

# BUSINESS

## OVERVIEW

The Group was founded in 1994, and has become one of the top air-conditioner brands in the PRC in terms of sales volume. The Group is principally engaged in the design, development, manufacture and sale of air-conditioning products, with more than 97% of its turnover for the year ended 31 December 2008 derived from the sale of air-conditioners and air-conditioner parts and components.

The Group has developed strong recognition of its CHIGO brand, which is evidenced by its accreditation by the General Administration of Quality Supervision, Inspection and Quarantine of the PRC (中華人民共和國國家質量監督檢驗檢疫總局) as “China Top Brand Product” (中國名牌產品), and by the Trademark Office of the State Administration for Industry and Commerce of the PRC (中華人民共和國國家工商行政管理總局商標局) as “Famous Trademark in China” (中國馳名商標). According to the annual research report on residential air-conditioners in the 2008 refrigeration year published by the State Information Center (國家信息中心), the domestic residential air-conditioner market is dominated by the top 10 manufacturers who accounted for over 80% of the PRC market in terms of sales volumes. The top five domestic air-conditioner manufacturers (including the Group) accounted for approximately 62.2% of the PRC market. According to the Information Resources Development Department of the State Information Center (國家信息中心資源開發部), among the top five domestic air-conditioner manufacturers, the Group ranked fourth in the PRC in terms of sales volume, which was approximately 7.6%, in 2008.

The table below sets forth the ranking and market share (in each case, as measured by sales volumes) of the Group’s CHIGO brand air-conditioners in the PRC market in recent years, which evidences the continuous improvement and development of the Group.

	2000	2001	2002	2003	2004	2005	2006	2007*	2008*
Ranking (note)	Outside 15	Outside 15	12	9	5	4	4	4	4
Market share (note) (by sales volume)	Not disclosed	Not disclosed	2.5%	3.6%	5.6%	6.0%	6.7%	6.8%	7.6%

Note: Save where otherwise indicated with “\*”, the above figures were extracted from the “Air-conditioning Industry Market Analysis Report” (空調行業市場分析報告) published by the Information Resources Development Department of the State Information Center (國家信息中心資源開發部) in May 2007, representing the sales volume of air-conditioners in the PRC market of each refrigeration year referred thereto.

\* These figures were extracted from confirmation letters issued by the Information Resources Development Department of the State Information Center in July, 2008 and April 2009, respectively, representing the sales volume of air-conditioners in the PRC market of each full year referred thereto.

The Directors also believe that the Group’s products and services are consistently of a high quality, as evidenced by the awards and certifications received by the Group such as the “China Energy Conservation Product Certification” (中國節能產品認證) in 2004 from the China Certification Centre (中國認證中心). In August 2007, the Group received the Global Human Settlements Award for Global Green Environment-Protection Energy-Saving Air-Conditioning from Friends of United Nations (The Organization Committee of Global Forum on Human Settlements).

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The Group sells its air-conditioning products and air-conditioner parts and components both domestically in the PRC and to overseas markets. The Group sold approximately 48.6% and 51.4% of its products in the PRC market and overseas, respectively, in the year ended 31 December 2008, and, during such period, in the PRC market, the Group's air-conditioning products were sold under CHIGO brand and 現代 HYUNDAI brand, whereas in the overseas market, the Group's air-conditioning products were sold both under the CHIGO brand and on an OEM basis.

For the three years ended 31 December 2008, sales of air-conditioners accounted for approximately 96.4%, 96.7% and 90.3%, respectively, and sales of air-conditioner parts and components accounted for approximately 0.6%, 1.3% and 7.0%, respectively, of the Group's total turnover. Other than air-conditioners, the Group also manufactures and sells air-curtains, water coolers, dehumidifiers and wine refrigerators. The Group also sources and resells small household electrical appliances, and licenses its CHIGO brand name to OEM manufacturers who sell these products. Pursuant to the Group's licensing arrangements with its OEM manufacturers, the Group may grant a licence to an OEM manufacturer for the manufacture of small household electrical appliances under the CHIGO brand, in return for a trademark licensing fee. Under such arrangements, the OEM manufacturers are not allowed to use the Group's CHIGO brand in any products other than the designated small household electrical appliances. Monthly sales targets would be given to the OEM manufacturers for the sale of the small household electrical appliances manufactured under the CHIGO brand. Customer services would be provided by the OEM manufacturers. The licensing fees from the OEM manufacturers under such arrangements accounted for, on average, not more than 0.06% of the Group's total turnover for the three years ended 31 December 2008.

The following table sets out the amount and percentage of the Group's total turnover, made through the Group's sales of CHIGO brand, HYUNDAI brand and OEM air-conditioners, air-conditioner parts and components, and other products for the three years ended 31 December 2008:

	Year ended 31 December					
	2006		2007		2008	
	<i>RMB'000</i>	<i>% of Turnover</i>	<i>RMB'000</i>	<i>% of Turnover</i>	<i>RMB'000</i>	<i>% of Turnover</i>
CHIGO brand						
air-conditioners	2,740,543	60.4	3,404,391	59.5	2,899,778	49.0
HYUNDAI brand						
air-conditioners	201,381	4.4	163,803	2.9	116,558	2.0
OEM air-conditioners	1,430,389	31.6	1,959,106	34.3	2,330,942	39.3
Air-conditioner parts and components	24,821	0.6	72,410	1.3	415,608	7.0
Other products	137,928	3.0	116,698	2.0	157,697	2.7
<b>Total</b>	<b>4,535,062</b>	<b>100.0</b>	<b>5,716,408</b>	<b>100.0</b>	<b>5,920,583</b>	<b>100.0</b>

For the three years ended 31 December 2008, the Group sold in aggregate approximately 2,719,800, 2,941,900 and 2,956,800 units of residential air-conditioners, respectively. During the same periods, the Group sold in aggregate approximately 45,600, 129,100 and 86,200 sets of commercial air-conditioning products, respectively.

The Group's domestic sales network is geographically divided into six sales regions covering 30 out of 31 provinces, municipalities and autonomous regions in the PRC. The Group has an extensive sales and distribution network in the PRC and it sells its products through independent regional distributors (經銷商) (who in turn may further distribute the

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Group's products through their resellers (分銷商) and household appliances retail chain operators. For overseas sales of the Group's products, the Group sells its products to overseas distributors and air-conditioning products manufacturers in the other Asian countries, the European market, the American market, the Middle East and African markets and other markets. The Group is a manufacturer and sells its products to the distributors, household appliances retail chain operators and manufacturers as described aforesaid, and, in this respect, the Group has limited direct contacts with the end-users of the Group's products. However, the Group works closely with such distributors (and, with respect to the PRC market, the regional distributors' resellers), household appliances retail chain operators and manufacturers in collecting market information and the relevant data. In addition, with respect to the PRC market, the Group also (i) maintains a network of product monitoring centres, which are charged with the responsibility of collecting market information and working closely with the Group's household appliances retail chain operator customers and distributor customers (and their resellers), and (ii) cooperates with the household appliances retail chain operators for the promotion of the Group's product by staffing sales representatives employed by the Group at the sales counters in their retail chain stores, thus allowing the Group to closely monitor market conditions.

The Group's vertically integrated manufacturing base, comprising seven production and support facilities, enables the Group to manufacture in-house eight of its 10 major component categories (the details of the major components are set out in the paragraph headed "Production — Parts and components" in this section below) and more than 65% of the total number of parts (including those parts used in the manufacture of the aforesaid major components) used in the manufacture of the Group's three main residential air-conditioner series (out of a total of 33 series) in terms of production volume (namely, its 3,500W and 5,100W wall-mounted type and 5,100W floor-standing type residential air-conditioners, which represented approximately 30% of the Group's total production volume of residential air-conditioners for the year ended 31 December 2008), which, the Group believes, enables it to control its production costs and coordinate procurement, production and delivery more efficiently. This vertical integration has effectively reduced the Group's production costs and improved the Group's profit margin by reducing the need to pay outside suppliers, and saved time by reducing the need to secure procurement of such parts and components from such suppliers.

The quality control management of the Group received ISO9001:2000 quality management system certification in December 2001. The Group's products have been accredited with over 400 certifications by various domestic and overseas authoritative organisations. Such certifications include China Compulsory Certification (3C certification) (中國國家強制性產品認證證書), China National Industrial Product Manufacture Certification (全國工業產品生產許可證), CE Certification, UL Certification, GS Certification and Energy Safe Victoria (Australia) certification. The Group also obtained ISO14001:2004 certification for its environmental management standards in June 2006. In addition, the design and manufacture of air-conditioners by the Group has been audited, and was found to be meeting the RoHS Compliance Verification Audit Requirements. These certifications are often designated by the Group's PRC and overseas customers as requirements in respect of the Group's products they purchase. Therefore, the obtaining of such certifications is essential for the Group to make its PRC and overseas sales. These certifications also signify the quality of the Group's products, and they are important in helping the Group attract and secure new customers and strengthening the competitiveness of the Group in the PRC and overseas markets.

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The Group has an established strategic relationship with the Vaillant group (a leading European heating technology group, which, through its wholly-owned subsidiary Saunier, invested in the Company in December 2006). Apart from Saunier, the Group also has four other investors, namely, High Surplus, Menlo Dynamics, Getchance and Raffles Partners. For details of the share purchase agreement entered into between Saunier, Chigo Group Holding and Mr. XH Li, and the four subscription agreements entered into between the Company and High Surplus, Menlo Dynamics, Getchance and Raffles Partners, please refer to the “Strategic investor and other investors” section of this prospectus.

### COMPETITIVE STRENGTHS

The Group believes that it has the following competitive strengths:

- **High quality products leading to strong brand recognition and increase in market share.** The Group focuses on the quality of its products and after sales services provided to customers. The Directors believe that the Group’s products and services are consistently of a high quality, as evidenced by the awards and certifications received by the Group such as the “China Energy Conservation Product Certification” (中國節能產品認證) in 2004 from the China Certification Centre (中國認證中心). In August 2007, the Group received the Global Human Settlements Award for Global Green Environment-Protection Energy-Saving Air-Conditioning from Friends of United Nations (The Organization Committee of Global Forum on Human Settlements).

The Group has developed strong recognition of its CHIGO brand, as evidenced by its accreditation as “China Top Brand Product” (中國名牌產品) in 2004 by the General Administration of Quality Supervision, Inspection and Quarantine of the PRC (中華人民共和國國家質量監督檢驗檢疫總局), and “Famous Trademark in China” (中國馳名商標) in 2006 by the Trademark Office of the State Administration for Industry and Commerce of the PRC (中華人民共和國國家工商行政總局商標局). The Group has also experienced an increase in market share in its sales of air-conditioners in the PRC market in recent years. The market share of the Group’s CHIGO brand air-conditioners in the PRC market (as measured by sales volume) increased from 3.6% in 2003 to 7.6% in 2008. For further details of the Group’s market share and ranking in recent years, please refer to the paragraphs headed “Overview” above.

- **Strong parts and components manufacturing capabilities strengthening the Group’s vertically integrated production process and supply chain management.** The Group’s vertically integrated manufacturing base, comprising seven production and support facilities, enables the Group to manufacture in-house eight of its 10 major components and more than 65% of the total number of parts (including those parts used in the manufacture of the aforesaid major components) used in the manufacture of its three main residential air-conditioner series (out of a total of 33 series) in terms of production volume (namely, its 3,500W and 5,100W wall-mounted type and 5,100W floor-standing type residential air-conditioners, which represented approximately 30% of the Group’s total production volume of residential air-conditioners for the year ended 31 December 2008), which, the Group believes, enables it to control its production costs and coordinate procurement, production and delivery more efficiently. This vertically integrated in-house production process and supply

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chain facilitates the research and development of new products and allows the Group to efficiently and flexibly adjust its production process to respond to changing production plans, as well as to save transportation and storage expenses associated with the sourcing of parts and components from external suppliers. Such vertically integrated supply chain also enables the Group to better maintain overall quality control over its products.

Furthermore, in times when raw material costs are relatively high, this gives the Group a competitive advantage for the Group to devise plans, if and to the extent feasible, to modify its parts and components and/or the production process in order to reduce the consumption of any particular raw material. For example, although the price per ton of copper, which is one of the principal raw materials of the Group's products, increased by 45.7% as from the beginning to the end of 2006 and then remained relatively high throughout 2007 with a slight decrease of 0.7% at the end of 2007 as compared to 2006, the average quantity of copper used in the manufacture of the evaporators and condensers of the Group's three main residential air-conditioner series in terms of production volume (as referred to above) decreased by approximately 21.8% as from 2005 to 2006 and 11.0% as from 2006 to 2007. The Group coordinates its own parts and components production and thus is able to lower its inventory levels for intermediate parts and components. As a result, the Group maintains a long-term and sustainable competitive cost structure.

- **Extensive distribution networks in the PRC and overseas markets.** The Group has an extensive distribution network in the PRC with coverage over Tier 1 to 4 markets. As of 31 December 2008, the Group worked with a total of 265 regional distributors (經銷商) (which generally resell the Group's products to resellers (分銷商)) and the three largest nation-wide household appliances retail chain operators, covering 30 out of 31 provinces, municipalities and autonomous regions in the PRC. The Directors consider that the Group has a competitive advantage in its sales network, especially the Tier 2 to 4 markets which were the Group's initial focused markets when the Group was established.

The Group also exports its air-conditioners (both under the CHIGO brand and on an OEM basis) and air-conditioner parts and components to countries and regions outside the PRC principally through, as of 31 December 2008, 207 overseas distributors and 1 air-conditioning products manufacturer customer who distributed CHIGO brand air-conditioners and/or used CHIGO brand air-conditioners in the manufacture of their products, and 811 OEM customers who distributed the Group's OEM air-conditioners and/or used the Group's OEM air-conditioners in the manufacture of their products. The brands under which some of the Group's OEM air-conditioners were marketed included Lennox and Saunier Duval. The Group believes that its extensive domestic and overseas distribution networks and experience in domestic sales and the export markets enable it to be well positioned to capture business opportunities both in the PRC and the overseas markets.

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- **Strong emphasis on product research and development.** The Group places strong emphasis on product research and development and it possesses more than 150 internally-developed patents. The number of engineering and technical personnel employed by the Group increased from 140 as of 31 December 2006 to 244 as of 31 December 2008. In 2007, the Group set up its new research and development centre with a gross floor area of approximately 11,000 sq.m. to further focus on research and development. The Group has the capability to design a wide range of residential and commercial air-conditioning products with a key focus on three principal goals: quiet level, energy efficiency and air-purification ability, which are key to enhancing the competitiveness of its air-conditioners. In April 2006, the Group launched the first generation of its “三超王” (“San Chao Wang”) series of residential air-conditioners, and the second and third generations were launched in March 2007 and September 2007, respectively. Each generation of this series of air-conditioners was designed with the objective of surpassing the highest national standards in terms of quiet level, energy efficiency and air purification ability, and featuring each of these high standards in one single air-conditioner product. The “三超王” (“San Chao Wang”) series of residential air-conditioners signifies the Group’s strong technology capabilities and its strategy to develop high-end air-conditioning products.
- **Experienced and dedicated management team.** The Group is led by an experienced and dedicated management team. Mr. XH Li, the Group’s founder, established the Group in 1994 and has since been the Chairman of the Group. In addition, each member of the senior management team of the Group has extensive experience within his/her corresponding field and the senior management team has an average of approximately 10 years of experience in the air-conditioner industry.

### BUSINESS STRATEGIES

The Group aims to become a top air-conditioner manufacturer in the PRC and intends to focus on the following principal strategies to strengthen its market position:

#### **Further strengthen vertical integration and quality control in the production process**

To strengthen the vertical integration capabilities of its in-house production process, the Group plans to further develop its upstream raw materials processing capability in order to reduce the unit production cost for the Group’s products, and provide the Group with greater flexibility in its production process. The Group intends to further manufacture more parts and components in-house, which will further integrate its manufacturing process, resulting in an increase in profit margin.

The Group also plans to further invest in quality control by setting up more stringent quality control mechanisms in the production process, so as to better monitor and control its product quality.



