## MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Investors should read the following discussion and analysis in conjunction with the consolidated financial information included in the accountants' report of the Group and the notes thereto, which are set out in Appendix I — "Accountants' report" to this prospectus, as well as the selected historical financial information and operating data included elsewhere in this prospectus. The financial information of the Group has been prepared in accordance with HKFRS. The following discussion and analysis contain certain forward-looking statements that involve risks and uncertainties. These statements are based on assumptions and analysis made by the Group in light of its experience and perception of historical trends, current conditions and expected future development, as well as other factors that the Group believes are appropriate under the circumstances. However, whether the actual results and developments will meet the Group's expectations and predictions depends on various risks and uncertainties over which the Group does not have control. Please review the section headed "Risk factors" in this prospectus for a discussion of important factors that could cause the Group's actual results to differ materially from the results described in or implied by these forward-looking statements. Investors should also note that certain figures stated in the following discussion and analysis are the result of rounding from those figures in, or from calculations based on the figures set out in, the accountants' report in Appendix 1 to this prospectus.

## BASIS OF PRESENTATION

Prior to the Global Offering, the Group underwent the Reorganisation pursuant to which the Company became the holding company of the Group. Please see the paragraph headed "Corporate reorganisation" in Appendix V to this prospectus for details. The Group resulting from the Reorganisation is regarded as a continuing entity. Accordingly, the financial information prepared presents the consolidated results and financial position of the Group as if the current group structure had been in existence throughout the Track Record Period or since the respective dates of incorporation or establishment of the relevant member(s) of the Group, whichever is earlier.

All significant intra-group transactions and balances have been eliminated on consolidation.

## FACTORS AFFECTING THE GROUP'S RESULTS OF OPERATIONS AND FINANCIAL CONDITION

The Group's results of operations and financial condition over the Track Record Period have been and will continue to be affected by a number of factors, including but not limited to those set forth in the section headed "Risk factors" in this prospectus and as set out below:

- The Group faces significant competition in all of the markets in which it operates from PRC and international competitors that may have greater financial, technical and/or raw material resources, greater economies of scale, broader name recognition, better distribution networks and/or more established relationships in certain markets. Increased competition may force the Group to lower prices, lead to a decrease in sales and ultimately have a material adverse impact on the Group's business, financial condition and results of operations.

- The Group is susceptible to fluctuations in price and supply of raw materials, parts and components. The Group's operations consume substantial amounts of compressors, as well as commodities such as copper and aluminium that are highly susceptible to price volatility and have recently experienced dramatic price increases. The Group's total expenditures for copper and aluminium were approximately 32.7%, 29.4% and 30.8% of the Group's costs of goods sold for the three years ended 31 December 2008, respectively. During the Track Record Period, the cost of copper and the cost of aluminium experienced significant fluctuations. The growth rate in the cost of copper was approximately 24.9% from January 2006 to April 2008 and dropped by approximately 42.8% in December 2008 as compared to January 2006, while the decline rates in the cost of aluminium were approximately 4.7% and 25.2% from January 2006 to April 2008 and from January 2006 to December 2008, respectively. Any substantial increase in the costs of these raw materials, parts and components, particularly compressors and copper, which accounted for a substantial part of the Group's costs of goods sold during the Track Record Period, could adversely affect the Group's business, financial condition and results of operations.

- Due to a significant and increasing portion of its sales made to overseas markets, the Group is subject to foreign exchange fluctuations and, specifically, negatively impacted by the continuing appreciation of the Renminbi relative to the US dollar, as most of the overseas sales of the Group are denominated in US dollars. During the three years ended 31 December 2008, approximately 38.7%, 40.7% and 51.4%, respectively, of the Group's sales were denominated in currencies other than the functional currency of the Group entity making the sales — predominantly the US Dollar. As a result of the fluctuations in exchange rates between the Renminbi and the US Dollar between the date of recognising sales and the date of receipt of payment from customers, the Group recognised net exchange losses of RMB6.4 million, RMB26.1 million and RMB29.8 million for the three years ended 31 December 2008, respectively.

- The Group must keep pace with technological changes and frequently introduce new products and models on a timely and cost-effective basis. The Group's success also depends in part on its ability to enhance continually its existing products and develop new and competitively priced products that offer technologies, features and appearances that meet the requirements of end users. For example, during the Track Record Period, the Group introduced new products and enhancements to existing products that accounted for RMB498.8 million, RMB1,033.6 million and RMB617.1 million of the Group's turnover during the three years ended 31 December 2008, respectively.

- The Group's products are sold primarily through independent distributors both in the PRC and overseas markets. Sales through these distributors accounted for approximately 84.5%, 84.2% and 84.3% of the Group's turnover for the three years ended 31 December 2008, respectively. For further details about the Group's distributor sales and relationships, please refer to the section headed

"Business — Sales and distribution" in this prospectus. There is no assurance that the Group will be able to maintain its business relationship with its distributor customers. If a significant number of the Group's distributor customers cease to purchase the Group's products and the Group is unable to find suitable replacement distributors or other customers, the Group's business, financial condition and results of operations will be adversely affected.

- As substantially all of the Group's production activities are conducted through its manufacturing facilities in the PRC, and a substantial portion of its sales are derived from the PRC market, the Group's operations are significantly exposed to PRC laws and regulations. However, due to the fact that these laws and regulations have not been fully developed, because of the limited volume of published cases and their non-binding nature, and as a result of other factors (including the influence that political considerations can have in legal matters), the implementation and application of PRC laws and regulations involves a degree of uncertainty. While PRC laws and regulations have not had a material impact on the business, financial condition or results of operations of the Group over the Track Record Period, the Group cannot predict the future development of the PRC legal system, including any promulgation of new laws, changes to existing laws or the interpretation or enforcement thereof, or the preemption of local laws and regulations by national laws, and the effect they may have on the Group. In addition, due to its extensive overseas sales, the Group is exposed to foreign laws and regulations in numerous areas, such as taxation, environmental laws, product liability, and so forth.

## CERTAIN INCOME STATEMENT ITEMS

### Turnover

The Group's turnover is almost entirely derived from sales of residential and commercial air-conditioners as well as air-conditioner parts and components. 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. During the Track Record Period, the Group's primary products were residential air-conditioning products, which accounted for approximately 88.9% of turnover, and commercial air-conditioning products, which accounted for approximately 5.3% of turnover. In addition to these air conditioning products, the Group also manufactures and sells air-curtains, water coolers, dehumidifiers and wine refrigerators, as well as resells compressors to certain of its customers. The Group also sources and resells small home electrical appliances, and licenses its own brand name to OEM manufacturers who sell these products. Turnover is net of value added tax and volume discounts.

The Group expects sales of its commercial air-conditioning products to increase in the future, both in absolute terms and as a percentage of total turnover. Although the Group's sales of commercial air-conditioning products decreased in 2008 as compared to that of 2007, which was principally due to the down turn in the property market in the PRC in 2008, which in turn affected the sales of small scale household-use central air-conditioning systems sold mostly to contractors who bulk purchase such air-conditioning systems for specific development projects, and to the Group shifting its emphasis to the sale of large scale central air-conditioning systems sold mostly to end-users who may be governmental bodies, or owners or operators of real estate, restaurants, hotels, shopping malls and supermarkets. Please refer to the section headed "Business — Sales and distribution networks and channels — (a) The PRC market — 6. Distribution and sales of commercial air-conditioners" on the sales strategy of the Group for commercial air-conditioning products. The Directors believe that the market opportunity for commercial air-conditioning products is developing, primarily due to (i) the improving competitive landscape for lower-cost Chinese manufacturers, such as the Group, as such manufacturers have narrowed the technological gap with overseas competitors for manufacturing commercial air conditioning products, and (ii) the growing commercial and central residential air conditioning demand in China, which is largely a result of continuing economic development and increasing wealth in China. Because of this market opportunity, the Group intends to increase production of commercial air-conditioning products, which is expected to account for RMB56.3 million or 60.0% of the proceeds of the Global Offering and is expected to involve the addition of production lines and purchase of manufacturing equipment to expand the Group's commercial product business, as well as the construction of two new manufacturing facilities in Jiangxi and Anhui provinces.

The Group sells its products both domestically in the PRC and overseas. The Group has an extensive distribution network in the PRC, consisting of relationships with a total of 228, 248 and 265 regional distributors (經銷商) for the three years ended 31 December 2008, respectively. In addition, in 2008, the Group's domestic distribution network included the three largest nation-wide household appliances retail chain operators, covering 30 of the 31 provinces, municipalities and autonomous regions in the PRC. The Group also exports its air-conditioners (both under the CHIGO brand and on an OEM basis) and air-conditioner parts and components overseas, principally through, as at 31 December 2008, over 200 overseas distributors of CHIGO brand products and over 800 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.

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.

In the past, the Group has generally experienced a high degree of seasonality patterns in its business. With the diversification of the Group's overseas sales markets and technological advancement in the Group's products, the Directors believe that the Group's sales of air-conditioners have become less susceptible to seasonal fluctuations in recent years, due in part to increasing exports to Southern Hemisphere customers, which amounted to approximately RMB192.3 million, RMB280.8 million and RMB300.1 million during the three years ended 31 December 2008, respectively, and had the effect of increasing sales during the Northern Hemisphere low season. However, seasonal fluctuations in the Group's sales of air-conditioners still exist. Demand for air-conditioners is usually higher during the Northern Hemisphere summer each year, resulting in the Group's sales in the six-month period from March through August being higher than in the other six months of the year. For the three years ended 31 December 2008, the Group's sales in the six-month period from March through August accounted for approximately 67.8%, 63.7% and 70.5%, respectively, of the sales in the whole year.

Additionally, in 2002, the Group commenced a strategic relationship with Hyundai Corporation, whereby the Group pays a flat annual trademark licensing fee to Hyundai Corporation in exchange for the exclusive right to sell its products in China under the 現代 HYUNDAI brand. During the three years ended 31 December 2008, the Group paid Hyundai Corporation annual trademark licensing fees of US$250,000, US$380,000 and US$200,000, respectively, in connection with this arrangement. This arrangement accounted for 4.4%, 2.9% and 2.0% of the Group's total turnover during the three years ended 31 December 2008, and is expected to continue to decline as a percentage of total turnover in the foreseeable future as the Group expands its overall sales volume and increases sales of its non-HYUNDAI brand products.

The table below sets out the Group's turnover for the Track Record Period:

| | Year ended 31 December | | | | | |
|---|---|---|---|---|---|---|
| | **2006** | | **2007** | | **2008** | |
| | *RMB'000* | *% of Turnover* | *RMB'000* | *% of Turnover* | *RMB'000* | *% of Turnover* |
| **PRC sales** | | | | | | |
| CHIGO brand | 2,458,355 | 54.2 | 3,094,000 | 54.1 | 2,563,396 | 43.3 |
| HYUNDAI brand | 201,381 | 4.4 | 163,803 | 2.9 | 116,558 | 2.0 |
| Air-conditioner parts and components | 2,523 | 0.1 | 50,837 | 0.9 | 86,259 | 1.4 |
| Other products | 118,998 | 2.6 | 78,664 | 1.4 | 112,314 | 1.9 |
| | 2,781,257 | 61.3 | 3,387,304 | 59.3 | 2,878,527 | 48.6 |
| **Overseas sales** | | | | | | |
| CHIGO brand | 282,188 | 6.2 | 310,391 | 5.4 | 336,382 | 5.7 |
| OEM | 1,430,389 | 31.6 | 1,959,106 | 34.3 | 2,330,942 | 39.3 |
| Air-conditioner parts and components | 22,298 | 0.5 | 21,573 | 0.4 | 329,349 | 5.6 |
| Other products | 18,930 | 0.4 | 38,034 | 0.6 | 45,383 | 0.8 |
| | 1,753,805 | 38.7 | 2,329,104 | 40.7 | 3,042,056 | 51.4 |
| Total | 4,535,062 | 100.0 | 5,716,408 | 100.0 | 5,920,583 | 100.0 |

The table below sets out the Group's turnover derived from each major product group for the Track Record Period:

| | Year ended 31 December | | | | | |
|---|---|---|---|---|---|---|
| | 2006 | | 2007 | | 2008 | |
| | *RMB'000* | *% of Turnover* | *RMB'000* | *% of Turnover* | *RMB'000* | *% of Turnover* |
| **Residential Air-conditioners** | | | | | | |
| Split type | 3,988,176 | 87.9 | 4,908,371 | 85.9 | 4,746,919 | 80.2 |
| Window type | 126,811 | 2.8 | 130,568 | 2.3 | 203,041 | 3.4 |
| Portable type | 108,427 | 2.4 | 86,539 | 1.5 | 85,527 | 1.4 |
| Sub-total of residential air-conditioners | 4,223,414 | 93.1 | 5,125,478 | 89.7 | 5,035,487 | 85.0 |
| **Commercial air-conditioning products** | 148,899 | 3.3 | 401,822 | 7.0 | 311,791 | 5.3 |
| **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 |
| **Total** | 4,535,062 | 100.0 | 5,716,408 | 100.0 | 5,920,583 | 100.0 |

As demonstrated in the table above, turnover derived from sales of portable-type residential air conditioners decreased during the Track Record Period, principally due to the Group's strategic decision to reduce production of such products as a result of increasing competitive advantages of more specialised competitors. Additionally, turnover derived from sales of air-conditioner parts and components increased significantly during the Track Record Period, principally due to exports to the Group's customers in Turkey, Brazil, Nigeria and Malaysia.

### *Geographic distribution*

The Group sold approximately 59.3% and 40.7% of its products in the PRC market and overseas, respectively, during the year ended 31 December 2007, compared to 48.6% and 51.4%, respectively, during the year ended 2008. The Group believes the overseas market will account for an increasing percentage of its turnover due to better sales opportunities in developing countries, increasing sales in Southern Hemisphere countries and improving technology in making commercial air-conditioning products, making Chinese manufacturers such as the Group more competitive internationally.

