which were included in the cost of assets before they are ready for use, and those arising in the pre-operating periods which were recorded as long term deferred expenditures for amortisation.

6. Basis of consolidation:

(1) Consolidation scope

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries made up to the period ended 31 December each year. A subsidiary is an enterprise in which the Company, directly or indirectly, holds more than half of the equity, or where the Company controls the operation of the investee enterprise via other methods.

However, for those subsidiaries whose total assets, operating revenue and net profit are of an amount not material in accordance with the regulatory document “Answer to the Question about Consolidation Scope” (CKZ (96) No. 2) issued by the Ministry of Finance, their results are not included in consolidation. The Company accounts for the unconsolidated subsidiaries by using equity methods.

(2) Consolidation method

The principal accounting policies adopted by the subsidiaries are not completely consistent with the Company’s policy. In preparing the consolidated financial statements, the Company made necessary adjustments to the financial statements of these subsidiaries according to the accounting policies.

The operating results of subsidiaries during the year are included in the consolidated income statement and the consolidated cash flow statement from the effective date of acquisition as appropriate.

All significant intercompany transactions and balances are eliminated on consolidation.

7. Method for translation of foreign currency financial statements:

The foreign currency financial statements of the Group’s overseas subsidiaries are translated into RMB for consolidation by adopting the following methods:

Assets and liabilities are translated into RMB at the market exchange rate prevailing at the balance sheet date. Shareholders’ equity, except for retained earnings, are translated into RMB at the market rates at transaction dates. All items in the statements of income and profit appropriation are translated at the applicable average exchange rates for the accounting period of the consolidated financial statements. Retained earnings at the beginning of the year represent the translated closing balance brought forward from the previous year; retained earnings at year end are arrived at after the translation of all other items in the income statement. The difference between translated assets and translated liabilities plus equity is shown separately in the balance sheet as exchange differences arising from the translation of the foreign currency in the financial statements under the item “Unappropriated profit”.

The translation of cash flow has been made at the average foreign exchange rate. The effect of foreign exchange rate changes on cash will be treated as adjustments and is shown separately as “Effect of foreign exchange rate changes on cash” in the cash flow statement.

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

II. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS *(continued)*

8. Cash equivalents:

Cash equivalents are short-term (usually less than three months), highly liquid investments that are readily convertible to known amounts of cash and which are held by enterprises and subject to insignificant risk on changes in value.

9. Provision for bad debts:

(1) *Criteria for recognition of bad debts*

- a. The irrecoverable amount for a debtor who becomes bankrupt after pursuing the statutory recovery procedures;
- b. The irrecoverable amount for a debtor who dies and has no offsetting estate and obligatory undertakers;
- c. The amount for a debtor who does not comply with repayment obligation after the debt becomes due, with sufficient evidence showing that such amount is irrecoverable or unlikely to be recovered.

(2) *Accounting for provision for bad debts*

Provisions for general bad debts and special bad debts are accounted for using the allowance method and provided based on with the recoverability of accounts receivable as at year end.

Provision for general bad debts against the account receivables for domestic customers is accounted for with reference to the aging analysis and the provision percentage is as follows:

Age	Provision percentage
Within 3 months	—
Over 3 months and within 6 months	10%
Over 6 months and within one year	50%
Over one year	100%

Bad debt provision is made against trade receivable from overseas customers by individually analysing large-amount receivables and then bad debts are calculated by using the aging analysis of accounts.

The provision for bad debts of other debtors is provided for individually based on the nature of current accounts and the past experiences of the Company, the actual financial position and cash flows condition of the debtor, and other information.

10. Inventories:

Inventories are stated at actual cost of acquisition. Inventories include raw materials, work-in-progress and finished goods.

Standard cost is applied for the record of raw materials movement. At the end of each period, amortisation for cost variances is made to the standard cost to arrive at the actual cost.

Actual cost is applied for the record of movement of work-in-progress and finished goods, and is recognised on a weighted average basis.

Inventories are kept on a periodic inventory system. Inventories at year-end are measured at the lower of cost and net realisable value. Provision for impairment loss of inventories is made when the cost of inventories is higher than the net realisable value because of damage, partially or totally obsolete or the sale price falling below the cost, etc. Provision for impairment loss of inventories is made on an individual basis for the difference between the cost and the net realisable value.

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For the year ended 2006 (Unless otherwise specified, expressed in RMB)

II. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS *(continued)*

11. Long-term investments:

(1) *Accounting for long-term equity investments:*

Long-term equity investments are stated at acquisition cost.

The cost method is used to account for long-term equity investments when the Company does not have control, joint control or significant influence over the investee enterprise. The equity method is used to account for long-term equity investments when the Company has control, joint control or has significant influence over the investee enterprise;

When the cost method is adopted, the amount of investment income recognised by the investing enterprise is limited to the amount distributed out of accumulated net profits after the investment made by the investing enterprise. The amount of profits or cash dividends declared by the investee enterprise in excess of the above threshold are regarded as return on investment and deducted from the carrying amount of investments accordingly.

When the equity method is adopted, the investment gain or loss is a portion of the investee's net income for the year by reference to the investor's interest in investee enterprise. Generally speaking, the Company recognises net losses incurred by an investee enterprise to the extent which the carrying amount of the investment is reduced to zero, except where the Company has committed financial support to the investee enterprise. If the investee enterprise realises net profit in subsequent periods, the carrying amount of the investment will be increased by the excess of the attributable share of profit over the share of unrecognised losses.

When a long-term equity investment is accounted for using the equity method, the difference between the initial investment cost of the Company and the Company's share of equity of the investee enterprise is shown as "long-term equity investment difference". The excess of the initial investments cost over the share of equity of the investee enterprise should be debited to the "long-term equity investment - equity investment difference" and amortised evenly over a specified investment period. Where the investment period is specified in the contract, it should be amortised over that investment period. If the investment period is not specified in the contract, the excess of the investment cost over the share of equity of the investee enterprise should generally be amortised over a period not more than 10 years. The shortfall of the initial investment cost over the share of equity of the investee enterprise, which has occurred prior to the issuance of document Caikuai [2003] No. 10, should be credited to the "long-term equity investment - equity investment difference" and amortised evenly over a specified period. Where the investment period is specified in the contract, it should be amortised over the investment period. If the investment period is not specified in the contract, the shortfall of the investment cost over the share of equity of the investee enterprise should generally be amortised over a period not less than 10 years. The shortfall of the initial investments cost over the share of equity of the investee enterprise, which occurred after the issue of document Caikuai [2003] No. 10, should be credited to "capital reserve - provision for equity investment".

(2) *Provision for impairment of long-term investment*

At the end of each year, the Company assesses if there is any indication that a long-term investment is suffered from an impairment case by case. Where the recoverable amount of long-term investment is lower than its book value, provision for impairment of long-term investment is recognised for the difference.

For Long-term equity investment accounted for by using the equity method, where difference between equity investment credit has been recognised previously and accounted for as capital reserve, impairment loss will first be used to offset capital reserve and shortcoming will be accounted for as current period profit and loss. Where difference between equity investment credit has been recognised during investment and amortised as an investment deduction, the impairment loss will first be used to offset the equity investment credit and the shortcoming will be accounted for as current profits and losses. Where difference between equity investment debit has been recognised during investment and amortised by stages, impairment loss will be fully accounted for the current profits and losses and at the same time eliminated the difference of equity investment. The shortcoming will be credited to the impairment provision of long-term investment.

12. Calculation of recoverable amount:

Recoverable amount represents the higher of the net selling price of the asset and the estimated discounted future cash flow generated from the continuing use of the asset and from the disposal of such asset at the end of its useful life.

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

II. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS *(continued)*

13. Fixed assets and depreciation:

Fixed assets are tangible assets held by the Company for production, provision of services, lease or operation, with useful life exceeding one year and with a relatively higher unit cost.

Fixed assets are recorded at actual cost on acquisition. Depreciation is provided to write off the cost of each category of fixed assets over their estimated useful lives using straight-line method from the month after they are put into use. The estimated residual values, estimated useful lives and annual depreciation rates of each category of fixed assets are as follows:

Category	Estimated rate of residual value	Estimated Useful life	Annual depreciation rate
Buildings and structures	0-5%	20-50	2-4.75%
Machinery and equipment	5%	10	9.50%
Furniture, fixtures and office equipment	5%	5	19%
Motor vehicles	5%	5	19%
Moulds	0%	3	33.33%

Provision for impairment of fixed assets:

At the end of each year, the Company assesses if there is any indication that fixed assets are suffered from an impairment loss case by case and determines whether provision for impairment of fixed assets should be made accordingly. When the recoverable amount of any fixed assets is lower than its carrying amount, an impairment loss on fixed assets will be recognised for the difference.

14. Construction in progress:

Construction in progress is stated at actual cost incurred for the construction. Cost comprises construction expenditure incurred during the construction period, capitalised borrowing costs incurred on a specific borrowing for the construction of fixed assets before it has reached the working condition for its intended use and other relevant expenses. The construction in progress is transferred to fixed assets when it has reached the working condition for its intended use. No depreciation is provided for construction in progress.

Provision for impairment on construction in progress is made when the following situation exist (1) construction project is suspended for a long period and is not expected to be resumed within three years; (2) construction project is technically and physically obsolete and its economic benefits to the Company is uncertain, (3) other evidences can prove the existence of the decline in value of construction project. An impairment loss is recognised individually for the shortfall of the recoverable amount of construction in progress below its carrying amount.

15. Intangible assets:

Intangible assets are stated at actual cost. The actual cost of the intangible assets injected by the investors is determined by the value having been recognised by each party. The actual cost of acquired intangible assets is determined on the basis of the actual consideration paid. Intangible asset obtained with receivables is recognised at the book value of the receivables plus the cash compensation payable and the related tax expenses which are payable.

Intangible assets shall be amortised evenly by installments within the estimated tenure of use from the month of acquisition and shall be stated in the profit and loss. Where the estimated tenure of use exceeds the benefited tenure provided in the relevant contract or the valid tenure required by law, the term of amortisation shall not be longer than the benefited tenure or the valid tenure whichever is the shorter. Where there is no benefited tenure in the contract nor valid tenure required by law, the tenure of amortisation shall be 10 years.

Provision for impairment of intangible assets:

At the end of each year, the Company assesses if there is any indication that intangible assets are suffered from an impairment loss case by case. Where the recoverable amount of any intangible asset is lower than its carrying amount, an impairment loss on intangible assets is recognised for the difference.

Notes to the Financial Statements

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II. SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS *(continued)*

16. Long-term deferred expenditures:

Unless related to the acquisition or construction of fixed assets, all expenditure incurred during the pre-operating period is recognised as an expense in the month in which the enterprise commences operation.

Long-term deferred expenditures are recorded at cost when incurred, and amortised evenly over the expected benefited period.

17. Provision:

Provision is recognised when obligations related to contingent items satisfy the following conditions: (1) such obligation is a present obligation of the enterprise, (2) it is probable that an outflow of economic benefits will be required to settle the obligation, and (3) a reliable estimate can be made of the amount of the obligation.

To the extent the amount payable for any provision will be compensated partly or wholly by a third party, such compensation will be recognised only when it is reasonably certain that the amount will be received.

18. Borrowing costs:

Borrowing costs represent costs incurred in connection with the borrowing of funds, including interest charges, amortisation of discount and premium, auxiliary costs, and exchange differences. Borrowing costs are capitalised if they are directly attributable to the acquisition, construction or production of a qualifying asset. Capitalisation of borrowing costs commences when the activities to prepare the asset are in progress and expenditures and borrowing costs are being incurred. Borrowing costs are capitalised until the assets are ready for their intended use. Other borrowing costs are recorded as financial expenses when incurred.

19. Basis of revenue recognition:

Sales revenue: Sales revenue is recognised when the Company and the subsidiaries have transferred the significant risk and rewards of ownership to the buyer; and the Company neither retains the continuous managing rights usually related to the ownership nor control over the goods sold; the economic benefits associated with the transactions will flow into the Company; and relevant revenue and cost can be reliably measured.

Service income: Service income is recognised when the amount of revenue can be measured reliably; the stage of completion can be measured reliably; the economic benefits associated with the transaction will flow to the enterprise and the costs incurred in respect of the transaction can be measured reliably.

Interest income: Interest income is recognised on a time proportion basis at the applicable interest rates.

20. Leases:

Finance lease is the lease having actually transferred all the risks and rewards related to the ownership of assets. The leases other than the finance lease are operating leases.

Rental payment for operating leases is recognised as an expense at the straight line method over the lease term.

Rental income from operating leases is recognised as income at the straight line method over the relevant term.

21. Income tax:

Income tax is provided under tax payable method.

Income tax provision is calculated based on the accounting results for the year after adjustments in accordance with relevant tax laws.

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

III. RECTIFICATION OF SIGNIFICANT ACCOUNTING ERRORS

In 2006, the Company repossessed its wholly-owned subsidiary, Jiangxi Kelon Industrial Development Co., Ltd. (hereinafter referred to as the "Jiangxi Kelon"), and cleaned up its assets and accounts and made corresponding impairments for inventory, fixed assets as well as construction in progress. In 2006, the Company cleaned up once again its internal current accounts and made corresponding adjustments and amendments. As a result, in preparing the accounting statements comparable between last year and the current year, the Company rectified the said significant accounting errors. As a result of the effect from the said accounting errors, the Company's opening balance of retained earnings for the year was inflated by an amount of RMB18,224,516.47.

- The following sets forth the Company's financial accounting statements prior to and after the rectification of the said accounting errors by the Company in 2005 (combined figures):

Accounting items	Original amount	Adjusted amount	Restated amount
Asset items			
Trade receivables	466,115,187.00	(6,763,900.00)	459,351,287.00
Other receivables	594,610,973.79	(19,944,648.70)	574,666,325.09
Inventories	1,248,765,899.51	(15,785,669.85)	1,232,980,229.66
Provision for impairment of fixed assets	210,442,218.73	3,310,724.46	213,752,943.19
Construction in progress	318,885,601.93	(4,825,635.98)	314,059,965.95
Liability items			
Advance from customers	301,318,221.63	(23,034,405.04)	278,283,816.59
Other payables	734,951,850.68	(9,371,657.48)	725,580,193.20
Profit and loss items			
Administration expense	1,505,353,830.38	15,785,669.85	1,521,139,500.23
Non operation expense	690,429,104.84	8,136,360.44	698,565,465.28
Unappropriated profits at the beginning of the year	(88,877,490.00)	5,697,513.82	(83,179,976.18)

- The above adjustments have the following effects on the financial position and operation results of the Company in 2005:

Accounting items	Original amount	Adjusted amount	Restated amount
Total assets	5,420,343,170.97	(50,630,578.99)	5,369,712,591.98
Net assets	(1,089,851,539.58)	(18,224,516.47)	(1,108,076,056.05)
Net profit	(3,693,615,437.69)	(23,922,030.29)	(3,717,537,467.98)

- Details of year 2005 accounting error adjustment for the Jiangxi Kelon : (subsidiary figures)

Accounting items	Original amount	Adjusted amount	Restated amount
Asset items			
Provision for Inventory	33,494,495.92	15,785,669.85	49,280,165.77
Provision of fixed asset	15,472,092.82	3,310,724.46	18,782,817.28
Provision of construction in progress	33,335,052.85	4,825,635.98	38,160,688.83
Profit and loss items			
Administration expense	155,536,658.72	15,785,669.85	171,322,328.57
Non operation expense	60,456,058.64	8,136,360.44	68,592,419.08

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

III. RECTIFICATION OF SIGNIFICANT ACCOUNTING ERRORS *(continued)*

The above adjustments have the following effects on the financial position and operation results of the Jiangxi Kelon in 2005:

Accounting items	Original amount	Adjusted amount	Restated amount
Total assets	585,856,599.28	(23,922,030.29)	561,934,568.99
Net assets	120,088,402.62	(23,922,030.29)	96,166,372.33
Net profit	(199,654,286.27)	(23,922,030.29)	(223,576,316.56)

IV. TAXATION

1. Value-added Tax

Output tax was calculated based on the 17% of sales revenue for products and industrial services sold in the domestic market, and was charged according to the balance after the deduction of input tax. Products sold to foreign countries are subject to the value-added tax ("VAT") rate of 0%, with 13% of the VAT included in purchased raw materials refunded.