### **Expand manufacturing and distribution capabilities for commercial air-conditioning products**

The Group commenced commercial air-conditioning products manufacturing in 2002. Despite the economic downturn which affected its sales of commercial air-conditioning products in 2008, the Group believes that the market for commercial air-conditioning products is rapidly developing in the long run primarily due to (i) the improving competitive landscape for lower-cost Chinese manufacturers, such as the Group, as such manufacturers have removed the technological gap with overseas competitors for merchandising commercial air-conditioning products, and (ii) the growing demand for commercial and central residential air-conditioning products in China, which is largely a result of continuing economic development and increasing wealth in China. In addition, during the Track Record Period, the Group's commercial air-conditioning products recorded consistently higher gross profit margin than residential air-conditioning products, which were 20.6%, 19.9% and 17.9%, respectively, for the three years ended 31 December 2008, as compared to 18.3%, 18.6% and 16.6%, respectively for residential air-conditioning products in the same period. Therefore, the Group intends to further expand the manufacturing and distribution capabilities for its commercial air-conditioning products, by setting up more production lines and expanding its sales network. The Group plans to increase the number of its commercial air-conditioning products production lines from seven in 2008 to nine in 2011, which will be funded in part by the proceeds of the Global Offering. The commercial air-conditioning expansion projects have commenced but were slowed down in view of the recent economic downturn, and the Group adjusted the construction work schedule in accordance with its business needs. It is expected that the manufacturing capacity expansion will commence in the second half of 2009 and will be completed in the first half of 2011.

### **Strengthen research and development capability and diversify product offerings with advanced features**

The Group believes that its future success depends significantly on its ability to design and launch innovative products. With a view to strengthening its research and development capability and diversifying its product offerings, the Group established a technology centre and a specialised division in charge of research and development of new products at the end of 2007. The Group plans to continue to develop higher-end products (being those with special features such as with an emphasis on high standards in terms of quiet level, energy efficiency and air purification ability for the “三超王” (“San Chao Wang”) series) and to continue to develop new technologies such as the ice-on-coil thermal energy storage (TES) technology (冰儲冷技術) and multi-split air-conditioning system (多聯空調機組), to broaden its capability to offer a larger variety of its residential and commercial air-conditioning products.

### **Strategic cooperation**

With regards to the development of the residential air-conditioners business, the Group invited the Vaillant group (a leading European heating technology group) to invest, through its wholly-owned Saunier, in the Company in December 2006. In December 2006, the Group also entered into a strategic supplier agreement with Vaillant GmbH (a member of the Vaillant group), whereby the Group agreed that it would sell its products exclusively to members of the Vaillant group (inclusive of

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Vaillant GmbH and Saunier) in Spain, France and Germany. The Group also agreed to appoint the Vaillant group as a distributor to distribute the Group's air-conditioning products (exclusive of portable air-conditioners, dehumidifiers and wine cellars) (the "Air-Conditioners") in Spain, France and Germany. Under the strategic supplier agreement, it was further agreed that the Group would not appoint new distributors (not including retailers, do-it-yourself shops, white goods shops (being those retail stores principally engage in the sale of household electrical appliances such as air conditioners, washer/dryers, refrigerators, and heaters), hypermarkets and department stores) to distribute its air-conditioners in Spain, France and Germany.

The Group believes that this strategic relationship with the Vaillant group will enable the Group to leverage on the Vaillant group's sales network and business relationships to further expand its sales in the European market.

### **Enhance brand awareness**

The Group believes that its CHIGO brand is important to the future development and expansion of its business. The Group intends to continue to enhance the awareness of its CHIGO brand in both the PRC and overseas markets. The Group intends to roll out more promotional and marketing activities to promote its brand image and further enhance its brand awareness.

## **PRODUCTS**

### **Product range**

The Group's principal products are residential and commercial air-conditioning products, as well as related air-conditioner parts and components, which in aggregate accounted for approximately 97.0%, 98.0% and 97.3% of the Group's total turnover for the three years ended 31 December 2008, respectively. The Group also manufactures and sells air-curtains, water coolers, dehumidifiers, wine refrigerators and other home electrical appliances on a small scale. The Group has been able to design, research, develop and manufacture a wide range of air-conditioners in response to the changing market environment and the diverse needs of its end-users.



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The following table sets out the Group's turnover generated from its principal products for the three years ended 31 December 2008:

	2006		Year ended 31 December 2007		2008	
	RMB'000	% of Turnover	RMB'000	% of Turnover	RMB'000	% of Turnover
<b>Residential air-conditioners</b>						
Split type air-conditioners	3,988,176	87.9	4,908,371	85.9	4,746,919	80.2
Window type air-conditioners	126,811	2.8	130,568	2.3	203,041	3.4
Portable type air-conditioners	108,427	2.4	86,539	1.5	85,527	1.4
Total residential air-conditioners	4,223,414	93.1	5,125,478	89.7	5,035,487	85.0
<b>Commercial air-conditioning products</b>	148,899	3.3	401,822	7.0	311,791	5.3
<b>Air-conditioner parts and components</b>	24,821	0.6	72,410	1.3	415,608	7.0
<b>Other products</b>	137,928	3.0	116,698	2.0	157,697	2.7
Total	4,535,062	100.0	5,716,408	100.0	5,920,583	100.0

For the three years ended 31 December 2008, the Group sold in aggregate approximately 2,719,800, 2,941,900 and 2,956,800 units of residential air-conditioners, respectively. During the same periods, the Group sold in aggregate approximately 45,600, 129,100 and 86,200 sets of commercial air-conditioning products, respectively.

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### (a) *Residential air-conditioners*

The Group's residential air-conditioners can be broadly divided into three main types: split type (which can be further divided into wall mounted type and floor standing type), window type and portable type, and include a wide variety of product series. Each series has further variations in their products' appearances. To satisfy consumers' different needs, certain types of the Group's air-conditioners are equipped with heating and/or dehumidifying functions. The Group's residential air-conditioners are compatible with worldwide power supply specifications. The following table sets out the product types and principal specifications of the Group's residential air-conditioners, as of 31 December 2008:

Product type	Cooling capacity (W)	Number of series	Energy efficiency grade (Note)	Noise level (dB(A))
<b>Split type</b>				
Wall mounted type	<2,500	3	1-5	24-40
	2,500-4,500	7	1-5	24-45
	4,500-7,100	4	3-5	36-52
	7,100-8,800	2	4-5	41-55
Floor standing type	4,500-7,100	2	2-5	30-52
	7,100-14,500	4	3-5	43-55
<b>Window type</b>				
	<2,500	1	3-5	46-54
	2,500-4,500	3	3-5	47-55
	4,500-6,600	4	3-5	53-60
<b>Portable type</b>				
	2,200-3,500	3	A-D	54-59

*Note:* Details on the various energy efficiency grades are set out in the "Glossary" section of this prospectus.

#### — *Split type air-conditioner*

The Group's split type air-conditioners are divided into two types: wall-mounted type and floor-standing type.

##### (i) Wall-mounted type

As of 31 December 2008, the Group's wall-mounted split type air-conditioners comprised 16 series, covering a wide spectrum of features and functions. The wall-mounted type represents the majority of the Group's product types as it is the most common residential air-conditioner type in both the overseas and PRC markets.

(ii) Floor-standing type

As of 31 December 2008, the Group's floor-standing split type air-conditioners comprised six series. For example, the “花好月圓” (Hua Hao Yue Yuan) series features a display screen function so that the end-user can install and display pictures and advertising materials on the front panel of the air-conditioners. This type of air-conditioners is generally more common in the PRC than the overseas market.

— *Window type air-conditioner*

As of 31 December 2008, the Group's window type air-conditioners comprised eight series. The Group's window type air-conditioner is a self-contained packaged air-conditioner, as all of its components are housed within the same unit. It is installed through an opening in a window or a wall.

— *Portable type air-conditioner*

As of 31 December 2008, the Group's portable type air-conditioners had three series. The Group's portable type air-conditioner is mounted on casters so it can be easily wheeled from one location to another. It employs the same basic components as the window type air-conditioner, with one or two exhaust hoses that direct hot air from the back of the air-conditioner to the outside of the premises through a window or a cut out in a wall or draws air from outside the premises to the condenser to exchange heat.

Portable type air-conditioners are widely used for keeping certain areas of a home or office cool, such as cooling down an attic or upstairs room, or keeping computer areas cool and dry. Apart from spot cooling, they are also ideal for places where traditional window type air-conditioners cannot be installed for architectural reasons.

**(b) Commercial air-conditioning products**

Depending on the scale of use, the Group's commercial air-conditioning products can generally be categorised into small scale household-use central air-conditioning systems and large scale central air-conditioning systems based on their cooling capacity as

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described in the following table. Each category can be further divided into the wind-cooled and water-cooled types. The following table sets out the principal specifications of the Group's commercial air-conditioning products:

Product type	Cooling capacity (W)	Energy efficiency grade (Note)	Noise level (dB(A))
Small scale household-use central air-conditioning	≤2,500	1-5	30-40
	2,500-15,000	1-5	33-48
Large scale central air-conditioning	15,000-25,000	1-5	53-58
	25,000-50,000	1-5	62-67
	50,000-100,000	1-5	65-68
	≥100,000	1-5	68-88

*Note:* Details on the various energy efficiency grades are set out in the "Glossary" section of this prospectus.

The Group's commercial air-conditioning products are used not only in residential apartments and houses, but also in commercial and government buildings, hotels, shopping malls and public infrastructures. During the Track Record Period, some of the notable facilities that opted to install, among others, the Group's central air-conditioning systems included Guangxi Beihai Resort Joy Life Hotel (廣西北海嘉萊假日酒店), Jiangxi Tumor Hospital (江西腫瘤醫院), a general assembly facility of a motor vehicle manufacturing company in Guangzhou, a governmental administrative building in Qitaihe, Heilongjiang province, and a home construction materials mart in Nanchang.

### **(c) Air-conditioner parts and components**

The Group also manufactures and sells air-conditioner parts and components to its customers for the manufacture of air-conditioning products. Air-conditioner parts and components manufactured by the Group mainly comprise condensers, evaporators, motors, fan blades, casings, copper pipes and valves and metal plates, which are used for the manufacture of different types of air-conditioners.

### **(d) Other products**

Other products manufactured and sold by the Group include air-curtains, water coolers, dehumidifiers and wine refrigerators. The Group also sources and resells small household electrical appliances and licenses its CHIGO brand name to OEM manufacturers in selling these products.

### **Certification**

The Group pursues continuous improvement in the quality of its products and, as of 31 December 2008, had over the years obtained China Compulsory Certification for over 1,000 models of products under the CHIGO brand. The Group is also committed to following the international standards imposed by different countries in which its products are marketed and sold. In order to export the Group's products overseas, the Group has

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obtained a large number of certifications for products under the CHIGO brand from different associations including, as of 31 December 2008, CE Certification for 476 models of products, GS Certification for 176 models of products, UL Certification for 62 models of products, and Energy Safe Victoria (Australia) Certification for 110 models of products.

### PRODUCTION

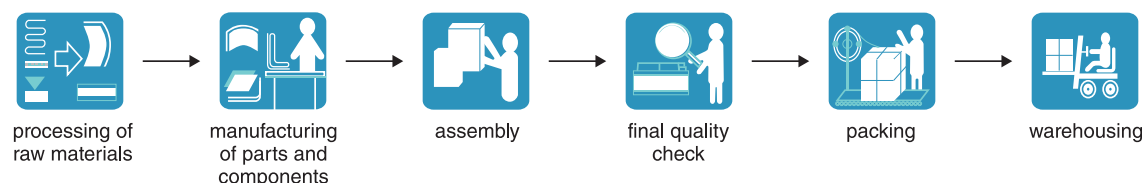
#### Production planning

The Group's production planning is prepared on an annual basis and is subject to monthly adjustments based on market conditions and seasonal updates. As of 31 December 2008, the Group had a production planning team of 50 staff responsible for preparing annual, quarterly and monthly production plans, and executing such production plans as scheduled. The production planning team works closely with personnel from the head office sales centre, procurement centre and production centre in order to monitor the rollout of the production schedule and implement adjustments when necessary.

Once a purchase order has been confirmed and approved, all data relating to that order, such as quantity, production specifications and delivery date, will be entered into the Group's ERP system which is linked with the Group's procurement centre, production centre and head office sales centre for coordinating production. Depending on the type of residential air-conditioners involved, it generally takes around 10 to 35 days from placement of order to delivery of finished products.

#### Production process

The following flow chart illustrates the major steps involved in the production process for the Group's air-conditioners, which can be broadly categorised into six stages: processing of raw materials; manufacturing of parts and components; assembly; final quality check; packing and warehousing.



#### Facilities

The Group's principal production facilities are located in Foshan, Guangdong province, the PRC, and they occupy a total gross floor area of approximately 159,000 sq.m. As of 31 December 2008, the Group had 23 production lines comprising 16 production lines for the manufacture of residential air-conditioners (eight of which are for the manufacture of outdoor air-conditioner units and eight are for the manufacture of indoor air-conditioner units) and seven production lines for the manufacture of commercial air-conditioning products.

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The following table sets out brief details of the Group's major production and support facilities:

Facility	Approximate gross floor area ( <i>m</i> <sup>2</sup> )	Primary purposes
Metal plate moulding and processing	34,292	Moulding and processing of the casings of the outdoor unit and other metal parts
Copper tube and valve	7,656	Processing of copper tubes and rods for the manufacture of the pipes connecting the outdoor unit to the indoor unit, valves and other copper parts
Condenser and evaporator	35,192	Manufacturing of condensers and evaporators
Electrical machinery	6,564	Manufacturing of motors for the fans
Plastic moulding and processing	8,424	Moulding and processing of the casings of the indoor unit and other plastic parts
Spraying	35,191	Spraying and coating the metal casings and other metal parts with anti-corrosion paint
Cardboard box and packaging materials	4,219	Printing and manufacturing of cardboard boxes for packaging; manufacturing of plastic packaging tapes, foam rubber, plastic bags and other packaging materials

### Production capacity

Approximately 93.1%, 89.7% and 85.0% of the Group's turnover was generated from the sales of residential air-conditioners in 2006, 2007 and 2008, respectively. Since the setup and the manufacturing processes for residential air-conditioners are more standardised and measurable, the production capacities and utilisation rates of the Group's production lines during the Track Record Period are presented in the table set out below.

	Year ended 31 December		
	2006	2007	2008
No. of production lines for residential air-conditioners <sup>(1)</sup>	14	16	16
Theoretical production capacity (units) <sup>(2)</sup>	3,339,623	4,418,296	4,610,338
Actual production volume (units) <sup>(3)</sup>	2,774,124	3,078,296	2,822,460
Utilisation rate (%)	83.1%	69.7%	61.2%

- (1) These production lines comprise of designated lines for manufacturing indoor air-conditioner units and outdoor air-conditioner units. Some of these production lines can be adjusted to manufacture different types of residential air-conditioners.



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- (2) The theoretical production capacity of the Group's production facilities during the Track Record Period is calculated by aggregating the maximum output per day of the bottleneck process for each of the residential air-conditioner production lines based on a number of assumptions, including the number of operating hours per day, the product type being produced, and the actual number of working days for each of 2006, 2007 and 2008.
- (3) The actual production volume of residential air-conditioners includes the split type air-conditioners, the window type air-conditioners and the portable type air-conditioners.

The fluctuation of utilisation rates of the Group's production lines for residential air-conditioners throughout the Track Record Period was due to changes in the theoretical production capacity and actual production volume of the Group's residential air-conditioners. The theoretical production capacity varied over the Track Record Period as the actual number of working days varied over the period, and due to the increase in the number of production lines and the improvement in production efficiency. The increase in theoretical production capacity from approximately 3,339,623 units in 2006 to approximately 4,418,296 units in 2007 was primarily due to the increase in number of production lines from 14 to 16 between the two periods. The increase in theoretical production capacity from approximately 4,418,296 units in 2007 to approximately 4,610,338 units in 2008 was mainly due to the decrease in the number of portable-type air-conditioners being produced and the increase in the number of split type air-conditioners being produced during the period. The average time in producing a portable-type air-conditioner is relatively longer than that of a split type air-conditioner. This shift in the types of products produced raised the theoretical production capacity of the Group in 2008. The increase in actual production volume of residential air-conditioners in 2007 was mainly due to the increase in production lines and the sales plan which reflected an increase in actual sales of the Group during that period. The decrease in actual production volume of residential air-conditioners in 2008 was mainly a result of the decrease in actual sales of the Group during that period. As production was driven by sales plan, the Group adjusted its production volumes of the residential air-conditioners according to the actual sales orders received. In 2008, affected by the economic downturn towards the end of the year, both the actual operating hours and the actual production volume of residential air-conditioners decreased.