The following table sets out a breakdown of the Group's turnover derived from the PRC and overseas markets as a percentage of total turnover during the Track Record Period.

| | Year ended 31 December | | |
|---|---|---|---|
| | 2006 | 2007 | 2008 |
| | | *% of Turnover* | |
| PRC sales | 61.3 | 59.3 | 48.6 |
| Overseas sales | 38.7 | 40.7 | 51.4 |
| Total | 100.0 | 100.0 | 100.0 |

*Turnover of the Group's products in the PRC market*

The Group's PRC sales network is geographically divided into six sales regions covering 30 of the 31 provinces, municipalities and autonomous regions and cities in the PRC. The sales analysis by regions during the Track Record Period is summarised below:

| | Year ended 31 December | | | | | |
|---|---|---|---|---|---|---|
| | 2006 | | 2007 | | 2008 | |
| | *RMB'000* | *% of Turnover* | *RMB'000* | *% of Turnover* | *RMB'000* | *% of Turnover* |
| **Geographic location** | | | | | | |
| Eastern 1 (Hua Dong 1) Region | 501,809 | 11.1 | 609,033 | 10.7 | 308,333 | 5.2 |
| Eastern 2 (Hua Dong 2) Region | 620,820 | 13.7 | 576,698 | 10.1 | 627,474 | 10.6 |
| Western (Hua Xi) Region | 326,495 | 7.2 | 567,180 | 9.9 | 351,179 | 5.9 |
| Southern (Hua Nan) Region | 677,090 | 14.9 | 841,394 | 14.7 | 762,589 | 12.9 |
| Northern (Hua Bei) Region | 387,169 | 8.5 | 466,584 | 8.2 | 449,639 | 7.6 |
| Central (Hua Zhong) Region | 267,874 | 5.9 | 326,415 | 5.7 | 379,313 | 6.4 |
| Total | 2,781,257 | 61.3 | 3,387,304 | 59.3 | 2,878,527 | 48.6 |

Turnover has fluctuated in these regions during the Track Record Period and is expected to continue to do so in the foreseeable future.

*Turnover of the Group's products in the overseas market*

The following table sets out a breakdown of the turnover of the Group, categorised by geographic regions of its overseas customers during the Track Record Period:

| | Year ended 31 December | | | | | |
|---|---|---|---|---|---|---|
| | 2006 | | 2007 | | 2008 | |
| | *RMB'000* | *% of Turnover* | *RMB'000* | *% of Turnover* | *RMB'000* | *% of Turnover* |
| **Geographic region** | | | | | | |
| Asia (excluding PRC) | 892,630 | 19.7 | 1,061,361 | 18.6 | 1,273,875 | 21.5 |
| Europe | 321,046 | 7.0 | 544,098 | 9.5 | 839,951 | 14.2 |
| Americas | 329,118 | 7.3 | 432,044 | 7.5 | 609,449 | 10.3 |
| Africa | 170,114 | 3.8 | 249,406 | 4.4 | 294,026 | 5.0 |
| Others | 40,897 | 0.9 | 42,195 | 0.7 | 24,755 | 0.4 |
| Total | 1,753,805 | 38.7 | 2,329,104 | 40.7 | 3,042,056 | 51.4 |

The Group has historically experienced, and expects to continue to experience in the foreseeable future, volatility in its sales in various overseas regions, which the Group believes is primarily due to seasonality, weather, changes in and compliance with international environmental regulations and relocation of certain customers sales points from outside to inside the PRC. The Group expects that sales to Europe will continue to increase in the foreseeable future due to the Group's strategic relationships with major European customers.

*Pricing of the Group's products*

The Group attempts to price its products competitively in the respective markets in which it conducts sales. While fluctuations in raw materials, parts and components prices affected the Group during the Track Record Period and are expected to continue to affect the Group's pricing policy, the Group's policy has historically been able to offset such fluctuations through improving its product design and technology so as to reduce such costs and to a certain extent transfer these costs to customers by increasing the per unit prices of its products, and expects to continue such policy in the future. The Group can give no assurances, however, that it will be successful in transferring any cost increases to customers in the future.

The following table shows the average sales price for the Group's products during the Track Record Period. Average sales prices are calculated by dividing total turnover by unit sales volume for each category of products for the relevant period.

| | Year ended 31 December | | |
|---|---|---|---|
| | **2006** | **2007** | **2008** |
| | *RMB* | *RMB* | *RMB* |
| Residential air-conditioning products (per unit) | 1,553 | 1,742 | 1,703 |
| Commercial air-conditioning products (per set) | 3,238 | 3,113 | 3,616 |

The Group experienced period to period fluctuations in average sales prices per residential unit during the Track Record Period due to (1) increasing sales of, and a shifting of product mix to, higher-end products (being products with special features, such as the "三超王" ("San Chao Wang") series) and increasing raw materials costs, especially copper and aluminium, which to a certain extent were passed along to consumers which led to higher average sales price per residential unit in 2007 as compared to that of 2006, and (2) increasing sales through contractors (being regional distributors, further details of which are set out in "Business — Sales and distribution networks and channels — (a)3(i)(a) Distributors and resellers" in this prospectus), which purchased lower-end air-conditioners in bulk from the Group and increasing overseas sales of OEM products which had a lower average per unit sale price and the impact of the depreciation of the US Dollar relative to Renminbi, as most overseas sales were denominated in US Dollar. Average sales price per commercial set increased in 2008 as compared to that of 2006 and 2007 as the Group shifted the focus to its product offerings from larger volume sales of standardised, off-the-shelf small scale household-use central air-conditioning systems in 2007 (which led to a slightly lower average sales price when compared with 2006) to producing larger scale sets with higher per-set prices.

The Group also increased its average sales price per commercial set in the year ended 31 December 2008 generally in implementing its pricing policy.

**Cost of goods sold**

The Group's cost of goods sold consists almost entirely of costs of raw materials, parts and components, and also includes direct labour costs, utilities, production costs and other costs.

The table below shows a breakdown of the Group's total cost of goods sold during the Track Record Period:

| | Year ended 31 December | | | | | |
|---|---|---|---|---|---|---|
| | 2006 | | 2007 | | 2008 | |
| | *RMB'000* | *% of Cost of goods sold* | *RMB'000* | *% of Cost of goods sold* | *RMB'000* | *% of Cost of goods sold* |
| Raw materials, parts and components: | | | | | | |
| Compressors | 1,035,563 | 28.0 | 1,271,182 | 27.3 | 1,417,334 | 28.7 |
| Copper | 987,130 | 26.7 | 1,104,405 | 23.7 | 1,285,542 | 26.0 |
| Plastic chips | 185,706 | 5.0 | 275,335 | 5.9 | 373,338 | 7.6 |
| Aluminium | 222,083 | 6.0 | 267,894 | 5.7 | 237,497 | 4.8 |
| Steel plates | 188,765 | 5.1 | 226,309 | 4.9 | 372,438 | 7.5 |
| Others *(Note 1)* | 862,408 | 23.3 | 1,181,477 | 25.4 | 885,108 | 17.9 |
| Total | 3,481,655 | 94.1 | 4,326,602 | 92.9 | 4,571,257 | 92.5 |
| Direct labour cost | 110,046 | 3.0 | 85,197 | 1.8 | 92,130 | 1.8 |
| Utilities | 18,343 | 0.5 | 22,337 | 0.5 | 28,373 | 0.6 |
| Production cost | 51,906 | 1.4 | 135,452 | 2.9 | 166,596 | 3.4 |
| Others | 37,968 | 1.0 | 90,229 | 1.9 | 82,294 | 1.7 |
| **Total cost of goods sold** | 3,699,918 | 100.0 | 4,659,817 | 100.0 | 4,940,650 | 100.0 |

1. Others includes many other miscellaneous parts and components used in production, such as electronic controller systems, refrigerant, power cords, capacitors and other small parts.

*Raw materials, parts and components*

The Group's raw materials, parts and components mainly consist of compressors, copper, aluminium, steel plates and plastic chips. During the Track Record Period, the Group was able to meet all of its requirements for compressors, copper, aluminium, steel plates and plastic chips by sourcing from its suppliers. The costs for raw materials, particularly copper, aluminium, plastic chips and steel plates, however, can be volatile and have fluctuated significantly in recent years. Prices of these raw materials may continue to fluctuate, and the Group may be unable to transfer future increases in the cost of these raw materials to its customers, in which case its costs of goods sold may increase and its margins may decrease.

*Direct labour costs*

The Group's direct labour costs mainly consist of wages and benefits of Guangdong Chigo's approximately 5,200 employees directly engaged in production as at 31 December 2008, despite some fluctuations in the number of employees during the year depending on production requirement from time to time. The Group has experienced fluctuation in its direct labour costs during the Track Record Period: for example, direct labour costs decreased from RMB110.0 million in the year ended 31 December 2006 to RMB85.2 million in the year ended 31 December 2007, then increased from RMB85.2 million in the year ended 31 December 2007 to RMB92.1 million in the year ended 31 December 2008, principally due to improved efficiencies that resulted from continuing improvement in the Group's production process, such as increasing adoption of automated production systems, optimization of production workflow and increased training of production staff in

2007. However, this advantage of cost reduction was partly offset by an increase in overall labour costs to comply with the requirements of new PRC labour legislation in 2008 despite a significant decline in the number of employees directly engaged in production in the second half of year 2008 due to slower sales.

*Utilities*

The Group's utilities costs primarily consist of water and electricity costs. The Group purchases the electricity it requires for its production from two local power grids and purchases water from one local water supplier. Although electricity shortage has periodically been a problem in Guangdong province, where the Group's production is based, the Group believes it can obtain its electricity supply from its alternate electricity network and can enjoy a relatively stable supply of electricity at relatively stable prices.

*Production costs*

The Group's production costs mainly consist of depreciation of equipment used in the production process, maintenance of production lines and equipment, moulding of parts and components and other miscellaneous production-related costs.

The Group's warranty obligations are a component of its production costs as well. The Group provides free repair services for its products and free replacement of the major components of its products for three to six years after sale. The costs of the warranty obligations are accrued at the time the related sales are recognised. Provision for warranty obligations is accrued based on the estimated costs of fulfilling the total obligations. The costs are estimated by the management of the Group and are based on past experience. The carrying amounts of the warranty provision at the balance sheet dates during the Track Record Period were RMB16.8 million, RMB35.1 million and RMB35.3 million, respectively.

*Other costs*

The Group's other costs mainly consist of the costs of compressors and raw materials manufactured by the production facilities of the Group that are sold to customers. The Group expects that in 2009 and beyond, these other costs will increase as the Group sells more raw materials manufactured by the Group to customers.

**Gross profit and gross margins**

The Group's gross profit and gross margins increased in 2007 as compared to those of 2006 but decreased in 2008 as compared to those of 2007, and, as among its different products, relative costs have not varied significantly during the Track Record Period. The decrease in the Group's gross profit in the year ended 31 December 2008 was mainly due to the increase in the cost of goods sold, especially the costs of raw materials which increased at a rate higher than the increase in the Group's sales in the first half of year 2008. As the Group completed a majority of its overseas sales in the first half of year 2008, the decrease in the cost of goods sold, especially the costs of raw materials, in the second half of the same year has a lesser effect on the Group's gross profit as sales in the second half of the year was generally slower. For more information of the seasonality of the Group's business, please refer to "Seasonal fluctuations and weather conditions" as set out in the "Risk Factors — Risks relating to the Group" section of this prospectus.

However, the Group expects its gross profit and gross margin to increase in the future due to (i) increased emphasis on higher margin products such as commercial air-conditioning products, (ii) enhanced awareness by customers of the Group's premium brand, (iii) a commitment to research and development of higher-end products across its other product lines and (iv) stabilising competition in the PRC, which has tended to reduce price competition among air-conditioner manufacturers in the PRC. Furthermore, 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 (details of which are set out in the "Business — Production — Parts and components" section of this prospectus), 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 is expected to improve the Group's margins in the long run. In 2008, the gross margin for residential air-conditioning products was approximately 16.6% and for commercial air-conditioning products was approximately 17.9%, and gross margins in the PRC market and overseas market were approximately 18.4% and 14.8%, respectively.

**Selling and distribution costs**

Selling and distribution costs consist primarily of (i) marketing, advertising and promotion costs, (ii) transportation costs for delivery of the Group's products to its customers, both in the PRC and overseas, (iii) sales and marketing staff salaries and benefits and (iv) business travel expenses and other miscellaneous selling and distribution expenses. Marketing, advertising and promotion costs consist mostly of training of distributors and promoters, as well as on-site promotional campaigns with the Group's household appliances retail chain operator customers.

The Group expects that its selling and distribution costs will change according to its sales, marketing, advertising and promotional activities in connection with the Group's strategy to enhance CHIGO brand awareness, develop broader marketing operations in overseas markets, and increase outdoor advertising.

**Administrative expenses**

The Group's administrative expenses primarily consist of administrative and management staff salaries and benefits, research and development expenses, social insurance and pension contributions, depreciation of non-production related fixed assets, amortisation of land use rights and bank handling fees. Salaries are expected to increase in the foreseeable future due to increasing overall labour costs in the PRC and growth in the Group's administrative and management staff ranks. Research and development expenses are expected to grow in absolute terms and as a percentage of total administrative expenses as the Group implements its strategic plan to grow its higher-end product offerings. Social insurance and pension contributions are expected to increase to comply with requirements of new PRC labour legislation.

**Other expenses**

The Group's other expenses primarily consist of allowance for doubtful debts, foreign exchange losses and legal and professional fees. In determining the recoverability of the trade receivables, the Group monitors changes in the credit quality of the trade receivables since the date such credit was granted and up to the respective year end date. At each of the year end date during the Track Record Period, the allowance for doubtful debts recognised on receivables represented individually impaired trade receivables from customers which have been placed under liquidation or in severe financial difficulties. Foreign exchange losses are expected to increase in the future if the Renminbi continues to appreciate relative to the US dollar, as is widely anticipated.

**Fair value changes of derivative financial instruments**

Derivative financial instruments entered into by the Group consist primarily of foreign currency forward contracts, copper forward contracts and copper swap contract. At each year end date during the Track Record Period, these derivative financial instruments were measured at fair value, with changes in fair value recognised directly in profit or loss in period in which they arise. The fair value of the foreign currency forward contracts were determined based on the valuation performed by an independent valuer of the Group, the fair value of the copper forward contract was determined based on open market fair value and the fair value of copper swap contract was measured by reference to the valuation provided by counterparty bank for this contract. The major terms of these contracts and the inputs into the valuation model are set out in Note 21 to Appendix I — "Accountants' report" of this prospectus. There were no outstanding copper and foreign currency forward contracts and copper swap contracts as at 31 December 2006. As at 31 December 2007 and 31 December 2008, the financial exposures of the Group to copper forward contracts were approximately RMB12,000 and nil, respectively, the financial exposures of the Group to foreign currency forward contracts were nil and RMB62.8 million, respectively and the financial exposures of the Group to copper swap contract was nil and approximately RMB19.5 million, respectively. As at 31 May 2009, the financial liabilities of the Group in respect of foreign currency forward contracts and copper swap contract were approximately RMB39.7 million and RMB3.8 million, respectively, and there were no outstanding copper forward contracts. As at the Latest Practicable Date, (i) the total notional amount of the outstanding foreign currency forward contracts held by the Group were approximately US$196.5 million (or equivalent to RMB1,342.4 million) and the forward contract rates of such contracts ranged from US$1/RMB6.4946 to US$1/RMB6.8170 and the mid-price of US dollars quoted by the People's Bank of China was RMB6.8316; (ii) the notional quantity of one outstanding copper swap contract was 50/100 metric tonnes and the fixed price of such contract was US$5,850 per metric tonne and the official cash price of copper quoted at the London Metal Exchange was US$4,890 per metric tonne; and (iii) there were no outstanding copper forward contracts.