2. Enterprise Income Tax

The Company was established in Foshan, Guangdong Province and located in Shunde High New Technology Development Zone. The Company was classified as a high new technology enterprise by Department of Science and Technology of Guangdong Province in June 2003. As recognised by the managing tax authority – National Tax Bureau of Shunde, the Company is subject to enterprise income tax ("EIT") at a rate of 15%. Together with the local EIT rate of 3%, the aggregate effective EIT rate is 18% in 2006.

The Company's sino-foreign joint venture subsidiaries established in coastal open economic zones in Foshan, Yingkou, Hangzhou are subject to an effective EIT rate of 27%.

The Company's sino-foreign joint venture subsidiaries established in special economic zones in Shenzhen and Zhuhai are subject to an effective EIT rate of 15%.

The Company's subsidiaries classified as high new technology enterprises are subject to an effective EIT rate of 15%.

The Company's sino-foreign joint venture subsidiaries established in the economy and technology development zones in cities such as Yangzhou, Nanchang, Wuhu, Kaifeng and Xi'an are subject to an effective EIT rate of 15-18%.

The effective EIT rate applicable for the sino-foreign subsidiaries established in Nanchang and Chengdu is 33% and 24%, respectively.

The Company's other subsidiaries established in Mainland China are subject to an EIT rate of 33%.

Profits tax for the Company's subsidiaries in Hong Kong has been provided at a rate of 17.5% on estimated assessable profit which was earned in or derived from Hong Kong.

Notes to the Financial Statements

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IV. TAXATION (continued)

3. Other tax

Sales tax is levied at a rate of 5% on the assessable income.

Urban construction tax is levied at a rate of 1%-7% on the assessable circular tax.

Land appreciation tax ("LAT") is levied at a rate of 1% of assigned land income on the assignment of land use rights in accordance with relevant provisions set out in the document named "Reply Letter on Adjusting taxation rate of LAT of Land Use Rights" (Fo-fu-ban No.[2003]46) issued by the office of People's Government of Foshan.

Urban real estate tax is levied at a rate of 18% on rental income if the property is held for lease, or at a rate of 70% of the original value of the property multiplying 1.2%. Property owners are given three years' tax exemption commencing on the purchase date or completion date.

Bank protection fee is levied at a rate of 0.12% of the turnover for the applicable period, according to the relevant provisions set out in the Notice on Bank Protection Fee issued by Shunde Water Bureau and Shunde Municipal Tax Bureau.

V. PARTICULARS OF SUBSIDIARIES AND ASSOCIATES AND SCOPE OF CONSOLIDATED FINANCIAL STATEMENTS

1. As at 31 December 2006, particulars of the subsidiaries of the Company are as follows:

Name of entity	Place of incorporation	Registered capital	Percentage of equity interest attributable to the Company			Principal activities	Nature of business	Consolidated in the period
			Directly	Indirectly	Total			
Pearl River Electric Refrigerator Company Limited ("Pearl River Refrigerator")	Hong Kong	HK\$400,000	-	100%	100%	Trading in raw materials and parts for refrigerators	Limited liability company	Yes
Kelon Electric Appliances Co., Ltd. ("Kelon Electric Appliances")	Hong Kong	HK\$10,000	-	100%	100%	Property investment	Limited liability company	Yes
Shunde Rongsheng Plastic Products Co., Ltd. ("Rongsheng Plastic Products")	Foshan	US\$15,800,000	45%	25%	70%	Manufacture of plastic parts	Sino-foreign joint venture enterprise	Yes
Kelon Development Company Limited ("Kelon Development")	Hong Kong	HK\$5,000,000	100%	-	100%	Investment holdings	Limited liability company	Yes
Guangdong Kelon Mould Co., Ltd. ("Kelon Mould")	Foshan	US\$15,000,000	40%	30%	70%	Manufacture of moulds	Sino-foreign joint venture enterprise	Yes
Guangdong Kelon Refrigerator Ltd. ("Kelon Refrigerator")	Foshan	US\$26,800,000	70%	30%	100%	Manufacture and sale of refrigerators	Sino-foreign joint venture enterprise	Yes
Guangdong Kelon Air-Conditioner Co., Ltd. ("Kelon Air-Conditioner")	Foshan	US\$36,150,000	60%	-	60%	Manufacture and sales of air-conditioners	Sino-foreign joint venture enterprise	Yes
Chengdu Kelon Refrigerator Co., Ltd. ("Chengdu Kelon")	Chengdu	RMB200,000,000	45%	25%	70%	Manufacture and sale of refrigerators	Sino-foreign joint venture enterprise	Yes

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V. PARTICULARS OF SUBSIDIARIES AND ASSOCIATES AND SCOPE OF CONSOLIDATED FINANCIAL STATEMENTS (continued)

Name of entity	Place of incorporation	Registered capital	Percentage of equity interest attributable to the Company			Principal activities	Nature of business	Consolidated in the period
			Directly	Indirectly	Total			
Yingkou Kelon Refrigerator Co., Ltd. ("Yingkou Kelon")	Yingkou	RMB200,000,000	42%	36.79%	78.79%	Manufacture and sale of refrigerators	Sino-foreign joint venture enterprise	Yes
Wetherell Development Limited ("Wetherell Development")	British Virgin Islands	US\$1	–	100%	100%	Advertising agency	Foreign company	Yes
Kelon International Incorporation ("Kelon International")	British Virgin Islands	US\$50,000	–	100%	100%	Investment holding and sales of household electrical appliance	Foreign company	Yes
Guangdong Kelon Fittings Co., Ltd. ("Kelon Fittings")	Foshan	US\$5,620,000	70%	30%	100%	Manufacture and sale of components for refrigerators and air-conditioners	Sino-foreign joint venture enterprise	Yes
Shunde Kelon Jiake Electronic Company Limited ("Kelon Jiake")	Foshan	RMB60,000,000	70%	30%	100%	IT and communication technology, and micro-electronics technology development	Limited liability company	Yes
Guangdong Kelon Freezer Co., Ltd. ("Kelon Freezer")	Foshan	RMB237,000,000	44%	56%	100%	Manufacture and sale of freezers	Sino-foreign joint venture enterprise	Yes
Shunde Kelon Household Electrical Appliance Company Limited ("Kelon Household Electrical Appliance")	Foshan	RMB10,000,000	25%	75%	100%	Manufacture and sales of electrical household appliances	Limited liability company	Yes
Shunde Wangao Import & Export Co., Ltd. ("Wangao Company")	Foshan	RMB3,000,000	20%	80%	100%	Import and export business	Limited liability company	Yes
Shunde Qifei Service Co., Ltd. ("Qifei Service")	Foshan	RMB1,000,000	–	100%	100%	Corporate management consultancy, catering services, household decoration designs	Limited liability company	Yes
Jiangxi Kelon Industrial Development Co., Ltd. ("Jiangxi Kelon")	Nanchang	US\$29,800,000	60%	40%	100%	Manufacture and sale of household and commercial air-conditioners, refrigerators, freezers and small electrical appliances	Sino-foreign joint venture enterprise	Yes
Shunde Huaao Electronics Co., Ltd. ("Huaao Electronics")	Foshan	RMB10,000,000	–	70%	70%	Research and development, manufacture and sale of electronic products	Limited liability company	Yes
Jilin Kelon Electric Co., Ltd. ("Jilin Kelon")	Jilin	RMB200,000,000	90%	10%	100%	Development, manufacture and sale of refrigerator, airconditioner, freezer and household electrical appliances	Limited liability company	Yes
Kelon (USA) Inc. ("Kelon (USA)")	USA	US\$100	–	100%	100%	Business liaison	Foreign company	Yes

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V. PARTICULARS OF SUBSIDIARIES AND ASSOCIATES AND SCOPE OF CONSOLIDATED FINANCIAL STATEMENTS (continued)

Name of entity	Place of incorporation	Registered capital	Percentage of equity interest attributable to the Company		Total	Principal activities	Nature of business	Consolidated in the period
			Directly	Indirectly				
Hangzhou Kelon Electrical Company Limited ("Hangzhou Kelon")	Hangzhou	US\$24,100,000	40%	30%	70%	Research and development of the technology for environmental friendly refrigerators, production of high efficiency, energy saving and environmental friendly refrigerators, information consultation, warehousing, and sale of the products made by the Company	Sino-foreign joint venture enterprise	Yes
Yangzhou Kelon Electrical Company Limited ("Yangzhou Kelon")	Yangzhou	US\$29,800,000	74.33%	25.67%	100%	Production of energy environmental friendly refrigerators and other energy saving cooling appliances, and sale of products made by the Company	Sino-foreign joint venture enterprise	Yes
Zhuhai Kelon Industrial Development Co., Ltd ("Zhuhai Kelon")	Zhuhai	US\$29,980,000	75%	25%	100%	Research and development of electric refrigerator, air-conditioner, freezer, small household electrical appliances and related accessories	Sino-foreign joint venture enterprise	Yes
Shangqiu Kelon Electrical Company Limited ("Shangqiu Kelon")	Shangqiu	RMB150,000,000	–	100%	100%	Research, development, production and sale of household and commercial air-conditioners, refrigerators, freezers, small household electrical appliances and parts and accessories, and provision of relevant information and technical consultancy services	Limited liability company	Yes
Jiangxi Kelon Combine Electrical Appliances Co., Ltd. ("Jiangxi Combine")	Nanchang	RMB20,000,000	–	55%	55%	Research and development, manufacture and sale of household and commercial air-conditioners, refrigerators, freezers and small household electrical appliances	Sino-foreign joint venture enterprise	No
Xi'an Kelon Refrigeration Co., Ltd. ("Xi'an Kelon")	Xi'an	RMB202,000,000	60%	–	60%	Development, manufacture, design, production of chlorofluorocarbon-free refrigerator (freezer) cooling compressor products; sale of products and conducting after-sale services, research and manufacture, development and production of newcooling compressor products subject to the market demands	Sino-foreign joint enterprise	Yes
Kaifeng Kelon Air-Conditioner Co., Ltd. ("Kaifeng Kelon")	Kaifeng	RMB60,000,000	–	70%	70%	Production, sale, research and development of air-conditioner products	Limited liability company	Yes
Wuhu Ecan Motors Company Limited ("Wuhu Motors")	Wuhu	US\$7,210,000	40%	40%	80%	Production and sale of motor starter and permanent-magnet current brushless motor, micro alternating current machine and electrical equipment Domestic commerce, Supply and sale of supplies (excluding specific marketing, specific control and specific sale products)	Sino-foreign joint venture enterprise	Yes
Shenzhen Kelon Purchase Company Limited ("Shenzhen Kelon")	Shenzhen	RMB200,000,000	95%	5%	100%	Import and export, provision of warehouse and storage, information consultation and technology services (excluding those items limited)	Limited liability company	Yes

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

V. PARTICULARS OF SUBSIDIARIES AND ASSOCIATES AND SCOPE OF CONSOLIDATED FINANCIAL STATEMENTS (continued)

Name of entity	Place of incorporation	Registered capital	Percentage of equity interest attributable to the Company		Total	Principal activities	Nature of business	Consolidated in the period
			Directly	Indirectly				
Guangdong Kelon Weili Electrical Appliances Company Limited ("Weili Electrical Appliances")	Zhongshan	RMB200,000,000	55%	25%	80%	Production of intelligent washing machine, air-conditioner and after-sale services and technology consultation for other products, 70% products for domestic sale	Sino-foreign joint venture enterprise	Yes
Kelon (Japan) Limited ("Kelon Japan") ^{*1}	Japan	JPY1,100,000,000	–	100%	100%	Technical research and trading in electrical household appliances	Foreign company	No
Kelon Europe Industrial Design Limited ("Kelon Europe") ^{*2}	United Kingdom	–	–	100%	100%	Business liaison	Foreign company	No
Sichuan Rongsheng Kelon Refrigerator Sales Company Limited ("Sichuan Kelon Sales")	Chengdu	RMB2,000,000	76%	–	76%	Sale of refrigerator	Limited liability company	Yes
Beijing Hengsheng Xin Chuang Technology Company ("Beijing Hengsheng")	Beijing	RMB 30,000,000	80%	–	80%	Research, development of industrial and commercial intelligent system	Limited liability company	Yes
Beijing Kelon Tiandi IT Network Limited ("Beijing Tiandi")	Beijing	RMB5,000,000	–	78%	78%	Operation items are under free-option, excluding those prohibited by laws and regulations	Limited liability company	Yes
Beijing Kelon Shikong Information Technology Company Limited ("Beijing Shikong")	Beijing	RMB5,000,000	–	78%	78%	Operation items are under free-option, excluding those prohibited by laws and regulations	Limited liability company	Yes

*1 The Company's investments made in Kelon Japan and Jiangxi Combine were RMB30.6304 million and RMB11.00 million, respectively.

*2 Kelon Europe, Kelon Japan and Jiangxi Combine were not included into consolidation as their asset scales were relatively small.