The commercial air-conditioning products are manufactured according to the specifications of each order placed. The setup and the time required for the production of commercial air-conditioning products therefore vary significantly and thus it is not practical for the Group to present its theoretical production capacity for its commercial air-conditioning products. The Group had five, seven and seven production lines for the manufacture of commercial air-conditioning products in 2006, 2007 and 2008, respectively, and the Group's actual production volume of commercial air-conditioning products during these periods is set out below.

	<b>Year ended 31 December</b>		
	<b>2006</b>	<b>2007</b>	<b>2008</b>
Actual production volume of commercial air-conditioning products (units)	110,880	155,268	158,331

The Group plans to expand its production capacity for the manufacture of commercial air-conditioning products at its facilities in Wuhu, Anhui province, the PRC and Jiujiang, Jiangxi province, the PRC, with the proceeds of the Global Offering. It is expected that

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with the completion of the manufacturing capacity expansion project in the first half of 2011, the number of production lines for the manufacture of the Group's commercial air-conditioning products will be increased from seven to nine.

### Parts and components

Major components used in the production of the Group's air-conditioners include condensers, condenser coils, evaporators, evaporator coils, motors, compressors, electronic controller systems, fan blades, metal plates and casings. Parts used in the production of the Group's air-conditioners include electrothermal tubes, screws, cables, filters, silencer cotton, shock absorbing pieces, damping rubber and stop valves.

As of 31 December 2008, the Group manufactured at the above mentioned production and support facilities eight of its 10 major component categories and more than 65% of the total number of parts (including those parts used in the manufacture of the said major components), in its three main residential air-conditioner series (out of a total of 33 series) in terms of production volume (namely, its 3,500W and 5,100W wall-mounted type and 5,100W floor-standing type residential air-conditioners, which represented approximately 30% of the Group's total production volume of residential air-conditioners for the year ended 31 December 2008). The table below sets out the functions and the principal raw materials required for the manufacture of the major components:

Major component	Function	Key raw materials/ components used
<b>Components manufactured in-house by the Group</b>		
Condenser	A device commonly installed in the outdoor unit of an air-conditioner, which transfers heat out of a refrigeration system to a medium that absorbs the heat and eventually to a disposal point	Aluminium and copper
Condenser coil	A series or network of tubes filled with refrigerant which remove heat from the hot gaseous refrigerant so that the refrigerant becomes liquid again	Copper tubes
Evaporator	A device commonly installed in the indoor unit of an air-conditioner, which absorbs heat from the surrounding air and, through the use of the refrigerant, transfers the heat to outside the refrigerated area	Aluminium and copper
Evaporator coil	A series or network of tubes filled with refrigerant which absorb the heat in the indoor air as the liquid refrigerant inside them evaporates	Copper tubes
Motor	A device which drives the fans in both the outdoor and indoor units as well as the air-diverters and door in the indoor unit	Steel and copper wires

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Major component	Function	Key raw materials/ components used
Fan blades	A device installed in both the outdoor and indoor units and used to move or circulate air	Plastic chips
Metal plates	The protective cover of the outdoor unit of the air-conditioner	Steel
Casing	The protective cover of the indoor unit of the air-conditioner	Plastic chips

### Components manufactured by third parties

Compressor	A device commonly installed in the outdoor unit of an air-conditioner. It squeezes the low-pressure gaseous refrigerant into higher pressured and hence higher temperature gaseous refrigerant	Steel and aluminium
Electronic controller system	A device which controls the various mechanisms of an air-conditioner in order to regulate the room temperature, humidity and wind speed, as well as to trigger automatic test and emergency start of an air-conditioner	Copper and plastic chips

## PRODUCT DESIGN AND RESEARCH AND DEVELOPMENT

The Group places strong emphasis on product design and research and development to increase its competitiveness. The Group focuses its efforts principally on expanding the Group's product offerings, enhancing product quality, new product design, technological development and improving production efficiency to achieve overall cost efficiency. The Group strives to diversify its product range with a view to capturing demand from end-users from different segments of the market.

The Group launched its first generation of “三超王” (“San Chao Wang”) series residential air-conditioners in April 2006. This series was designed with the objective of surpassing the highest national standards in terms of quiet level, energy efficiency and air purification ability, and featuring each of these high standards in one single air-conditioner product. The first generation was introduced to test customers' and consumers' reception and obtain their feedback on operating performance and reliability, increase market recognition of the Group's technology and brand name, and obtain industry accreditation. The second generation of “三超王” (“San Chao Wang”) was an improved version of the first generation, and it was launched in March 2007.

The third generation of “三超王” (“San Chao Wang”) was launched in September 2007. The “三超王” (“San Chao Wang”) split type air-conditioner (model KF-28GW/M(M71A)+1) has an EER of 4.29, surpassing the national energy efficiency grade 1 standard of 3.40 by 26.2%. With a specially designed air purifying system, this model can

remove more than 90% of the germs naturally present in indoor conditions (as accredited by the Chinese Centre for Disease Control and Prevention (中國疾病預防控制中心)). In addition, as low noise level fans and motors are used in conjunction with its advanced ventilation design, the inverter type air-conditioner such as model KFR-28GW/X1DBP has a noise level of merely 20.0dB(A), surpassing the national standard of 45dB(A) by 55.6%. Moreover, the move touch technology (動感技術) is featured in this series of “三超王” (“San Chao Wang”) air-conditioners. Equipped with a detection sensor, movement in a room in which a unit is located can be detected, thus enabling the cooling or heating effect, and the volume and direction of air flow, to be adjusted automatically. Such technology also enables the air-conditioner to be switched off automatically when the sensor detects no movement in the serviced area for a duration of time, so as to reduce wastage of energy. The “三超王” (“San Chao Wang”) series of residential air-conditioners signifies the Group’s capability and strategy to develop high-end air-conditioning products.

The residential air-conditioners manufactured by the Group cover a complete EER range of between 1 to 5 (for split type residential air-conditioners) and have an EER of between 3 to 5 (for window type residential air-conditioners). As the Group generally manufactures and supplies domestic air-conditioners to the PRC market based on market demand and consumer preference, the Group estimates that around half of its residential air-conditioners sold in the PRC market in 2008 (which were targeted at the mass market) had an EER of 4 or 5. Thus, the Group believes that its said higher-end products, which are brought about by its product design and research and development efforts, will not only generate more sales, they can also enhance the reputation of its CHIGO brand and product quality, which in turn will assist the Group in selling its mass market residential air-conditioners.

For the three years ended 31 December 2008, the Group incurred approximately RMB6.0 million, RMB9.9 million and RMB12.7 million, respectively, as research and development expenses. The Group’s research and development activities are carried out on a project-by-project basis. Prior to the implementation of any research and development project, the proposal for the project together with the budgeting would have to be assessed and approved by the management. The management would continue to monitor the research and development expenses incurred during the implementation of the research and development projects.

### **Core technology**

The Group continuously invests in the research and development of its core technologies and manufacturing processes. Such core technologies mainly include the optimisation of the cooling power of air-conditioning systems and high energy efficiency design (including heat exchange flow system (換熱器流路設計)), research and development on electronic control systems which control all mechanisms and functions of an air-conditioner, liquid dehumidification (液體除濕), central air-conditioning ventilation pipes (中央空調通風管道) cleaning system, wind-flow design (風道設計) and noise control.

With its core technologies, the Group is able to produce air-conditioning products with high energy efficiency ratios, low noise levels and high air-purification abilities.

## Laboratories and testing equipment

The Group owns the following laboratories and testing equipment, certain of which have been accredited by the China National Accreditation Committee for Laboratories in 2003 as nationally recognised laboratories in the PRC:

- An advanced enthalpy difference laboratory (熱函差實驗室), which was designed for the purpose of developing new products, optimising functions of products, and testing finished products.
- A noise level testing room (噪音水平測試室).
- A balance ambient room-type calorimeter laboratory (平衡法實驗室) for the purpose of testing a product's functions with high precision.
- An EMC (electromagnetic compatibility) laboratory (電磁兼容EMC測試室) for the purpose of testing an electrical product's immunity to interfering electromagnetic sources.
- An anti-corrosion paint laboratory (噴淋實驗室) and anti-material aging/fatigue testing equipment (抗老化測驗設備) for the purpose of testing a product's resistance to water, ability to prevent electricity leakage and the life of the components.
- Impurities analysis facilities (雜質分析設備) for the purpose of conducting impurities analysis and quality control of air-conditioning products and parts and components.

## Professional staff

As of 31 December 2008, the Group had 244 technical and engineering personnel in its research and development team who specialised in the development of air-conditioning products and parts and components. Approximately 80% of these staff in the research and development team hold college or university degrees, with some of them holding master's or doctor's degrees.

## PROCUREMENT

### Sourcing and inventory control

The raw materials, parts and components sourced by the Group can be broadly categorised into compressors, copper, plastic chips, aluminium, steel plates, and others such as electronic controller systems, refrigerants, power cords and capacitors. For the year ended 31 December 2008, procurement of compressors, copper, plastic chips, aluminium, steel plates, and other raw materials, parts and components accounted for approximately 28.9%, 24.6%, 7.0%, 4.8%, 6.6% and 28.1%, respectively, of the Group's total procurement in terms of purchase amounts.

The Group maintains its inventory level of raw materials, parts and components by reference to the Group's annual production plan (which is adjusted from time to time based on the prevailing market conditions and the actual sales made), with the assistance of its

ERP system. The Group's ERP system tracks, on a real time basis, the purchase orders, the production plan, the bill of materials (which sets out the up-to-date production materials requirements of the relevant products), the inventory level of finished components and air-conditioners, the delivery schedule, and the prices and price trends of such raw materials, parts and components. The Group has also entered into annual supply agreements with its suppliers, with the amount of purchases to be adjusted regularly by the Group based on the prevailing market conditions and the Group's actual sales. The annual supply agreements entered into by the Group with its suppliers typically set out the quality and specifications of the raw materials, parts and components, the terms of payment by the Group (for details, please refer to the paragraphs headed "Procurement – Suppliers" in this section of the prospectus), the packaging requirements for the raw materials, parts and components and the delivery arrangements. There is no purchase commitment in terms of quantity or purchase price imposed on the Group. The Group generally places monthly purchase orders with its suppliers.

### **Raw materials, parts and components**

#### *(a) Compressors*

The Group sources compressors from specialist manufacturers who have proven track records and established technology to ensure the quality of their products. It is the Group's present strategy to continue to source compressors from external suppliers, which the Group believes is beneficial and cost effective for the Group, as such sourcing relieves the Group of the need to incur heavy capital expenditures (and the related depreciation expense) on the construction of a production line for compressors or to incur continuous research and development efforts and expense to improve the quality of such components so as to attain the level of the established technology already possessed by the sophisticated compressor manufacturers.

During the Track Record Period, the Group sourced compressors from over 10 suppliers. The Group sourced a majority of its compressors from suppliers which are invested by renowned Japanese manufacturers. For the year ended 31 December 2008, the three largest suppliers of compressors to the Group accounted for approximately 77.4% of the total compressors sourced by the Group. The Group has had over ten years of business relationship with each of these suppliers. Due to the long-term business relationship established with these suppliers, the Group has been able to obtain a reliable supply of quality compressors.

#### *(b) Copper*

Copper is one of the major raw materials required for the production of air-conditioners. The Group purchases copper tubes and copper rods for manufacture of the copper parts of its air-conditioners. For the year ended 31 December 2008, the Group's purchases from the three largest suppliers of copper accounted for approximately 46.9% of the total copper purchased by the Group. Prices are generally determined on a monthly basis with reference to the copper price quoted on the Shanghai Futures Exchange.

Whilst copper, which is subject to price fluctuation, is a major raw material for the Group's production, the Group has been improving its research and development technique to reduce the average quantity of copper used in the Group's main products and has entered into copper forward contracts and the copper swap contract to hedge



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against fluctuation in the price of copper. The Group took into account several factors when entering into the hedging contracts in 2007, such as (i) the then prevailing price of copper and the perceived price trend; (ii) the copper usage level of the Group; and (iii) the security deposits required and other costs. During the Track Record Period, the Group did not have a fixed hedging policy. For the year ended 31 December 2008, net gain on fair value changes arising from the usage of copper forward contracts by the Group amounted to approximately RMB0.5 million. As at 31 December 2008, the copper swap contract has remaining nine monthly settlement. Total realised and unrealised losses amounted to approximately RMB4.0 million and RMB19.5 million has been recognised in the consolidated income statement for year ended 31 December 2008, respectively.

### (c) *Plastic chips, aluminium and steel plates*

The Group purchases plastic chips mainly for the manufacturing of casings of the indoor unit and other plastic parts of its air-conditioners. For the year ended 31 December 2008, the Group's purchases from the three largest suppliers of plastic chips accounted for approximately 33.0% of the total plastic chips purchased by the Group. The Group has had between five and six years of business relationship with each of these suppliers.

Aluminium is one of the principal raw materials for the manufacture of evaporators and condensers. For the year ended 31 December 2008, the three largest suppliers of aluminium accounted for approximately 83.2% of the Group's total aluminium purchases. The Group has had between two and six years of business relationship with each of these suppliers.

The steel plates purchased by the Group are mainly used for the manufacture of the casing of the outdoor unit and other steel parts of its air-conditioners. For the year ended 31 December 2008, the Group's purchases from the three largest suppliers of steel plates accounted for approximately 68.9%, of the total steel plates purchased by the Group. The Group has had between three and six years of business relationship with each of these suppliers.

### **Suppliers**

A majority of the raw materials, parts and components used by the Group in its manufacture of air-conditioners were sourced from suppliers based in the PRC. Suppliers are chosen based on a number of criteria, including the quality of the raw materials supplied, stability of supply in the past, delivery time, pricing of the raw materials as well as the financial and industrial status of the supplier. The Group's sourcing strategy is to avoid heavily relying on any single supplier and seek to source the same type of raw material, part or component from at least two different suppliers so as to ensure stable supply and cost competitiveness.

For the three years ended 31 December 2008, the Group's five largest raw materials, parts and components suppliers in aggregate accounted for approximately 33.1%, 37.0% and 32.8%, respectively, of the Group's total amount of purchases. Purchases from the single largest raw materials, parts and components supplier for the same periods accounted for approximately 10.7%, 11.3% and 10.5%, respectively, of the Group's total amount of purchases. None of the Directors, their respective associates or shareholders holding more than 5% of the Group's issued share capital held any interest in any of the Group's five largest raw materials, parts and components suppliers during the Track Record Period.

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For its sourcing of raw materials, parts and components, the Group generally receives credit terms from its suppliers. Due to the Group's long term relationship with its suppliers and the volume of its purchases, with respect to the principal raw materials, parts and components, the Group generally receives credit periods of between 30 and 180 days from its suppliers. The payment terms for the Group's purchases with its suppliers vary from each other and payments can be made by telegraphic transfer, cheque, acceptance bill, post-dated cheque or domestic letter of credit, upon the Group's inspection of the products to its satisfaction together with the VAT invoice presented by the supplier.

Although no long-term supply contracts were entered into with the major suppliers, the Group has not experienced any significant difficulties in sourcing raw materials, parts and components. Given that the Group has maintained long-term and stable relationships with its major suppliers, and the Group usually sources the same type of raw material, part and component from multiple suppliers, the Group does not foresee any major problems in sourcing raw materials, parts and components required for production in the near future.