**Finance costs**

Finance costs consist primarily of interest on bank and other borrowings as well as finance charges paid to banks for discounting commercial bills.

**Taxation**

Pursuant to relevant laws and regulations in the PRC, Guangdong Chigo JSC was subject to PRC Enterprise Income Tax ("EIT") of 33% for the seven-month period from 1 January 2006 up to August 2006, at which time it was converted into a WFOE. After that, it was subjected to PRC Foreign Enterprise Income Tax ("FEIT") of 33%, but entitled to the tax holiday as elaborated below from August 2006 onwards.

Pursuant to the approval documents issued by the Guangdong Provincial Commission of Science and Technology on 14 May 2002 and 24 May 2004, Guangdong Chigo JSC was endorsed as a High and New Technology Enterprise and allowed with a reduced EIT rate of 15% for the period from 14 May 2003 to 13 May 2006 ("Tax Reduction Period") and had paid its tax liability accordingly. However, pursuant to the relevant tax laws and regulations issued by the State Administration of Taxation ("SAT") of the PRC, enterprises entitled to the reduction should be situated within a High and New Technology Industry Development Zone endorsed by the Central Government. During the Tax Reduction Period, Guangdong Chigo JSC was situated in areas outside any High and New Technology Industry Development Zone and accordingly, would be subject to potential additional tax liability, equivalent to the reduced portion of EIT at 18% on the profits of the relevant periods, if the relief is clawed back. Hence, for each of the two years ended 31 December 2006, EIT was accrued at the tax rate of 33% despite the tax reduction. Guangdong Chigo JSC has recognised the reduced portion of EIT liabilities of RMB18,027,000 for the year ended 31 December 2006.

According to the letter issued by Guangdong Foshan Provincial Local Tax Bureau on 25 August 2006 and pursuant to Rule 52 "The regulations of charging and managing taxes in the PRC", should the relevant PRC tax authorities claw back the relief of the reduced EIT rate of 15% in determining the amount of EIT of Guangdong Chigo JSC, no tax penalties would be levied except for the additional tax attributable to the relief of 18% previously given to Guangdong Chigo JSC.

Effective from August 2006, pursuant to the Income Tax Law for the Foreign Investment Enterprises and Foreign Enterprises in the PRC ("FEIT Law"), Guangdong Chigo should be qualified as a Production Enterprise and entitled to exemption from FEIT for two years commencing from its first profit making year of operation and thereafter a 50% relief from FEIT for the following three years. Since Guangdong Chigo commenced its operations in the second half of 2006 when it became a WFOE, i.e. less than six months in the year of establishment, it could defer its first exemption year to 2007, provided that Guangdong Chigo elected not to commence its first profit making year in 2006 and paid FEIT for 2006. The FEIT exemption and reduction was approved by the relevant PRC tax authorities on 15 May 2007. Guangdong Chigo has selected 2007 as its first profit making year.

On 16 March 2007, the Enterprise Income Tax Law (the "new EIT Law') was passed at the Fifth session of the Tenth National People's Congress of the PRC, the income tax rate for both PRC and foreign-investment enterprise will be unified at 25% effective from 1 January 2008. Guangdong Chigo which is currently entitled to exemption and reduction from the standard income tax rate from 1 January 2007 would continue to enjoy such treatment until the exemption and reduction period expires, but not beyond 2012. The deferred tax balance has been adjusted to reflect the tax rates that are expected to apply to the respective periods when the asset is realised.

According to a joint circular of Ministry of Finance and State Administration of Taxation, Cai Shui [2008] No. 1, only the profits earned by a foreign-investment enterprise prior to 1 January 2008, when distributed to foreign investors, can be grandfathered and exempted from withholding tax. Dividends distributed out of the profits generated thereafter are subject to EIT at 10% and shall be withheld by the PRC entity, pursuant to Articles 3 and 27 of the EIT Law and Article 91 of its Detailed Implementation Rules. Deferred tax liability on the undistributed profits earned during the year ended 31 December 2008 has been accrued at the tax rate of 10% on the dividend stream of 30% determined by the Directors.

No provision for Hong Kong Profits Tax has been made as the Group's assessable profits neither arose in nor was derived from Hong Kong during the Track Record Period.

In 2006, the Group had two operating subsidiaries, Flavordigit and Yee Shun, which provided product assurance and technical support to other Group companies. These subsidiaries provided market intelligence to the Group companies to formulate their product development strategies. The Group subsequently wound up these subsidiaries and consolidated their functions with Guangdong Chigo's R&D headquarters in Foshan, PRC. As these two former subsidiaries were non-PRC entities, Yee Shun was subject to PRC taxation with its taxable profits being determined by the PRC authorities based on a deemed profit ratio of 10% of the turnover, while Flavordigit was agreed to be subject to PRC business tax only and its profits were exempted from the PRC corporate income tax. The relevant intra-group transactions were carried out on the above-mentioned basis and on normal commercial terms. There was no scheme or plan or any other arrangements where the sole or dominant purpose was to enable any company or person to enjoy any tax benefits. Further details of the taxation of these two former operating subsidiaries were set out in Note 11 to Appendix I — "Accountants' report" of this prospectus.

As a result of the above and the availability of preferential tax treatments under the FEIT Law, the Group's effective tax rate for the Track Record Period was 16.1%, 0.8% and 2.5%, respectively. Once the preferential tax treatments end at the end of 2011, the Group expects its effective tax rate to increase to approximately 25%.

**Other income**

Other income consist primarily of certain non-operating income, such as grants and subsidies provided by PRC government entities and interest income. The Group did not receive any subsidies for air conditioning units sold during the Track Record Period.

**Fair value changes in respect of embedded conversion option derivatives of other borrowings**

On 30 March 2005, as part of its plan to attract strategic investors, the Group entered into a number of loan agreements with Menlo Dynamics, Getchance and Raffles Partners. Pursuant to the loan agreements, these investors provided a loan of HK$82.0 million (approximately RMB86.1 million) to the Group, denominated in Hong Kong dollars and repayable within one year. The loans were unsecured, guaranteed by the Director, Mr. XH Li, and carried interest at the best lending rate plus 1.5% per annum offered by Hong Kong Bank quoted at the maturity date. On the same date, Mr. XH Li and 218 other individual shareholders of Guangdong Chigo JSC (being employees of Guangdong Chigo JSC, including Mr. LY Li) also entered into a capital contribution agreement (the "Capital Contribution Agreement") with the Investors. Pursuant to the Capital Contribution

Agreement, Menlo Dynamics, Getchance and Raffles Partners would contribute capital to Guangdong Chigo JSC in an amount equivalent to the loan amount and subscribe for a defined percentage of the enlarged paid-in capital of Guangdong Chigo JSC in accordance with a conversion formula and specific conditions that Guangdong Chigo JSC was required to fulfill. The loans were deemed to be renewed at their maturity date of 30 March 2006 and were extended until 17 November 2006 as the Group continued to retain the funds from the original loan agreement and pay interest until 17 November 2006.

On 17 November 2006, the Group entered into a new share subscription agreement (the "Subscription Agreement") with Menlo Dynamics, Getchance and Raffles Partners. Pursuant to the Subscription Agreement, the Investors subscribed for 8,500 ordinary shares representing 8.5% of the enlarged issued capital of the Company at the time of issue satisfied by the proceeds from the original loan agreements. In the opinion of the Directors, the funds provided by Menlo Dynamics, Getchance and Raffles Partners were considered as convertible loans and contained two components: a liability component and conversion option derivatives.

| | | |
|---|---|---|
| Grant date | : | 31 March 2005 |
| Principal | : | HK$82,000,000 (approximately RMB86,100,000) |
| Maturity date | : | 30 March 2006 (subsequently extended to 22 November 2006) |
| Coupon rate | : | Prime rate +1.5% (compound daily) |
| Conversion period | : | Before 30 June 2006 or later date subsequent to the Global Offering at discretion of Menlo Dynamics, Getchance and Raffles Partners |
| Effective interest rate | : | 13.78% |

On 22 November 2006, Menlo Dynamics, Getchance and Raffles Partners exercised their rights and converted the loans into ordinary shares of the Company pursuant to the Subscription Agreement. For a complete description of the reasons for entering into the loan agreements, Capital Contribution Agreement and Subscription Agreement, and further detail relating thereto, please see the section of this prospectus entitled "Strategic investor and other investors".

As a result of the foregoing, the Group recognised one-time, non-recurring charges in the amount of RMB35.3 million for the year ended 31 December 2006, respectively.

The fair values of the embedded conversion option derivative of other borrowings during the Track Record Period were estimated by using the Black-Scholes option pricing model. The valuations were conducted at three respective dates: (i) 30 March 2005, being the day when the other borrowings raised; (ii) 31 December 2005, being the year-end day; and (iii) 22 November 2006, being the date on which Menlo Dynamics, Getchance and Raffles Partners have exercised their convertible right and convert the loans into the Shares of the Company, respectively. The inputs used in the model at the three respective valuation dates are set forth in Note 27 to the Appendix I — "Accountants' report" to this prospectus.

The fair value of the embedded conversion option derivative of other borrowings increased by (i) RMB12.6 million, to RMB15.6 million in the year ended 31 December 2005 from RMB3.0 million as at 30 March 2005 and (ii) by RMB35.3 million, to RMB50.9 million, immediately before being converted into the shares of the Company as at 22 November

2006 from RMB15.6 million as at 31 December 2005. The increases in both periods were primarily due to the increases in equity value per Share which was in turn the result of increases in total equity of the Company as valued by using discounted cash flow approach and market approach during the Track Record Period. The key assumptions and main inputs used in the discounted cash flow approach are also set forth in Note 27 to the Appendix I — "Accountants' report" to this prospectus.

**RESULTS OF OPERATIONS**

The table below summarises the audited consolidated results of the Group for the Track Record Period. The consolidated results should be read in conjunction with the accountants' report of the Group, the text of which is set out in Appendix I to this prospectus.

| | Year ended 31 December | | |
|---|---|---|---|
| | **2006** | **2007** | **2008** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Turnover | 4,535,062 | 5,716,408 | 5,920,583 |
| Cost of goods sold | (3,699,918) | (4,659,817) | (4,940,650) |
| Gross profit | 835,144 | 1,056,591 | 979,933 |
| Other income | 10,750 | 49,310 | 49,071 |
| Selling and distribution costs | (351,436) | (525,604) | (500,336) |
| Administrative expenses | (149,403) | (136,532) | (183,694) |
| Other expenses | (4,221) | (26,378) | (49,197) |
| Net gain (loss) in fair value changes of derivative financial instruments | — | 44,214 | (83,978) |
| Fair value changes in respect of embedded conversion option derivatives of other borrowings | (35,258) | — | — |
| Finance costs | (42,171) | (91,567) | (114,065) |
| Profit before taxation | 263,405 | 370,034 | 97,734 |
| Taxation | (42,450) | 2,869 | (2,446) |
| Profit for the year | 220,955 | 372,903 | 95,288 |

**Year ended 31 December 2008 compared to year ended 31 December 2007**

***Turnover***

The Group's total turnover increased by RMB204.2 million, or 3.6%, to RMB5,920.6 million in the year 31 December 2008 from RMB5,716.4 million in the year ended 31 December 2007. This increase was principally due to the significant increase in sales of air-conditioner parts and components and the expansion of sales to overseas markets in the first half of year 2008 before the economy slowdown, which partially offset by the decline in the sales in the PRC market.

*Residential*

Turnover from sales of residential air-conditioning products decreased by RMB90.0 million, or 1.8%, to RMB5,035.5 million in the year ended 31 December 2008 from RMB5,125.5 million in the year ended 31 December 2007. As a percentage of total turnover, sales of residential air-conditioning products decreased from 89.7% in the year ended 31 December 2007 to 85.0% in the year ended 31 December 2008, primarily due to significant decrease in sales of residential air-conditioning products in the PRC markets and a significant increase in sales of air-conditioner parts and components.

Total unit sales of residential air-conditioning products increased from approximately 2,941,900 units in the year ended 31 December 2007 to approximately 2,956,800 units in the year ended 31 December 2008, primarily due to increased sales volume to the overseas market more than offsetting the decrease in the PRC market. This was because the Group completed a majority of its overseas sales in the first half of year 2008 before the economy slowdown. The average per unit selling price of the Group's residential air-conditioners decreased by RMB39, or 2.2%, to RMB1,703 in the year ended 31 December 2008 from RMB1,742 in the year ended 31 December 2007, primarily due to (i) an increase in overseas sales as a percentage of total turnover, which sales typically have a lower average per unit sales price, and (ii) the impact of the depreciation of the US dollar relative to the Renminbi, as most overseas sales were denominated in US dollars.

Residential air-conditioning sales were 59.2% to the PRC market and 40.8% to the overseas market in the year ended 31 December 2007, and 49.8% to the PRC market and 50.2% to the overseas market in the year ended 31 December 2008. The increase in overseas sales in 2008 was principally due to the Group's growing overseas customers and distributors base especially in the Eastern Europe and Brazil in the first half of 2008 before the economy slowdown and a strategic emphasis on overseas sales.

*Commercial*

Turnover from sales of commercial air-conditioning products decreased by RMB90.0 million, or 22.4%, to RMB311.8 million in the year ended 31 December 2008 from RMB401.8 million in the year ended 31 December 2007, primarily due to a decrease in sales to the PRC market as a results of the downturn on the property market in the PRC in 2008, which in turn affected the sale of the larger sales volume, small scale household-use central air-conditioning systems and the Group shifting its emphasis to large scale central air-conditioning systems and, to a lesser extent, the impact of adverse weather conditions on sales in key geographic regions in the first quarter of 2008. In addition, the Group increased the average selling price from RMB3,113 in 2007 to RMB3,616 in 2008. As a percentage of total turnover, sales of commercial air-conditioning products also decreased, from 7.0% in the year ended 31 December 2007 to 5.3% in the year ended 31 December 2008, primarily due to the decrease in overall sales of commercial air-conditioning products for the reasons stated above and significant increases in sales of air-conditioner parts and component.

Total sales volume of commercial air-conditioning products decreased from approximately 129,100 sets in the year ended 31 December 2007 to approximately 86,200 sets in the year ended 31 December 2008, primarily due to the reasons stated above. The average selling price per set of the Group's commercial air-conditioners increased by RMB503 or 16.2% to RMB3,616 in the year ended 31 December 2008 from RMB3,113 in the year ended 31 December 2007, primarily due to increases in raw materials costs and the Group's strategic emphasis on producing larger scale, more sophisticated units with higher per-set prices.