2. Particulars of associates of the Company are set forth below:

Name of entity	Place of incorporation	Registered capital	Percentage of equity interest attributable to the Company		Total	Principal activities	Consolidated in the period
			Directly	Indirectly			
Huayi Compressor Holdings Company Limited ("Huayi Compressor")	PRC	RMB260,854,000	18.26%	–	18.26%	Manufacture and sale of compressors	Joint stock limited company
Chongqing Kelon Rongsheng Refrigerator Sales Co., Ltd. ("Chongqing Kelon")	PRC	RMB1,000,000	–	28%	28%	Sale and after-sale service of refrigerators	Limited liability company
Guangzhou Antaida Logistic Co., Ltd. ("Antaida")	PRC	RMB10,000,000	20%	–	20%	Logistic and storage	Limited liability company

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES)

1. Bank balances and cash

Items	At the end of the year			At the beginning of the year			
	Currencies	Exchange rate	RMB equivalent	Currencies	Exchange rate	RMB equivalent	
Cash	RMB	204,329.74	1.00	204,329.74	442,216.60	1.00	442,216.00
	HKD	30,000.00	1.00467	30,140.10	368,711.31	1.04	383,570.38
	USD	55.75	7.8087	435.33	0.75	8.07	6.05
	Others			78.45			234.88
Sub-total			234,983.62			826,027.91	
Bank deposit	RMB	105,422,046.14	1.00	105,422,046.14	143,793,089.85	1.00	143,793,089.85
	HKD	5,709,884.09	1.00467	5,736,562.67	5,115,163.35	1.04	5,321,304.43
	USD	3,911,641.23	7.8087	30,544,829.24	3,392,670.36	8.07	27,379,528.37
	JPY	-	-	-	896,194.00	0.07	61,582.87
	EUR	29,058.14	10.2665	298,326.02	720,533.43	9.58	6,902,494.10
	Others			9,758.46			
Sub-total			142,011,522.53			183,457,999.62	
Other monetary assets	RMB	248,173,813.93	1.00	248,173,813.93	99,976,166.40	1.00	99,976,166.40
	HKD	148.24	1.00467	148.93	148.24	1.04	154.22
	USD	10,641.64	7.8087	83,097.37	351,484.93	8.07	2,836,553.72
	Others			-			641.06
Sub-total			248,257,060.23			102,813,515.40	
Total			390,503,566.38			287,097,542.93	

* Other monetary assets represent pledged deposits that are used to issue bank acceptance notes, commercial acceptance notes, letter of credits and bank borrowings.

** The significant increase in cash at bank and on hand at the end of the year as compared with the beginning of the year was due to the increase of bank security deposits resulting from the increase of notes payable.

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) *(continued)*

2. Notes receivable

Type	At the end of the year	At the beginning of the year
Bank acceptance notes		
– discounted	–	3,185,560.00
– pledged	28,200,000.00	21,900,000.00
– non-pledged	49,117,440.80	99,233,385.54
Commercial acceptance notes		
– discounted	–	–
– pledged	–	–
– non-pledged	–	16,499,999.90
Total	77,317,440.80	140,818,945.44

* The reason for the significant decrease in the amount of notes receivable at the end of the year as compared with that at the beginning of the year is that, the Company has regulated its notes financing procedures by eradicating any notes without transactional backgrounds.

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

3. Trade receivables

The combined figures of trade receivables are as follows:

Age	At the end of the year			At the beginning of the year		
	Amount	Percentage of total amount	Provision for bad debt	Amount	Percentage of total amount	Provision for bad debt
Within three months	280,031,134.56	47.03%	–	362,030,762.95	47.93%	145,430.30
Three months to six months	98,655,030.57	16.57%	8,259,564.01	47,337,689.83	6.27%	4,284,700.26
Six months to one year	9,064,379.04	1.52%	4,579,696.12	112,812,961.94	14.93%	58,399,997.16
Sub total Within one year	387,750,544.17	65.12%	12,839,260.13	522,181,414.72	69.13%	62,830,127.72
One to two years	81,838,674.86	13.75%	81,838,674.86	34,755,426.24	4.60%	34,755,426.24
Two to three years	20,204,958.59	3.39%	20,204,958.59	51,617,880.60	6.83%	51,617,880.60
Over three years	105,606,603.86	17.74%	105,606,603.86	146,842,480.75	19.44%	146,842,480.75
Total	595,400,781.48	100%	220,489,497.44	755,397,202.31	100%	296,045,915.31

* The total figures of the five largest trade receivables were as follows:

	At the end of the year		At the beginning of the year	
	Amount	Percentage of the total	Amount	Percentage of the total
Total of the five largest	127,807,259.42	21.47%	277,839,652.48	35.58%

** There was RMB335,121.67 due from shareholders whose shareholding is no less than 5% at the end of the year. See Appendix 7.

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

3. Trade receivables (continued)

*** There were a series of related party transactions and abnormal cash flows between Greencool Companies and the Company during the period between October 2001 and July 2005, and moreover, during the period, the Greencool Companies also had a series of abnormal cash flows with the Company through the specified third-party companies such as Tianjin Lixin Trading Development Company Limited (hereinafter referred to as the "Specified Third Party Companies"). Set out below is the breakdown of the special bad debts provision made to the trade receivable from the Greencool Companies and the aforesaid Specified Third-Party Companies:

Name of related companies	At the end of the year	
	Amount	Provision for bad debts
Hefei Weixi Electrical Appliance Co., Ltd ("Hefei Weixi")	18,229,589.24	7,805,094.62
Wuhan Changrong Electrical Appliance Company Limited ("Wuhan Changrong")	20,460,394.04	14,921,847.02
Total	38,689,983.28	22,726,941.64

**** The provision for the bad debts of trade receivables at the end of the year decreased by 25.52% as compared with that at the beginning of the year, mainly due to the reverse of the provision of bad debts from the elimination and recovery of trade receivables.

The Company's figures of trade receivables are as follows:

Age	At the end of the year			At the beginning of the year		
	Amount	Percentage of total amount	Provision for bad debt	Amount	Percentage of total amount	Provision for bad debt
Within three months	210,038,792.42	50.34%	—	228,774,771.08	41.81%	—
Three months to six months	8,148,423.73	1.95%	814,842.37	27,774,533.00	5.08%	1,789,594.24
Six months to one year	5,789,380.94	1.39%	2,894,690.47	100,365,975.56	18.34%	50,182,987.78
Sub total Within one year	223,976,597.09	53.68%	3,709,532.84	356,915,279.64	65.23%	51,972,582.02
One to two years	79,035,852.86	18.94%	79,035,852.86	20,857,885.37	3.81%	20,857,885.37
Two to three years	10,458,514.59	2.51%	10,458,514.59	31,463,873.43	5.75%	31,463,873.43
Over three years	103,747,934.58	24.87%	103,747,934.58	137,931,748.90	25.21%	137,931,748.90
Total	417,218,899.12	100%	196,951,834.87	547,168,787.34	100%	242,226,089.72

* At the end of the year, there was no amount due from shareholders holding 5% or more (including 5%) of shares.

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

4. Other receivables

The aging analysis of other receivables is as follows:

Age	At the end of the year			At the beginning of the year		
	Amount	Percentage of total amount	Provision for bad debt	Amount	Percentage of total amount	Provision for bad debt
Within one year	66,643,136.54	7.19%	3,681,420.24	899,396,070.75	86.35%	434,909,165.10
One to two years	808,237,698.18	87.20%	435,927,721.65	17,666,674.69	1.70%	13,042,207.69
Two to three years	12,037,266.32	1.30%	11,264,633.24	68,839,542.37	6.61%	3,451,576.46
Over three years	39,993,289.46	4.31%	5,311,633.60	55,636,665.39	5.34%	15,469,678.86
Total	926,911,390.50	100%	456,185,408.74	1,041,538,953.20	100%	466,872,628.11

The total figures of the five largest other receivables were as follows:

	Figure at the end of the year		Figure at the beginning of the year	
	Amount	Percentage of the total	Amount	Percentage of the total
Total of the five largest	534,887,296.08	57.71%	534,887,296.08	51.36%

- (1) There was no amount due from shareholders holding 5% or more (including 5%) of shares at the end of the year.
- (2) Except other receivables of RMB546,534,397.88 due from Greencool companies and specified third-party companies described in note 4(3) below, other receivables of RMB168,855,132.63 due from Jiegao Investments Company Limited, Shunde District, Foshan described in note 4(4) below, and other receivables of RMB34,000,000.00 due from Chengdu Xinxing Electrical Appliance Holding Company Limited and granted real estate amounts of 25,441,470.00 for the year, balances of all other receivable at the end of the period decreased significantly as compared to last year, mainly due to strengthened internal control system and enhanced repayment management by the new management in 2006.

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

4. Other receivables (continued)

- (3) The Company has made provision for the bad debts of other receivables from the related parties and the Specified Third Party Companies as follows:

Among which, Greencool Companies and Specified Third party Companies:

Name of companies	At the end of the year	
	Amount	Provision for bad debts
Guangdong Greencool	13,754,600.00	7,962,961.47
Hainan Greencool Environmental Protection Engineering Co., Ltd. ("Hainan Greencool")	12,289,357.71	11,313,119.16
Jiangxi Kesheng Trading Company Limited ("Jiangxi Kesheng")	27,462,676.72	21,390,370.86
Jinan San Ai Fu Chemical Co., Ltd. ("San Ai Fu")	121,496,535.45	64,813,858.20
Tianjin Xiangrun Trading Development Company Limited ("Tianjin Xiangrun")	96,905,328.00	48,706,110.00
Tianjin Lixin Trading Development Company Limited ("Tianjin Lixin")	89,600,300.00	44,800,150.00
Jiangxi Keda Plastic Technology Co., Ltd ("Jiangxi Keda")	13,000,200.00	6,500,100.00
Zhuhai Longjia Refrigerating Plant Co., Ltd. ("Zhuhai Longjia")	28,600,000.00	14,300,000.00
Zhuhai Defa Air-Conditioner Fittings Company Limited ("Zhuhai Defa")	21,400,000.00	10,700,000.00
Wuhan Changrong Zhejiang Yuhuan	20,000,000.00	10,000,000.00
Beijing Deheng Solicitors ("Beijing Deheng")	4,000,000.00	3,000,000.00
Finance Bureau of Yangzhou Economic Development Zone	40,000,000.00	40,000,000.00
Shangqiu Bin Xiong Frozen Equipment Co., Ltd.	58,030,000.00	58,030,000.00
Total	546,534,997.88	341,516,669.69

Other related parties:

Name of related parties	At the end of the year	
	Amount	Provision for bad debts
Shunde Yunlong Consultancy	4,525,832.74	4,525,832.74

- (4) Among which, provision for bad debts related to Foshan Shunde Jiegao Investments Co., Ltd. is set out as follow:

Company name	At the end of the year	
	Amount	Provision for bad debts
Foshan Shunde Jiegao Investments Co., Ltd	168,855,132.63	84,427,566.32

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

4. Other receivables (continued)

Note 4 (4), In respect of receivables from Jie Gao Investment, which represents the amounts receivable due to the transfer of lands with an area of 254,600 m² in Shunde by the Company to it. Given that relevant property rights have been transferred, the Company hasn't received any amounts as of the date of this report. The Company has issued the claim, the judgment of the High Court of Guangdong Province dated in December 2006 against this case adjudged that Jia Gao Investment shall repay the Company the land transfer amount. Particulars please refer to Note X and note 4.

The Company's figures of other receivables are as follows:

Aging	At the end of the year			At the beginning of the year		
	Amount	Percentage of the total	Provision for bad debts	Amount	Percentage of the total	Provision for bad debts
Within one year	1,297,501,542.09	86.08%	3,253,506.15	2,419,467,841.57	99.16%	94,309,996.43
One to two years	196,318,174.98	13.02%	94,309,996.43	11,941,396.68	0.49%	10,942,351.69
Two to three years	11,611,669.18	0.77%	10,942,351.69	1,722,443.46	0.07%	1,722,443.46
Over three years	1,952,603.47	0.13%	1,952,603.47	6,862,772.84	0.28%	6,862,772.84
Total	1,507,383,989.72	100%	110,458,457.74	2,439,994,454.55	100%	113,837,564.42

* There are no other amounts due from shareholders holding 5% or more (including 5%) of shares.

5. Prepayments

Age	At the end of the year		At the beginning of the year	
	Amount	Percentage of total amount	Amount	Percentage of total amount
Within one year	3,853,093.24	4.70%	112,833,977.75	85.17%
One to two years	64,511,962.40	9.11%	13,316,924.00	10.05%
Two to three years	13,316,924.00	85.83%	5,452,196.97	4.12%
Over three years	298,686.28	0.36%	878,288.83	0.66%
Total	81,980,665.92	100%	132,481,387.55	100%

(1) Total amount of top five debtors is as follows:

	At the end of the year		At the beginning of the year	
	Amount	Percentage of total amount	Amount	Percentage of total amount
Total of top five	55,631,471.98	67.86%	81,284,072.54	61.36%

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

5. Prepayments (continued)

- (2) On 31 October 2006, the Company signed the Letter of Intent on Transferring of Chengdu Kelon Shares and Other Matters with Chengdu Engine (Group) Co., Ltd (hereinafter collectively “Chengdu Engine”), Chengdu Refrigerator Co., Ltd and Chengdu Xinxing Electrical Appliances Co., Ltd. The following matters contained therein were reached:
1. The Company acquired 30% shares of Chengdu Kelon held by Chengdu Engine, the transfer price of which was RMB81,000,000;
 2. The Company prepaid Chengdu Engine RMB47,000,000 as share transfer amounts, and charged 30% shares of Chengdu Refrigerator held by Chengdu Engine to the Company and winded up the historical issue that Chengdu Xinxing, a subsidiary of Chengdu Engine, occupied RMB34,000,000 of Chengdu Kelon;
 3. As of the date of audit report, the Company hadn’t completed share transfer.
- (3) During the year, there is no prepayment due from shareholders holding 5% or more (including 5%) of shares.

6. Subsidy receivables

Item	At the end of the year	At the beginning of the year
Export tax receivables	5,021,210.04	39,221,876.72

7. Inventories and provision for inventories

Category	At the end of the year		At the beginning of the year	
	Carrying value	Provision	Carrying value	Provision
Raw materials	245,529,272.47	61,479,234.24	802,960,662.66	205,323,043.26
Work-in-progress	46,413,227.41	12,485,014.20	96,280,958.85	17,518,765.79
Storage goods	750,377,339.50	48,518,968.32	758,544,585.89	201,964,168.69
Total	1,042,319,839.38	122,483,216.76	1,657,786,207.40	424,805,977.74

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

7. Inventories and provision for inventories (continued)

Breakdown of provision for inventory:

Category	Balance at the beginning of the year	Increase during the year	Decrease during the year			Balance at the end of the year
			Reversal due to recover of realised value	Other reduction during the year	Total	
Raw materials	205,323,043.26	9,110,441.90	—	152,954,250.92	152,954,250.92	61,479,234.24
Work-in-progress	17,518,765.79	1,502,837.32	—	6,536,588.91	6,536,588.91	12,485,014.20
Storage goods	201,964,168.69	32,086,860.82	—	185,532,061.19	185,532,061.19	48,518,968.32
Total	424,805,977.74	42,700,140.04	—	345,022,901.02	345,022,901.02	122,483,216.76

* The amount of inventory at the end of the year decreased by 25.40% as compared with the amount at the beginning of the year, mainly due to the fact that management of the Company gradually reduced the unreasonable occupation of funds by inventories by adopting appropriate accounting methods and taking appropriate measures. In particular, the management has taken measures to reduce the irrational stock of many old products and inferior products to increase inventory turnover and reduce the inefficient occupation of funds.

** The sharp decrease in provision for inventory is due to that a corresponding portion of impairment provision is reversed after the Company has taken measures to reduce the irrational stock of many old products and inferior products.

*** The provision for inventory is due to the fact that: 1) The Company performed NRV tests over the inventory and makes provision for those inventories with NRV lower than costs. 2) Some products sold to overseas are returned by customers, and it is impossible to ship these products back to China due to high transportation cost, so that full amount impairment was provided.