### AWARDS AND RECOGNITION

The Group has received various awards and recognition for its products and achievements in the air-conditioner manufacturing industry. Some of the major awards and recognition include:

Year of award	Award/Recognition	Awarding institution
2000	中國行業十大特別推薦優秀品牌 (China Quality Non-Complaint Enterprise)	中國企業發展研究中心 (China Enterprise Development Research Centre) (Note 1)
2001	全國高技術產業化示範企業 (Model Enterprise in China's High-technology Industry)	全國高技術產業化協作組織 (China High-tech Industrialization Cooperation Organization) (Note 2)
2002	產品質量國家免檢證書 (Certificate for Product Exemption from Quality Surveillance Inspection)	國家質量監督檢驗檢疫總局 (General Administration of Quality Supervision, Inspection and Quarantine of the PRC) (Note 3)
2004	中國名牌產品 (China Top Brand Product)	國家質量監督檢驗檢疫總局 (General Administration of Quality Supervision, Inspection and Quarantine of the PRC) (Note 3)
	中國企業500強 (Top 500 China Enterprises)	中國企業聯合會、中國企業家協會 (China Enterprise Confederation, China Enterprise Directors Association) (Note 4)
	中國節能產品認證 (China Energy Conservation Product Certification)	中標認證中心 (China Standard Certification Center) (Note 5)

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Year of award	Award/Recognition	Awarding institution
2005	中國出口名牌 (China Export Famous Brand)	中華人民共和國商務部 (Ministry of Commerce of the PRC) (Note 6)
2006	中國馳名商標 (Famous trademark in China)	中國國家工商行政管理總局商標局 (Trademark Office of the State Administration for Industry and Commerce of the PRC) (Note 7)
2007	Global Human Settlements Award (Global Green Environment-Protection Energy-Saving Air-Conditioning)	Friends of the United Nations (The Organization Committee of Global Forum on Human Settlements) (Note 8)
2008	2008年度能效標識先進企業 Advanced Energy Efficiency Label Enterprise of 2008	中國標準化研究院能效標識管理中心 Energy Efficiency Label Management Centre of the China National Institute of Standardization (Note 9)

*Notes:*

1. This is an independent research centre primarily engaged in research on the development and growth of PRC enterprises.
2. This is an organisation set up by the former National Science & Technology Committee, National Education Committee, China Academy of Science, Ministry of Information Industry, Ministry of Construction, Ministry of General Military Logistics, Ministry of Agriculture, Ministry of Machinery and Ministry of Chemical Industry in 1996, to promote the development of high technology in the PRC.
3. This is a ministerial administrative organ directly under the State Council of the PRC, which is in charge of national quality, metrology, entry and exit commodity inspection, entry and exit health quarantine, entry and exit animal and plant quarantine, import and export food safety, certification and accreditation, standardisation, as well as administrative law enforcement.
4. China Enterprise Confederation and China Enterprise Directors Association were non-governmental institutions established in 1979 and 1983, respectively, and they were merged into one institution in 1988. China Enterprise Confederation/China Enterprise Directors Association's members are mainly enterprises, companies, entrepreneurs, provincial and municipal associations, industry associations and trade associations.
5. This is an independent certification institution in the PRC authorised to organise, manage and implement energy conservation products certification. It was officially founded in October 1998. Its establishment was initiated by China National Development and Reform Commission, and approved by the General Administration of Quality Supervision, Inspection and Quarantine and Certification Accreditation Administration of the PRC.
6. This is a governmental division in the PRC responsible for regulating trading activities and international commercial co-operation.
7. This is a subordinate of the State Administration for Industry and Commerce, responsible for trademarks registration and management.
8. This is an independent organisation founded in 1985, dedicated to promoting the principles and values of the United Nations Charter and increasing awareness of the United Nations' activities.

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9. This is a non-profit national research body engaging in standardisation research as well as to provide authoritative standards information services, which is affiliated with the General Administration of Quality Supervision, Inspection and Quarantine of the PRC.

The above awards and recognitions signify the quality of the Group's products and the established position of the Group's brand in the PRC market, which make it more effective for the Group to promote its products in the PRC market and assist the Group in capturing a larger market share of its products.

### QUALITY CONTROL

The Group has implemented a comprehensive quality control system covering major stages of production, and received the ISO9001:2000 quality management system standard certification (which, upon the latest renewal, is valid from 26 November 2007 to 25 November 2010) in December 2001. The Group also obtained ISO14001:2004 environmental management system standard certification (which is valid from 22 June 2006 to 21 June 2009) in June 2006. The Directors believe that the ISO9001:2000 quality management system standard certification and the ISO14001:2004 environmental management system standard certification are important to the Group as they serve to enhance customers' confidence in the Group's products. These certifications are also essential for the Group in promoting its products to overseas customers.

The aforementioned certifications are subject to annual review. In the event that the Group fails to renew the certifications after their expirations, the Directors believe that it would affect the competitiveness of the Group's products, and the Group's turnover and results of operation would be adversely affected. To ensure ongoing compliance with the accreditation requirements, all the Group's production lines are monitored at various stages to ensure the quality in the Group's products manufactured. The Group also implemented a set of quality control manuals, giving guidance and instructions for the relevant production process regarding the quality control procedures, including the production monitoring procurement procedure, defect control, product lines quality control, and safety testing. In addition, the Group has established a Quality Control Committee, which is headed by Dr. Zheng Zuyi, a vice president and a member of the senior management of the Group, and comprises five core members from the following departments of the Group (holding the following positions): the chief officer and the deputy chief officer of the Group's quality control centre; the head of the quality control department of residential air-conditioning division; the deputy head of the raw material inspection division; and the head of the quality control department of the commercial air-conditioning division. Each of the aforesaid committee members has received one of the following certifications: (i) ISO9000:2000 Quality Control System Internal Assessor certification (質量管理體系內審員資格); (ii) ISO14001:2004 Environmental Management System Internal Assessor Certification (環境管理體系內審員資格); or (iii) IECQ QC080000: 2005 Hazardous Substance Process System Internal Assessor Certification (有害物質過程管理體系內審員資格). The Quality Control Committee conducts yearly reviews and assessments over the quality control procedures in the Group's production process. Should any of the Group's production processes be found not to be in compliance with the requirements for accreditation, action would be taken to rectify the problems.

As of 31 December 2008, the Group had a dedicated team of 303 members, who report to the Quality Control Committee and are in charge of day-to-day implementation of the quality control procedures throughout the production process from inspection of raw

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materials, parts and components to examination of finished products. As of 31 December 2008, members of the Group's quality control team had between one to eight years of relevant working experience. Over 35% of them held a university degree or higher degree, and three of them also acquired professional qualification in quality control.

During the Track Record Period, the Group did not receive any material claims in respect of its products.

### SALES AND DISTRIBUTION

The table below shows the Group's turnover by customer type for the three years ended 31 December 2008:

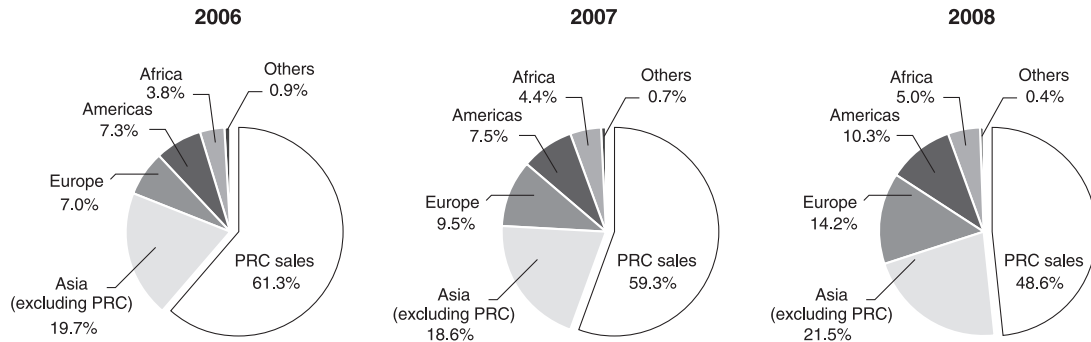
	Year ended 31 December					
	2006		2007		2008	
	<i>RMB'000</i>	<i>% of Turnover</i>	<i>RMB'000</i>	<i>% of Turnover</i>	<i>RMB'000</i>	<i>% of Turnover</i>
<b>PRC</b>						
Household appliances retail chain operators	705,327	15.5	891,580	15.6	931,953	15.7
Regional distributors ( <i>Note 1</i> )	<u>2,075,930</u>	<u>45.8</u>	<u>2,495,724</u>	<u>43.7</u>	<u>1,946,574</u>	<u>32.9</u>
<b>PRC Total</b>	<b><u>2,781,257</u></b>	<b><u>61.3</u></b>	<b><u>3,387,304</u></b>	<b><u>59.3</u></b>	<b><u>2,878,527</u></b>	<b><u>48.6</u></b>
<b>Overseas</b>						
Household appliances retail chain operators	—	—	12,398	0.2	—	—
Regional distributors ( <i>Note 2</i> )	323,416	7.1	357,600	6.2	711,114	12.1
OEM manufacturers	<u>1,430,389</u>	<u>31.6</u>	<u>1,959,106</u>	<u>34.3</u>	<u>2,330,942</u>	<u>39.3</u>
<b>Overseas Total</b>	<b><u>1,753,805</u></b>	<b><u>38.7</u></b>	<b><u>2,329,104</u></b>	<b><u>40.7</u></b>	<b><u>3,042,056</u></b>	<b><u>51.4</u></b>
<b>Total Turnover</b>	<b><u>4,535,062</u></b>	<b><u>100.0</u></b>	<b><u>5,716,408</u></b>	<b><u>100.0</u></b>	<b><u>5,920,583</u></b>	<b><u>100.0</u></b>

*Note 1:* These sales included the Group's sales to (i) a number of contractors who bulk purchase commercial air-conditioners for specific development projects and to (ii) end-users who may be governmental bodies, or owners or operators of real estate, restaurants, hotels, shopping malls and supermarkets.

*Note 2:* The overseas regional distributors' turnover comprised the Group's sales for CHIGO branded air-conditioning products and OEM products.

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The following charts set out a breakdown of the turnover of the Group, categorised by geographical locations of its customers during the Track Record Period.



### SALES AND DISTRIBUTION NETWORKS AND CHANNELS

#### (a) The PRC market

##### 1. Overview

As of 31 December 2008, the Group's sales and distribution network in the PRC was operated by three nation-wide household appliances retail chain operators and 265 regional distributors (經銷商) and their resellers (分銷商) in 30 out of 31 provinces, municipalities and autonomous regions in the PRC. All of these household appliances retail chain operators, regional distributors and resellers are independent from the Group. This sales and distribution network is managed by the Group's head office sales centre (營銷中心), which is supported by its product monitoring centres (產品管理中心) and customer services centres (客戶服務中心) located outside the head office.

Revenue from sales to the Group's regional distributors and household appliances retail chain operator customers is recognised when goods are delivered and title of the goods is passed. There would only be replacement of products or sales return when there is a problem with the quality of the Group's products as confirmed by the Group's quality control team and as governed by the Product Quality Law. Requests for replacement of products or sales return should be made to the Group within a designated period of time pursuant to the agreements with the Group. Sales returns are recognised when goods previously delivered to the Group's customers have been returned to the Group and the Group has acknowledged receipt of the returned goods. The Group recognises the sales return as a reduction in its turnover. During the Track Record Period, no sales return was recorded by the Group.

The Group's sales and distribution network is geographically divided into six sales regions covering 30 out of 31 provinces, municipalities and autonomous regions in the PRC. These six sales regions include Eastern region 1 (Hua Dong region 1), Eastern region 2 (Hua Dong region 2), Western (Hua Xi region), Southern (Hua Nan region), Northern (Hua Bei region) and Central (Hua Zhong region). Within each sales region, the Group typically maintains between five and eight product monitoring centres. The domestic market residential air-conditioners division (國內家用空調事業本部) of the head office sales centre is responsible for devising sales and



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marketing strategies and making sales as well as the supervision and management of the product monitoring centres, each of which reports regularly to the head office sales centre.

As of 31 December 2008, the Group maintained a total of 38 product monitoring centres and 36 customer services centres in the PRC, which are distributed across all six sales regions in the PRC.

### 2. Organisation

#### – Head office sales centre and its staff

The head office sales centre is situated at the Group's headquarters in Foshan, Guangdong Province, the PRC, and is responsible for the overall planning and overseeing the sales, marketing and promotion of the Group's products for the PRC market and the overseas markets, as well as making sales, and it also has the oversight of the Group's product monitoring centres, customer services centres and delivery logistics.

The head office sales centre is also responsible for devising the sales targets to be met by the Group's household appliances retail chain operator customers and regional distributors and their resellers. The Group devises the sales targets having regard primarily to the size of the designated sales regions, the level of economic development of the designated sales regions and the history of co-operation with the household appliances retail chain operator customers and regional distributors and their resellers.

The Directors believe that it is important to properly manage its sales and distribution network in order to strengthen and expand its business. To this end, the domestic market residential air-conditioners division of the head office sales centre maintains product monitoring centres outside the Group's headquarters which are responsible for, *inter alia*, monitoring and supervising the Group's network of household appliances retail chain operators, regional distributors and resellers in implementing the sales, distribution and promotion policies of the head office sales centre with a view to ensuring a competitive environment within an efficient and orderly sales and distribution network for the distribution of the Group's residential air-conditioners.

#### – Product monitoring centres and their staff

The product monitoring centres are responsible for monitoring and supervising the regional distributors (including contractors) in implementing the sales, distribution and promotion policies of the head office sales centre as well as collecting market information. The product monitoring centres will also communicate with the regional distributors (including contractors) on the sales targets and contract terms devised by the head office sales centre, but any modification of contract terms will need the approval of the head office sales centre.

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The product monitoring centres are also responsible for submitting customers' orders to the head office sales centre for approval, checking that payments have been made by customers to the head office sales centre and coordinating delivery logistics with the customers. As of 31 December 2008, the Group had a network of 38 product monitoring centres with a total of 1,337 sales and administrative support staff.

### 3. *Sales and distribution channels*

#### (i) Residential air-conditioners

For the three years ended 31 December 2008, sales of residential air-conditioners in the PRC amounted to approximately RMB2,530.7 million, RMB3,036.5 million and RMB2,507.4 million, respectively, representing approximately 55.8%, 53.1% and 42.3%, respectively, of the Group's turnover.

Although competition in Tier 1 and 2 markets for air-conditioners is more intense as compared with that for Tier 3 and 4 markets, the Group has been able to make significant inroad into Tier 1 and 2 markets during the Track Record Period, due to the Group's continuing cooperation with the household appliances retail chain operators, which principally operated in these markets. Since 1 November 2008, the Group has also commenced to manufacture residential air conditioners on an OEM basis for one of its nation-wide household appliances retail chain operator customers, which was granted the exclusive rights to sell an international brand of air-conditioners in the PRC market, for sale in these markets. Given that the Tier 3 and 4 markets are less urbanised areas, it is not the Group's strategy to work with any household appliances retail chain operators in those markets.

The Group started selling its products to customers in Tier 3 to 4 markets in 1995. The Group has been able to maintain a good relationship with its distributor customers in these markets, partly because of the Group's strategy of allowing its distributor customers in these markets to distribute the Group's products on an exclusive basis in respect of certain sales regions. Leveraging on its strong connection with customers in Tier 3 and 4 markets, the Group is poised to take advantage of the urbanisation and development of the Tier 3 and 4 markets. The Group's well-established network of regional distributors is therefore an invaluable asset, and provides the Group with an existing and well structured platform to further develop these markets. Through its business activities in the domestic market, the Group aims at extending its geographic sales coverage and achieving sales growth.

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In order to effectively serve all Tier 1 to 4 markets, the Group principally employs a dual channel strategy for marketing and selling its residential air-conditioners, namely (1) through distributors and resellers (also known as the traditional distribution channels), and (2) household appliances retail chain operators with nationwide networks.

(a) Distributors and resellers

The Group sells its products to regional distributors, which primarily comprise wholesalers (who specialise in the distribution of household electrical appliances and are experienced in promoting and selling air-conditioning products) and a number of contractors (工程商) (being principally building and electrical services contractors). As of 31 December 2008, the Group had 265 regional distributors, covering 30 out of 31 provinces, municipalities and autonomous regions in the PRC. The Group maintains long-term relationship with a majority of the regional distributors, among which, as of 31 December 2008, more than 50% had been in cooperation with the Group for more than three years.

Regional distributors purchase air-conditioners from the Group and (i) in the case of them being wholesalers, wholesale the products to resellers, who in turn resell such products directly to the end-users or to retailers, and (ii) in the case of them being contractors, principally installing and selling such products in the course of their projects. Sales made through these channels cover the Tier 1, 2, 3 and 4 markets.

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The table below illustrates the locations and number of the Group's regional distributors in the PRC during the Track Record Period:



Regions	Number of distributors as of			
	1 January 2006	31 December 2006	2007	2008
Northern	44	46	62	40
Eastern Region 1	12	17	16	53
Eastern Region 2	43	46	40	34
Southern	28	35	40	61
Western	34	39	42	35
Central	57	45	48	42
<b>Total</b>	<b>218</b>	<b>228</b>	<b>248</b>	<b>265</b>

For the three years ended 31 December 2008, domestic sales to regional distributors (including contractors) accounted for approximately 45.8%, 43.7% and 32.9%, respectively, of the Group's total turnover.