Commercial air-conditioning sales were 55.1% to the PRC market and 44.9% to the overseas market in the year ended 31 December 2007, and 55.4% to the PRC market and 44.6% to the overseas market in the year ended 31 December 2008.

*Others products and air-conditioner parts and components*

Turnover from sales of other products increased by RMB41.0 million, or 35.1%, to RMB157.7 million in the year ended 31 December 2008 from RMB116.7 million in the year ended 31 December 2007, primarily due to a significant increase in sales of small electrical appliances and raw materials manufactured by the production facilities of the Group. Turnover from sales of air-conditioner parts and components increased by RMB343.2 million, or 474.0%, to RMB415.6 million in the year ended 31 December 2008 from RMB72.4 million in the year ended 31 December 2007, primarily due to a significant increase in sales of air-conditioner parts and components to customers in Turkey, Malaysia, Brazil and Nigeria, which accounted for approximately RMB119.3 million, RMB68.0 million, RMB17.9 million and RMB10.2 million, respectively or in aggregate approximately 65.4% of the sales of air-conditioner parts and components to overseas. Among these customers, one of them was a member of the Vaillant group, an existing customer of the Group, which sourced air-conditioner parts and components from the Group for its new factory in Turkey for the manufacture of air-conditioning products. As a percentage of total turnover, sales of other products increased from 2.0% in the year ended 31 December 2007 to 2.7% in the year ended 31 December 2008, and sales of air-conditioner parts and components increased significantly from 1.3% in the year ended 31 December 2007 to 7.0% in the year ended 31 December 2008.

***Cost of goods sold***

Cost of goods sold increased by RMB280.8 million, or 6.0%, to RMB4,940.7 million in the year ended 31 December 2008 from RMB4,659.8 million in the year ended 31 December 2007. The increase in cost of goods sold was greater than the increase in turnover over the same period, and was primarily due to increases in prices of raw materials, parts and components costs, which collectively accounted for RMB4,326.6 million in the year ended 31 December 2007, and RMB4,571.3 million in the year ended 31 December 2008. However, as a percentage of total cost of goods sold, raw materials, parts and components decreased slightly from 92.9% in the year ended 31 December 2007 to 92.5% in the year ended 31 December 2008, primarily due to the increase in raw materials prices in the first half of 2008 as the Group purchased in advance such raw materials and components, especially copper, for its production use later in the year, despite a substantial decrease in raw material prices in the last quarter of 2008 which had a lesser effect on the cost of goods sold of the Group in 2008. Such an increase in raw materials prices was partially offset by the decrease in costs of other miscellaneous parts and components used in production.

The Group's cost of goods sold represented 83.4% of turnover in the year ended 31 December 2008 compared to 81.5% in the year ended 31 December 2007. Cost of goods sold as a percentage of turnover increased due to the increases in raw materials, parts and components costs which increased at a rate higher than sales in the first half of year 2008 despite a substantial decrease in the last quarter of 2008 on the same reasons as explained above.

***Gross profit***

As a result of the factors discussed above, the Group's gross profit decreased by RMB76.7 million, or 7.3% to RMB979.9 million in the year ended 31 December 2008 from RMB1,056.6 million in the year ended 31 December 2007. The Group's overall gross profit margin decreased to 16.6% in the year ended 31 December 2008 from 18.5% in the year ended 31 December 2007. In the year ended 31 December 2008, gross margin for residential air conditioning products and commercial air conditioning products was approximately 16.6% and 17.9%, respectively, as compared to approximately 18.6% and 19.9%, respectively, in the year ended 31 December 2007. In the year ended 31 December 2008, gross margins in the PRC market and overseas market were approximately 18.4% and 14.8%, respectively, as compared to approximately 18.8% and 18.0%, respectively, in the year ended 31 December 2007.

***Other income***

Other income remained relatively stable with a slight decrease of approximately RMB0.2 million, or 0.5%, to RMB49.1 million in the year ended 31 December 2008 from RMB49.3 million in the year ended 31 December 2007.

***Selling and distribution costs***

The Group's selling and distribution costs decreased by RMB25.3 million, or 4.8%, to RMB500.3 million in the year ended 31 December 2008 from RMB525.6 million in the year ended 31 December 2007. This decrease was due primarily to decreases in commissions, advertising and exhibition expenses, travelling and other selling related expenses in line with lower sales turnover in the PRC market, offset by the increases in the salary of sales and marketing staffs to comply with the new labour law requirements, as well as increased transportation costs for the Group's products that were largely a result of increases in fuel costs in the first half of year 2008.

***Administrative expenses***

The Group's administrative expenses increased by RMB47.2 million, or 34.5%, to RMB183.7 million in the year ended 31 December 2008 from RMB136.5 million in the year ended 31 December 2007. This was mainly due to an increase in the number of management staff and overall salaries and benefits of management staff and increased bank handling fees as a result of a significant increase in bank transactions.

***Other expenses***

The Group's other expenses increased by RMB22.8 million, or 86.5%, to RMB49.2 million in the year ended 31 December 2008 from RMB26.4 million in the year ended 31 December 2007. This was mainly due to an increase in legal and professional fees to RMB15.8 million for the preparation of the Group for the Listing, the increase in the net exchange losses by RMB3.7 million to RMB29.8 million and an increase in provision for doubtful debts amounted to approximately RMB3.9 million as trade receivable turnover has slowed down especially in relation to regional distributors in the PRC.

***Net loss on fair value changes of derivative financial instruments***

The Group incurred a net loss in fair value changes of foreign currencies forward contracts of approximately RMB61.0 million in the year ended 31 December 2008, as compared to a net gain in fair value changes of such contracts amounted to RMB43.0 million as at 31 December 2007. Such foreign currency forward contracts were entered into in 2007 to hedge against part of its exposure on potential variability of foreign currency risk since 2007 because the Group believed that the Renminbi would continue to appreciate relative to the U.S. dollar and other foreign currencies. As Renminbi continued to appreciate against other foreign currencies in the first quarter of 2008, the Group further entered into more forward contracts in 2008 in the belief that the Group could lock in favourable Renminbi exchanges rates. However, Renminbi kept on appreciating against other foreign currencies until mid July 2008 and remained relatively stable thereafter. As such, the Group incurred a net loss in fair value changes of such contracts in 2008.

In addition to the copper forward contracts entered into in 2007 to hedge against the rise in copper price, the Group had also entered into an OTC Asian Style copper swap contract ("Copper Swap Contract") in 2008. At time when the cost of copper experienced a significant increase in 2006, which remained relatively high throughout 2007 and in the first quarter of 2008, a committee was set up by the Group since 2007 comprising 5 senior executives and mid-level personnel namely, Mr. Hu Zhengfu, Vice President of the Group, and two managers from the finance department together with Dr. Ding Xiaojiang, Executive Director of the Company, and one manager from the procurement department to study and research on the market price trend of copper. The members of the committee have relevant experiences in different areas such as procurement management, corporate governance and financial matters, raw materials purchasing especially copper, aluminium, steel and plastic and financial management. Each of the members of the committee has almost 10 years or more experiences in their related field. The committee considered factors such as the historical prices of the copper price and the market's outlook on the future trend of the copper price before making any recommendation to the senior management of the Group comprising the Chairman of the Company, the head of the finance department and the head of the procurement department.

Having considered that quantity of copper to be notionally purchased under the Copper Swap Contract was relative small (as compared to the average usage of copper of the Group of approximately 20,000 tonnes per annum during the Track Record Period) and that the price of copper experienced an upward trend from 2006 to the first quarter of 2008, the Group entered into the Copper Swap Contract with a licensed bank in the PRC on 16 September 2008 to purchase (i) a notional quantity of 50 metric tonnes of copper per month if the floating price is above the agreed fixed price of US$5,850 per metric tonne; or (ii) 100 metric tonnes of copper per month if the floating price is below the agreed fixed price US$5,850 per metric tonne, for a period of 1 year effective from 1 October 2008 until 30 September 2009, subject to the stipulated maximum aggregate gain of US$75,000 (or equivalent to approximately RMB512,000). If the average market floating price of the month is lower than the agreed fixed price of US$5,850 per metric tonne, the Group is obliged under the Copper Swap Contract to notionally purchase 100 metric tonnes of copper and to settle the difference between the market floating prices of copper and the agreed fixed price every month, without any physical delivery of coppers notionally purchased. If the average market floating price of the month is higher than the agreed fixed price of US$5,850 per metric tonne, the Group is obliged under the Copper Swap Contract to notionally purchase 50 metric tonnes of copper and the licensed bank is obliged to settle the difference between the market floating prices of copper and the agreed fixed price every month, without any physical delivery of coppers notionally purchased, subject to a maximum aggregate gain under the Copper Swap Contract of US$75,000 (or equivalent to approximately RMB512,000).

When the Group was exploring whether to enter into the Copper Swap Contract, the copper price was in a declining trend. However, having studied the historical price trend of copper from 2006 to the first quarter of 2008, the Group was then of the view that the copper price had the potential to increase, and hence, decided to enter into such Copper Swap Contract to notionally purchase a relatively small quantity of copper. Unfortunately, since the entering into of the Copper Swap Contract, the price of copper continued to decrease because the global demand of copper was adversely affected by the 2008 financial crisis. The monthly market floating prices of copper per metric tonne from October 2008 until May 2009 fluctuated between the range of US$3,071.98 (being the lowest recorded in December 2008) and US$4,925.70 (being the highest recorded in October 2008) per metric tonne and were below the agreed fixed price of US$5,850 per metric tonne.

As the market floating prices of copper were below the agreed fixed price of US$5,850 per metric tonne from October 2008 to May 2009, the Group was obliged to settle at the end of every month, without any physical delivery of coppers notionally purchased, pursuant to the Copper Swap Contract, the losses being the difference between the floating market price and the agreed fixed price calculated based on a notional quantity of copper of 100 metric tonnes. Therefore, the Group recorded from the Copper Swap Contract a total realised loss of approximately US$0.6 million (or equivalent to approximately RMB4.0 million) from October 2008 to December 2008 and an unrealised loss of approximately US$2.9 million (or equivalent to approximately RMB19.5 million) as at 31 December 2008. The realised loss from the Copper Swap Contract from January 2009 to May 2009 was approximately US$1.0 million (or equivalent to approximately RMB6.8 million).

The Group expected that, if the market floating price remains below the agreed fixed price until the end of the Copper Swap Contract, the total potential further loss from the Copper Swap Contract from June 2009 to the September 2009, which is the expiry date of the Copper Swap Contract, will be approximately US$0.6 million (or equivalent to approximately RMB4.0 million). The total potential further loss from the Copper Swap Contract from June 2009 to the September 2009 is measured by reference to the valuation provided by counterparty financial institutions for this instrument. Since September 2008 until the Latest Practicable Date, the Group did not enter into any other copper swap contract.

The Group currently has a committee in place which meets regularly from time to time, when necessary and is responsible for reviewing, researching and studying the future pricing trend of foreign currency and raw materials and the methods of hedging. In deciding whether to enter into any future financial derivative contracts, the Group will undertake a more cautious approach and will expand the composition of the committee to undertake more thorough market researches and studies of the future pricing trend of foreign currency and raw materials and the methods of hedging. The Group will also only consider less risky financial derivative contracts in the future should the Group decide to enter into any other financial derivative contracts in the future.

The particulars of the Copper Swap Contract are set forth in Note 21 to the Appendix I "Accountants' Report" to this prospectus. As the market price of copper dropped and moved unfavourable to the Group after its entering into the Copper Swap Contract, the Group recorded a realised loss of RMB4.0 million and a net loss on fair value changes of such contract amounted to approximately RMB19.5 million in the year ended 31 December 2008.

***Finance costs***

The Group's finance costs increased by RMB22.5 million, or 24.6%, to RMB114.1 million in the year ended 31 December 2008 from RMB91.6 million in the year ended 31 December 2007, primarily as a result of an increase in the Group's short-term bank borrowings from RMB688.7 million as at 31 December 2007 to RMB1,078.0 million as at 31 December 2008 in spite of a decrease in interest rates in the PRC market from an average of 6.3% for the year ended 31 December 2007 to 5.9% for the year ended 31 December 2008. This increase in bank borrowings was primarily for working capital purpose due to slower receivable turnover and slower sales.

***Taxation***

The Group's tax charge increased by RMB5.3 million to RMB2.4 million in the year ended 31 December 2008 from a tax credit of RMB2.9 million in the year ended 31 December 2007. This increase in tax charge was due to the provision of withholding tax accrued at EIT rate of 10% on the expected dividend stream of 30% from Guangdong Chigo.

***Net profit and net profit margin***

As a result of the foregoing, the Group's net profit decreased by RMB277.6 million, or 74.4%, to RMB95.3 million in the year ended 31 December 2008 from RMB372.9 million in the year ended 31 December 2007. Net profit margin decreased from 6.5% for the year ended 31 December 2007 to 1.6% for the year ended 31 December 2008, primarily due to (i) a decrease in gross profit, driven primarily by significant increases in cost of goods sold that outpaced increases in turnover, (ii) the increase in other expenses, administrative expenses and (iii) the net loss in fair value changes of derivative financial instruments as mentioned above.

**Year ended 31 December 2007 compared to year ended 31 December 2006**

***Turnover***

The Group's total turnover increased by RMB1,181.3 million, or 26.0%, to RMB5,716.4 million in the year ended 31 December 2007 from RMB4,535.1 million in the year ended 31 December 2006. This increase was principally due to the increase in sales volume as well as in the average per unit selling prices of most of the Group's products.

*Residential*

Turnover from sales of residential air-conditioning products increased by RMB902.1 million, or 21.4%, to RMB5,125.5 million in the year ended 31 December 2007 from RMB4,223.4 million in the year ended 31 December 2006, primarily due to increased sales volume, increased average per unit sales price and an increase in the overall distribution network of the Group. As a percentage of total turnover, sales of residential air-conditioning products decreased from 93.1% in the year ended 31 December 2006 to 89.7% in the year ended 31 December 2007, primarily due to the Group's increasing strategic focus on commercial air-conditioning products.

Total unit sales of residential air-conditioning products increased from approximately 2,719,800 units in the year ended 31 December 2006 to approximately 2,941,900 units in the year ended 31 December 2007, primarily due to increased sales volume and increased brand awareness of the Group's products, as well as the launch of several new product lines, including enhancements, modifications and improvements to numerous existing models. The average per unit selling price of the Group's residential air-conditioners increased by RMB189 or 12.2% to RMB1,742 in the year ended 31 December 2007 from RMB1,553 in the year ended 31 December 2006, primarily due to the Group's increased "premium" brand awareness among consumers, the Group's continuing focus on more technologically advanced and feature-packed products and increased raw materials costs passed along to consumers.