**** By the end of the year at 31 December 2006, inventory impawn by company is RMB 140,225,757.28.

8. Long-term investments

(1) Details of long-term investments are as follows:

Item	At the end of the year			At the beginning of the year		
	Carrying balance	Provision for impairment	Carrying value	Carrying balance	Provision for impairment	Carrying value
Investment in associates	77,458,421.15	—	77,458,421.15	92,186,163.51	—	92,186,163.51
Investment in subsidiaries*	41,630,378.96	11,000,000.00	30,630,378.96	42,716,666.40	11,000,000.00	31,716,666.40
Difference of equity investment	9,966,798.80	67,219,525.00	(57,252,726.20)	6,572,677.40	67,219,525.00	(60,646,847.60)
Other equity investment	—	—	—	—	—	—
Long-term debenture investment	—	—	—	—	—	—
Total	129,055,598.91	78,219,525.00	50,836,073.91	141,475,507.31	78,219,525.00	63,255,982.31

* Kelon (Japan) and Combine, controlling subsidiaries of the Company, are not consolidated as they are too small in size.

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

8. Long-term investments (continued)

(1) Details of long-term investments are as follows: (continued)

a. Investments in associates

Name of investee	Percentage of registered capital of investee	Original cost	At the beginning of the year	Change in equity during the year	Accumulated changes in equity	At the end of the year
Chongqing Rongsheng	28%	280,000.00	344,367.00	40,297.55	104,664.55	384,664.55
Guangzhou Antaida	20%	2,000,000.00	3,556,238.76	561,882.60	2,118,121.36	4,118,121.36
Huayi Compressor	22.725%	118,013,641.00	88,285,557.75	2,509,449.30	(27,218,633.95)	90,795,007.05
Sub-total		120,293,641.00	92,186,163.51	3,111,629.45	(24,995,848.04)	95,297,792.96
Share floating right						(17,839,371.81)
Total		120,293,641.00	92,186,163.51	3,111,629.45	(24,995,848.04)	77,458,421.15

(1) An investee, Huayi Compressor, completed its share reform scheme on December 20 2006. The Company originally held 22.725% of Huayi Compressor's shares, and following completion of the share reform scheme the number of shares held by the Company remained unchanged but the percentage of its shareholdings was diluted to 18.26%.

(2) Since the Company has significant influence on Huayi Compressor, so the equity method was applied when calculating. In addition, the share reform was completed on 20 December 2006, thus the investment income for the year 2006 was still calculated based on the rate of 22.725%. At the end of the year, the carrying amount of long-term investment was correspondingly decreased according to the consideration of the share floating right. The consideration resulted therein was deemed as long-term assets, separately reflected as share floating right under the long-term assets in the balance sheet. The share floating right for current year is RMB17,839,371.81.

b. Investments in subsidiaries

Name of investee	Percentage of registered capital of investee	Original cost	At the beginning of the year	Change in equity during the year	Accumulated changes in equity	At the end of the year
Japan Kelon	100%	31,716,666.40	30,630,378.96	—	—	30,630,378.96
Jiangxi Combine	55%	11,000,000.00	11,000,000.00	—	—	11,000,000.00
Total		42,716,666.40	41,630,378.96	—	—	41,630,378.96

* Investment to Japan Kelon is HK\$30,488,000.00, or RMB31,716,666.40 at exchange rate at the beginning of the year, or RMB30,630,378.96 at exchange rate at the end of the year;

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

8. Long-term investments (continued)

(1) Details of long-term investments are as follows: (continued)

c. Changes in provision for impairment

Provision for impairment of long-term investment	At the beginning of the year	Increase during the year	Reversal during the year	At the end of the year
Kelon Air-Conditioner	59,381,641.00	–	–	59,381,641.00
Jiangxi Combine	11,000,000.00	–	–	11,000,000.00
Wangao Company	2,629,693.00	–	–	2,629,693.00
Huaao Electronics	5,208,191.00	–	–	5,208,191.00
Total	78,219,525.00	–	–	78,219,525.00

d. Equity investment difference

Name of investee	Amortisation period	Original investment cost	At the beginning of the year	Amortisation charge for the year	Accumulated amortisation	Balance after accumulated amortisation
Kelon						
Air-Conditioner	10 years	66,596,234.00	59,381,641.00	–	7,214,593.00	59,381,641.00
Yingkou Kelon	10 years	1,010,737.00	510,737.00	100,000.00	600,000.00	410,737.00
Kelon Freezer	18.5 years	(88,611,120.00)	(71,846,852.70)	(4,789,790.30)	(21,554,057.60)	(67,057,062.40)
Wangao Company	10 years	2,744,027.00	2,629,693.00	–	114,334.00	2,629,693.00
Huaao Electronic	10 years	5,434,634.00	5,208,191.00	–	226,443.00	5,208,191.00
Xi'an Kelon	10 years	12,956,689.00	10,689,268.10	1,295,668.90	3,563,089.80	9,393,599.20
Total		131,201.00	6,572,677.40	(3,394,121.40)	(9,835,597.80)	9,966,798.80

* As Kelon Air-Conditioner, Wangao Company and Huaao Electronics. suffered excessive loss and the carrying value of long-term equity investments of the Company in these subsidiaries was reduced to negative, the Company ceased to amortise the equity investment difference of these three subsidiaries and made full amount provision for impairment of long-term investment.

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

8. Long-term investments (continued)

(2) Details of long-term investment companies are as follows:

Item	At the end of the year			At the beginning of the year		
	Carrying balance	Provision for impairment	Carrying value	Carrying balance	Provision for impairment	Carrying value
Long-term equity investment						
Consist of: Investments						
in subsidiaries	1,214,334,081.31	59,381,641.00	1,154,952,440.31	931,244,799.73	59,381,641.00	871,863,158.73
Investments in associates	77,073,756.60	-	77,073,756.60	91,841,796.51	-	91,841,796.51
Equity investment difference	(7,675,421.40)	-	(7,675,421.40)	(12,465,211.70)	-	(12,465,211.70)
Other equity investment	-	-	-	-	-	-
Total	1,283,732,416.51	59,381,641.00	1,224,350,775.51	1,010,621,384.54	59,381,641.00	951,239,743.54

a. Investments in associates

Name of investee	Percentage of registered capital of investee	Original cost	At the beginning of the year	Change in equity during the year	Accumulated changes in equity	At the end of the year
Huayi Compressor	22.725%	118,013,641.00	88,285,557.75	2,509,449.30	(27,218,633.95)	90,795,007.05
Antaida	20%	2,000,000.00	3,556,238.76	561,882.60	2,118,121.36	4,118,121.36
Sub-total		120,013,641.00	91,841,796.51	3,071,331.9	(25,100,512.59)	94,913,128.41
Share reform listing rights						(17,839,371.81)
Total		120,013,641.00	91,841,796.51	3,071,331.9	(25,100,512.59)	77,073,756.60

An investee, Huayi Compressor, completed its share reform scheme on December 20 2006. The Company originally held 22.725% of Huayi Compressor's shares, and following completion of the share reform scheme the number of shares held by the Company remained unchanged but the percentage of its shareholdings was diluted to 18.26%. As most members of Huayi Compressor's board of directors are from the Company and exercise substantial influence over Huayi Compressor, so Huayi Compressor is accounted for by using equity method. Besides, due to the fact that the share reform scheme completed on 20 December 2006, the loss and gain incurred in 2006 was still calculated on a proportion of 22.725% to fully adjust the long term investment to the consideration obtained by the share reform conversion rights, and was reflected in the balance sheet as share reform conversion rights under mid-long term assets. See appendix 6 note 8 (1) a.

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

8. Long-term investments (continued)

(2) Details of long-term investment companies are as follows: (continued)

b. Investments in subsidiaries

Name of investee	Percentage of registered capital of investee	Original cost	At the beginning of the year	Change in equity during the year	Accumulated change in equity during	At the end of the year *
Kelon Refrigerator	70%	155,552,426.00	206,719,170.77	259,861,199.37	311,027,944.14	466,580,370.14
Kelon Air-Conditioner	60%	214,403,766.00	(445,053,830.87)	99,908,300.65	(559,549,296.22)	(345,145,530.22)
Kelon Fittings	70%	32,634,554.00	2,251,337.72	10,522,351.47	(19,860,864.81)	12,773,689.19
Kelon Mould	40%	49,860,000.00	59,153,554.75	1,266,626.05	10,560,180.80	60,420,180.80
Rongsheng Plastic Products	45%	53,270,064.00	156,893,350.17	(3,075,826.52)	100,547,459.65	153,817,523.65
Chengdu Kelon	45%	90,000,000.00	47,548,671.84	(8,049,673.72)	(50,501,001.88)	39,498,998.12
Yingkou Kelon	42%	84,000,000.00	37,881,471.47	2,086,892.72	(44,031,635.81)	39,968,364.19
Beijing Hengsheng	80%	24,000,000.00	13,115,220.85	-	(10,884,779.15)	13,115,220.85
Kelon Development	100%	11,200,000.00	(345,939,739.80)	(30,600,149.81)	(387,739,889.61)	(376,539,889.61)
Kelon Jiake	70%	42,000,000.00	(35,906,563.48)	19,727,172.69	(58,179,390.79)	(16,179,390.79)
Sichuan Kelon Sales	76%	1,520,000.00	835,353.24	-	(684,646.76)	835,353.24
Kelon Freezer	44%	104,280,000.00	33,020,543.74	14,085,840.67	(57,173,615.59)	47,106,384.41
Wangao Company	20%	600,000.00	(18,247,367.70)	(12,941,983.88)	(31,789,351.58)	(31,189,351.58)
Kelon Household Electrical Appliance	25%	2,500,000.00	(74,550,760.17)	(8,180,867.82)	(85,231,627.99)	(82,731,627.99)
Jiangxi Kelon	60%	147,763,896.00	(15,909,659.24)	(54,384,157.78)	(218,057,713.02)	(70,293,817.02)
Jilin Kelon	90%	180,000,000.00	81,404,894.43	(20,244,763.94)	(118,839,869.51)	61,160,130.49
Hangzhou Kelon	40%	24,000,000.00	16,470,345.73	(11,719,780.84)	(19,249,435.11)	4,750,564.89
Yangzhou Kelon	74.33%	178,026,998.00	(89,583,905.75)	(3,916,434.99)	(118,167,290.74)	59,859,707.26
Zhuhai Kelon	75%	189,101,850.00	169,386,873.34	1,215,030.99	(18,499,945.67)	170,601,904.33
Xi'an Kelon	60%	107,729,620.00	53,278,614.54	(20,356,781.30)	(74,807,786.76)	32,921,833.24
Shenzhen Kelon	95%	95,000,000.00	50,812,990.09	(12,603.79)	(44,199,613.70)	50,800,386.30
.Wuhu Motors	40%	12,428,893.00	2,472,407.05	(2,348,936.84)	(12,305,422.79)	123,470.21
Weili Electrical Appliances	55%	-	(7,521,462.22)	(5,394,864.91)	(12,916,327.13)	(12,916,327.13)
Sub-total		1,799,872,067.00	(101,468,489.50)	227,446,588.47	(1,520,533,920.03)	279,338,146.97
Add: Accrued liability of investee enterprise			1,032,713,289.23			934,995,934.34
Total		1,799,872,067.00	931,244,799.73	227,446,588.47	(1,520,533,920.03)	1,214,334,081.31

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

8. Long-term investments (continued)

(2) Details of long-term investment companies are as follows: (continued)

b. Investments in subsidiaries (continued)

* The amount at the end and the beginning of the year includes equity change of indirectly controlled shares.

** In 2006, the Company increased its investment in Yangzhou Kelon by RMB153,360,048.00, together with its previous contribution to Yangzhou Kelon, bringing the total original investment cost to RMB178,026,998.00.

*** The Company reduced the unappropriated profits at the beginning of the year of Jiangxi Kelon by RMB23,922,030.29 and as such the corresponding long-term investment to be reduced at the beginning of the period was RMB23,922,030.29, for details of which please refer to Note III "Rectification of Significant Accounting Errors".

**** As of 31 December 2006, the Company pledged 28% shares of Kelon Refrigerator held by the Company, 44% shares of Kelon Air-conditioner held by the Company (both are subsidiaries of the Company) and 56% shares of Kelon Air-conditioner held by Kelon Development to Foshan Shunde Rongfui Branch of the Bank of Communications, with net finance of RMB142,000,000; Zhujiang Refrigerator pledged 20% shares of Kelon Refrigerator, the controlled subsidiary of Zhujiang Refrigerator, to Shanghai Pudong Development Bank, Guangzhou Branch, with net finance of RMB60,000,000; the Company pledged 70% shares of Kelon Fittings held to Shanghai Pudong Development Bank, Shenzhen Branch, with net finance of RMB105,800,000; the Company pledged 42% shares of Kelon Refrigerator held to Industrial Bank, Guangzhou Branch, with net finance of RMB90,000,000.

Note: The following subsidiaries of the Company, namely, Kelon Air-Conditioner, Wangao Company, Kelon Household Electrical Appliance, Kelon Development, Jiangxi Kelon, Kelon Jiake and its subsidiary Huaao Electronics, recorded excessive losses and the net assets dropped below their liabilities. The Company had committed to the subsidiaries aforesaid to provide financial supports to enable them to implement future business plans and repay the debts in maturity. The bank loans of Yangzhou Kelon were guaranteed by the Company. The Company continues to debit its long-term equity investment in subsidiaries that recorded excessive losses when the carrying value decreases to nil, the credit balance of long-term equity investment occurred therefrom will be reflected as liabilities under a separately set item "accrual liabilities of investee enterprise" in balance sheets. The negative reclassified in this term is RMB 934,995,934.34.

c. Changes in provision for impairment of long-term investment

Name of investee	At the beginning of the year	Increase during the year	Reversal during the year	At the end of the year
Kelon Air-Conditioner	59,381,641.00	-	-	59,381,641.00

d. Equity investment difference

Name of investee	Amortisation period	Original investment cost	At the beginning of the year	Amortisation charge for the year	Accumulated amortisation	Balance after accumulated amortisation
Kelon Air-Conditioner	10 years	66,596,234.00	59,381,641.00	-	7,214,593.00	59,381,641.00
Kelon Freezer	18.5 years	(88,611,120.00)	(71,846,852.70)	(4,789,790.30)	(21,554,057.60)	(67,057,062.40)
		(22,014,886.00)	(12,465,211.70)	(4,789,790.30)	(14,339,464.60)	(7,675,421.40)

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

9. Fixed assets, accumulated depreciation and provision for impairment loss

Fixed assets, at cost	At the beginning of the year	Increase during the year	Decrease during the year	Less: reclassification	At the end of the year
Buildings and structures	1,385,586,952.54	6,491,430.39	68,082,794.97	288,150.00	1,323,707,437.96
Machinery and equipment	1,908,316,965.62	52,874,639.33	119,147,738.77	(32,653,817.27)	1,874,697,683.45
Electronic equipment, fixtures and furniture	321,659,229.19	8,152,554.05	38,944,993.76	32,399,508.35	258,467,281.13
Motor vehicles	72,355,145.59	1,872,325.46	28,600,916.38	(81,856.49)	45,708,411.16
Moulds	194,344,979.80	74,542,414.19	42,915,423.02	48,015.41	225,923,955.56
Total	3,882,263,272.74	143,933,363.42	297,691,866.90	-	3,728,504,769.26
Accumulated depreciation	At the beginning of the year	Increase during the year	Decrease during the year	Less: reclassification	At the end of the year
Buildings and structures	435,666,498.38	71,894,252.87	28,057,738.13	(1,950,530.82)	481,453,543.94
Machinery and equipment	1,226,926,454.89	104,607,986.93	83,790,507.16	(21,405,393.49)	1,269,149,328.15
Electronic equipment, fixtures and furniture	268,431,902.18	9,460,952.92	35,010,377.77	24,443,798.95	218,438,678.38
Motor vehicles	55,249,615.52	5,342,784.39	23,936,572.60	(233,252.22)	36,889,079.53
Moulds	95,867,884.76	53,955,516.22	34,106,765.23	(854,622.42)	116,571,258.17
Total	2,082,142,355.73	245,261,493.33	204,901,960.89	-	2,122,501,888.17
Provision for impairment	At the beginning of the year	Increase during the year	Reversal during the year	Other reduction	At the end of the year
Buildings and structures	32,868,745.07	3,215,914.03	-	763,982.66	35,320,676.44
Machinery and equipment	143,730,814.49	13,394,261.61	-	9,568,508.91	147,556,567.19
Electronic equipment, fixtures and furniture	9,023,157.23	272,406.18	-	5,729,191.92	3,566,371.49
Motor vehicles	1,840,043.84	315,410.35	-	88,784.15	2,066,670.04
Moulds	26,290,182.56	6,690,666.26	-	10,799,673.12	22,181,175.70
Total	213,752,943.19	23,888,658.43	-	26,950,140.76	210,691,460.86
Net	1,586,367,973.82				1,395,311,420.23

* The increase in fixed assets during the period includes transfer from construction in progress of RMB41,194,989.76.