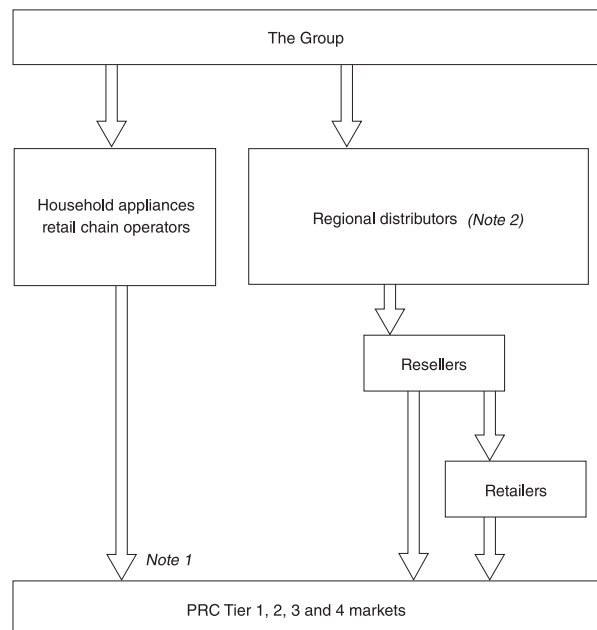
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### (b) Household appliances retail chain operators with nationwide networks

The Group deals directly with household appliances retail chain operators, and these operators purchase air-conditioners from the Group and then resell them to retail consumers. These operators generally operate nationwide networks, and the Group works with them principally in respect of Tier 1 and 2 markets. In addition, since the last quarter of 2008, the Group has also commenced to manufacture residential air conditioners on an OEM basis for one of its nation-wide household appliances retail chain operator customers, which was granted the exclusive rights to sell an international brand of air-conditioners in the PRC market, for sale in these markets.

For the three years ended 31 December 2008, sales to household appliances retail chain operators in the PRC accounted for approximately 15.5%, 15.6% and 15.7%, respectively of the Group's total turnover. During the Track Record Period, air-conditioners sold by the Group to its household appliances retail chain operators customers in the PRC were all CHIGO branded air-conditioners.

The following chart is a diagrammatic illustration of the above-mentioned principal distribution channels for the Group's residential air-conditioners in the PRC market.



#### Notes:

1. The Group sells its products to these household appliances retail chains operators which have operations principally in Tier 1 and 2 markets.
2. The Group understands that certain regional distributors also sell a small amount of the Group's products directly to the end users through their promotion stores.

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With the dual channel strategy for the marketing and sale of its residential air-conditioners, the Group obtains market information relating to its products mainly through its product monitoring centres, which are charged with the responsibility of collecting market information, and working closely with its customers and the resellers. The Group obtains indicative demands and delivery schedules from the household appliances retail chain operators, regional distributors and resellers, who will sign an agreement to purchase air conditioners from the Group (in the case of the regional distributor and household appliances retail chain operator customers) or from the regional distributors (in the case of the resellers), at the beginning of each planning year, and updates the relevant data on a monthly basis through the regional distributors and the resellers preparing and submitting their actual sales records and other prevailing market information. The Group also on a regular basis visits its existing and potential customers and resellers to collect market information, interviews end-users and conducts end-users surveys, and conducts on-site inspection of products retail counters. In addition, the household appliances retail chain operators place orders with the Group based on end-users demand and market conditions. The household appliances retail chain operators reduce the quantity of the products under purchase orders before delivery and/or return unsold products to the Group if the sales results of the relevant products do not reach the anticipated targets. Accordingly, although the Group does not sell its products directly to the end-users and in this respect has limited direct contact with the end-users, the Directors believe that the Group's customers' purchase mechanism generally reflects the market perception of the Group's products and allows the Group to adjust its sales strategy from time to time. For details on the placing of orders by the Group's customers, please refer to the paragraphs headed "8. Planning, placing of orders and payment terms" in this section below.

### (ii) Commercial air-conditioning products

For the three years ended 31 December 2008, sales of commercial air-conditioning products in the PRC amounted to approximately RMB126.6 million, RMB221.3 million and RMB172.6 million, respectively, representing approximately 2.8%, 3.9% and 2.9%, respectively of the Group's turnover. The Group sells its commercial air-conditioning products under CHIGO brand and HYUNDAI (現代) brand in the PRC through the regional distributors, which include a number of contractors who bulk purchase air-conditioners for specific development projects as well as directly to end-users who may be governmental bodies, or owners or operators of real estate, restaurants, hotels, shopping malls and supermarkets.

### (iii) Other products

For the three years ended 31 December 2008, sales of the Group's other products in the PRC amounted to approximately RMB119.0 million, RMB78.7 million and RMB112.3 million, respectively, representing approximately 2.6%, 1.4% and 1.9%, respectively, of the Group's turnover. The Group sells such other products in the PRC through regional distributors.



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#### 4. *Relationship with regional distributors and resellers with respect to the sale of residential air-conditioners*

In Tier 1 and 2 markets, the Group generally appoints regional distributors on a mutually non-exclusive basis such that the Group has the freedom to appoint more than one regional distributor who has established air-conditioning products promotion and distributing experience in each sales region. In Tier 3 and 4 markets, it is the Group's strategy to appoint one distributor (who would distribute the Group's products on a non-exclusive basis) in respect of certain sales regions. The regional distributors purchase the Group's products and principally resell them to the resellers, who are local traders and generally experienced in air-conditioning products trading. The resellers purchase the Group's products from the regional distributors and resell them to local retail customers or retailers. As of 31 December 2008, the Group's regional distributors had a network of over 3,000 resellers covering provinces and cities around the PRC.

Each reseller will usually enter into a tri-party appointment agreement with the Group and its regional distributor. Such agreement normally has a term of one year. The principal terms of appointment and practices are summarised as follows:

- Each regional distributor and reseller is designated a specific sales region for selling the Group's products. The regional distributors and resellers are not permitted to sell the Group's products outside their respective designated areas.
- The Group sets market suggested retail price (subject to adjustment by the Group) of its products for the regional distributors and the resellers. The prices of the products to be sold to the resellers and end-users are generally determined by the relevant regional distributors and resellers (as the case may be), subject to the Group's overriding minimum retail prices specified to them.
- The Group sets monthly sales targets for the regional distributors and the resellers. The resellers are obligated to submit weekly reports on their sales and inventory to their respective regional distributors, followed by the regional distributors preparing and submitting a monthly report to the Group. The Group has the right to terminate a tri-party agreement if any of the other parties fails to fulfill the sales target in any period, and the Group can engage other distributors and require that a distributor engages other resellers within the same sales region.
- The tri-party agreements with respect to the regional distributors allow the Group to (i) control the manner in which the regional distributors manage their markets, networks and resellers and sell the Group's products as described herein, and (ii) allocate market share to each regional distributor so as to ensure a competitive environment within an orderly marketplace.

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- The Group will be responsible for the product return and exchange upon (i) the regional distributors and resellers' timely objection (within 10 days upon the product delivery inspection and discovery of defects for Tier 1 markets and 15 days for Tier 2 markets) to any defective products and (ii) the confirmation by the relevant governmental quality control departments.
- Depending on the capabilities of the regional distributors and resellers, as well as the Group's strategy for developing particular sales areas, the after sales services for a particular area may be provided by the Group's service centres and/or by the regional distributors or resellers. The Group will reimburse the regional distributors and resellers for the costs incurred in providing customer services to the end-users.
- The Group offers prepayment discounts to the regional distributors and, through the regional distributors to the sale agents, as an incentive to make payments to the Group in a timely manner. Where a regional distributor or a reseller makes advanced payments for a purchase order, a credit will be given to the distributor or reseller such that the amount of the credit will be applied to off-set their next purchase of the Group's products. In addition, upon a regional distributor or a reseller accomplishing certain annual sales milestones set by the Group, the Group will reward the regional distributor or (through the relevant distributor) the reseller a percentage of their gross sales as incentives.
- In addition to the above, a tri-party agreement can be terminated upon mutual consent of the parties thereto or upon a breach thereof by a party thereto. Upon the termination or expiration of the agreement: (a) only sales materials such as display air-conditioning products provided by the Group must be returned to the Group. Unsold goods cannot be returned to the Group; (b) the Group will (but is not obliged to) assist such reseller in liaising with other distributors and/or resellers for the latter to purchase any unsold products of such reseller.

During the Track Record Period, there was no material cancellation or adjustment of orders by the regional distributors and/or resellers, and the Group processed an immaterial amount of exchange of goods with the regional distributors and/or resellers. There was also no termination of agreement for cause between the Group and the regional distributors and resellers during the same period.

5. *Relationship with household appliances retail chain operators with respect to the sale of residential air-conditioners*

The Group deals directly with household appliances retail chain operators. The Group appoints these household appliances retail chain operators on a non-exclusive basis such that the Group is free to enter into agreements with other household appliances retail chain operators.

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The term of engagement of the household appliances retail chain operators is normally one year. The principal terms of cooperation and practices are summarised as follows:

- The Group sets the market suggested retail prices (subject to adjustment by the Group) for each sales area to the household appliances retail chain operators. The prices of the products to be sold to the end-users are generally determined by the relevant household appliances retail chain operators, subject to the Group's overriding minimum retail prices specified to them.
- The household appliances retail chain operator has the right to, before the delivery of the products, cancel or make adjustment to change the quantity of the order.
- The household appliances retail chain operators will be given annual sales targets but they have the right to return any particular product type to the Group if a particular product fails to reach a minimum threshold of gross sales target for three consecutive months.
- The Group cooperates with the household appliances retail chain operators for the promotion of the Group's product by staffing sales representatives employed by the Group at the sales counters in the retail chain stores, and providing display counters, stages and promotional materials for the Group's products. Managed directly by the Group, the sales counters enable the Group to have direct access to the sales and market information, and thus enable the Group to closely monitor market conditions.
- Depending on the capabilities of the household appliances retail chain operators, as well as the Group's strategy for developing particular sales areas, the after sales services for a particular area may be provided by the Group's service centres and/or by the household appliances retail chain operators. The Group will reimburse the household appliances retail chain operators for the costs incurred in providing after sale services to the end-users.
- The Group is responsible for product returns and exchanges upon the household appliances retail chain operators' timely objection (within 10 days upon the product delivery inspection and discovery of defects for Tier 1 markets and 15 days for Tier 2 markets) to any defective products.
- As an incentive to promote certain product models and/or develop loyalty to the Group, the Group may designate a particular household appliances retail chain operator as its exclusive agent for such product models within its sales region.
- The relevant agreement can be terminated upon mutual consent of the Group and the household appliances retail chain operator or a breach of the agreement by either party thereto. Upon the termination or expiration of

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the agreement, only sales materials such as display air-conditioning products provided by the Group must be returned to the Group. Unsold goods cannot be returned to the Group.

On the other hand, the term of engagement for one of the household appliances retail chain operators which the Group manufactures residential air-conditioners on an OEM basis is for two years commencing from 1 November 2008 until 30 October 2010, subject to automatic renewal for a further one year if none of the parties to the contract notifies the other party of its intention to terminate within two months prior to the expiry date of the initial contract or the renewed contract, as the case may be. The principal terms of cooperation and practices are summarised as follows:

- The Group manufactures certain licensed international brand air-conditioners with its own human resources, facilities, factories and such other resources under the supervision and guidance of and according to the agreed specifications, qualifications and the purchase, production, inspection and management requirements of the household appliances retail chain operator customer (“OEM Customer”).
- The OEM Customer has the exclusive rights to sell the contracted products manufactured by the Group.
- The agreed selling prices of the contracted products manufactured by the Group are subject to adjustments, among others:
  - (i) if the prices of raw materials, parts and components fluctuate by more than 5% (as compared to their prices as at October 2008), both parties can within 15 days set the new selling price, which must be mutually agreed in writing. Such new prices will not affect orders placed before the price adjustments;
  - (ii) if the price of copper as quoted on the Shanghai Non-ferrous Metals Price Index (上海有色金屬網) as at the date of placement of an order fluctuates exceeding the range of 10%, the selling price can be adjusted upward or downward (as the case may be) by 1.5% for each 10% variance;
  - (iii) if the Group sells other products with 90% or more similarity (in terms of technology), etc. as the contracted products, the Group must ensure that the selling price for the contracted products is lower than the selling price for such other products supplied to other customers; and
  - (iv) if other manufacturers can manufacture the contracted products at a lower selling price but with the same quality, the OEM Customer has the right to require the Group to adjust the selling price downwards to the same as or lower than the price quoted by other manufacturers.

If there are sufficient proofs in respect of items (iii) and (iv) and if the Group does not adjust the selling price and is unable to provide any reasonable explanation on why no such adjustment within 15 days of a written request

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by the OEM Customer, the OEM Customer has the right to deduct the difference between the prices in the invoices or to require the Group to supply stock of such number of the contracted products equivalent to the value of the difference, and at the same time, the OEM Customer may terminate the performance of the contract.

- The OEM Customer will provide the next month production forecast within the first 20 days of each month and the Group will ensure at least 2 months average stock supply based on such forecast. The Group will be subjected to late delivery penalty calculated based on an agreed formulae ranging from 0.15% up to 15% on the value of shortfall for each day of delay in delivery of the contracted products to the OEM Customer.
- The OEM Customer may place orders up to 3 times per month. Both parties must agree the orders within 20 days and the Group must guarantee production and delivery of such agreed orders. Each batch of contracted products ordered must be fully taken by the OEM Customer within 30 days of delivery, otherwise, the OEM Customer shall pay to the Group monthly warehousing fees at the rate of RMB8.3 per square meter and monthly working capital fee of 1%.
- Each order placed by the OEM Customer for each type of contracted products must be at the minimum of 100 units.
- The OEM Customer is responsible for the transportation of the contracted products from the Group's warehouse after being notified in writing by the Group in accordance with the agreed procedures.
- No logos, plates or labels of any kind regarding the Group shall be affixed onto the contracted products.
- The Group shall be responsible for the costs in relation to product returns due to defects. If the defects are discovered within 18 months of sale of the contracted products to end customers and such defects are caused by the Group, the Group is also responsible for repairing, the relevant expenses, compensation to the end customers, provide a replacement product and is subject to penalty by the relevant governmental authorities. If there are defects in relation to the engines of the contracted products within 15 days of sale to end customers, and such defective products are returned according to the relevant laws and regulations of the PRC and requirements of the OEM Customer, and all expenses in relation to such product returns shall be borne by the Group and the Group shall collect such defective goods from the OEM Customer's warehouse within 15 days of notification.
- The Group shall be liable for all costs or damages to human beings or properties due to defects in the designs of the contracted products or manufacturing process.

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- The OEM Customer shall pay 10% of the selling price as deposit for each order placed. However, such deposit is waived to promote cooperation among the parties. On each Tuesday, the parties will calculate payments for contracted products which have been accepted by the OEM Customer for more than 7 days, and payment will be settled in the following Friday. Each payment shall be 50% by cash and 50% by 6 months honourable notes.
- During the term of the contract, either party may terminate the contract with the other party's consent. If the Group continuously delays or unable to deliver the required orders of the contracted products for 2 consecutive months, the OEM Customer has the right to terminate the contract. Within 30 days after termination of the contract, the Group must return to the OEM Customer all goods and materials supplied by the OEM Customer for the Group to perform the contract. Upon termination of the contract, the Group remains obliged to protect the contracted products for a period of 1 year after termination of the contract.

During the Track Record Period, there was no material cancellation or adjustment of orders by the household appliances retail chain operators, and the Group processed an immaterial amount of exchange of goods with the household appliances retail chain operators. There was also no termination of agreement by cause between the Group and the household appliances retail chain operators during the same period.

### 6. *Distribution and sales of commercial air-conditioners*

The Group sells commercial air-conditioners to regional distributors (including contractors) and end-users (who may be governmental bodies, or owners or operators of projects or enterprises such as hotels or shopping malls), and provides them with design and technical support, where the sales involve specific projects. The commercial air-conditioning products division of the head office sales centre is responsible for the overall strategy planning as well as the sales and marketing activities, contract negotiation and tender process of large projects, and the provision of technical support in the implementation phase.

The Group's sales personnel regularly visit its regional distributors, design institutes, contractors, governmental departments and real estate owners to collect market information, and identify potential projects and collect site requirements. The Group's services span from product design, material selection, manufacture of air-conditioners and implementation. Implementation includes the provision of technical support and installation. Installation is carried out either by the Group's sub-contractors or the client's staff, in which case, the Group's technical team will provide technical support and supervision services. As of 31 December 2008, the Group had 351 staff in the commercial air-conditioning products division at the head office sales centre carrying out the aforesaid functions.