Residential air-conditioning sales were 60.0% to the PRC market and 40.0% to the overseas market in the year ended 31 December 2006, and 59.2% to the PRC market and 40.8% to the overseas market in the year ended 31 December 2007. This slight increase in overseas sales is principally due to the Group's growing overseas customer and distributor base.

*Commercial*

Turnover from sales of commercial air-conditioning products increased by RMB252.9 million, or 169.9%, to RMB401.8 million in the year ended 31 December 2007 from RMB148.9 million in the year ended 31 December 2006, primarily due to the Group's growing strategic emphasis on expanding sales of its commercial products. As a percentage of total turnover, sales of commercial air-conditioning products increased from 3.3% in the year ended 31 December 2006 to 7.0% in the year ended 31 December 2007.

Total sales volume of commercial air-conditioning products increased from approximately 45,600 sets in the year ended 31 December 2006 to approximately 129,100 sets in the year ended 31 December 2007, primarily due to increased brand awareness of the Group's products, launches of new products, including enhancements, modifications and improvements to numerous existing models, and the development and expansion of a sales network for the Group's commercial products. The average selling price per set of the Group's commercial air-conditioners decreased by RMB125, or 3.9%, to RMB3,113 in the year ended 31 December 2007 from RMB3,238 in the year ended 31 December 2006, primarily due to the Group's shift in focus from manufacturing a smaller number of more expensive, customised commercial products to an increasingly larger volume of less expensive and standardised, off-the-shelf commercial sets.

Commercial air-conditioning sales were 85.5% to the PRC market and 14.5% to the overseas market in the year ended 31 December 2006, and 55.1% to the PRC market and 44.9% to the overseas market in the year ended 31 December 2007. This significant increase in overseas sales was principally due to an increase in the number of products the Group offered for the overseas market beginning in 2007 and the establishment of a new commercial sales and marketing department focusing on overseas sales in August 2007.

*Other products and air-conditioner parts and components*

Turnover from sales of other products decreased by RMB21.2 million, or 15.4%, to RMB116.7 million in the year ended 31 December 2007 from RMB137.9 million in the year ended 31 December 2006, primarily due to the growing emphasis on the Group's core air conditioner products business. As a percentage of total turnover, sales of other products decreased slightly from 3.0% in the year ended 31 December 2006 to 2.0% in the year ended 31 December 2007.

***Cost of goods sold***

Cost of goods sold increased by RMB959.9 million, or 25.9%, to RMB4,659.8 million in the year ended 31 December 2007 from RMB3,699.9 million in the year ended 31 December 2006. The increase was generally in line with increases in turnover over the same period, and was primarily due to increases in raw materials, parts and components costs, which accounted for RMB3,481.7 million in the year ended 31 December 2006, and RMB4,326.6 million in the year ended 31 December 2007. However, as a percentage of total cost of goods sold, raw materials, parts and components decreased from 94.1% in the year ended 31 December 2006 to 92.9% in the year ended 31 December 2007, primarily due to the Group's decreasing use of raw materials (such as copper) in production and improved efficiencies that resulted from increasing vertical integration of the Group's production process.

The Group's cost of goods sold was 81.5% of turnover in the year ended 31 December 2007 compared to 81.6% in the year ended 31 December 2006. Cost of goods sold as a percentage of turnover remained stable despite increases in raw materials, parts and components costs, which was primarily due to the Group's ability to transfer these costs to its customers, efficiencies in production process and a continuing emphasis on higher-margin products.

***Gross profit***

As a result of the factors discussed above, the Group's gross profit increased by 26.5% to RMB1,056.6 million in the year ended 31 December 2007 from RMB835.1 million in the year ended 31 December 2006. The Group's overall gross margin remained stable at 18.5% in the year ended 31 December 2007 compared to 18.4% in the year ended 31 December 2006. In the year ended 31 December 2007, gross margin for residential air-conditioning products and commercial air conditioning products was approximately 18.6% and 19.9%, respectively, as compared to approximately 18.3% and 20.6%, respectively, in the year ended 31 December 2006. In the year ended 31 December 2007, gross margins in the PRC market and overseas market were approximately 18.8% and 18.0%, respectively, as compared to approximately 18.6% and 18.1%, respectively, in the year ended 31 December 2006.

***Other income***

Other income increased by RMB38.5 million, or 358.7%, to RMB49.3 million in the year ended 31 December 2007 from RMB10.8 million in the year ended 31 December 2006. This increase was primarily due to the increase in interest income on bank balances, which income increased from RMB6.6 million in the year ended 31 December 2006 to RMB31.6 million in the year ended 31 December 2007, principally due to (A) rising interest rates in China during 2007 and (B) an increase in the Group's pledged bank deposits, which increased in line with the Group's overall turnover, due to an increase in the balances of commercial bills issued to suppliers, which was a result of the proportional increase in overall volume of sales and corresponding purchases of material.

***Selling and distribution costs***

The Group's selling and distribution costs increased by RMB174.2 million, or 49.6%, to RMB525.6 million in the year ended 31 December 2007 from RMB351.4 million in the year ended 31 December 2006. This increase, which was significantly higher than the Group's increase in total turnover over the same period, was due primarily to increases in marketing, advertising and promotion costs relating principally to the Group's increasing sales to household appliances retail chain operators in the PRC, as well as increasing transportation costs for the Group's products that were largely a result of increases in fuel costs. These increases were also a function of the Group's increased sales volume, and to a lesser extent increases in sales and marketing staff salaries and benefits and other miscellaneous expenses.

***Administrative expenses***

The Group's administrative expenses decreased by RMB12.9 million, or 8.6%, to RMB136.5 million in the year ended 31 December 2007 from RMB149.4 million in the year ended 31 December 2006. This was mainly due to a decrease in payments of city construction tax and education supplementary tax in 2007 as Guangdong Chigo was converted into a wholly foreign-owned enterprise on 1 September 2006 and was not subject to such tax payments thereafter, offset by an increase in the number of management staff and overall salaries and benefits of management staff, increased bank handling fees as a result of a significant increase in bank transactions.

***Other expenses***

The Group's other expenses increased by RMB22.2 million, or 524.9%, to RMB26.4 million in the year ended 31 December 2007 from RMB4.2 million in the year ended 31 December 2006. This was mainly due to an increase in foreign exchange losses by RMB19.7 million to RMB26.1 million as Renminbi continued to appreciate relative to the US dollar. Beginning in March 2007, the Group began to enter into foreign exchange forward contracts to hedge against the continuing Renminbi appreciation. In addition, there was also an increase in legal and professional fees to prepare the Group for the Listing and an increase in the provision for doubtful debt.

***Net gain in fair value changes of derivative financial instruments***

Net gains on fair value changes of derivative financial instruments, which increased from nil in the year ended 31 December 2006 to RMB44.2 million in the year ended 31 December 2007, principally due to the net effect of the Group entering into foreign currency and copper forward contracts during such time. The Group entered into such contracts in 2007 because it believed that both (i) the Renminbi would continue to appreciate relative to the U.S. dollar and other foreign currencies and (ii) the cost of copper, one of the Group's principal raw materials, would continue to rise in line with global trends in commodity prices. These contracts enabled the Group to lock in favourable Renminbi exchange rates and copper prices. Prior to 2007, the Group did not enter into such contracts due to the relative stability in the value of the Renminbi. The Group was in the process of formulating plans to hedge against rise in copper price.

***Finance costs***

The Group's finance costs increased by RMB49.4 million, or 117.1%, to RMB91.6 million in the year ended 31 December 2007 from RMB42.2 million in the year ended 31 December 2006, as a result of increases in interest rates in the PRC market from an average of 6.0% for the year ended 31 December 2006 to 6.3% for the year ended 31 December 2007, and an increase in the Group's short-term bank borrowings from RMB226.0 million as at 31 December 2006 to RMB688.7 million as at 31 December 2007. This increase in bank borrowings was primarily to fund (i) the purchase and stockpile of additional raw materials, in particular compressors, the cost of which the Group expects to increase in the foreseeable future, and (ii) increased working capital needs due to the addition of several household appliances retail chain operator customers, which typically have longer payment cycles.

***Taxation***

The Group's tax charge decreased to tax credit of RMB2.9 million in the year ended 31 December 2007 from a charge of RMB42.5 million in the year ended 31 December 2006. This reduction in tax charge was due to the commencement of a two-year tax exemption period on 1 January 2007, which entitles the Group to complete tax relief from PRC corporate tax during such period.

***Net profit and net profit margin***

As a result of the foregoing, the Group's net profit increased by RMB151.9 million, or 68.8%, to RMB372.9 million in the year ended 31 December 2007 from RMB221.0 million in the year ended 31 December 2006. Net profit margin increased from 4.9% for the year ended 31 December 2006 to 6.5% for the year ended 31 December 2007 due to the reasons discussed above.

## ANALYSIS OF FINANCIAL POSITION

The following table sets out major balance sheet items and key financial ratios of the Group during the Track Record Period.

| | As at 31 December | | |
|---|---|---|---|
| | **2006** | **2007** | **2008** |
| | *RMB million* | *RMB million* | *RMB million* |
| **Non-current assets** | | | |
| Property, plant and equipment | 423.7 | 333.5 | 372.6 |
| **Current assets** | | | |
| Inventories | 774.3 | 1,595.5 | 1,422.8 |
| Trade and other receivables | 896.1 | 1,124.8 | 1,499.1 |
| **Current liabilities** | | | |
| Trade and other payables | 1,787.4 | 2,248.7 | 2,031.9 |
| **Net current assets** | 340.0 | 733.3 | 860.7 |
| Total assets less current liabilities | 834.2 | 1,247.6 | 1,444.6 |

**Key financial ratios**

| | As at 31 December | | |
|---|---|---|---|
| | **2006** | **2007** | **2008** |
| Current ratio *(Note 1)* | 1.1 times | 1.2 times | 1.3 times |
| Inventories turnover days *(Note 2)* | 66.8 days | 92.8 days | 111.5 days |
| Debtor turnover days *(Note 3)* | 65.2 days | 59.9 days | 76.7 days |
| Creditor turnover days *(Note 4)* | 151.4 days | 143.8 days | 137.4 days |
| Interest cover *(Note 5)* | 7.2 times | 5.0 times | 1.9 times |
| Gearing ratio *(Note 6)* | 6.7% | 15.4% | 22.5% |
| Return on equity *(Note 7)* | 27.3% | 31.5% | 6.9% |
| Debt to equity ratio *(Note 8)* | 27.9% | 58.2% | 78.2% |

*Notes:*

1. $$\frac{\text{Current assets}}{\text{Current liabilities}}$$

2. $$\frac{\text{Average inventories}}{\text{Cost of goods sold}} \times 365 \text{ days}$$

3. $$\frac{\text{Average trade and bills receivables}}{\text{Turnover}} \times 365 \text{ days}$$

4. $$\frac{\text{Average trade and bills payables}}{\text{Cost of sales}} \times 365 \text{ days}$$

5. $$\frac{\text{Profit before tax and finance costs}}{\text{Finance costs}}$$

6. $\dfrac{\text{Interest-bearing loans and other borrowings}}{\text{Total assets}} \times 100\%$

7. $\dfrac{\text{Profit for the year}}{\text{Total equity}} \times 100\%$

8. $\dfrac{\text{Interest-bearing loans and other borrowings}}{\text{Total equity}} \times 100\%$

**Analysis of major balance sheet items and financial ratios**

*Property, plant and equipment*

As at 31 December 2006 and 2007, the Group's property, plant and equipment ("PPE") decreased from RMB423.7 million to RMB333.5 million, primarily due to the disposal of certain property and buildings used as dormitory facilities for the Group's employees, plus increasing depreciation, in particular of the Group's plant and machinery, related to an increase in asset values. The Group sold the dormitory due to a change in the Group's practice relating to housing its employees and did not build any new dormitory. As at 31 December 2008, PPE increased to RMB372.6 million, primarily due to increased expenditures in (i) plant and machinery and (ii) construction in progress.

*Inventories and inventories turnover days*

As at 31 December 2006, 2007 and 2008, the Group's inventory of raw materials increased from RMB158.6 million to RMB658.4 million and decreased to RMB561.0 million, respectively, primarily due to (i) with respect of the increase in 2007 (as compared to 2006) the Group's proactive purchase and stockpiling of compressors, for which the Group expected price increases in the foreseeable future; an overall increase in raw materials prices, in particular volatile commodities such as copper and aluminium; advanced purchase of raw materials to satisfy production needs related to the Group's backlog of orders for the first quarter of 2008; and an increase in overall volume of sales and (ii) with respect of the decrease in 2008 (as compared to 2007), a decrease in stockpiling of raw materials due to slower sales in the second half of 2008.

The Group's inventory of finished products primarily consists of products awaiting delivery to customers, products produced in anticipation of existing customers' demand and products produced and stored to meet unexpected demand. In order to efficiently manage its inventory, the Group generally manufactures its products for overseas sales only after it has received orders from overseas customers. As at 31 December 2006, 2007 and 2008, the Group's inventory of finished goods increased from RMB615.6 million (2006) to RMB929.1 million (2007), and then decreased to RMB852.8 million, respectively, primarily due to (i) with respect to the increase in 2007 (as compared to 2006), an increase in production from June to August 2007 in connection with the Group's anticipated relocation of its manufacturing facility in August 2007, the Group's main processing facility in Foshan being relocated to an industrial area nearby while the old production site was changed into a production facility for commercial air-conditioners and the whole relocation process was completed by December 2007, an increase in product types and enhanced the then existing products for overseas sales, an increase in offsite inventories as a result of an increase in the number of offsite warehouses, which increased from 22 in 2006 to 35 in 2007, located in various provinces in order to serve an increasing number of household appliances retail chain operators and to deliver products to customers in a more timely basis, as well as an increase in the overall volume of sales, and (ii) with respect to the decrease in 2008 (as compared to 2007), the Group's decision to maintain lesser inventory due to the cooler weather in the summer in the PRC in 2008 and the anticipated economic slow down in the second half of 2008 and in 2009.

The inventory turnover ratio of the Group's products as at 31 December 2006, 2007 and 2008 increased from 66.8 days, 92.8 days to 111.5 days, respectively. Inventory increased faster than costs of goods sold over the Track Record Period principally due to: (i) an increase in inventory stockpile in anticipation of interruptions expected as a result of the Group's 2007 relocation of its main processing facility, (ii) an increase in inventory stockpile of compressors in late 2007 by approximately 200,000 units due to an anticipated rise in raw material costs, and (iii) the economic slow down and a cooler summer in the PRC in 2008, which led to slower sales of the Group's products and, hence, an increase in time for inventory to turn into sales.