** As at December 31, 2006, the original fixed assets value secured for bank loans of the Company is RMB1,427,011,571.99, and its net value is RMB575,964,027.03.

*** The increase of moulds during the year is mainly due to external purchases, among which the value of moulds at cost purchased by Kelon Refrigerator externally is RMB29,361,602.01, and the value of moulds at cost purchased by Kelon Air-Conditioner externally is RMB27,020,729.83.

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

9. Fixed assets, accumulated depreciation and provision for impairment loss (continued)

**** The decrease of equipments during the period includes the followings:

- (1) decrease of assets at cost by RMB28,185,367.08, accumulated depreciation of RMB19,952,584.37 and provision for fixed asset impairment of RMB926,369.90 to the Company's subsidiary, Kelon Air-Conditioner, due to clearance during the year.
- (2) decrease of assets at cost by RMB19,783,003.89, accumulated depreciation of RMB14,142,091.53 and provision for fixed asset impairment of RMB4,193,397.76 to the Company's subsidiary, Kelon Fittings, due to clearance during the year.

***** The provision for impairment of fixed asset during the period includes the followings:

- (1) impairment to equipment of RMB12,028,518.71 provided for the Company's subsidiary, Kelon Air-Conditioner due to some old equipment unable to withstand normal use; (2) total additional provision of RMB5,349,757.72 due to the shortage of fund, two subsidiaries of the Company, Shangqou Kelon and Weili Electrical Appliances, continued to cease their business as at December 31, 2006, and provision ratios used for the fixed asset of these subsidiaries are 50% and 100% respectively.

***** Only part of the properties purchased by the Company in Meijin Tower (美景大厦) have been granted Realty Ownership Certificates. As at 31 December 2006, the value at cost of these properties without Realty Ownership Certificates is RMB13,815,154.28 while their net value is RMB10,496,461.38.

10. Construction in progress

Project Name	At the beginning of the year	Increase during the year	Transfer to fixed assets during the year	Other reduction during the year	At the end of the year	Source of capital
Project for reconstruction of Yangzhou Kelon factories*	242,277,661.47	725,904.40	631,728.00	14,673,220.31	227,698,617.56	Self-raised
Project for Jiangxi Kelon production line	89,530,361.81	158,760.96	—	50,119,456.01	39,569,666.76	Self-raised
Project for Zhuhai refrigerator production line	30,216,161.52	—	—	30,216,161.52	—	Self-raised
Project for Xi'an Power Control Company compressor production line	10,215,385.20	274,572.10	1,445,700.96	—	9,044,256.34	Self-raised
Others	39,114,202.23	62,707,503.40	39,117,560.80	1,710,476.71	60,993,668.12	Self-raised
Total	411,353,772.23	63,866,740.86	41,194,989.76	96,719,314.55	337,306,208.78	

* As at 31 December 2006, the land use right of RMB46,800,000 under the project for reconstruction of Yangzhou Kelon factories was pledged for bank loans.

** There is no capitalisation of borrowing costs in increase of construction in progress during the year.

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

10. Construction in progress (continued)

*** Provision for impairment of construction in progress is set out below:

Project name	Balance at the beginning of the year	Increase during the year	Decrease in the year		Total	Balance At the end of the year
			Amount reversed for increase in asset value	Amount transferred out for other reasons		
Project for reconstruction of Yangzhou Kelon factories	19,749,323.80	156,968.80	-	6,094,413.60	6,094,413.60	13,811,879.00
Project for Jiangxi Kelon production line	45,826,437.33	-	-	22,581,469.03	22,581,469.03	23,244,968.30
Project for Zhuhai refrigerator production line	16,146,704.15	157,618.63	-	16,304,322.78	16,304,322.78	-
Project for Shangqiu refrigerator production line	-	1,181,652.30	-	-	-	1,181,652.30
Others	15,571,341.00	-	-	223,400.00	223,400.00	15,347,941.00
Total	97,293,806.28	1,496,239.73	-	45,203,605.41	45,203,605.41	53,586,440.60

**** Provision for impairment of construction in progress amounted to RMB1,496,239.73 was made for this year, which was mainly due to the incompleteness of project for Shangqiu refrigerator production line, obsolete purchased equipment, some equipment unusable or need to be replaced. Furthermore, this subsidiary ceased to operate. Impairment provision for this production line of RMB1,181,652.30 was made in 2006

11. Intangible assets

Category	Initial cost	At the beginning of the year	Increase during the year	Transferred out for the year	Amortisation for the year	At the end of the year
Non-patent technology	548,200.00	296,941.74	-	-	137,049.96	159,891.78
Land use rights	560,992,835.93	429,493,265.28	-	81,663,769.68	15,018,453.08	332,811,042.52
Software systems	28,719,325.66	13,943,602.18	1,167,957.48	-	4,507,814.90	10,603,744.76
Others	17,100.00	4,900.00	8,000.00	-	1,332.90	11,567.10
Total	1,112,135,160.54	848,178,425.60	1,175,957.48	81,663,769.68	36,376,923.84	731,313,689.56

* As at 31 December 2006, the land use right with a carrying amount of RMB245,558,493.65 was pledged for bank loans.

** Certain land use right (with an original value of RMB89,874,253.93) and trademarks were acquired by the Company in 2003 through the accounts due from the former substantial shareholder Rongsheng Group and its labor union and the payment of certificates handling charges as well as tax and fees. The trademarks have been amortised over ten years since October 2003, the remaining amortization term of the land use right was 8 to 66 years.

*** An independent third party was entrusted by the Company to value the brands "Kelon" and "Ronshen", according to the "Project Assets Valuation Report of Guangdong Kelon Electrical Holdings Company Limited Concerning the Value Certification on Trademarks and Intangible Assets", as at 31 December 2005, the value of the brands "Ronshen" and "Kelon" were RMB118,378,600.00 (of which "Ronshen" was RMB79,905,500.00, and "Kelon" was RMB38,473,100.00), valuation impairment was RMB286,061,116.40. As at 31 December 2006, the Company incurs no further impairment.

**** Detail about use of land right transfer see appendix 10 (4).

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

11. Intangible assets (continued)

Provision for impairment of intangible assets is set out below:

Project name	At the beginning of the year	Increase for the year	Decrease for the year		Total	At the end of the year
			Amount reversed for increase in asset value	Amount transferred out for other reasons		
Trademarks	286,061,116.40	-	-	-	-	286,061,116.40
Non-patent technology	23,421,758.81	-	-	-	-	23,421,758.81
Software systems	3,322,848.29	-	-	-	-	3,322,848.29
Total	312,805,723.50	-	-	-	-	312,805,723.50

12. Long-term deferred expenditures

Category	At the beginning of the year	Increase for the year	Amortisation for the year	At the end of the year	Remaining term for amortization
Leasehold Improvements	810,858.99	-	628,762.47	182,096.52	1-4 years
Others	1,489,079.38	-	790,724.38	698,355.00	1-4 years
Total	2,299,938.37	-	1,419,486.85	880,451.52	

13. Short term loans

Nature of loan	Currency	At the end of the year		At the beginning of the year	
		Original amount	RMB equivalent	Original amount	RMB equivalent
Guaranteed loan	RMB	263,708,629.32	263,708,629.32	570,722,025.01	570,722,025.01
Secured loan	RMB	599,493,619.20	599,493,619.20	632,211,627.57	632,211,627.57
	HKD	-	-	36,998,889.56	38,489,944.81
Pledged loan	RMB	255,800,000.00	255,800,000.00	149,070,873.12	149,070,873.12
Credit loan	RMB	59,700,000.00	59,700,000.00	214,750,000.00	214,750,000.00
Overdue bank acceptance notes	RMB	-	-	233,346,490.85	233,346,490.85
Bank acceptance notes financing	RMB	218,000,000.00	218,000,000.00	35,714,203.98	35,714,203.98
Commercial notes financing	RMB	160,000,000.00	160,000,000.00	188,500,000.00	188,500,000.00
Domestic L/C	RMB	-	-	13,328,596.00	13,328,596.00
Inward bills	USD	-	-	10,456,873.34	84,389,059.22
Total			1,556,702,248.52		2,160,522,820.56

The substantial decrease in short term loans was mainly the result that: (i) the Company had strengthened fund management, proactively liquidised the inefficient occupation of fund and enhanced the efficiency of fund utilization; (ii) the Company expanded debt financing channels and increased notes financing accordingly.

As at 31 December 2006, the balance of overdue short term loans of the Company was RMB 255,108,629.32.

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

14. Notes payable

Category	At the end of the year	At the beginning of the year
Bank acceptance notes	487,927,200.00	122,739,055.85
Commercial acceptance notes	20,120,187.22	60,725,971.66
Total	508,047,387.22	183,465,027.51

This included no amount due to shareholders holding 5% or more (including 5%) of the share capital of the Company.

* The balance at the end of the year sharply increased by 176.92% compared to that at the beginning of the year, mainly due to the Company expanded debt financing channels, increased notes financing and decreased borrowing financing accordingly.

15. Trade payables

The year-end balance of trade payables was RMB1,467,483,921.58 and RMB 8,790,332.47 was due to shareholders holding 5% or more (including 5%) of the share capital of the Company. See appendix 7, 3, (1).

16. Advance from customers

(1) The amount at year-end was RMB760,291,406.34, of which RMB490,796.57 was attributed to shareholders holding 5% or above, details see Note VII, 3 and (1).

(2) The 173.21% increase of the amount from year-end to year-beginning was attributed to:

- (1) Advance from Hisense Agent increased by RMB290,000,000;
- (2) In the year, the Company tightened control of the refund of sales amounts; the method of payment-before-delivery was adopted by most customers;
- (3) The Company increase returning bonuses for customers who made payment before delivery, which attracted more customers making payment before delivery.

17. Taxes payables

Tax	At the end of the year	At the beginning of the year
Value-added tax	(141,962,398.98)	146,969,330.15
Business tax	8,193,596.39	(14,980.18)
Enterprise Income tax	25,823,702.61	26,845,581.44
Urban Construction Tax	45,716.28	60,425.61
Stamp duty	(72,705.22)	—
Real estate tax	271,865.72	392,857.34
Individual Income tax	471,314.23	(114,017.55)
Land use tax	4,070,164.79	201,006.20
Total	(103,158,744.18)	174,340,203.01

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

18. Other payables

The year-end balance of other payables was RMB570,915,593.57, of which no amount was due to shareholders holding 5% or more (including 5%) of the share capital of the Company.

19. Accrued charges

Items	At the end of the year	At the beginning of the year	Reasons for not settled
Installation costs	55,511,614.50	63,743,988.70	Provision made for the unpaid installation cost of sold products
Interest expenses	18,446,920.52	22,206,757.05	Occurred but not paid
Sales discounts	90,838,732.79	96,030,139.85	Occurred but not paid
Transportation costs	3,781,825.99	8,011,859.63	Occurred but not paid
Audit fee	15,508,531.04	7,150,220.00	Provision made for audit fee
Entertainment expenses	20,451,092.40	22,188,399.88	Occurred but not paid
Bonus	22,650,751.24	31,526,778.51	Occurred but not paid
Agent fee and price difference	–	13,402,831.68	Occurred but not paid
Capital utilization fee	19,799,822.42	3,409,550.50	Occurred but not paid
Others	18,535,082.91	20,015,979.92	Occurred but not paid
Total	265,524,373.81	287,686,505.72	

- (1) Accrued expenses at the end of the year changed slightly and decreased by RMB22,162,131.91 compared to the beginning of the year.
- (2) Capital occupation fee represents the amounts paid to the marketing agents of Hisense. The price difference and capital occupation fees for this year increased compared to that for previous year, details of which please Note VII. 2(4).
- (3) The decrease of the awards in the breakdown items compared to the end of 2005 was mainly because the Company and its controlled subsidiaries calculated the sales commission of the awards as part of salaries payable in 2006.

20. Provision

Items	Balance at the end of the year	Balance at the beginning of the year
Litigation costs	4,212,299.81	5,737,064.34
Provision for maintenance *	165,782,783.11	204,178,681.55
Total	169,995,082.92	209,915,745.89

Mainly because the number of products sold that required quality warranty at the end of this year was decreased by 13.40% compared to that in previous year, and the average repair fee per unit of the air-conditioner decreased 4% from last year whereas the provision of air-conditioner repair warranty reached 63% in all repair provisions.

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

21. Long-term payables

Items	At the end of the year	At the beginning of the year
Pension liabilities *	32,619,896.33	46,993,026.79
Special long-term payables **	27,952,397.90	26,427,148.47
Others	–	503,249.18
Total	60,572,294.23	73,923,424.44

* Pension liabilities represent the contributions paid by the employees and the Company, which are payable to the employees after their retirement or resignation.

** Special long-term payables mainly represent the state debenture projects capital for technical advancement and industry upgrade and other government exclusive financial grant.