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### 7. *Selection criteria for, assessment and control of household appliances retail chain operators, regional distributors and resellers*

The head office sales centre applies certain pre-determined criteria to the selection of regional distributors and resellers, and they include:

- experience and track record in the distribution of air-conditioning products, financial strength and credit record;
- the revenue generated in the distribution and sales of the Group's air-conditioning products (when considering contract renewal, the Group would give preference to those regional distributors and resellers who reach or top the sales targets);
- ability and experience in providing customer services such as having established customer service centres with experienced technicians;
- technical and implementation capabilities of commercial air-conditioning systems requiring design and installation.

The decision in the selection of resellers is normally made by the regional distributors. Upon the designation of the reseller by a regional distributor, the Group enters into a tri-party agreement with the regional distributor and the reseller, pursuant to which the Group retains the right of termination upon the reseller's breach of engagement. During the Track Record Period, neither the Group nor the regional distributors or resellers exercised their right of termination pursuant to the tri-party agreements.

The Group conducts quarterly assessments of the performance of its regional distributors and resellers. The head office sales centre and the sales offices together assess the performance of the regional distributors based on factors such as their ability to manage their designated marketing regions, manage and coordinate with their resellers, and seize market opportunities, as well as the quality of the customer services provided and the amount of revenue generated. As part of the assessment, the Group generally requests the regional distributors and resellers to submit monthly records of their sales to end-users, although the Group does not have the right to obtain and review the financial statements of the regional distributors and resellers. The Group also assesses the quality of customer services rendered by the regional distributors and resellers to the end-users by interviewing end-users on a random basis. In the event that a regional distributor or reseller fails to achieve its designated targets or pass the quarterly assessment, the Group may reduce the number of regions under its distributorship or may even terminate the appointment.

In considering whether to renew its agreements with the regional distributors and resellers, in addition to the above assessments, the Group will also consider and evaluate the history of cooperation and their performance over the period under review including factors such as whether they accomplished their monthly and annual sales targets, the promotional activities they undertook for the Group's products, and their loyalty to the Group and logistics capabilities.



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Through the quarterly assessment with regional distributors and resellers and the agreements with the household appliances retail chain operators (which confer on the Group the right to terminate their appointment upon breach of the terms of the agreements), the Group is able to effectively monitor its customers to ensure that their activities are in compliance with the Group's guidelines, policies and procedures. Apart from the said arrangements, the Group has no ownership or management control over its distribution network.

### 8. *Planning, placing of orders and payment terms*

At the beginning of each planning year, the Group works closely with and obtains indicative demand and delivery schedules from the household appliances retail chain operators, regional distributors and resellers, and will update the relevant data on a monthly basis based on actual sales and other prevailing market factors.

Household appliances retail chain operators place orders with the Group based on demand and market conditions. The Group allows credit periods of between 90 and 270 days to its retail chain operator customers, depending upon their cooperation relationship with the Group and credit history.

Regional distributors usually purchase products from the Group based on demand, and they usually submit product model and quantity purchase plan to the Group five days before they require delivery of the Group's products, subject to the Group's inventory availability, while contractors and end-user customers usually place orders with the Group on a project basis. In respect of the sale of residential air-conditioners to the Group's regional distributors, the Group may require full payment against delivery or allow credit periods of between 30 and 180 days, depending upon their cooperation relationship with the Group and credit history. In respect of the sale of the Group's commercial air-conditioners, after the conclusion of a purchase order but prior to commencement of production, the Group usually requires the regional distributors (including contractors and end-user customers) to pay a 30% deposit, with the balance to be paid off before the delivery of the products. If technical support is required from the Group, a separate payment schedule will be agreed.

Sales in the PRC domestic market are denominated in Renminbi and are made in cash or letters of credit. Whilst credit periods are available, the Group may impose credit limits. Further information is set out in the paragraph headed "Credit control" in this section below.

### **(b) Overseas market**

#### 1. *Overview*

For the three years ended 31 December 2008, the Group's turnover derived from overseas sales amounted to approximately RMB1,753.8 million, RMB2,329.1 million and RMB3,042.1 million, respectively, representing approximately of 38.7%, 40.7% and 51.4%, respectively, of the Group's turnover. The Group's exports principally comprise residential and commercial air-conditioners and air-conditioner parts and components. For the year ended 31 December 2008, sales of CHIGO brand air-conditioners, OEM air-conditioners and air-conditioner parts and components

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increased by approximately 8.4%, 19.0% and 1,426.7%, respectively, as compared to the year ended 31 December 2007. The Group generally completes the majority of its overseas sale in the first half of each calendar year. The Group distributes its residential and commercial air-conditioners under the CHIGO brand and on an OEM basis as well as air-conditioner parts and components principally through the following channels:

(i) Residential air-conditioners

- overseas OEM manufacturers which source whole machines on an OEM basis as well as air-conditioner parts and components from the Group and distribute to local resellers and/or use the air-conditioning products in the manufacture of their products, labeling with various brands; and
- overseas distributors for distribution of both CHIGO brand and OEM air-conditioners in their respective markets. These distributors also purchase air-conditioner parts and components from the Group for repair and maintenance purposes.

All the overseas regional distributors and overseas OEM manufacturers are independent from the Group. For the year ended 31 December 2008, there was an increase in overseas sales of the Group's residential air-conditioning products, with the overseas sales of residential air-conditioning products accounted for 50.2% of the Group's total sales of residential air-conditioners in 2008 (compared with 40.8% for the year ended 31 December 2007). Such an increase was primarily due to the Group's growing overseas customers especially in the Eastern Europe and Brazil and distributor base and the Group completed a majority of its overseas sales in the first half of the year ended 2008 before the economy slowdown, coupled with the Group's strategic emphasis on overseas sales.

In addition, there was a substantial increase in overseas sales of the Group's air-conditioner parts and components accounted for 79.2% of the Group's total sales of air-conditioner parts and components in 2008 (compared with 29.8% for the year ended 31 December 2007). Such an increase was primarily due to the increase sales of air-conditioner parts and components to customers in Turkey, Malaysia, Brazil and Nigeria.

(ii) Commercial air-conditioners

- overseas distributors for distribution in their respective local markets.

For the year ended 31 December 2008, there was a decrease in overseas sales of the Group's commercial air-conditioning products, with overseas sales of commercial air-conditioning products accounted for 44.6% of the Group's total sales of commercial air-conditioners in 2008 (compared with 44.9% for the year ended 31 December 2007). Such decrease was primarily due to the economic down turn in the European and American markets.

2. *Sales channels and strategies*

The Group started its export business in 2001. To solicit business opportunities and bring more business, the Group approaches its overseas customers (or potential customers) directly or through the Group's business contacts, and meets with these customers (or potential customers) at trade fairs in the PRC or overseas (such as the China Import and Export Trade Fair in Guangzhou (中國廣州進出口商品交易會), International Trade Fair for Refrigeration, Air Conditioning and Ventilation (IKK) in Germany, International Air-conditioning, Heating, Refrigerating Exposition (AHR Expo) in the United States), or places where these customers (or potential customers) are based.

During the Track Record Period, a large portion of the Group's overseas sales were made on an OEM basis to overseas regional distributors and overseas OEM manufacturers. During the Track Record Period, sales to overseas regional distributors increased from RMB323.4 million in the year ended 31 December 2006 to RMB357.6 million in the year ended 31 December 2007 and reached RMB711.1 million in the year ended 31 December 2008, representing a year-on-year increase of 10.6% in 2007 as compared to 2006 and 98.9% in 2008 as compared to 2007, respectively. On the other hand, sales to overseas OEM manufacturers increased from RMB1,430.4 million in the year ended 31 December 2006 to RMB1,959.1 million in the year ended 31 December 2007 and reached RMB2,330.9 million in the year ended 31 December 2008, representing a year-on-year increase of 37.0% in 2007 as compared to 2006 and 19.0% in 2008 as compared to 2007, respectively. The Group believes that the success of this business model is founded on the range of its product offerings available, as the Group's OEM customers would provide specific requests on product designs and specifications based on the Group's existing products when placing orders from the Group.

The Group's overseas markets are geographically grouped into the following five sales regions. Each overseas market has employed its own sales strategy.

(i) Asia (excluding the PRC)

For the South-east Asia, South Asia and West Asia regions, the Group sells its residential air-conditioners under the CHIGO brand and on an OEM basis as well as air-conditioner parts and components principally through distributors, and the Group also sells air-conditioners on an OEM basis to air-conditioning products manufacturers. Whilst it is the Group's strategy to further enhance its CHIGO brand, the Group derived a substantial portion of its sales in this market through its distribution of residential air-conditioners on an OEM basis and air-conditioner parts and components to distributors, and, accordingly, the Group will also work towards developing more distributor customers. As of 31 December 2008, the Group had 59 distributors who distributed CHIGO brand air-conditioners and 254 customers who distributed the Group's OEM air-conditioners and/or used the Group's OEM air-conditioners in the manufacture of their products in these markets who placed purchase orders to the Group in 2008.

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The Group first exported its products to the Middle East in 2002. The Group's distributor customers in this market distribute residential air-conditioners under the CHIGO brand and on an OEM basis. The Middle East is an established market for the Group, and the Group plans to concentrate on exploring further business opportunities with these distributors. As of 31 December 2008, the Group had 9 distributors who distributed CHIGO brand air-conditioners and 50 customers who distributed the Group's OEM air-conditioners and/or used the Group's OEM air-conditioners in the manufacture of their products in this market who placed purchase orders to the Group in 2008.

### (ii) Europe

For the European market, the Group mainly sells its residential air-conditioners on an OEM basis to distributors and air-conditioning products manufacturers. The Group sells its CHIGO brand residential air-conditioners to its distributor customers in this market. The Group also sells a small quantity of commercial air-conditioners to distributors in this market. The Group intends to develop strategic relationship with large-sized customers in this market, and to further develop the customer base for higher-end air-conditioning products. The Group will continue to work closely with the Vaillant group to develop this market. In particular, the Group also supplies air-conditioner parts and components to a member of the Vaillant group in Turkey for the manufacture of air-conditioning products. (For details of the Vaillant group, please refer to the section headed "Strategic investor and other investors" in this prospectus.) As of 31 December 2008, the Group had 27 distributors who distributed CHIGO brand air-conditioners and 194 customers who distributed the Group's OEM air-conditioners and/or used the Group's OEM air-conditioners in the manufacture of their products in these markets who placed purchase orders to the Group in 2008.

### (iii) America

For the North American market, the Group supplies residential air-conditioners on an OEM basis and air-conditioner parts and components to distributors and certain US based multi-national air-conditioning products manufacturers including Lennox Industries Inc. The Group sells its CHIGO brand residential air-conditioners through distributors in this market. The Group also sells a small quantity of commercial air-conditioners to distributors in this market. The Group will continue to work with renowned air-conditioning products manufacturers and distributors in North America and leverage on such relationships to enhance the Group's reputation. The Group will continue to leverage on its research and development capability to develop more air-conditioning products with higher EER for this market. As of 31 December 2008, the Group had 8 distributors who distributed CHIGO brand air-conditioners and 67 customers who distributed the Group's OEM air-conditioners and/or used the Group's OEM air-conditioners in the manufacture of their products in these markets who placed purchase orders to the Group in 2008.

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For the Central and South American regions, the Group sells its residential air-conditioners under the CHIGO brand and on an OEM basis as well as air-conditioner parts and components through distributors. Whilst it is the Group's strategy to further enhance its CHIGO brand, the Group derived a substantial portion of its sales in these markets from the distribution of residential air-conditioners on an OEM basis to distributors. The Group also sells a small quantity of commercial air-conditioning products to distributors in the Central and South American markets. The Group will strive to seek more opportunities for technical co-operation with its customers, and to increase its export sales of air-conditioner parts and components to these markets. As of 31 December 2008, the Group had 25 distributors who distributed CHIGO brand air-conditioners and 77 customers who distributed the Group's OEM air-conditioners and/or used the Group's OEM air-conditioners in the manufacture of their products in these markets who placed purchase orders to the Group in 2008.

### (iv) Africa

The Group has established a sales network in the African market, where the Group's air-conditioners are sold under the CHIGO brand through distributors. The Group will step up its efforts in working with and nurturing these distributors with a view to further enhancing the awareness of the Group's CHIGO brand. In parallel with the Group's effort to promote the CHIGO brand, the Group also sells its products on an OEM basis to air-conditioning products manufacturers and distributors in Africa. In Nigeria, the Group has granted an air-conditioning products manufacturer an exclusive licence to manufacture and sell its air-conditioning products under the Group's CHIGO brand in Nigeria, Benia and Togo markets and provides it with technical support in the production of air-conditioning products, and such manufacturer has undertaken to purchase a minimum value of air-conditioner parts and components from the Group for a period commencing on 1 August 2007 to 31 July 2008, which is renewed to 31 July 2009. As of 31 December 2008, the Group had 72 distributors who distributed CHIGO brand air-conditioners, an air-conditioning products manufacturer who manufactured and sold its air-conditioners under the Chigo brand and 122 customers who distributed the Group's OEM air-conditioners and/or used the Group's OEM air-conditioners in the manufacture of their products in these markets who placed purchase orders to the Group in 2008.

### (v) Others

For the Australian (including New Zealand and certain South Pacific Islands) market, the Group sells its residential air-conditioners under the CHIGO brand and on an OEM basis principally through distributors. As of 31 December 2008, the Group had 7 distributors who distributed CHIGO brand air-conditioners and 47 customers who distributed the Group's OEM air-conditioners and/or used the Group's OEM air-conditioners in the manufacture of their products in these markets who placed purchase orders to the Group in 2008.

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However, as this is the Group's export business (as opposed to its home market business), the Group's strategy is to develop its relationship with and offer more products to its OEM and distributor customers and identify new OEM and distributor customers. The Group does not seek to actively participate in the business development of its OEM and distributor customers.

### 3. *Relationship with overseas OEM manufacturers*

The Group sells its residential and commercial air-conditioning products on an OEM basis to overseas air-conditioner manufacturers which are enterprises engaging in the sale of household electrical appliances.

The Group has had between one to six years' business relationship with the major OEM manufacturers customers. The Group believes that it is able to maintain continuing relationship with its OEM manufacturers customers, principally because of the Group's wide range of product offering, for example, the Group's OEM manufacturers customers can select the appropriate models that can be modified to suit their requested designs and specifications, as well as the Group's relatively stable supply of air-conditioning products, both of which are made possible principally due to the Group having its own vertically integrated manufacturing base, which allows the Group greater flexibility in modifying its products to meet the requirement of the OEM manufacturers customers. The Group also believes that it has competitive strength in the quality of its products, which is evidenced by the certification received by the Group in respect of its products, and which is also an important factor in appealing to the OEM manufacturers customers. For further details about the certification received by the Group, please refer to the paragraph headed "Certification" in this section above.

Owing to the Group's strengths as mentioned above, the Group has been able to forge good business relationship with its OEM manufacturers customers, including renowned multi-national OEM air-conditioning products manufacturers such as Saunier and Lennox Industries Inc.

The Group generally does not enter into any long-term sales and distribution agreements with its OEM manufacturers customers. The OEM manufacturers customers generally place purchase orders with the Group directly, based on their own demand and market conditions. The Group would only accept purchase orders placed by its OEM manufacturers customers if the quantity of air-conditioning products ordered reaches certain designated levels (determined and adjustable by the Group from time to time).

The Group does not provide customer services to the OEM products' end-users, and the Group would only provide technical guidance and advice to the OEM manufacturers customers.



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#### 4. *Relationship with overseas CHIGO brand distributors and OEM products distributor*

The Group sells its CHIGO brand residential and commercial air-conditioning products to distributors (who principally resell the Group's products) and its OEM air-conditioning products to overseas distributors which are enterprises engaging in the sale of household electrical appliances.

The Group has had between one to five years' business relationship with its major overseas distributors customers. The Group believes that it is able to maintain continuing relationship with its overseas distributors customers, principally because of the quality of the Group's products and the diverse range of its product offerings. The good quality of the Group's products is evidenced by the certification received by the Group in respect of its products, details of which are set out in the paragraph headed "Certification" in this section above.

It is the Group's strategy to appoint overseas CHIGO brand distributors on an exclusive basis, and as such most of the Group's overseas CHIGO brand distributors are given the exclusive right to distribute the Group's CHIGO brand products in their specific designated sales regions.