The table below sets forth an aging analysis of the Group's inventories as at the respective balance sheet dates during the Track Record Period:

| | **As at 31 December** | | |
|---|---|---|---|
| | **2006** | **2007** | **2008** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Age | | | |
| 0–30 days | 332,734 | 831,191 | 805,041 |
| 31–90 days | 326,324 | 721,837 | 498,693 |
| 91–180 days | 72,611 | 41,491 | 118,261 |
| 181–365 days | 42,625 | 1,009 | 735 |
| More than 365 days | — | — | 108 |
| | 774,294 | 1,595,528 | 1,422,838 |

The subsequent usage status of the Group's inventories of RMB1,422.8 million as at 31 December 2008 up to 31 May 2009 was RMB1,421.2 million.

*Trade and other receivables and debtor turnover days*

As at 31 December 2006, 2007 and 2008, the Group's trade and bills receivables increased from RMB862.1 million, RMB1,013.7 million to RMB1,474.1 million, respectively, primarily due to (i) an increase in overall volume of sales, (ii) an increase in sales to household appliances retail chain operators, to which the Group extended longer credit periods, and (iii) with the economic slow down in the PRC, certain of the Group's regional distributors in the PRC required longer periods to settle their purchases from the Group (and, in respect thereof, the Group has made a provision in the amount of RMB3.9 million in 2008). As a result, the Group's debtor turnover ratio for 31 December 2006, 31 December 2007 and 31 December 2008 varied from 65.2 days, 59.9 days to 76.7 days, respectively.

Payment terms with customers are mainly on credit. The Group may extend credit to a customer or distributor depending on its relationship with the Group, its credibility, or its volume of sales with the Group, among other reasons.

Household appliances retail chain operators place orders with the Group based on demand and market conditions. The Group allowed credit periods of between 90 and 270 days during the Track Record Period to its retail chain operator customers. Sales to such retail chain operators accounted for RMB705.3 million, RMB904.0 million and RMB932.0 million or 15.5%, 15.8% and 15.7%, of the Group's total turnover for the three years ended 31 December 2006, 2007 and 2008, respectively. As at 31 December 2006, 2007 and 2008, accounts receivable from such retail chain operators were RMB120.7 million, RMB203.1 million and RMB256.6 million, respectively. The Group assesses the creditworthiness of such retail chain operators in a similar manner as other customers: by analyzing the relationship, size, quality, history and other factors of such customers, and by periodically reviewing and reassessing such factors.

In addition to credit periods, customers are subject to credit limits and are required to settle their accounts with the Group before further delivery of products will be made if they have reached the credit limits before expiration of the credit periods. Payment upon delivery or in advance of delivery is required for certain customers, in particular new, smaller and/or less credit worthy customers. The Group places significant emphasis on 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 "Business — Sales and distribution — Planning, placing of orders and payment terms" and "Business — Sales and distribution — Settlement arrangement and payment terms" elsewhere in this prospectus.

Invoices are normally payable from 30 days to 90 days from date of issuance, while invoices to long-established customers are normally payable within 270 days. The following is an aging analysis of trade receivables and bills receivables as at the respective balance sheet dates during the Track Record Period:

| | As at 31 December | | |
|---|---|---|---|
| | **2006** | **2007** | **2008** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Age | | | |
| 0–30 days | 171,269 | 245,503 | 560,414 |
| 31–60 days | 186,739 | 173,832 | 182,974 |
| 61–90 days | 284,747 | 173,073 | 144,663 |
| 91–180 days | 143,372 | 320,917 | 307,374 |
| 181 to 365 days | 76,022 | 100,410 | 248,517 |
| Over 1 year | — | — | 30,117 |
| | 862,149 | 1,013,735 | 1,474,059 |

The subsequent settlement of trade and bills receivables of RMB1,474.1 million as at 31 December 2008 up to 31 May 2009 was RMB1,250.1 million.

As at 31 December 2006, 2007 and 2008, the Group's deposits paid to suppliers, prepayments, other loan receivables and other receivables, increased from RMB33.9 million (2006) to RMB111.1 million (2007) and then decreased to RMB25.1 million (2008), respectively, primarily due to (i) with respect to the increase in 2007 (compared to 2006), the increases in deposits paid to suppliers, which was a result of the prepayment for procurement of raw materials and (ii) with respect to the decrease in 2008 (compared to 2007), the Group's decision to purchase lesser raw materials due to the anticipated economic slow down and hence lesser deposits were made to suppliers of raw materials. As noted above, included in the Group's other loan receivables balance as at 31 December 2007 and 2008 were certain loan receivables related to loans by the Group to (i) employees, principally representing advances of business travel expenses, and (ii) certain business partners of Mr. XH Li, all of whom are independent third parties not connected with the Group. As at 31 December 2006, 2007 and 2008, (i) the aggregate amount of the outstanding loans to employees of the Group was nil, RMB11.5 million and RMB11.2 million, respectively, and (ii) the aggregate amount of the outstanding loans to the business partners of Mr. XH Li was nil, RMB11.1 million and nil, respectively, as such loans were repaid in full to the Group in 2008. The loans to employees remained relatively stable as at 31 December 2008 with a slight net decrease of approximately RMB0.3 million. These loans to employees did not include any loans to any Directors. As advised by the PRC legal advisers to the Company, although such loans to the business partners of Mr. XH Li by Guangdong Chigo violated 貸款通則 (General Rules on Loan), according to the documents provided by the Company, Guangdong Chigo has not claimed nor received any interest from such loans (i.e. Guangdong Chigo had no revenue from such loans), and accordingly there should be no penalty to Guangdong Chigo for such loans under the General Rules on Loan.

As at 31 December 2006, 2007 and 2008, included in the Group's net trade receivables balances are trade debtors with aggregate carrying amounts of RMB33.1 million, RMB34.8 million and RMB203.7 million, respectively, which were past due at the reporting date and for which the Group has not provided for impairment loss. The increase in the aging of trade receivables that were past due but not impaired at the reporting date is primarily due to (i) certain customers failing to make full payments to the Group in relation to trade receivables and the aging of which had exceeded the relevant credit periods given by the Group, which amounted to gross trade receivables of RMB206.8 million as at 31 December 2008 (as at 31 May 2009, the subsequent settlement of these receivables was RMB170.4 million), among which (a) certain customers having disputes in relation to the trade receivables, pursuant to which such payments have not been settled and the aging has exceeded the respective credit periods given by the Group to these customers, which amounted to gross trade receivables of RMB6.3 million as at 31 December 2008 (as at 31 May 2009, the subsequent settlement of these receivables was RMB4.3 million); and (b) the Group having outstanding payments due to certain customers who at the same time owe trade receivables to the Group, which amounted to gross trade receivables of RMB115,000 as at 31 December 2008 (as at 31 May 2009, the subsequent settlement of these receivables was nil). As the terms of settlement have not been agreed to between the customers and the Group, such outstanding balances have not yet been offset and may last longer than the credit period granted. Despite the disputes on the unsettled payments pending for offset, these customers continue to make other payments due to the Group.

The Directors believed that the significant increase in trade receivables that exceeded the relevant credit periods given by the Group as at 31 December 2008 was primarily due to the economic slow down in 2008 which caused the Group's regional distributors in the PRC to delay payments to the Group. In determining the recoverability of the trade receivables, the Group monitors changes in the credit quality of the trade receivables since the date such credit was granted and up to the year end date. As for trade receivables which have been past due but are not impaired, the Group has taken further measures to assess the recoverability of such trade receivables, mainly include (i) requesting from the customers their written commitments on stipulated repayment plans; (ii) making reference to the then current economic condition, the repayment history, years of relationship and the outstanding amount owed by the respective customers in considering whether to grant a temporary extension of credit period to such customers; (iii) checking the current status of good standing of the respective customers to determine whether any of them has been placed under liquidation or faces any threat of winding up; and (iv) conducting weekly counterchecking of the financial position of the customers with other customers/suppliers. Generally, if the Group does not receive the outstanding trade receivables seven days before the agreed extended due date, the head of the product management department will write to the relevant customers and notify them of the outstanding amount and the due date and a sales personnel of the Group will closely monitor and follow-up on the collection of such trade receivables. If the outstanding trade receivables remain unpaid for fifteen days or more after the agreed extended due date, the relevant sales personnel will notify the Group's finance department. For outstanding trade receivables of three months or more and for a sum of RMB10,000 or more and that the Group does not have any further business relationship with such customers, the sales department will immediately notify the head of finance department and the head of sales department and to submit all relevant documents to the Group's legal department, which will issue demand letters to such customers to press for repayment of the outstanding amounts. For all trade receivables which fall due for more than three months after the agreed extended due date and such amounts are still not recovered despite all efforts made by the Group, the Group will then take legal actions to seek recovery of such amounts. Accordingly, the Group is of the view that such credit control measures are sufficient and reasonable to assess the recoverability of such trade receivables and hence, the Group had not provided for impairment loss for such trade receivables during the Track Record Period.

Aging of trade receivables which are past due but not impaired were as follows as of the respective balance sheet dates during the Track Record Period:

| | As at 31 December | | |
|---|---|---|---|
| | **2006** | **2007** | **2008** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Age | | | |
| 31–60 days | 1,653 | 181 | 5,880 |
| 61–90 days | 1,852 | 164 | 5,319 |
| 91–180 days | 15,758 | 8,177 | 39,796 |
| 181–365 days | 13,849 | 26,298 | 122,599 |
| Over 1 year | — | — | 30,117 |
| | 33,112 | 34,820 | 203,711 |

The Group does not hold any collateral over these balances. The average age of these receivables as at 31 December 2006, 2007 and 2008 was 149 days, 277 days and 231 days, respectively.

No interest is charged on trade receivables. Allowances on trade receivables are made based on estimated irrecoverable amounts from the sale of goods by reference to past default experience and objective evidences of impairment determined by the difference between the carrying amount and the present value of the estimate future cash flow discounted at the original effective interest rate.

In determining the recoverability of the trade receivables, the Group monitors any change in the credit quality of the trade receivables since the credit was granted and up to the reporting date. The Directors considered that the concentration of credit risk is limited due to the customer base being large and unrelated.

As at 31 December 2006, 2007 and 2008, the allowance for doubtful debts represented individually impaired trade receivables of the Group's customers which have been placed under liquidation or in severe financial difficulties. The Group does not hold any collateral over these balances.

*Trade and other payables and creditor turnover days*

As at 31 December 2006, 2007 and 2008, the Group's trade and other payables increased from RMB1,787.4 million (2006) to RMB2,248.7 million (2007) and decreased to RMB2,031.9 million, respectively, primarily due to (i) with respect to the increase in 2007 (compared to 2006), increased procurement of raw materials, parts and components, which was a result of an increase in sales and turnover of the Group, an increase in raw materials costs and an increase in inventory stockpile of raw materials due to the Group's expectation that raw materials costs would continue to rise, and increases in payables related to customers' deposits, which increased significantly from RMB4.7 million as at 31 December 2006 to RMB225.2 million as at 31 December 2007 and then decreased to RMB193.0 million as at 31 December 2008 due to (i) with respect to the increase in 2007 (as compared to 2006), a change of the Group's policy relating to its overseas customers — as of late 2006, the Group began requiring its overseas customers to pay a deposit of approximately 20% to 30% of the purchase order in order to more efficiently manage its trade and other payables, and (ii) with respect to the decrease in 2008 (as compared to 2007), the Group reducing its requirements for raw materials in anticipation of the economic slow down and, in view of the relatively favourable interest rate for bank borrowing, the Group took out more bank loans and used a part of the loan proceeds to settle trade payables in return for better purchasing discounts from its supplies for further purchases. Of the RMB193.0 million in other payables related to customers' deposits, RMB102.8 million was subsequently utilised and recognised as sales as at 31 March 2009.

As a result, the Group's creditor turnover ratio as at 31 December 2006, 2007 and 2008 was 151.4 days, 143.8 days and 137.4 days, respectively. The Group's financing policy for procurement of raw materials and its working capital requirements is principally a combination of bills payable and short-term bank loans. For the year ended 31 December 2007, the credit turnover period dropped slightly from 151.4 days (in 2006) to 143.8 days, mainly due to the Group using more short-term bank loans and a relatively lesser amount of bill payables to finance its working capital requirements. For the years ended 31 December 2008, the credit turnover period decreased from 143.8 days (in 2007) to 137.4 days mainly due to the increase in cost of goods sold was greater than that of the average trade and bills payables as lesser amount was spent on purchase and stockpile of raw materials during the second half of 2008 the cost of goods sold.

The Group normally receives credit terms of 30 days to 180 days from its suppliers. The following is an aging analysis of trade payables and bills payables at the respective balance sheet dates during the Track Record Period:

| | **As at 31 December** | | |
|---|---|---|---|
| | **2006** | **2007** | **2008** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Age | | | |
| 0 to 90 days | 1,225,896 | 1,279,907 | 1,200,759 |
| 91 to 180 days | 491,943 | 648,437 | 558,434 |
| 181 to 365 days | 2,261 | 11,985 | 7,090 |
| 1–2 years | — | 11,295 | 2,718 |
| | 1,720,100 | 1,951,624 | 1,769,001 |

The subsequent settlement of trade and bills payables of RMB1,769.0 million as at 31 December 2008 up to 31 May 2009 was RMB1,454.8 million.

*Short-term bank loans and gearing ratio*

The following table sets forth the short-term banks loans of the Group at the respective balance sheet dates during the Track Record Period:

| | As at 31 December | | |
|---|---|---|---|
| | **2006** | **2007** | **2008** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Short-term bank loans | | | |
| — secured | 36,200 | 101,242 | 115,565 |
| — unsecured | 52,536 | 153,359 | 7,592 |
| — secured and jointly guaranteed by directors and third parties | 76,000 | 59,700 | 97,110 |
| — jointly guaranteed by directors and third parties | 50,000 | 335,000 | 857,719 |
| — guaranteed by directors | 11,245 | 39,429 | — |
| | 225,981 | 688,730 | 1,077,986 |

Short-term bank loans increased from RMB226.0 million as at 31 December 2006 to RMB688.7 million as at 31 December 2007 and RMB1,078.0 million as at 31 December 2008, primarily due to the Group's increased liquidity needs in connection with (i) with respect to the increase in 2007 (compared to 2006), the purchase and stockpile of additional raw materials, in particular compressors, the cost of which the Group expects to increase in the foreseeable future, and the increased working capital needs due to the addition of several household appliances retail chain operator customers, which typically have longer payment cycles (ranging from 74 to 123 days in 2006, 107 to 175 days in 2007 and 67 to 162 days in 2008 as compared to approximately 102 days in 2006, 88 days in 2007 and 119 days in 2008 for other customers), which such longer payment cycles are principally a result of favourable commercial terms granted in light of the high creditworthiness of such customers due to the high profit, low risk nature of such customers, and (ii) with respect to the increase in 2008 (compared to 2007), the Group paying down its trade payables so as to obtain better purchasing discounts from its suppliers for further purchases, as well as for funding its working capital requirements due to its slower collection of trade receivables as certain of the Group's customers were affected by the economic slow down in 2008. Average interest rates paid were 6.0%, 6.3% and 5.9% during the years ended 31 December 2006, 2007 and 2008, respectively. All the bank loans were fixed rate borrowings, subject to renegotiation at the renewal or drawndown date, and most of which were denominated in Renminbi.