22. Share capital

Items	At the beginning of the year	Increase (decrease) during the year			At the end of the year
		Number of bonus shares	Increase	Decrease	
A. Unlisted shares					
1. Promoter shares					
Domestic legal person shares	337,915,755.00	–	–	–	337,915,755.00
Total unlisted shares	337,915,755.00	–	–	–	337,915,755.00
B. Listed shares					
1. Domestic listed ordinary shares					
denominated in RMB	194,501,000.00	–	–	–	194,501,000.00
2. Overseas listed foreign shares	459,589,808.00	–	–	–	459,589,808.00
Total listed shares	654,090,808.00	–	–	–	654,090,808.00
C. Total number of shares	992,006,563.00	–	–	–	992,006,563.00

* The face value of the above shares is RMB1.00 each.

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

23. Capital reserve

Items	At the beginning of the year	Increase during the year	Decrease during the year	At the end of the year
Share premium	1,468,501,786.00	–	–	1,468,501,786.00
Provision for donation of non-cash assets	17,696,745.00	–	–	17,696,745.00
Price difference between related party transactions	17,712,651.00	–	–	17,712,651.00
Equity investment reserve	70,731,421.56	11,009,933.04	–	81,741,354.60
Others	6,457,045.19	15,992,545.41	–	22,449,590.60
Total	1,581,099,648.75	27,002,478.45	–	1,608,102,127.20

* The capital reserve of the Company for this year increased by RMB27,002,478.45, which is mainly because: the Company wound up the debts of RMB15,992,545.41 which need not be paid. Jiangxi Kelon, the controlled subsidiary of the Company, restructured the debts with construction in progress, and Shunde Electrical Appliance, the other controlled subsidiary wound up the debts which need not be paid, and the two factors contributed to the increase of RMB11,009,933.04.

24. Surplus reserve

Items	At the beginning of the year	Increase during the year	Decrease during the year	At the end of the year
Statutory common reserve	114,580,901.49	–	–	114,580,901.49
Consist of: Discretionary reserve	–	–	–	–
Statutory common welfare fund	114,580,901.49	–	–	114,580,901.49

* Statutory common reserve can be utilized for staff welfare.

25. Unappropriated profits

At the beginning of the year	Increase during the year	Decrease during the year	At the end of the year
(3,800,717,444.16)	24,120,753.48	–	(3,776,596,690.68)

* The original balance of the unappropriated profits at the end of 2005 is -3,782,492,927.69, the account error in the past year has been adjusted by management team in this term, the year beginning unappropriated profit was totally reduced by 18,224,516.47. See appendix 3.

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

26. Revenue from principal operations and cost

(1) By product segment

Classification	2006		2005	
	Revenue	Cost	Revenue	Cost
Sales of refrigerators	3,326,980,129.96	2,722,932,188.13	2,542,838,900.40	2,571,065,120.71
Sales of air-conditioners	2,536,816,403.41	2,241,785,596.64	3,600,489,209.12	3,423,931,356.14
Sales of freezers	231,972,093.02	233,958,570.02	261,112,606.19	237,960,719.98
Others	469,473,018.44	467,107,684.45	573,931,000.92	581,286,362.00
Total	6,565,241,644.83	5,665,784,039.24	6,978,371,716.63	6,814,243,558.83

* The aggregate amount sales income of the top five was as follows:

	2006		2005	
	Amount	% to the aggregate	Amount	% to the aggregate
The aggregate amount of the top five	2,140,396,162.60	32.60%	2,223,701,282.27	31.87%

(2) By geographic segment

Classification	2006		2005	
	Revenue	Cost	Revenue	Cost
Domestic	4,031,835,209.92	3,237,266,778.19	4,154,956,841.33	3,957,233,763.29
Overseas	2,533,406,434.91	2,428,517,261.05	2,823,414,875.30	2,857,009,795.54
Total	6,565,241,644.83	5,665,784,039.24	6,978,371,716.63	6,814,243,558.83

In connection with the recognition method for cost of principal operations in 2005, the Company adopted an accounting policy pursuant to which the inventory is calculated with a year-end stock-take of finished products and the weighted purchase unit price, and the cost of principal operations in 2005 was calculated retrospectively. This method make the cost of principal operations in 2005 comprise the cost accrual in previous years. Therefore, the Company's cost of principal operations figures for 2006 and 2005 are not comparable.

Details of Company's revenue and cost of principal operations are as follows:

Classification	2006		2005	
	Revenue	Cost	Revenue	Cost
Sales of refrigerators	2,051,017,229.20	1,825,675,148.49	1,673,302,169.29	1,595,688,793.28
Sales of air-conditioners	1,661,876,879.70	1,480,775,987.61	2,040,451,807.54	1,989,694,300.64
Sales of freezers	103,720,687.88	92,239,891.62	66,394,782.04	69,914,018.63
Others	74,295,785.22	65,936,627.14	82,561,359.77	128,911,542.07
Total	3,890,910,582.00	3,464,627,654.86	3,862,710,118.64	3,784,208,654.62

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

27. Other operating profit

Classification	2006	2005
Materials	(41,897,847.93)	(11,993,443.00)
Leases	4,213,075.38	926,328.54
Moulds	(595,537.25)	2,478,309.35
Others	14,047,276.48	–
Total	(24,233,033.32)	(8,588,805.11)

Other operating profit has recorded a loss, which was mainly due to the overall clearing of inventories of the Company conducted by the new management during the year. The Company found a lot of raw materials which had been stocked for a long time or whose components were aged or unable to be used. To avoid a larger loss of the Company due to delay of clearing of the accounts, the Company disposed of the raw materials which had been stocked for too long or damaged in accordance with the relevant management regulations.

28. Operation expense

The actual spending for this reporting period was RMB831,614,349.02, which represented a significantly decrease compared to last year. The reason was the Company recognized substantial accruable unrecognized fees such as installation fee occurred during previous year, and the figures of 2005 was not comparable to that of 2006.

29. Administrative expense

The amount incurred in the reporting period is RMB–23,086,935.53, the administrative expenses in 2006 is negative, and plummet compared with that of 2005, the main reasons are: (1) the Company disposed large amount of raw materials in 2006 which had been provided for these inventory in 2005, the provision transferred out due to disposal of inventories are RMB345,000,000; (2) the data of 2005 is not comparable with data 2006.

30. Financial expenses

Classification	2006	2005
Interest expenses	116,511,547.30	125,715,310.56
Less: Interest income	4,754,020.02	29,442,938.48
Exchange gain/loss	28,542,983.29	35,309,059.05
Discount interests	21,140,152.09	32,125,489.46
Others	(2,633,095.66)	2,971,693.24
Total	158,807,567.00	166,678,613.83

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

31. Investment profit

Details of combined investment profit are as follows:

Classification	2006	2005
Profit on share of results of investments in associates	3,588,175.99	(31,570,522.33)
Amortisation of long-term equity investment difference	3,394,121.40	3,394,121.40
Dividends received from investees	–	–
Profit on dealing with equity	–	–
Provision for impairment of long-term investments	–	(11,000,000.00)
Other investment profits	–	(6,904,850.00)
Total	6,982,297.39	(46,081,250.93)

* See appendix 6 Note 8

Details of the Company's investment profit are as follows:

Classification	2006	2005
Profit on share of results of investments in subsidiaries	215,919,811.34	(1,656,446,428.83)
Profit on share of results of investments in associates	3,588,175.99	(31,952,195.49)
Amortisation of long-term equity investment difference	4,789,790.30	4,789,790.30
Provision for impairment of long-term equity investments	–	–
Income from Stock rights dispose	–	–
Other investment profits	–	(6,904,850.00)
Total	224,297,777.63	(1,690,513,684.02)

* The original balance at the beginning of the year decreased by RMB 23,922,030.29 compared with the restated figures, as the net loss of Jiangxi Kelon in 2005 was increased by RMB 23,922,030.29 in the audit, which resulted in the decrease of the investment profit of the parent company from Jiangxi Kelon by RMB 23,922,030.29.

32. Subsidy income

Items	2006	2005
Technology improvement and innovation subsidy*	70,000,000.00	–
Others	510,933.77	2,307,703.99
Total	70,510,933.77	2,307,703.99

* According to the document [2006] No 29 issued by shun de rong gui jie dao ban shi chu, subsidy was offered to the company in one time.

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

33. Non-operating income/expenses

1. Non-operating income

Items	2006	2005
Gain on disposal of fixed assets	24,564,518.45	5,609,333.73
Penalty income	5,986,563.79	2,831,475.11
Insurance compensation income	4,023,134.63	185,840.00
Land transfer income*	36,360,404.27	11,984,246.34
Others	18,805,531.95	1,962,470.65
Total	89,740,153.09	22,573,365.83

* The Company originally owned the land use right of the land with an area of 133,334.05 m² under the land use right certificate (Shunfuguoyong (2004) No. 1001950). On 1 December 2006, the Company transferred part of the land with an area of 133,334.05 m² to Foshan Mingsheng Investments Co., Ltd. (佛山市名勝投資有限公司) at a consideration of RMB127,207,347.72 (see Note X-4 for details).

2. Non-operating expenses

Items	2006	2005
Net losses on disposal of fixed assets	19,390,062.70	51,014,477.86
Losses on count deficit of fixed assets	(32,970.08)	2,423,661.63
Amercement outlay	2,815,417.59	3,345,381.75
Tax overdue fine	–	7,627,962.57
Provision for impairment of construction in progress	1,496,239.73	92,938,782.24
Provision for impairment of fixed assets	23,888,658.43	173,612,014.44
Provision for impairment of intangible assets	–	304,698,032.50
Others	22,780,145.65	62,905,152.29
Total	70,337,554.02	698,565,465.28

* The substantial decrease in non-operating expenses was due to the provisions made by the Company in 2005 for impairment of construction in progress, fixed assets and intangible assets, while in 2006, the Company had no further impairment on assets.

** Net loss on disposal of fixed assets was mainly due to further disposal of spare and obsolete fixed assets at prices lower than the carrying amounts.

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) (continued)

34. Income tax

Classification	2006	2005
Income tax payable by the Company (note)	–	–
Income tax payable by subsidiaries	515,965.59	1,020,742.69
	515,965.59	1,020,742.69

Note: No income tax is provided as the Company incurred estimated tax loss for the year.

35. Other cash received from investing activities

Items	2006	2005
Interest income	4,754,020.02	29,442,938.48

36. Other cash received from financing activities

Items	2006	2005
Year ended security bank deposit	–	1,302,587,030.00
Less: Year beginning security bank deposit	–	102,813,515.40
	–	1,199,773,514.60

37. Other cash paid for financing activities

Items	2006	2005
Cash returned to HISENSE	110,000,439.21	–
Year ended security bank deposit	248,257,060.23	–
Less: Year beginning security bank deposit	102,813,515.40	–
	255,443,984.04	–

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VI. NOTES TO MAJOR ITEMS OF THE FINANCIAL STATEMENTS (UNLESS OTHERWISE SPECIFIED, THE FOLLOWINGS ARE COMBINED FIGURES) *(continued)*

38. Cash and cash equivalents

Group

Classification	2006	2005
Bank balances and cash	390,503,566.38	287,097,542.93
Less: Pledged deposits	248,257,060.23	102,813,515.40
	142,246,506.14	184,284,027.53

Company

Classification	2006	2005
Bank balances and cash	205,118,842.75	66,230,863.58
Less: Pledged deposits	150,999,855.37	1,035,605.39
	54,118,987.38	65,195,258.19

VII. RELATED PARTY RELATIONSHIPS AND RELATED PARTY TRANSACTIONS

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 has become the sole substantial shareholder of the Company.

There occurred a series of connected transactions and abnormal cash flow occurred during the period from October 2001 to July 2005 between Guangdong Greencool Enterprise Development Limited (the former controlling shareholder of the Company) and its connected parties (the "Greencool Companies"). The above transactions and capital embezzlement are still under investigation of the relevant authority. Those events are related to the receivables and payables between the Company and each of Greencool Companies as at 31 December 2006. In addition, abnormal cash flow occurred also between the Company and Tianjin Lixin (Please refer to note VII.1(4) for details) during the period from October 2001 to July 2005.

Please refer to note VII.2 for the connected transactions occurred between the Company, and Hisense Group and Greencool companies and the above "specified third parties".

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VII. RELATED PARTY RELATIONSHIPS AND RELATED PARTY TRANSACTIONS (continued)

1. Related party relationships

(1) Related parties with controlling interests include:

Name of related parties	Nature	Legal representative	Registered Capital	Business Scope	Shares or interests held	Relationship
Qingdao Hisense Air-Conditioner Company Limited ("Hisense Air-Conditioner")	Sino-foreign joint venture company	Tang Ye Guo	674,790,000	*	26.43%	Controlling shareholder
Combine	limited liability company	Fang Zhi Guo	20,000,000	**	55.00%	Unconsolidated subsidiary of the Company

* Manufacture of air-conditioners, moulds and after-sale service.

** Research, manufacture and sale of air-conditioners, household electrical appliances and after-sale service.

(2) Greencool Companies

Name of related parties	Relationship
Guangdong Greencool Enterprise Development Company Limited, Gu Chu Jun	Fomer controlling shareholder of the Company Fomer controlling shareholder and legal representative of the Company
Greencool Environmental Protection Engineering (Shenzhen) Co., Ltd. ("Greencool Technology Environmental Protection (Shenzhen)")	Related party of Guangdong Greencool
Greencool Technology Development (Shenzhen) Company Limited ("Greencool Technology Development (Shenzhen)")	Related party of Guangdong Greencool
Greencool Procurement (Shenzhen) Co., Ltd. ("Greencool Procurement")	Related party of Guangdong Greencool
Hainan Greencool	Related party of Guangdong Greencool
Jiangxi Greencool Electrical Appliance Company Limited ("Jiangxi Greencool")	Related party of Guangdong Greencool
Hefei Meiling Holdings Limited ("Meiling Holdings")	Related party of Guangdong Greencool
Yangzhou Yaxing Motor Coach Company Limited ("Yangzhou Yaxing")	Related party of Guangdong Greencool

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VII. RELATED PARTY RELATIONSHIPS AND RELATED PARTY TRANSACTIONS *(continued)*

1. Related party relationships *(continued)*

(3) *Related parties with no controlling interests include:*

Name of related parties	Relationship
Huayi Compressor	Associate of the Company
Chongqing Kelon	Associate of the Company
Antaida	Associate of the Company
Chengdu Engine (Group) Company Limited (“Chengdu Engine”)	Minority shareholder of Chengdu Kelon
Chengdu Xinxing Electrical Appliance Holdings Company Limited (“Chengdu Xinxing”)	Subsidiary of the minority shareholder of Chengdu Kelon
Xi’an Gaoke Group Company	Minority shareholder of Xi’an Kelon
Hangzhou Xileng Group Company Limited (“Hangzhou Xileng”)	Minority shareholder of Hangzhou Kelon
Jiaxibeila Compressor Company Limited (“Jiaxibeila”)	Subsidiary of an associate
Shunde Yunlong Consultancy (“Shunde Yunlong”)	Minority shareholder of Huaao Electronics
Hisense Agent	Subsidiary of controlling shareholders
Hisense Zhejiang	Subsidiary of controlling shareholders
Hisense Nanjing	Subsidiary of controlling shareholders
Hisense Beijing	Subsidiary of controlling shareholders
Qingdao Hisense Import& Export Co., Ltd.	Subsidiary of controlling shareholders
Hisense-Hitachi Air-conditioning System Co., Ltd.	Subsidiary of controlling shareholders