The Group has entered into framework agreements with most of its CHIGO brand distributor customers, which normally have a term of one year. The framework agreements typically set out, among others, the marketing area for the sales of the Group's products and the sales target for each month or each season. Under such agreements, the CHIGO brand distributor customers cannot sell outside their respective designated sales regions. Customer services would be provided by the distributor customers, and the Group would only provide technical guidance and advice to such distributor customers.

The Group's OEM products distributors comprise mainly (i) CHIGO brand distributors who also maintain OEM distribution lines and (ii) OEM products distributors who purchase from the Group solely for OEM products which are in turn distributed to OEM manufacturers as well as OEM resellers.

The Group generally does not enter into any long-term agreements with all of its OEM products distributors for the sales and distribution for the OEM products. The OEM products distributors generally place purchase orders with the Group on a regular basis based on the market conditions and the distributors' own demand.

#### 5. *Settlement arrangement and payment terms*

The Group's exports to its overseas OEM manufacturers and overseas regional distributors are principally settled in US dollars by letter of credit or bank telegraphic transfer. Generally, upon placement of purchase orders, these overseas customers must pay to the Group a deposit representing approximately 30% of the total value of the products ordered. Save for open account (OA) customers, the Group's overseas sales are paid in full shortly after receipt by the Group of a purchase order (but before despatch of products) by bank telegraphic transfer or letter of credit. Open account (OA) is only used very occasionally with respect to long term and/or high volume customers with good credit standing, where the customer concerned will, between 60



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and 90 days after the customer's receipt of the Group's products, settle the Group's invoice by bank telegraphic transfer. The Group will also effect credit insurance in respect of OA sales.

### Pricing policy

For domestic sales in the PRC market, the prices of the Group's products are not subject to official price guidelines under the PRC laws and regulations. For export sales, the Household Electrical Appliances Branch, China Chamber of Commerce for Import and Export of Machinery and Electronic Products (中國機電產品進出口商會家用電器分會) has issued "Reference Price Guide for Exporters of Air-conditioners and Vacuum Cleaners" (《空調器、吸塵器出口同行參考價格本》), which serves as a reference for PRC exporters of air-conditioning products, but it does not have binding effect. The Group's head office sales centre formulates and adjusts the prices of the Group's products based on changes in market conditions, with reference to market trends, industry information, costs of production and competitors' prices. Although competitive pricing remains an important factor, the Group believes that consumers are more concerned with the air-conditioning products' performance in terms of quiet level, energy efficiency and air purification ability. A further discussion on the Group's pricing policy is set out in the section "Financial information – Management discussion and analysis" in this prospectus.

### Credit control

The Group places significant emphasis in controlling its cash and credit sales. For details of the Group's settlement arrangements and payment terms with and credit periods for its PRC and overseas customers, please refer to the paragraphs headed "Sales and distribution – (a) The PRC market – 8. Planning, placing of orders and payment terms" and "– (b) Overseas market – 5. Settlement arrangement and payment terms" in this section above and the section headed "Financial information – Analysis of financial position – Analysis of major balance sheet items and financial ratios – Trade and other receivables and debtor turnover days" in this prospectus.

### Customers

The Group's customer base is broad and geographically diverse.

#### (a) *The PRC market*

With respect to the PRC market, the Group sells its products to household appliances retail chain operators and regional distributors and, accordingly, they constitute the Group's customers.

For the year ended 31 December 2008, the Group had three large-scale household appliances retail chain operators in the PRC selling the Group's products. The Group has had approximately four to five years of business relationship with these household appliances retail chain operators.

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It is the Group's policy to nurture and develop its regional distributors by giving them sales and marketing support and product and services training. As of 31 December 2008, the Group had established a network of 265 regional distributors selling the Group's products. The Group has had between approximately one to eight years of business relationship with these regional distributors.

### *(b) Overseas market*

As the Group exports its air-conditioners under the CHIGO brand and on an OEM basis to distributors and air-conditioning products manufacturers, and sells air-conditioner parts and components to air-conditioning products manufacturers and distributors, these distributors and air-conditioning products manufacturers constitute the Group's overseas customers. As of 31 December 2008, the Group had 207 overseas distributors who distributed CHIGO brand air-conditioners and 1 air-conditioning products manufacturer who manufactures and sells its air-conditioners under the Chigo brand, and 811 customers who distributed the Group's OEM air-conditioners and/or used the Group's OEM air-conditioners in the manufacture of their products. The Group has had approximately one to five years of business relationship with these customers.

### *(c) Customer concentration*

For the three years ended 31 December 2008, the Group's five largest customers in aggregate accounted for approximately 18.1%, 18.2% and 21.8%, respectively, of the Group's total turnover. Sales to the single largest customer for the same periods accounted for approximately 6.1%, 7.0% and 8.8%, respectively, of the Group's total turnover. None of the Directors, their respective associates or shareholders holding more than 5% of the Company's issued share capital holds any interest in any of the Group's five largest customers during the Track Record Period.

## **MARKETING AND PROMOTION**

The Group places great emphasis on marketing and promoting end-users' awareness of products under the CHIGO brand. The head office sales centre is responsible for the Group's overall marketing and promotion activities. As of 31 December 2008, the Group had 41 staff who worked in the formulation and implementation of the Group's marketing strategies.

The Group frequently pursues advertising campaigns through different media including newspapers, magazines, websites, television commercials and billboards. The Group also attends trade shows and exhibitions in major cities in the PRC and overseas in order to identify potential customers and promote its CHIGO brand.

The Group also periodically invites its domestic and overseas customers to visit the Group's headquarters in Foshan, Guangdong province, the PRC so as to enable them to have a better understanding of the Group's products and its development.

## **COOPERATION WITH HYUNDAI**

The Group started its relationship with Hyundai Corporation in May 2002, when it was granted an exclusive right to manufacture, distribute and sell air-conditioners under the 現代 HYUNDAI brand in the PRC. Guangdong Chigo and Hyundai Corporation entered into a

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trademark licence agreement on 1 September 2003 for a term of five years expiring on 31 August 2008, pursuant to which Guangdong Chigo is entitled to use Hyundai Corporation's "現代" trademark in connection with the manufacturing, distribution and sale of split type, window type, portable type and ceiling type air-conditioners, and central air-conditioning systems under the 現代 HYUNDAI brand in the PRC, in return for the payment of a fixed trademark licensing fee which is payable on a monthly basis to Hyundai Corporation. Under the agreement, Guangdong Chigo is prohibited from accepting licence of trademark granted by other Korean companies for the manufacture and sale of air-conditioners in the PRC, and Hyundai Corporation is prohibited from authorizing any other PRC company to manufacture and sell air-conditioners for itself in the PRC. In addition, Hyundai Corporation shall be liable for disputes concerning the authenticity and legitimacy for the use of the "現代" trademark under the agreement. Pursuant to an agreement entered into between Guangdong Chigo and Hyundai Corporation on 25 September 2007, the term of the trademark licence agreement dated 1 September 2003 has been extended to 31 August 2010.

During the three years ended 31 December 2008, the total trademark licensing fee incurred by the Group amounted to US\$250,000, US\$380,000 and US\$200,000, respectively. For the years ended 31 December 2006, 2007 and 2008, air-conditioners sold under the 現代 HYUNDAI brand accounted for approximately 4.4%, 2.9% and 2.0%, respectively, of the Group's total turnover.

### CUSTOMER SERVICES

#### The PRC market

The customer services department of the Group's head office sales centre has overall responsibility for formulating the Group's customer services standards, whilst the Group's customer services centres, which, as of 31 December 2008, totalled 36 in number, and serviced 30 out of 31 provinces, municipalities and autonomous regions across the PRC, are responsible for monitoring the customer services points managed by the Group, its regional distributor customers and resellers, and collecting market intelligence. The Group's customer services centres monitor the customer services points by issuing guidelines of customer services to the regional distributors and resellers, providing everyday guidance and supervision, as well as providing training to them on features of the Group's products and technical skills for the repair and maintenance of the Group's air-conditioning products. The customer services points managed by the Group, its regional distributors and resellers, which as of 31 December 2008, totalled over 3,000, covering 30 out of 31 provinces, municipalities and autonomous regions in the PRC, are charged with the duty of providing day-to-day customer services to the end-users. The Group supplies air-conditioner parts and components to the relevant customer services points for repair and maintenance purpose free of charge during the warranty period. Upon the expiry of the warranty period, the customer services points are advised to use the Group's air-conditioner parts and components for the repairment of the Group's products. The Group reimburses regional distributors and resellers for the costs incurred in providing day-to-day customer services to the end-users. The reimbursement is typically approved by the Group upon the regional distributors and resellers submitting proof of such services, including copies of repair records, product warranty certificates and other related documentation.

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The Group's customer service centres are staffed based on the geographical area and sales volume of its service areas as well as the number of service areas covered by each of them. As of 31 December 2008, the Group's customer services centres were staffed by 175 personnel.

Apart from the abovementioned customer services, the Group also has 24 hour telephone hotlines to respond to end-users' enquiries.

### **Overseas markets**

The overseas customers who purchase the Group's products are responsible for providing customer services to their end-users. However, for each purchase order, the Group supplies parts to the relevant distributors and air-conditioning products manufacturers for repair and maintenance purpose free of charge provided that the aggregate value of such parts does not exceed 1% of the sales amount under the relevant purchase order. The Group also provides technical support and consultation services to its overseas customers.

### **Product warranty**

#### *(a) The PRC market*

The Group offers a standard three year warranty for its residential air-conditioners and a six year warranty for the related compressors, and a one year warranty for its commercial air-conditioners and a three year warranty for the related compressors. During such periods, free repair and maintenance services under normal usage are provided to the end-users. Following the expiry of the standard warranty period, the Group provides parts replacement service to the end-users of its residential air-conditioners. Under the service, defective parts and components (except compressors) can be replaced free of charge, subject to the charging of staff cost and transportation fee, for a period of 10 years. Such service does not cover improper use on the part of the end-users, and it is subject to circumstances where the three guarantees<sup>Note</sup> (三包規定) obligations under the national laws are invoked.

*Note:* Under the Law of the People's Republic of China on Product Liability (中華人民共和國產品質量法) and the Law of the People's Republic of China on the Protection of Consumer Rights and Interests (中華人民共和國消費者權益保護法), consumers may demand repair, replacement or return of defective products from the relevant products manufacturers or distributors.

#### *(b) Overseas markets*

The Group provides to its overseas customers a standard one year warranty for whole machines, a three year warranty for main parts such as electronic controller systems, motors and remote-controllers, and a five year warranty for compressors, respectively. During such warranty periods, free parts and components for the above products and components will be provided by the Group to its customers. The Group also generally provides technical support and training to its customers. Apart from such warranties, the Group supplies parts to its customers for repair and maintenance purposes free of charge, provided that the aggregate value of such parts does not exceed 1% of the purchase amount under the relevant purchase order, and the customers pay for any parts which exceed 1% of the purchase amount under the relevant purchase order.

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### (c) *Warranty provided by suppliers of compressors to the Group*

The Group sourced the compressors used in its air-conditioning products from external suppliers. The compressor suppliers usually provide the Group with a six year warranty (from the date the compressors are used in the Group's production) for the compressors supplied. During the warranty period, free replacement services under normal usage are provided by the compressor suppliers. For each purchase order placed by the Group, the compressor suppliers would provide free of charge to the Group, additional compressors that do not exceed 2% of the purchase amount, for maintenance purposes. During the Track Record Period, the Group did not discover any material defects in the compressors purchased from external suppliers.

### **ERP SYSTEM, LOGISTICS AND WAREHOUSING**

The Group has implemented the ERP system. The ERP system of the Group was designed and is maintained according to the operation flow of the Group. Implementation of this ERP system started in 2003, and all major business processes such as sales, production planning, procurement, production, quality control, inventory and warehouse management are now supported by this system.

As the ERP system tracks purchase orders and the production plan with the related bills of materials (which set out the up-to-date production materials requirements of the relevant products), it has assisted the Group in reducing the stocking of the wrong, and over-stocking of, raw materials, parts and components. Furthermore, as the ERP system allows the sales and production personnel to monitor the Group's inventory of finished products on a real time basis, unnecessary production can be reduced, and shipment of goods can be made on a first-in first-out basis, which assists in increasing inventory turnover and reducing stock obsolescence.

The Group has a stock-take policy to manage the stock-taking process and discrepancies reporting. The purposes of the Group's stock-take policy are to (i) safeguard the existence and safety of its products stored in its warehouses; and (ii) to resolve any discrepancies discovered during the stock-taking process. Pursuant to the Group's stock-take policy, stock-taking will be conducted daily, weekly, monthly, quarterly or non-periodically. Coverage of products which would be checked during the Group's stock-taking process is summarised below:

Daily:	Products of large quantity moving in and out of the Group's warehouses
Weekly:	Same model of products as randomly selected by the Group's internal audit division
Monthly/quarterly:	All products
Non-periodically:	Any of the scope of coverage above

In the event that discrepancies are found during or after the stock-taking process, an analysis report and proposal for treatment of discrepancies will be submitted to the Group's management for approval within a prescribed time period.


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The Group distributes products either to its warehouses for customers' collection or to its domestic customers by vessel, railway or trucks, and to overseas customers through exports from ports in the PRC. Depending on the terms of the contract, the transportation and related costs are generally borne by the Group.

The Group has warehouses at its headquarters in Foshan, Guangdong province, the PRC with an aggregate storage capacity of up to 300,000 units of finished products as well as warehouses in other parts of the PRC serving the Group's distribution network. As of 31 December 2008, there were 34 warehouse providers providing warehousing services to the Group in 35 different locations of the PRC, serving customers based in the six sales regions.

### INTELLECTUAL PROPERTY

#### (a) Trademarks

The Group is the registered owner of a number of trademarks in connection with its business, including "CHIGO", "志高" and  trade marks, which have been registered in the PRC and other relevant overseas countries. For details of the Group's trademark portfolio, please refer to the paragraph headed "Intellectual property rights of the Group" in Appendix V to this prospectus.

By trademark licence agreements dated 1 May 2002, 1 September 2003 and 25 September 2007, respectively, entered into between Guangdong Chigo and Hyundai Corporation, Guangdong Chigo was granted an exclusive right to use the "現代" trademark and the "HYUNDAI" trade name in connection with the manufacturing, distribution and sale of air-conditioners under the 現代 HYUNDAI brand in the PRC for a term of seven years expiring on 31 August 2010 in exchange for the payment of a fixed trademark licensing fee to Hyundai Corporation.

#### (b) Patents

The Group is also the registered owner of a number of design patents and model patents in respect of its air-conditioners and other products, the details of which are set out in Appendix V to this prospectus. The Directors believe that the patents owned by the Group are important in protecting the Group's core technologies from infringement, and safeguarding the technological competitiveness of the Group.

During the Track Record Period, the Group did not experience any infringement of its intellectual property rights and has not been found liable for any infringement of third parties' intellectual property rights.

### ENVIRONMENTAL MATTERS

The Directors confirmed that the Group's manufacturing process does not generate significant chemical wastes, waste water or other industrial wastes. Therefore, the impact of the Group's production process on the environment is believed to be limited.

The Group is subject to the environmental protection laws and regulations promulgated by the PRC government. During the process of production, the Group has complied with applicable national and municipal environmental protection regulations in



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relation to, particularly, disposal of waste water, gaseous emissions, metal and plastic waste, and industrial waste which are produced during the production process. The Group has implemented a set of waste treatment procedures in its production facilities during the production process.

The European Union implemented the WEEE and RoHS directives in August 2005 and July 2006, respectively. Accordingly, the Group has implemented a set of quality control standards in compliance with WEEE and RoHS for its air-conditioners manufacturing. For instance, externally, in the procurement of raw materials, the Group has set up and implemented an “RoHS supplier quality management manual (RoHS供應商質量管理制度)” requiring that the raw material suppliers comply with the RoHS directives. Internally, the Group is in strict compliances with both WEEE and RoHS directives, which is evidenced by the RoHS certification obtained by the Group in 2007 and the fact that the Group’s overseas customers may also require compliance with both WEEE and RoHS directives for their purchases. For information of the composition and functions of the Quality Control Committee, please refer to the section headed “Business – Quality control”.

The residential air-conditioners manufactured by the Group have an EER range of between 1 to 5 (for split type residential air-conditioners) and between 3 to 5 (for window type residential air-conditioners). As the Group generally manufactures and supplies domestic air-conditioners to the PRC market based on market demand and consumer preference, the Group estimates that around half of its residential air-conditioners sold in the PRC market in 2008 had an EER of 4 or 5.