As at 31 December 2008, short-term bank loans (i) secured and jointly guaranteed by directors and third parties, (ii) jointly guaranteed by directors and third parties and (iii) guaranteed by directors were RMB97.1 million, RMB857.7 million and RMB0, respectively. The Directors confirm that all guarantees given by third parties and/or Directors on the Group's short-term bank loans will be fully released or replaced by the Company's guarantees before listing.

As a result, the Group's gearing ratio has varied at 6.7%, 15.4% to 22.5% as at 31 December 2006, 2007 and 2008, respectively, primarily due to the fluctuation of the Group's working capital needs, as described above, in proportion to its increasing total assets over time and the resulting increase in borrowings. Additional factors affecting the gearing ratio include (i) in 2006, the conversion of convertible loans from strategic investors loans to shares, resulting in a drop in the gearing ratio; and (ii) in 2007 and 2008, an increase in the amount of bank loans, resulting in a corresponding increase in the gearing ratio.

*Return on equity*

Return on equity decreased from 31.5% as at 31 December 2007 to 6.9% as at 31 December 2008, primarily due to a decrease in net profit.

Return on equity increased from 27.3% as at 31 December 2006 to 31.5% as at 31 December 2007, primarily due to improvement of net profit as a result of increase in other income and decrease in taxation during the year.

*Debt to equity ratio*

The Group's debt to equity ratio increased from 58.2% as at 31 December 2007 to 78.2% as at 31 December 2008, primarily due to the increase in total bank borrowings. The Group's debt to equity ratio increased from 27.9% as at 31 December 2006 to 58.2% as at 31 December 2007, primarily due to an increase in short-term bank loans for the Group's increased liquidity needs.

## LIQUIDITY AND FINANCIAL RESOURCES AND CAPITAL STRUCTURE

The Group's principal sources of liquidity and capital resources have been principally derived from cash generated from operations and short-term debt. As at 31 December 2008, the Group had bank and cash balances of RMB1,266.9 million, consisting of cash and cash equivalents of RMB260.8 million and pledged bank deposits of RMB1,006.1 million, and approximately RMB1,400.9 million of unutilised banking facilities. The Group's primary liquidity needs have been for working capital purposes.

As at 31 December 2008, the Group's banking facilities were from over 10 different PRC banks, totaling RMB2,939.9 million and consisted of short-term bank loans and other revolving banking facilities.

The following table summarises the Group's cash flows for each of the years ended 31 December 2006, 2007 and 2008:

| | Year ended 31 December | | |
|---|---|---|---|
| | **2006** | **2007** | **2008** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Net cash from (used in) operating activities | 432,093 | (146,616) | (72,512) |
| Net cash (used in) from investing activities | (338,651) | (319,728) | 15,024 |
| Net cash from financing activities | 133,284 | 242,123 | 243,555 |
| Increase/(decrease) in cash and cash equivalents | 226,726 | (224,221) | 186,067 |
| Cash and cash equivalent at the end of year | 298,988 | 74,767 | 260,834 |
| Pledged bank deposits at the end of year | 894,590 | 1,115,022 | 1,006,067 |

As at 31 May 2009, being the indebtedness statement date, unaudited consolidated current assets and unaudited consolidated current liabilities of the Group were RMB4,315.3 million and RMB3,262.9 million, respectively, resulting in an unaudited consolidated net current assets of RMB1,052.4 million, which consists of the following major components:

| | **As at 31 May 2009** |
|---|---|
| | *RMB million* (unaudited) |
| Inventories | 1,488 |
| Bill receivables | 720 |
| Pledged bank deposits | 1,139 |
| Bank balances and cash | 206 |
| Trade receivables and others | 762 |
| Current assets | 4,318 |
| Bill payables | 1,618 |
| Taxation payable | 107 |
| Derivative financial instruments | 44 |
| Short-term bank loans | 1,118 |
| Trade payables and others | 376 |
| Current liabilities | 3,263 |
| Net current assets | 1,052 |

**Operating activities**

Net cash from operating activities decreased by RMB578.7 million to an outflow of RMB146.6 million in the year ended 31 December 2007 compared with an inflow of RMB432.1 million in the year ended 31 December 2006. The decrease was primarily due to:

(i) an increase in the Group's inventory of raw materials from RMB158.6 million to RMB658.4 million as at 31 December 2006 and 2007, respectively, primarily due to:

(A) the Group's proactive purchase and stockpiling of compressors, for which the Group expected both price increases and a shortage of supply in the foreseeable future,

(B) an overall increase in raw materials prices, in particular volatile commodities such as copper and aluminium,

(C) advanced purchase of raw materials to satisfy production needs related to the Group's backlog of orders for the first quarter of 2008, and

(D) an increase in overall volume of sales;

(ii) an increase in the Group's trade and other payables from RMB1,787.4 million to RMB2,248.7 million as at 31 December 2006 and 2007, respectively, primarily due to:

(A) increased procurement of raw materials, parts and components, which was a result of an increase in sales and turnover of the Group, an increase in raw materials costs and an increase in inventory stockpile of raw materials due to the Group's expectation that raw materials costs would continue to rise, and

(B) increases in payables related to customers' deposits, which increased significantly due to a change of the Group's policy relating to its overseas customers; and

(iii) an increase in trade and other receivables from RMB896.1 million to RMB1,124.8 million as at 31 December 2006 and 2007, respectively, primarily due to:

(A) an increase in overall volume of sales; and

(B) an increase in sales to household appliances retail chain operators, to which the Group extends longer credit periods.

Net cash used in operating activities deceased by RMB74.1 million to an outflow of RMB72.5 million in the year ended 31 December 2008 compared with an outflow of RMB146.6 million in the year ended 31 December 2007. Although profit before tax decreased significantly, the slight improvement in net cash outflow from operating activities in 2008 (compared to 2007) was primarily due to a substantial decrease in inventories by RMB172.7 million in 2008 (compared to a significant increase in inventories in 2007 of RMB821.2 million) and a decrease in trade and other payables by RMB216.8 million which was partially offset by an increase in trade and other receivables by RMB378.0 million.

**Investing activities**

The principal items affecting net cash used in investing activities have been increases and decreases in pledged bank deposits, as well as capital expenditures for PPE and land use rights. Net cash from investing activities in the year ended 31 December 2008 amounted to approximately RMB15.0 million, of which RMB109.0 million related to decreases in pledged bank deposits, RMB86.9 million related to purchases of PPE, RMB33.4 million related to interest received and RMB39.3 million related to prepaid lease payments made. Net cash used in investing activities in the year ended 31 December 2007 amounted to approximately RMB319.7 million, of which RMB220.4 million related to increases in pledged bank deposits, RMB62.6 million related to purchases of PPE, RMB43.3 million related to purchases of land use rights and RMB49.8 million related to prepaid lease payments made. Net cash used in investing activities in the year ended 31 December 2006 amounted to RMB338.7 million, of which RMB245.7 million related to increases in pledged bank deposits, RMB81.0 million related to purchases of PPE, and RMB14.8 million related to prepaid lease payments made. RMB26.6 million related to purchases of land use rights.

Pledged bank deposits increased from RMB894.6 million to RMB1,115.0 million as at 31 December 2006 and 2007, respectively, principally due to (i) a proportional increase in drawdowns by the Group of its bank and credit facilities — as the Group drew down larger sums for its working capital needs, its bank deposits grew correspondingly, and (ii) the Group's use of such bank deposits as security bank borrowings. Pledged bank deposits decreased from RMB1,115.0 million as at 31 December 2007 to RMB1,006.1 million as at 31 December 2008, principally due to a corresponding reduction in bills payable, which was a result of the Group increasingly using cash to finance its working capital requirements. The pledged bank deposits do not contain any covenants or similar restrictions that would adversely affect the Group's business or operations.

Notwithstanding RMB62.6 million being used in relation to purchases of PPE, PPE decreased from RMB423.7 million as at 31 December 2006 to RMB333.5 million as at 31 December 2007, primarily as a result of the disposal of certain property and buildings used as dormitory facilities for the Group's employees, plus increased depreciation, in particular of the Group's plant and machinery, related to an increase in asset values. During the year ended 31 December 2007, the Group purchased PPE amounting to RMB62.6 million which mainly consisted of new plant and machinery for production, furniture, fixtures and equipment for replacement and regular maintenance purposes. PPE increased from RMB333.5 million as at 31 December 2007 to RMB372.6 million as at 31 December 2008, primarily due to increased expenditures in (i) plant and machinery and (ii) construction in progress.

### Financing activities

The items that have affected cash flows from financing activities are primarily new loans payable and repayment of borrowings. For example, short-term bank loans increased from RMB226.0 million as at 31 December 2006 to RMB688.7 million as at 31 December 2007 and to RMB1,078.0 million as at 31 December 2008, primarily due to the Group's increased liquidity needs in connection with:

(A) the purchase and stockpile of additional raw materials, in particular compressors, in 2007, the cost of which the Group expected to increase;

(B) increased working capital needs due to the addition of several household appliances retail chain operator customers in 2007, which typically have longer payment cycles (74 to 123 days in 2006 and 107 to 175 days in 2007, as compared to approximately 102 days in 2006 and 88 days in 2007 for other customers); and

(C) the slow down in the Group's regional distributors in the PRC in making payments in 2008 as well as the Group's strategy of paying down certain of its trade payables so as to receive better purchasing discounts from the relevant suppliers.

Net cash from financing activities in the year ended 31 December 2008 amounted to RMB243.6 million, primarily as a result of new bank borrowings of approximately RMB2,050.6 million, which was off-set by the repayment of borrowings of approximately RMB1,661.3 million, payment of interest on bank borrowings in the amount of RMB114.1 million and the repayment of an advance to a Director of RMB31.6 million. Net cash from financing activities in the year ended 31 December 2007 amounted to RMB242.1 million, primarily as a result of new bank borrowings of approximately RMB1,476.8 million, which was off-set by the repayment of borrowings of approximately RMB1,014.0 million and the repayment of an advance to the Company's ultimate holding company of RMB179.4 million. In the year ended 31 December 2006, net cash from financing activities amounted to RMB133.3 million, reflecting primarily new loans of RMB347.9 million and repayment of borrowings of approximately RMB398.0 million, as well as capital contributions to Guangdong Chigo in the amount of RMB300.0 million and net cash used in the acquisition of Guangdong Chigo in the amount of RMB379.5 million.

## CAPITAL EXPENDITURES

The Group's capital expenditures are incurred primarily in connection with purchases of PPE, construction of the Group's facilities, leasehold improvements and investment in equipment, technology and operating systems. The Group's capital expenditures were RMB108.7 million, RMB123.0 million and RMB88.2 million for the years ended 31 December 2006, 2007 and 2008, respectively. The Group expects to spend approximately RMB130.0 million in 2009 on capital expenditure, including general expenditure such as replacement of existing machines for regular maintenance purpose of approximately RMB75.0 million for Guangdong Chigo, factory construction costs of RMB28.0 million for Chigo Jiu Jiang and factory construction costs of RMB28.0 million for Chigo Wuhu. The Group intends to fund its future capital expenditures needs through proceeds from the Global Offering, cash flow from operations, working capital facilities and bank borrowings.

## CONTRACTUAL COMMITMENTS

The following table sets for the Group's contractual commitments as of the dates indicated:

| | As at 31 December | | |
|---|---|---|---|
| | **2006** | **2007** | **2008** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Operating lease commitments | 25,151 | 22,140 | 20,495 |
| Capital expenditure contracted for but not provided in respect of acquisition of property, plant and equipment | 2,738 | 31,934 | 13,936 |
| | 27,889 | 54,074 | 34,431 |

Operating lease commitments are mainly in respect of leases of properties for office and ware house uses.

The increase in capital expenditure contracted in respect of acquisition of PPE in 2007 was due to the then anticipation of the increase in production needs in 2008, where the decrease in such capital expenditure contracted in 2008 was primarily due to the Group adjustment its business plan in view of the economic slow down.

## CONTINGENT LIABILITIES

The Group has no significant contingent liabilities at the respective balance sheet dates during the Track Record Period.

Save as discussed above, as at the close of business on 31 December 2008, the Group did not have any outstanding mortgages, charges, pledges, debentures, loan capital, bank loans and overdrafts, debt securities or other similar indebtedness, finance leases or hire purchase commitments, acceptance liabilities or acceptance credits or any guarantees.

## DIVIDENDS AND DISTRIBUTABLE RESERVES

The Directors are of the view that the timing, form and amount of any dividends to be declared in the future will depend on, among other things, the Group's results of operations, cash flows and financial condition, the Group's future prospects, general business conditions, contractual restrictions on the payment of dividends by the Group to its shareholders or by any subsidiaries, taxation considerations, possible effects on the Group's creditworthiness, operating and capital requirements, the amount of distributable profits based on HKFRS, applicable laws and regulations and all other factors the Board may deem relevant.

The Directors intend to declare and recommend dividends which would amount in total to not less than 30% of the net profit, if any, from ordinary activities attributable to Shareholders for the first financial years subsequent to the Global Offering. Such intention does not amount to any guarantee or representation or indication that the Company must or will declare and pay dividend in such manner or declare and pay any dividend at all. Cash dividends on the Shares, if any, will be paid in Hong Kong dollars.

The Company's reserves available for distribution represents the aggregate of the share premium amount and the retained earnings. Under the Companies Law, the share premium of the Company is available for distribution or paying dividends to shareholders subject to the provisions of its Memorandum and Articles of Association and provided that immediately following the distribution or dividend, the Company is able to pay its debts as they fall due in the ordinary course of business.

There can be no assurance that any dividends will be paid. Investors should consider the risk factors affecting the Group contained in the section headed "Risk Factors".