(4) *The Greencool Companies had a series of transactions or abnormal cash inflow/outflow through the following “Specified Third Party Companies”*

Name of companies	Relationship
Jiangxi Kesheng	Specified third party companies
Zhongshan Dongyue Electrical Specified third party companies Co., Ltd. (Dongyue Zhongshan)	Specified third party companies
Jinan San’ ai’ fu	Specified third party companies
Tianjin Xiangrun	Specified third party companies
Tianjin Lixin	Specified third party companies
Jiangxi Keda Plastic Technology Company Limited (“Jiangxi Keda”)	Specified third party companies
Refrigerant Production Consultants Limited	Specified third party companies
Hefei Weixi	Specified third party companies
Zhejiang Guoda Trading Company Limited (“Zhejiang Guoda”)	Specified third party companies
Zhuhai Longjia	Specified third party companies
Zhuhai Defa	Specified third party companies
Wuhan Changrong	Specified third party companies
Tianjin Taijin Yunye Company Limited (“Tianjin Taijin Yunye”)	Specified third party companies
Chengdu Refrigerating Components Factory	Specified third party companies
Beijing De Heng Solicitors	Specified third party companies
Shangqiu Bingxiong Freezing Facilities Company Limited (“Shangqiu Bingxiong”)	Specified third party companies

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VII. RELATED PARTY RELATIONSHIPS AND RELATED PARTY TRANSACTIONS *(continued)*

1. Related party relationships *(continued)*

(5) *Movements in the Company's share capital or equity held by related parties with controlling Interest*

Name of related party	At the beginning of the year	Increase during the year	Decrease during the year	At the end of the year
Hisense Air-Conditioner	–	262,212,194	–	262,212,194

2. Transactions with related parties and “Specified Third Party Companies”

(1) *Purchases from the related parties*

Items	Name of related parties	2006	2005
Purchases from:	Chengdu Xinxing	25,235,907.94	28,804,895.81
	Chengdu Engine	–	4,389,881.55
	Huayi Compressor	35,327,742.94	19,453,868.42
	Jiaxi Beila	92,650,029.09	85,834,349.26
	Hisense Air-Conditioner	17,503.34	2,570,769.23
	Hisense Marketing	209,729,271.60	–
	Hisense Zhejiang	69,854,091.13	–
	Hisense Nanjing	1,829,885.47	–
	Hisense Beijing	5,519,658.12	–
In total		440,164,090.63	141,053,764.27

On 15 September 2006, Kelon Air-conditioner signed the “Raw Material Purchase and Supply Framework Agreement” (《原材料採購供應框架協議》) with Hisense Zhejiang, and concluded that from the date of signing till 31 December 2006, Kelon Air-conditioner shall negotiate with Hisense Zhejiang to decide the price of Raw Material, and Kelon Air-conditioner will purchase the Raw Material from Hisense Zhejiang with amount not more than RMB12,000,000.

On 15 September 2006, Kelon Air-conditioner signed the “Air-Conditioners Production and Purchase Framework Agreement” (空調器產品生產加工(採購)框架協議) with Hisense Zhejiang and Hisense Marketing, and concluded that from the date of signing till 31 December 2006, and Kelon Air-conditioner will purchase Air-Conditioners Production from Hisense Zhejiang and Hisense Marketing with amount not more than RMB120,000,000.

The main terms and conditions of the “Air-Conditioners Production and Purchase Framework Agreement” (空調器產品生產加工(採購)框架協議) is as follows:

Kelon Air-conditioner shall negotiate with Hisense Zhejiang and Hisense Marketing to decide the price of Raw Material with reference to the market prices of the air-conditioners, and the OEM pricing level in the Air-Conditioner industry.

(2) Kelon Air-conditioner decide the price of a Air-conditioner with Hisense Zhejiang and Hisense Marketing according to the following standards:

The price of a Air-conditioner purchased by Kelon Air-conditioner from Hisense Zhejiang and Hisense Marketing \leq The manufacturing cost + administrative expenses + transportation cost (from Guangdong to Zhejiang) of a Air-conditioner by Party A.

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VII. RELATED PARTY RELATIONSHIPS AND RELATED PARTY TRANSACTIONS *(continued)*

2. Transactions with related parties and "Specified Third Party Companies" *(continued)*

Upon fully consideration of the above standards, and based on the relevant manufacturing cost of Kelon Air-conditioner itself and the administrative expenses levels, both parties concluded their respective prices of models specified by them after their negotiation and with reference to the market prices are as follows:

Prices of models specified by Kelon Air-conditioner from Hisense Zhejiang and Hisense Marketing = the cost of such models made by Kelon Air-conditioner/0.95.

In the year, the Company has a purchase amount of RMB209,729,271.60 from Hisense Marketing, which is what the Company repurchased the product from Hisense Marketing at the original sale prices.

(2) Sales of products to the related parties

Items	Name of related parties	2006	2005
Sales of products to	Chengdu Xinxing	3,336,588.68	26,522,096.00
	Chongqing Kelon	39,600,955.87	760,851.62
	Hefei Meiling	–	98,803.42
	Hisense Marketing	1,572,695,090.00	868,234,609.82
	Hisense Zhejiang	7,252,794.06	–
	Qingdao Hisense Import and Export Co., Ltd.	265,885.64	–
	Qingdao Hisense Hitachi Air-conditioning Systems Co., Ltd.	285,932.31	–
	Huayi Compressor Holdings Company Limited	355,574.71	–
	In total	1,623,792,821.27	895,616,360.86
Percentage of total sales	24.73%	12.83%	

(3) Sales of moulds fixed assets

Items	Name of related parties	2006	2005
Sales of moulds to	Hisense Electric	2,554,273.50	2,081,196.58
	Hisense Marketing	648,718.00	–
Sales of equipments to	Hisense Zhejiang	300,198.74	–
In total		3,503,190.24	2,081,196.58

Kelon Mould and Hisense Air-Conditioner had entered into the Mould Purchase Framework Agreement on 15 September 2006, which stipulates that, for the period from the date of signing the agreement to 31 December 2006, Hisense Air-Conditioner will purchase moulds in an amount not exceeding RMB8,000,000 from Kelon Mould at the market prices determined by way of public tender between Kelon Air-Conditioner and Hisense Air-Conditioner.

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VII. RELATED PARTY RELATIONSHIPS AND RELATED PARTY TRANSACTIONS *(continued)*

2. Transactions with related parties and "Specified Third Party Companies" *(continued)*

(4) Sales Agent

On 16 September 2005 and 26 September 2005, the Company and Hisense Marketing entered into the Sales Agency Agreement and Supplemental Agreement. On 1 April 2006, the Company and Hisense Marketing entered into the Second Supplemental Agreement to the Sales Agency Agreement, pursuant to which, the parties agreed that from the date of the agreement to 10 May 2006, Hisense Marketing would act as the agent of the Company to sell domestic products in the value of not more than RMB2.8 billion, of which not more than RMB800 million should be sold by the end of 2005. For the year 2006, the Company had sold domestic finished products in the value of RMB1,572,695,090.00 (sales in 2005: 868,234,609.82).

The main terms of the Sales Agency Agreement and Supplemental Agreement are as follows:

- (1) Hisense Marketing shall prepay no more than RMB0.6 billion to the Company for purchasing its products, wherein RMB0.3 billion shall be paid within 10 working days after the signing of the agreement. Within one month after the date of the first payment, Hisense Marketing shall prepay no more than RMB0.3 billion according to the Company's actual financial need for starting its production, marketing and sales. During the term of the agreement, Hisense Agent shall not ask the Company to refund the amount of no more than RMB0.6 billion prepaid by Hisense Marketing to the Company.
- (2) The Company shall start providing Hisense Agent with products and deliver them to the warehouses designated by Hisense Agent on the date of receiving prepayment. Upon the products arrive at the warehouses designated by Hisense Agent, the ownership of these products shall transfer to Hisense Agent. Both parties shall complete a loan procedure when the amount of delivered products exceeds the prepayment of Hisense. The actual capital period of Kelon Electric's products occupied by Hisense Agent is 60 days.
- (3) The Company shall, after the signing of this agreement and in accordance with the relevant terms of this agreement, persuade all distributors to sign the Three-Party Agreement with the Company and Hisense Agent, which specifies that all distributors shall get products from Hisense Marketing and make payments to Hisense Agent;

Hisense Agent shall strictly collect sales proceeds in accordance with the foresaid Three-Party Agreement and make payments to Kelon Electric within three working days after these proceeds are collected.

- (4) The settlement price of the products that Hisense Agent get from Kelon Electric shall be equal to the settlement price of the products that the distributors get from Hisense Agent, which price is to be determined by Kelon Electric and the distributors.

Kelon Electric shall check and pay all marketing fee, including but not limited to the discount of retailers, price difference, slotting allowance, advertising fee, stand construction cost, rent of the products' warehouse, load and unload cost, logistic cost (including main lines and sublines) and labour cost, etc.

- (5) During the effective period of the agreement, Hisense Agent pre-charged the Company the capital utilisation fee, which is calculated in the following formula and charged on a quarterly basis:

Capital Utilisation Fee = Prepayment Amount x Effective Days of Capital Utilisation x Interest Rate as quoted by the People's Bank of China for one-year loans ÷ 360

As at 31 December 2006, the Company had the advance balance of RMB290,164,676.95 from Hisense Marketing. Pursuant to the agency agreement, the commission payable to Hisense Marketing amounted to RMB13,178,420.01 and the capital utilisation fee payable to Hisense Marketing amounted to RMB16,390,172.45. (2005: RMB 3,409,550.50).

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VII. RELATED PARTY RELATIONSHIPS AND RELATED PARTY TRANSACTIONS *(continued)*

2. Transactions with related parties and “Specified Third Party Companies” *(continued)*

(5) *Use of land and buildings*

A subsidiary of the Company, Jiangxi Kelon, has since October 2003 used the land and buildings of Jiangxi Greencool located in Jiangxi Kelon Greencool Industrial Park. Another subsidiary of the Company, Zhuhai Kelon, has established its small refrigerator manufacturing facility in the land and buildings of the Company’s substantial shareholder Greencool. As at 31 December 2006, Jiangxi Kelon and Zhuhai Kelon had not signed any asset rent agreement with the counterparty.

(6) *Use of trademark*

The Company signed a trademark licensing agreement (“Licensing Agreement”) with Greencool (China) on 3 April 2003, which allows the Company and its subsidiaries to use the trademark “COMBINE” without paying licensing fees. The Company and its subsidiaries only sold few air-conditioners with the trademark “COMBINE” carried down from last year in the year.

(7) *Other transactions*

Items	2006	2005
Other income (expenses) received from (paid to) related parties		
– Interest income from Chengdu Xinxing	–	1,985,940.00
– Logistics management fee paid to Antaida	51,538,372.05	6,374,827.70
– Electric and water utilities paid to Chengdu Engine	6,467,760.10	5,072,120.05
– Equipment rent paid to Hangzhou Xileng	6,000,000.00	6,000,000.00
– Services fee paid to Guangzhou Antaida	103,305.56	–

(8) *Guarantees*

As at 31 December 2006, Guangdong Greencool, the former controlling shareholder of the Company, provided the Company with guarantees for the remaining borrowings of RMB327,971,300. A guaranteed amount of RMB85,708,600 was utilized by the Company. Hisense Group Co. Ltd., the beneficial controller of the Company, provided the Company with guarantees for the borrowings of RMB50,000,000.

3. Transactions with related companies and “Specified Third Party Companies”

(1) *Transactions with the related companies under control of the Company*

Items	Name of related companies	At the end of the year	At the beginning of the year
Trade receivables	Hisense Air-conditioner	335,121.67	–
Trade payables	Hisense Air-conditioner	8,790,332.47	–
Prepayments	Hisense Air-conditioner	490,796.57	–
Other payables	Combine	5,099,880.00	5,099,880.00

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VII. RELATED PARTY RELATIONSHIPS AND RELATED PARTY TRANSACTIONS *(continued)*

3. Transactions with related companies and “Specified Third Party Companies” *(continued)*

(2) Transactions with Greencool Companies

Items	Name of related companies	At the end of the year	At the beginning of the year
Trade receivables	Hefei Meiling	6,975.00	115,600.00
Other receivables	Guangdong Greencool	13,754,600.00	13,754,600.00
	Shenzhen Greencool Environmental	33,000,000.00	33,000,000.00
	Shenzhen Greencool Technology	32,000,000.00	32,000,000.00
	Hainan Greencool	12,289,357.71	12,289,357.71
Trade payables	Hefei Meiling	50,125.18	17,385.31
Other payables	Jiangxi Greencool	13,000,000.00	13,000,000.00

(3) Transactions with the related companies not controlled by the Company

Items	Name of related companies	At the end of the year	At the beginning of the year
Trade receivables	Chongqing Kelon	107,070.00	137,136.40
	Hisense Marketing	436,224.01	204,349,247.04
	Hisense Zhejiang	590,285.77	–
	Guangzhou Antaida Logistic Co. Ltd.	8,166.40	–
	Hisense Rili	334,540.80	–
Prepayment	Chengdu Xinxing	–	1,802,308.16
	Hisense Nanjing	730,450.00	–
	Chengdu Engine	47,000,000.00	–
Other receivables	Antaida	31,635.44	2,613.20
	Chengdu Engine	190,964.00	26,780.00
	Chengdu Xinxing	34,000,000.00	34,000,000.00
	Shunde Yunlong	4,525,832.74	4,685,832.74
	Hisense Marketing	103,506.00	–
Trade payables	Huayi Compressor	13,739,250.30	17,766,207.52
	Chengdu Engine	–	433,940.00
	Chengdu Xinxing	11,815,976.65	2,538,151.87
	Jiaxi Beila	12,905,409.58	57,541,612.28
	Hisense Marketing	–	7,800.00
	Hisense Beijing	1,284.40	–
	Hisense Nanjing	279,020.60	–
Advance from customers	Chongqing Kelon	4,082,988.12	–
	Hisense Marketing	290,164,676.95	436,478.09
Other payables	Antaida	20,651,902.63	24,463.43
	Xi'an Gaoke	1,785,476.00	1,785,476.00
	Xi'an Gaoke	15,772,269.71	9,773,892.29
	Chengdu Engine	5,308,840.00	–
	Huayi Compressor	200,000.00	–
	Jiaxi Beila	100,000.00	–

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VII. RELATED PARTY RELATIONSHIPS AND RELATED PARTY TRANSACTIONS *(continued)*