The Group also obtained the ISO14001:2004 environmental management system standard certification (which is valid from 22 June 2006 to 21 June 2009, and the Group was attending to the renewal of the same as at the Latest Practicable Date). Many members of the Quality Control Committee obtained the ISO14001:2004 Environment Management System Internal Assessor Certification (環境管理體系內審員資格). These environmental management system standards certification for both the Group and its staffs are important to the Group as they serve to enhance customers’ confidence in the Group’s products and are essential for the Group in promoting its products to overseas customers.

The Group has devised and carried out an environmental protection plan by establishing its own internal environmental monitoring and survey procedural manual, pursuant to which the relevant manufacturing department would be responsible for the collection of waste water/gas emission data and report to the Quality Control Committee. Group’s quality committee (the details of which are set out in the paragraph headed “Quality control” in this section above) closely monitors the Group’s production process. The Quality Control Committee conducts random inspection for the relevant departments’ operational control on a regular basis and a full-scale inspection of the same on a quarterly basis. In order to address any potential pollution problem in a timely manner. In addition, before selecting and sourcing raw materials, parts and components from external suppliers, the Group would inspect their facilities and require the external suppliers to supply raw materials, parts and components to check that they meet with the recognised environmental standards (Note). As of 31 December 2008, this team comprised 46 members who were involved in formulating and implementing measures for compliance with environmental standards. These team members typically have two to three years of environmental compliance experience.



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*Note:* The “recognised environmental standards” refer to the RoHS directives and the standards of environmental control set by the Group regarding the following raw materials:

Control substance	Lead	Cadmium	Mercury	Hexavalent chrome	PBB and PBDE
Maximum consistency	0.1% (1,000 ppm)	0.01% (100 ppm)	0.1% (1,000 ppm)	0.1% (1,000 ppm)	0.1% (1,000 ppm)

Based on its systematic procedures of environmental protection, combining with the confirmation from the relevant environmental protection authority on the Group’s compliance with the relevant environmental protection rules and regulations, the Group’s environmental protection procedures and systems are adequate to enable the Group to comply with the current applicable national and municipal environmental protection regulations in the PRC.

The PRC is a signatory to both the Montreal Protocol and the Kyoto Protocol. Under the terms of these protocols, with regard to the air-conditioning products industries, the PRC must discontinue the consumption and production of CFC(s) and gradually reduce the consumption and production of HCFC by 2030. In compliance with these two protocols, a series of governmental announcements and implementation guidelines have been promulgated in relation thereto.

The Group does not produce refrigerants and sources refrigerants from third party suppliers. In compliance with the relevant governmental regulations and the customers’ requirements, the Group uses both HCFC(s) and HFC (a more environmental friendly substitute for CFCs as recommended by both protocols) refrigerants for its air-conditioning products, depending on the specific standards and export requirement pursuant to the individual purchase order from the different markets, as the two protocols stipulate different prohibition and adoption periods for refrigerant usage for the different countries.

The increase in costs for the substitution of the HCFC refrigerant with more environmental friendly refrigerants is not significant to the overall manufacturing cost of the Group. Also, such replacement will not affect the functionalities of the Group’s products, nor will they require major adjustments to the product design or production technology of the Group. Therefore, the Directors are of the view that both the Montreal Protocol and the Kyoto Protocol do not have significant impact on the Group’s operation.

During the Track Record Period, the Group did not receive any notification or warning nor has it been subject to any fines or legal actions in relation to any breach of any relevant environmental laws and regulations. As of the Latest Practicable Date, the Group had obtained all the required permits and environmental approvals for its production facilities.

### PROPERTY

As of 31 March 2009, the Group had obtained collectively-owned land use rights certificates for and had the rights to use approximately 220,657.71 sq.m. of land in Foshan, Guangdong Province, the PRC, with the consent from the relevant villager representatives. The Group’s land use rights are for various terms expiring between 29 June 2050 and 28 February 2054. As advised by the PRC legal counsel to the Company, Guangdong Chigo’s ownership of these collectively-owned land use rights is in compliance with Notice Regarding Trial Circulation of Village Collectively-owned

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Construction Land Use Rights 《廣東省人民政府關於試行農村集體建設用地使用權流轉的通知》 and Guangdong Management Rules on Circulation of Collectively-owned Construction Land Use Rights 《廣東省集體建設用地使用權流轉管理辦法》, which were promulgated by the people's government of the Guangdong Province in 2003 and 2005, respectively. Guangdong Chigo has obtained the relevant land and building title certificates from the relevant land and housing bureaus. The relevant land-use rights and buildings are legally owned by Guangdong Chigo. As of 31 March 2009, the Group had also leased approximately 148,600.15 sq.m. of buildings in Foshan. Such buildings in Foshan are for office, production and warehousing uses.

As of 31 March 2009, the Group had also obtained land use rights certificate for and had the right to use approximately 200,000 sq.m. of land in Wuhu, Anhui province, the PRC, for a term of 50 years. The land will be used by the Group for manufacturing of commercial air-conditioning products.

In addition, as of 31 March 2009, the Group had obtained land use rights certificate for and had the right to use approximately 200,001 sq.m. of land in Jiujiang, Jiangxi province, the PRC, for a term of 50 years. The land will be used by the Group for manufacturing of commercial air-conditioning products.

The Group intends to use approximately 60.0% of the net proceeds from the Global Offering for expansion of the Group's manufacturing capacity for the production of commercial air-conditioning products to be located at the new manufacturing facilities in Jiujiang and Wuhu, respectively, the total investments for the first phase of which are estimated to be approximately RMB119.0 million. From the 60.0% of the net proceeds from the Global Offering, it is expected approximately 50.0% and 50.0% of them will be allocated for the Jiujiang project and the Wuhu project, respectively and that for each project, approximately 51% will be allocated as the construction costs and the remaining 49% will be allocated for the purchase of fixed assets. The remaining funds for the expansion project (including the second phase of approximately RMB200.0 million) will be funded by internally generated resources. Each of Chigo Jiu Jiang and Chigo Wuhu commenced construction on a piece of land located in Jiujiang and Wuhu, respectively on 1 August 2008 and 26 March 2008, respectively before each of them having obtained the permit for commencement of work. As advised by the PRC legal advisers of the Company, such actions may lead to a fine from 1% to 2% of the contract prices of the construction contracts (and the contract prices of the construction contracts for the land located in Jiujiang and Wuhu are RMB29.3 million and RMB2.7 million, respectively) and the relevant authorities have the right to instruct each of Chigo Jiu Jiang and Chigo Wuhu to stop the construction works and to take remedial actions within a specific time frame. Both Chigo Jiu Jiang and Chigo Wuhu have taken steps to apply for the permits for commencement of work. Nonetheless, as at the Latest Practicable Date, such permits had yet to be obtained. In any event, in view of the economic downturn, the Company has slowed down and adjusted the construction work schedule in respect of the manufacturing facilities for the production of commercial air-conditioning products in Jiujiang and Wuhu in accordance with its business needs. It is expected that the construction of such facilities will commence in the second half of 2009 and will be completed in the first half of 2011. Based on a letter of confirmation from Guangdong Chigo which confirmed that after its consultation with the relevant governmental bodies, it expected that it would need 45 working days to obtain the permits for commencement of works on the above land, and there is no material legal impediment to obtain such permits for commencement of works, and to the best of its knowledge and belief, the PRC legal advisers of the Group are of the

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view that there is no material legal impediment for Chigo Jiu Jiang and Chigo Wuhu to obtain the permits for commencement of works should they submit all the relevant documents to the relevant governmental bodies. Pursuant to the deed of indemnity entered into by Mr. XH Li and Chigo Group Holding in favour of the Company (for itself and as trustee for each of its subsidiaries), each of Mr. XH Li and Chigo Group Holding jointly and severally agreed and undertook to indemnify any member of the Group against any loss and damages suffered by the Group due to the absence of the permits to commence construction work.

As of 31 March 2009, the Group leased three buildings in Foshan, Guangdong province with a total lettable area of approximately 102,945 sq.m. from Shengli Economy United Community of Lishui Town, for use as temporary warehouses. In respect of these leased buildings, the Group has not been provided with the relevant title certificates of the lessor. As such, the Group may be requested to vacate these facilities. Nevertheless, the Group considers that the three leased buildings are not crucial to the Group's operation, and the impact of relocation will be minimal for the Group's production process and business operation. The Group estimates that relocation would take about 15 days and the relocation cost would be approximately RMB1,500,000. The lessor had undertaken to compensate the Group in the event of any title dispute. Further, each of the controlling shareholders, Mr. XH Li and Chigo Group Holding has also given an indemnity in respect of any relocation expenses and losses suffered by the Group as a result of such relocation.

### **INSURANCE**

The Group maintains a number of insurance policies to cover its buildings, facilities, machinery, equipment, inventories and other assets. The Group also maintains product liability insurance for liabilities in respect of claims arising from bodily injury, illness or death or loss of or damage to property arising from using of the Group's products under the CHIGO brand.

The Group did not make any material insurance claims during the Track Record Period. The Directors believe that the Group's insurance coverage is adequate for its operations.

### **LITIGATION**

As at the Latest Practicable Date, the Group had not been involved in any litigation, arbitration or administrative proceedings which were pending or threatened against it or any of its subsidiaries which could have a material adverse effect on its financial condition or results of operation.

### **COMPETITION**

According to the annual research report on residential air-conditioners in the 2008 refrigeration year published by the State Information Center (國家信息中心), the domestic residential air-conditioner market is dominated by the top 10 manufacturers who accounted for over 80% of the PRC market in terms of sales volumes. The top five domestic air-conditioner manufacturers (including the Group) accounted for approximately 62.2% of the PRC market, certain information of which is disclosed in the section headed "Industry Overview — Characteristics of the PRC Air-Conditioner Market — Market consolidation giving rise to top 5 market leaders concentration" in this prospectus.

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According to the Information Resources Development Department of the State Information Center (國家信息中心資源開發部), among the top five domestic air-conditioner manufacturers, the Group ranked fourth in the PRC in terms of sales volume, which was approximately 7.6%, in 2008. 62 out of 96 domestic air-conditioner manufacturers ceased operation from 2004 to 2008 refrigeration year. The Directors believe that the domestic air-conditioner market will be further dominated by the larger domestic manufacturers which have comparable scale of operation and production capacity.

The Group faces intense competition from the top domestic manufacturers in the PRC, some of which may have certain advantages over the Group, including greater financial, technical and raw materials resources, greater economies of scale, broader name recognition and more established sales networks in certain markets.

The Directors believe that, whilst competitive pricing remains an important factor in the PRC market, end-users of air-conditioners are more concerned with performance in terms of quiet level, energy efficiency and air purification ability. Accordingly, the Group has been working towards improvements in these areas and, since 2006, the Group has launched three successive series of its “三超王” (“San Chao Wang”) air-conditioners. (Please refer to the paragraph headed “Product design and research and development” for details of the “三超王” (“San Chao Wang”) products.) The Directors believe that the quality of its air-conditioners, together with the awareness of the Group’s CHIGO brand and the Group’s wide range of products will allow the Group to be competitive in the PRC air-conditioner market.

In addition, the Directors believe that the ability to control and reduce costs is another important factor for air-conditioner manufacturers to stay competitive, and that the Group has competitive strength in this regard. The strategy of building its vertically integrated supply chain (details of which are set out in the paragraph headed “Production – Parts and components” in this section above) allows the Group to better control the fixed unit production cost of its air-conditioners, as it does not need to pay the profit margin otherwise charged by outside suppliers. This also provides the Group the flexibility of adjusting its product design, production plan and production process in times of fluctuation in the prices of raw materials, as the Group can, to the extent possible or feasible, work towards reducing the consumption of the raw materials that are expensive.

### CONTROLLING SHAREHOLDERS

Apart from the Company, Mr. XH Li, a Controlling Shareholder and an executive Director, and Mr. Huang Guoshen, an executive Director, have interests in other business, particulars of which are set out below:

Mr. XH Li wholly owns American Global York Co. LLC (“American Global”), a company incorporated under the Laws of the State of Delaware on 14 May 2003 and indirectly owns a 50% interest in American Global York (HK) Co. Limited (美國環球約克(香港)有限公司) (“American Global (HK)”) through its parent company, American Global. Mr. XH Li also has an 80% interest in 日本格菱電氣(香港)有限公司 (Japan Green Electric (HK) Limited) (“Japan Green Electric”) and a 35.5% interest in 廣東粵廣數字多媒體廣播有限公司 (Guangdong Yue Guang Shu Zi Multimedia Broadcasting Co., Ltd.) (“Yue Guang Shu Zi”). Mr. Huang Guoshen has a 11.65% interest in 廣東中盈盛達擔保投資有限公司 (Guangdong Join-Share Guarantee Investment Co., Ltd.) (“Guangdong Join-Share”).

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American Global, American Global (HK), Japan Green Electric are inactive companies. Yue Guang Shu Zi is engaged in multimedia broadcasting business and Guangdong Join-Share is engaged in business principally related to the provision of guarantees to lending banks (the “Excluded Business”). None of the above businesses controlled by Mr. XH Li and Mr. Huang Guoshen are suppliers or customers of the Group.

The Directors are of the view that there is a clear delineation between the Excluded Business and the Group’s business, as a result of which none of the Excluded Business would compete, or is expected to compete, directly or indirectly, with the Group’s business.

None of the Controlling Shareholders and the Directors has interests in any business which competes or is likely to compete with the business of the Company.

### **Management independence and operational independence**

Although the Controlling Shareholders will retain a controlling interest in the Company upon the completion of the Global Offering, the day-to-day management of the business of the Group will be the responsibility of the Directors and senior management. The Board has seven Directors with four executive Directors and three independent non-executive Directors, and only Mr. XH Li, the executive Director, is the Controlling Shareholder. In addition, members of senior management of the Company are also independent from the Controlling Shareholders and their respective associates. Further, the Company manufactures its own air-conditioners independently and outsources its products through its own distribution, sales and marketing network. During the Track Record Period, the Company has not been dependent on the Controlling Shareholders in any material way related to its business operations.

### **Financial independence**

The Directors confirm that they have the ability to operate independently from the Controlling Shareholders from a financial perspective. The Directors also confirm that all loans and/or guarantees provided by the Controlling Shareholders for the benefit of the Group will be repaid or released before the Global Offering. For the above reasons, the Directors believe they are capable of carrying on the business of the Company independently of the Controlling Shareholders and their respective associates after the Listing.

### **Non-competition Undertakings**

In order to eliminate any future competing business with the Group, on 19 June 2009, Mr. XH Li (for himself and on behalf of Chigo Group Holding) entered into a deed of non-competition with the Company pursuant to which he confirms/undertakes, *inter alia*, that:

- (a) as at the date of the deed of non-competition, each of them did not engage or was not interested in any entities which engaged in any business that is directly or indirectly in competition with the business of the Group;

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- (b) each of them will not and will procure their respective associates not to engage, directly or indirectly, whether as a shareholder, director, officer, partner, agent, lender, employee, consultant or otherwise and whether for profit, reward or otherwise, in businesses which will or may compete with the business carried on or to be carried on by the Group;
- (c) in the event that each of them or their respective associates is given/identifies any opportunities to engage in a business that is in competition with a business carried on by the Group, he or his associates will as soon as practicable inform the Company of such opportunity and the Company has a right within three months thereafter to request him or his associates to allow the Company to take up the opportunity and in the event that the Company decides to take up the opportunity, he will endeavour to assist the Company to obtain the opportunity;
- (d) each of them will not (i) solicit business in which the Group is involved or engaged from a person, firm, company, corporation, partnership or organization which is a client or a potential client of the Group; and (ii) on behalf of themselves or any other person, firm or company solicit or endeavour to cause any of the employees, former employees or, agents of the Group to work for any other person, firm or company engaging in a business which will or may compete directly or indirectly with the business carried on or to be carried on by the Group; and
- (e) for so long as Mr. XH Li is a Director, he will provide all information necessary for the review and enforcement of the non-competition undertakings.

Notwithstanding the undertakings under (b) and (c) above given by Mr. XH Li (for himself and on behalf of Chigo Group Holding), nothing in their undertakings shall prevent them after the completion of the Global Offering from acquiring or holding interests in equity securities issued by any company engaged in the design, development, manufacture and sale of air-conditioning products or related businesses provided that each of Mr. XH Li and Chigo Group Holding will not directly or indirectly own more than 5% of the total issued share capital of such company or control the exercise of more than 5% of the voting rights thereof or control the composition of the board of directors of such company.