3. Transactions with related companies and “Specified Third Party Companies” *(continued)*

(4) Transactions with specified third party companies

Items	Name of companies	At the end of the year	At the beginning of the year
Trade receivables	Hefei Weixi	18,229,589.24	18,229,589.24
	Wuhan Changrong	20,460,394.04	20,460,394.04
Prepayment	Hefei Weixi	465,213.00	465,213.00
Other receivables	Jiangxi Kesheng	27,462,676.72	27,462,676.72
	Zhongshan Dongyue	–	12,678,281.25
	San'ai'fu	121,496,535.45	121,496,535.45
	Tianjin Xiangrun	96,905,328.00	96,905,328.00
	Tianjin Lixin	89,600,300.00	89,600,300.00
	Jiangxi Keda	13,000,200.00	13,000,200.00
	Zhuhai Longjia	28,600,000.00	28,600,000.00
	Zhuhai Defa	21,400,000.00	21,400,000.00
	Wuhan Changrong Electrical Appliance Company Limited	20,000,000.00	20,000,000.00
	Beijing De Heng	4,000,000.00	4,000,000.00
	Finance Bureau of Yangzhou Economic Development Zone	40,000,000.00	40,000,000.00
Shangqin Bingxiong	58,030,000.00	58,030,000.00	
Trade payables	Jiangxi Keda	–	621,968.35
	Zhongshan Dongyue	3,876,158.85	2,593,644.03
Other payables	Zhuhai Longjia	28,316,425.03	28,316,425.03
	Zhuhai Defa	21,400,000.00	21,400,000.00
	Tianjin Taijin	65,000,000.00	65,000,000.00
	Zhongshan Dongyue	500,000.00	

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

VIII. LITIGATION AND OTHER CONTINGENT MATTER

On 17 August 2006, the Supreme Court of the PRC promulgated the “Notice of the Extension of the Time Limit for the Suspension of the Acceptance, Trial and Execution of the Civil and Commercial Cases with Guangdong Kelon Electrical Holdings Company Limited and its Controlling Companies and its Investee Companies as the Defendants”, and new cases filed in 2006 were mainly labor service disputes. Most cases filed in 2005 had been closed or withdrawn by counterparties. As at the date of the auditors’ report, the pending litigations involving the Company (including cases filed in 2005 and not yet closed and new cases filed in 2006) are summarized as follows:

(1) The cases with the Company as the plaintiff (other than cases involving Greencool and Gu Chu Jun)

Plaintiff	Defendants	Reason	Total amounts involved
The Company	Guangzhou Youyicheng Trading Co., Ltd	Outstanding amount for completed construction	4,500,000.00
The Company	Beijing Diamond Advertising Company Limited (北京戴夢得廣告有限公司)	Due refund of business fee	5,000,000.00
The Company	Beijing De Heng	Due refund of legal service fee	4,000,000.00
The Company	Hangxiao gang gou holding ltd	Project overdue, penalty paid	11,547,000.00
The Company	Greencool and Guchujiun	Ostensible purchase, infringement	791,534,264.00
The Company	Others		2,509,512.44
Total			819,090,776.44

(2) The cases with the Company as the defendant (other than cases involving Greencool companies)

Plaintiff	Defendant	Reason	Total amounts involved
Materials supplier	The Company	Outstanding amount for goods	12,067,540.09
Kaifeng Economic Technology Development (Group) Company	The Company	Disputes on joint venture contract	27,160,000.00
Zhejiang Hangxiao Steel Structure Co., Ltd	The Company	Outstanding amount for completed construction	19,853,000.00
CAN/MC	The Company	Obligations set out in contract were not performed on a timely basis and goods delivered were defective	USD13,750,719.19
Domestic commercial banks	The Company	Outstanding amount for borrowings	87,607,915.00
Labor disputes	The Company	Labor disputes	1,600,678.51
Henan bingxiongbingli, air-conditioner	Greencool and the company	Delay for contract carry out	5,840,000.00
Total			261,504,374.54

* As at 31 December 2006, USD1 = RMB7.8087.

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

IX. SUBSEQUENT EVENTS

1. Share reform matters

- (1) The Share Reform Plan of the Company was approved and passed by the related A Share shareholders meetings on 29 January 2007 and had been completed its implementation before 29 March 2007.
- (2) Holders of non-circulating shares of the Company have paid 23,340,120 shares to the holders of A Shares of the Company whose names were registered on the register on the date of registration for changes in shares of the Share Reform Plan, i.e., the holders of A Shares of the Company received 1.2 shares for every 10 circulating shares, and the plan has been implemented.

2. Sales of fixed assets

- (1) On 15 March 2007, Kelon Electric Limited, a wholly-owned subsidiary of the Company, entered into an Assets Transfer Agreement with Gateway Limited in relation to the disposal of the Property (together with the existing lease agreement, electrics and furniture of this property) of the whole of 25/F., Harbour Centre, 25 Harbour Road, Hong Kong (with a total floor area of 1,467.86 m²) to Gateway Limited for a consideration of HK\$123,295,400.
- (2) The net booking amount of the property is HK\$66,884,000.00.

3. Subsequent guarantee matters

The first session of the sixth board meeting has resolved that: resolution of “the Company proposed to provide guarantees in the amount up to RMB1.566 billion for its controlling subsidiaries in 2007”; resolution of “the Company proposed to provide guarantees in the amount up to RMB267 million for its distributors”.

4. Subsequent connected transactions

- (1) On February 2007, subsidiaries of the Company Kelon Refreezer, Kelon Air-conditioner, Kelon Refrigerator, Yingkou Kelon, Hangzhou Kelon, Chengdu Kelon, Yangzhou Kelon (hereinafter referred to as “Party A”) signed with Huayi Compressor, the associates of the Company, Jiayi Beila and Huayi (Jingzhou) of connected companies of the Company (hereinafter referred to as “Party B”) the compressors purchase and supply framework agreement; and concluded that from the date of signing till 31 December 2007, both parties will negotiate the pricing, and Party A will purchase raw materials from Party B with amount not more than RMB33,600,000.
- (2) On February 2007, the Company and its subsidiaries Kelon Refrigerator, Kelon Air-conditioner, Kelon Module (hereinafter referred to as “Party A”) signed with subsidiaries of Hisense Group (hereinafter referred to as “Party B”) the Business Cooperation framework agreement; and concluded that from the date of signing till 31 December 2007, both parties will negotiate the pricing; and Party A, as the purchaser, will purchase goods or receive services from Party B with amount not more than RMB942,500,000; Party A, as the supplier, will supply goods or offer services to Party B with amount not more than RMB845,500,000.

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

X. OTHER SIGNIFICANT EVENTS

1. Land use right of Shangqiu Kelon

Shangqiu Kelon's minority shareholder Shangqiu Bing Xiong Freezing Facilities Company Limited (hereinafter named "Shangqiu Bingxiong") entered into the Land Transfer Agreement with Shangqiu Kelon and the Administration Committee of Shangqiu Economic and Technology Development Zone in July 2004, which stipulated that Shangqiu Bingxiong shall transfer the land use right of the land totaling 200 mu located to the south of Nanjing Road in Shangqiu City, and that Shangqiu Kelon shall construct a project on the land while taking it over from Shangqiu Bingxiong to produce 2 million ice-making machines and sell them for RMB2.5 billion annually and to produce 1.6 million freezers and sell them for RMB1.2 billion. If the project is not completed, the Administration Committee of Shangqiu Economic and Technology Development Zone will reserve its right to recover the remaining land. Shangqiu Kelon has obtained the land use certificate, but as it has not completed "three connections and one leveling", Shangqiu Kelon has never used the land, and has not achieved the output as stipulated in the agreement.

In addition, Shangqiu Kelon received the notice from the local court in August 2005 that the Administration Committee of Shangqiu Economic and Technology Development Zone has lodged a claim to the court against Shangqiu Kelon, requesting to recover the 200 mu of land located in Shangqiu Economic and Technology Development Zone which was transferred from Shangqiu Bingxiong to Shangqiu Kelon. Meanwhile the Court has seized the above mentioned land use right. Shangqiu Kelon has made impairment provision of RMB18,207,006.81 for the land use right. As at 31 December 2006, this case was on trial proceedings.

2. Chengdu Kelon

In 1998, Chengdu Kelon entered into a borrowing agreement with Chengdu Xinxing Electrical Appliance Holdings Company Limited (hereinafter named "Chengdu Xinxing") which is a subsidiary of Chengdu Kelon's minority shareholder Chengdu Engine (Group) Company Limited, pursuant to which Chengdu Kelon provided Chengdu Xinxing with an operating fund of RMB34,000,000. The operating fund is guaranteed by Chengdu Engine (Group) Company Limited. As the consideration for Chengdu Kelon in providing the operating fund to Chengdu Xinxing, Chengdu Xinxing agreed to repay the operating fund to Chengdu Kelon by supplying an agreed number of refrigerator accessories. If Chengdu Xinxing does not repay the fund, Chengdu Kelon has the right to deduct the outstanding amount from the dividend due to Chengdu Engine (in whatsoever form). Chengdu Xinxing has never repaid the fund because of its poor operations.

3. Yangzhou Kelon

In June 2003, the Company entered into the Project Investment and Cooperation Contract with Yangzhou Economic Development Zone, stipulating that Yangzhou Economic Development Zone shall provide the land of 729,000 square meters in area in the Development Zone, that the consideration of the land use right transfer was RMB45 million and that the Company would obtain the land use certificate on 12 December 2003. In August 2003, the Company's subsidiary Yangzhou Kelon entered into the State-owned Land Use Right Transfer Contract with Yangzhou State Land Resources Bureau Development Zone Branch, stipulating that the transferor shall transfer the land of 729,000 square meters at a consideration of RMB102,073,860.00. In November 2003, Yangzhou Kelon has paid RMB45 million land amount to Yangzhou State Land Resources Bureau Development Zone Branch, and in April 2004, Yangzhou Kelon paid RMB40 million to Finance Bureau of Yangzhou Economic Development Zone again.

Yangzhou Kelon originally recognised the cost of land as RMB102,073,860 in its account. On 31 December 2005, Yangzhou Kelon, as advised by lawyers, was of the opinion that the actual purchase price of the above land was RMB45 million and, adding to the relevant tax charges of RMB1.8 million, the carrying value of the above land should be RMB46.8 million. In this connection, Yangzhou Kelon reduced the cost of land by RMB55,273,860 in adjustment.

4. The land use right of the Company

The Company originally owned the Shun Fu Guo Yong (2004) No.1002282 Land Use Certificate which was for the land of 266,668 square meters. In 22 June 2005, the Company transferred 254,629.68 square meters of it at a consideration of RMB168,855,132.63 to Foshan Shunde Jiegao Investments Company Limited. The Company has not received the relevant land transfer amount till now. The Company had provided an amount of RMB84,427,566.32 for such bad debt.

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

XI. GUARANTEES, PLEDGE AND IMPAWN

1. GUARANTEES

- (1) As at 31 December 2006, the guaranteed amount provided by the Company for its controlling subsidiaries was RMB1,330,217,400 and the actual guaranteed amount was RMB3,169,693,300, among which, the guaranteed amount provided by the Company for entities with a gearing ratio of over 70% was RMB1,233,526,600 and the actual guaranteed amount provided by the Company for entities with a gearing ratio of over 70% was RMB2,911,889,800.
- (2) As at 31 December 2006, balances of loan guarantees provided by Guangdong Greencool and Hisense Group Company Limited, both being related parties, for the Company and its subsidiary amounted to RMB85,708,600 and RMB50,000,000 respectively.
- (3) During the reporting period, the Company did not provide any guarantees to any company outside the scope of consolidation. Save for the above guarantees, we are not aware of any other external guarantees.

2. PLEDGE

- (1) Fixed asset pledge see Appendix 6 Note 9
- (2) Intangible asset pledge see Appendix 6 Note 11

3. IMPAWN

- (1) Inventory impawn see Appendix 6 Note 7
- (2) Long term share investment impawn see Appendix 6 Note 8

XII. COMMITMENT

Below is the capitalised pay out commitment with the contract signed and do not need to confirmed in the financial statement in the period of the statement.

1. Capitalised commitment

	2006	2005
House, Building and Machine	14,004,000.00	23,308,512.58

2. Operation lease commitment

According to the irrevocable operation lease contract, the minimum lease payable in the future by the end of 2006-12-31 listed below:

Year	2006	2005
Within 1 year	2,589,965.37	25,625,367.44
2 Years to 5 Years	1,116,463.59	9,739,911.93
	3,706,428.96	35,365,279.37

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

XII. COMMITMENT (continued)

3. External investment commitment

NO

XIII. RETURN ON NET ASSETS AND EARNINGS PER SHARE

Profit for the period	Return on net assets		Earnings per share	
	Fully diluted	Weighted average	Fully diluted	Weighted average
Profit derived from principal operations	N/A	N/A	0.9057	0.9057
Operating profits	N/A	N/A	(0.0938)	(0.0938)
Net profit	N/A	N/A	0.0243	0.0243
Net profit less of extraordinary items	N/A	N/A	(0.0914)	(0.0914)

The above figures were calculated as required by “No.9 Document of Regulations of Information Disclosure for Public Companies” issued by China Securities Regulatory Commission.

XIV. EXTRAORDINARY LOSS AND PROFIT

Items	2006
Non-operating income:	19,402,599.07
Add: Provision for impairment of construction in progress	1,496,239.73
Add: Provision for impairment of fixed assets	23,888,658.43
Add: Subsidy income - subsidy for technology renovation and innovation	70,000,000.00
Extraordinary loss and profit before income tax	114,787,497.23
Effect on income tax	—
Extraordinary loss and profit after income tax	114,787,497.23

The Company has confirmed the extraordinary loss and profit items in accordance with “No. 1 Questions and answers on information disclosure standards of listed securities companies” (2007) issued by the China Securities Regulatory Commission.

XV. COMPARATIVE INFORMATION

The Company has corrected the material accounting errors of the prior years and re-prepared the financial statement of 2005, of which the comparative information has been regrouped to conform to those presented in the financial statements of 2005. Part of the accounting records confirmed by the previous management of the Company has material difference with the actual operating activities. With the restrictions of objective conditions, the above material accounting errors may be incomplete. Upon completion of the financial settlements by the Company, we may need to restate the information of the above period.

Notes to the Financial Statements

For the year ended 2006 (Unless otherwise specified, expressed in RMB)

XVI. COMPARISON OF DIFFERENCES ARISING FROM THE FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH PRC ACCOUNTING STANDARD AND HONG KONG FINANCIAL REPORTING STANDARDS

This financial statement is made on PRC accounting standard, which is differed from the financial statement made on International accounting standard.

Currency: RMB

Item	2006 Net profit	2006-12-31 Net asset
Financial statement based on PRC standard	24,122	(1,046,929)
Adjustment based on International standard		
– Adjustment on fixed assets revaluation and related depreciation	(771)	(11,142)
– Adjustment on the amortization of investment variance of stock right	(4,790)	–
– Adjustment on the account payable which is unnecessary to pay	27,479	–
– Adjustment on intangible asset amortization	16,712	16,712
– Adjustment on the profit and loss of subsidiary shareholders	–	(26,684)
– Adjustment on goodwill provision and amortization	–	57,253
– Adjustment on deferred income tax	21,387	21,387
– Adjustment on the loss of the associated company share reform dilution	(16,317)	(16,317)
Other	1,396	–
Financial statement based on International standard	69,218	(1,005,720)

XVII. APPROVAL OF THE FINANCIAL STATEMENT

The Company's financial statements are approved by the Board on 26 April 2006.