## INDEBTEDNESS AS AT 31 MAY 2009

As at 31 May 2009, the Group had a total amounts of RMB3,357.0 million of banking facilities available to it, of which an amount of RMB969.2 million was still being unutilised. As at 31 May 2009, for the purpose of this indebtedness statement, the Group had total outstanding borrowings of approximately RMB2,784.8 million as set forth below:

| | **As at 31 May 2009** *RMB'000* |
|---|---|
| Amount due to ultimate holding company(1) | 28,251 |
| Amount due to a director(2) | 21,070 |
| Short-term bank loans | |
| — secured | 73,516 |
| — secured and jointly guaranteed by directors and third parties(3) | 44,045 |
| — jointly guaranteed by directors and third parties(3) | 1,000,309 |
| | 1,117,870 |
| Bill payables | |
| — secured(4) | 1,617,564 |
| | 2,784,755 |

*Notes:*

(1) The amount due to ultimate holding company was unsecured, interest-free and was repayable on demand. It was fully repaid on 26 June 2009.

(2) The amount due to a director, Mr. XH Li, was unsecured, interest-free and was repayable on demand. It was fully repaid on 26 June 2009.

(3) The Directors confirm that all guarantees given by third parties and/or Directors on the Group's short term bank loans will be fully released or replaced by the Company's guarantee before Listing.

(4) The amount was secured by pledged bank deposits of approximately RMB1,138.8 million.

Save as disclosed in this section of this prospectus, apart from normal trade payables and intra-group liabilities, as at the close of business on 31 May 2009, the Group did not have (i) any outstanding mortgages, charges or pledges, debentures or other debt securities (including those authorised or otherwise created but unissued), term loans, loan capital, other borrowings or other similar indebtedness (including bank loans and overdrafts, , hire purchase commitments, acceptance liabilities or acceptance credits), finance leases or any guarantees or other material contingent liabilities.

The Directors confirmed that there have been no material adverse changes in the Group's indebtedness or contingent liabilities since 31 May 2009.

## WORKING CAPITAL

The Directors are of the opinion that, taking into account the financial resources available to the Group including internally generated funds, the available banking facilities and the estimated net proceeds from the issue of Shares under the Global Offering, the working capital available to the Group is sufficient for its present requirements and for at least the next 12 months from the date of this prospectus.

## MARKET RISKS

The Group is, in the normal course of business, exposed to market risks primarily relating to fluctuations in foreign currencies, interest rates, commodity prices and inflation.

### Foreign currency risk

The Group has certain transactions that are denominated in foreign currencies, hence there are exposures to foreign currency risk. During the three years ended 31 December 2008, approximately 39%, 41% and 51%, respectively, of the Group's sales were denominated in currencies other than the functional currency of the Group predominantly the US Dollar, whilst all of the costs are denominated in the Group's functional currency, the Renminbi. As a result, the Group recognised net exchange losses of RMB6.4 million, RMB26.1 million and RMB29.8 million for the three years ended 31 December 2008, respectively.

The carrying amount of the Group's foreign currency denominated monetary assets at each balance sheet date during the Track Record Period are disclosed in the accountants' report of the Group and the notes thereto which are set out in Appendix I "Accountants' Report" to this prospectus. Since 2007, the Group has entered into certain foreign currency forward contracts to hedge against part of its exposure to potential variability of foreign currency risk arising from changes in foreign currency exposure. The Group recognised a net gain on fair value changes of these foreign currency forward contracts of RMB43.0 million in the year ended 31 December 2007 and a net loss on fair value changes of these foreign currency forward contracts of RMB61.0 million in the year ended 31 December 2008, respectively. The management of the Group monitors foreign currency exposure and will consider further hedging should the need arise.

As a result of its increasing sales to overseas markets, the Group is mainly exposed to currency fluctuations in the US dollar, Euro and Hong Kong dollar. The following table details the Group's sensitivity to a 5% increase or decrease in the value of the Renminbi against these foreign currencies. The sensitivity analysis includes only outstanding foreign currency denominated monetary items, trade and other receivables, and bank balances and adjusts their translation at the respective year end during the Track Record Period for a 5% change in foreign currency rates. A negative number indicates a decrease in profit for the year where the Renminbi strengthens against the relevant currency.

| | The Group | | |
|---|---|---|---|
| | Year ended 31 December | | |
| | 2006 | 2007 | 2008 |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| United States dollars | (7,333) | (14,007) | (35,824) |
| Euro | – | (199) | (109) |
| Hong Kong dollars | – | (60) | (34) |

During the Track Record Period, the Group did not apply hedge accounting with respect to its forward foreign currency contracts as the management considers that (i) the amount of the foreign currency forward contracts entered into by the Group and that of the Group's foreign currency denominated receivables were not perfectly effective at offsetting each other; and (ii) the Group had not specifically and formally designated and documented the hedging accounting relationship between the foreign currency forward contracts and the foreign currency denominated receivable, the Group's risk management objective and strategy for undertaking the hedge transactions at inception of the hedge relationship as required by the accounting standards. When evaluating its hedging needs, it is the Group's policy to consider the prevailing economic conditions, its then foreign exchange exposure and the historical trend of fluctuation of the relevant foreign currencies, especially US dollars, as compared to Renminbi. It is also the Group's policy to only hedge not more than 50% of its estimated foreign currency denominated receivables. The Group will continue to consider entering into foreign currencies forward contract to hedge its foreign currency exposure in the future if and when the need arises. In the event that the Group continues with the above practice and policy in entering into forward foreign currency contracts, the Group will not apply hedge accounting for such hedging transactions, if any.

**Interest rate risk**

The Group is exposed to interest rate risk through the impact of rate changes on interest bearing financial assets and liabilities, mainly interest bearing pledged bank deposits, bank balances and other borrowings at prevailing market interest rates. Average interest rates paid were 6.0%, 6.3% and 5.9% during the three years ended 31 December 2008, respectively. The Group's interest rate risk relates primarily to its fixed rate bank loans subject to negotiations at each renewal date. The Group currently does not use any derivative contracts to hedge its exposure to interest rate risk. However, the management will consider hedging significant interest rate risk should the need arise.

### Commodities risk

The Group is exposed to fluctuations in the prices of commodities used as raw materials in the manufacturing process, primarily copper and aluminium. While the Group may be able to partially offset these fluctuations with a flexible pricing policy, the Group bears the risks of fluctuation in the costs of these materials. Accordingly, rising prices for commodities has affected and is expected to continue to affect the Group's cost of goods sold in the form of higher raw materials prices. During the year ended 31 December 2007, the Group entered into certain copper forward contracts in an aggregate contract amount of RMB27.8 million and copper swap contract (the details of which were set out in Note 21 to the Appendix I "Accountants' Report" to this prospectus) to hedge against its exposure to volatile copper prices. For the year ended 31 December 2008, the Group recognised a net gain in fair value changes on copper forward contracts of RMB0.5 million. As at 31 December 2008, the total amount outstanding under these copper forward contracts was nil.

The Group recorded from the Copper Swap Contract a total realised loss of approximately US$0.6 million (or equivalent to approximately RMB4.0 million) from October 2008 to December 2008 and an unrealised loss of approximately US$2.9 million (or equivalent to approximately RMB 19.5 million) as at 31 December 2008.

During the Track Record Period, the Group did not apply hedge accounting with respect to its copper forward contracts and copper swap contract as the management considers that (i) the amount involved in such contracts entered into by the Group and that of the Group's procurement amounts of copper were not perfectly effective at offsetting each other; and (ii) the Group had not specifically and formally designated and documented the hedging accounting relationship between such contracts and the procurement amounts of copper, the Group's risk management objective and strategy for undertaking the hedge transactions at inception of the hedge relationship as required by the accounting standards. When evaluating its hedging needs, it is the Group's policy to consider the prevailing economic conditions, its then commodities risk in relation to copper and the historical trend of fluctuation of the copper price. In the event that the Group continues with the above practice and policy, the Group will not apply hedge accounting for such hedging transactions, if any.

### Inflation

China has not experienced significant inflation or deflation in recent years. Recent inflation and deflation have not materially affected the Group's business. The Group cannot make any assurances that the inflation rate in the PRC will increase or decrease in the future. The Group cannot predict the impact a sustained increase in inflation will have on its business, financial condition, results of operations or prospects.

## OFF-BALANCE SHEET ARRANGEMENTS

Other than the above, the Group does not have any outstanding off-balance sheet guarantees, interest rate swap transactions, foreign currency and commodity forward contracts or other off-balance sheet arrangements. The Group does not engage in trading activities involving non-exchange traded contracts. In its ongoing business, the Group does not enter into transactions involving, or otherwise form relationships with, unconsolidated entities or financial partnerships that are established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

## CRITICAL ACCOUNTING POLICIES

This management discussion and analysis of the Group's financial condition and results of operations is based upon the Group's consolidated financial statements for the three years ended 31 December 2008, which have been prepared in accordance with HKFRSs. The Group's reported financial condition and results of operations are sensitive to accounting methods, assumptions and estimates that underlie the preparation of the financial statements. The Group bases its estimates on its historical and industry experience and on various other factors that management believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. The Group can give no assurance that these judgments will prove correct, and actual results may differ from the Group's estimates.

The selection of critical accounting policies and the sensitivity of reported results to changes in conditions and assumptions are factors to be considered when reviewing the Group's financial statements. The Group believes the following critical accounting policies are among those that involve the most significant judgments and estimates used in the preparation of its consolidated financial statements.

### Revenue recognition

The Group recognises revenue from sales of goods when goods are delivered and title has passed to a customer. Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods sold in the normal course of business, net of discounts and sales related taxes.

Interest income from a financial asset is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts the estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

### Property, plant and equipment

Property, plant and equipment, other then construction in progress, are stated at cost less subsequent accumulated depreciation and accumulated impairment losses.

Construction in progress includes property in the course of construction for production or for its own use purposes. Construction in progress is carried at cost less any recognised impairment loss. Construction in progress is classified to the appropriate category of property, plant and equipment when completed and ready for intended use.

The cost of buildings is depreciated over the shorter of the unexpired lease term of the land which the buildings are located or their estimated useful lives of 8 to 30 years after the date of completion.

Depreciation is provided to write off the cost of items of property, plant and equipment other than construction in progress over their estimated useful lives and after taking into account of their estimated residual value, using the straight-line method. During the Track Record Period, (i) furniture, fixtures and equipment, (ii) motor vehicles and (iii) plant and machinery were depreciated over 3–6 years, 5 years and 5–10 years, respectively. Depreciation of construction in progress only commences when the assets are ready for their intended use.

The recorded values of property, plant and equipment are affected by a number of management estimates, including estimated useful lives, residual value and impairment losses. The Directors assess the need for any impairment only if any such indication exists. Such information may include a significant decrease in market of the property, plant and equipment or a significant deterioration of market conditions such that the carrying value of property, plant and equipment may not be recovered.

**Inventories**

Inventories are stated at the lower of cost and net realisable value. Cost is calculated using the first-in, first-out method. Inventories of the Group comprise raw materials, work in progress and finished goods. The Group has a stock-take policy in place to manage the stock-taking process and monitor inventories because a significant portion of the Group's working capital is devoted to inventories. During the Track Record Period, the Group conducted stock-taking and reviewed the usage of inventories on daily, weekly, monthly, quarterly or non-periodically basis. Carrying values of the aged inventory items are compared with their respective net realisable values to ascertain whether an allowance is required to be made for obsolete or slow-moving items. No provision has been made during the Track Record Period and the inventory provisioning policy has been applied consistently throughout the Track Record Period.

**Loans and receivables**

Loans and receivables (including trade and other receivables, amounts due from subsidiaries, pledged bank deposits and bank balances and cash) are non-derivative financial assets with fixed or determinable payments that are not quoted in active market. These assets are initially measured at fair value. At each balance sheet date subsequent to the initial recognition, loans and receivables are carried at amortised cost using the effective interest method, less any identified impairment loss.

These assets are impaired where there is objective evidence that, as a result of one or more events that occurred after their initial recognition, the estimate future cash flows of the financial assets have been impacted. Objective evidence of impairment for loans and receivables could include the Group's past experience of collecting payments, an increase in the number of delayed payments in the portfolio past the average credit period and observable changes in national or local economic conditions that correlate with default on receivables.

### Provisions

Provisions are recognised when the Group has a present obligation as a result of a past event, and it is probable that the Group will be required to settle that obligation. Provisions are measured at the Directors' best estimate of the expenditure required to settle the obligation at the balance sheet date, and are discounted to present value where the effect is material.

At each balance sheet date, the Directors will assess whether the Group has a present obligation (legal or constructive) as a result of a past event and review the provision made after initial recognition and adjust the provision to reflect current best estimates.

### Warranty obligation

The Group typically provides free repair services for its products and free replacement of certain major components of its products for three to six years after sales.

The costs of the warranty obligation under which the Group agrees to remedy defects in its products are accrued at the time the related sales are recognised. Provision for warranty is accrued based on the estimated costs of fulfilling the total obligation. At each balance sheet date, the management estimates the cost based on past experience. The assumptions used to estimate the warranty provision are reviewed periodically in light of actual results. When a material defect is subsequently tested and identified, further warranty provision may arise.

## DISCLOSURE UNDER RULES 13.13 TO 13.19 OF THE LISTING RULES

The Directors have confirmed that, as at the Latest Practicable Date, they were not aware of any circumstances which would give rise to a disclosure obligation under Rules 13.13 to 13.19 of the Listing Rules.

## RELATED PARTY TRANSACTIONS

During the Track Record Period, the Group had certain related party transactions, namely (1) messing expenses; (2) repairs and maintenance; (3) proceeds from disposal of PPE; and (4) purchase of patents. For details of such related party transactions, please refer to Note 37 to Appendix I "Accountants Report" of this prospectus. The Directors confirm that all of these related party transactions were conducted on normal commercial terms. Save for the PPE, the Directors confirm that the other related party transactions were conducted in the ordinary course of business.

## PROPERTY INTERESTS AND PROPERTY VALUATION

Jones Lang LaSalle Sallmanns Limited, an independent property valuer, has valued the Group's property interests as 31 March 2009 and is of the opinion that the value of the Group's interest as of such date was an aggregate amount of approximately RMB372.4 million. The full text of the letter, summary of values and valuation certificates in connection with such property interests are set out in Appendix III to this prospectus.

## NO MATERIAL ADVERSE CHANGE

The Directors confirmed that there has been no material adverse change in the Group's financial or trading position or prospects since 31 December 2008, which is the date at which the Group's latest audited financial statements were prepared.

The statement below shows the reconciliation of aggregate amounts of certain properties as reflected on the audited consolidated financial statements as at 31 December 2008 with the valuation of these properties as at 31 March 2009 as set out in the property valuation report in Appendix III to this prospectus.

| | *RMB (million)* | *RMB (million)* |
|---|---|---|
| Valuation of properties owned by the Group as at 31 March 2009 as set out in the property valuation report in Appendix III to this prospectus | | 372.4 |
| Net book value of the following properties as at 31 December 2008 as set out in the Accountants' Report in Appendix I to this prospectus: | | |
| — Buildings | 58.2 | |
| — Construction in progress | 50.1 | |
| — Land use rights | 85.9 | |
| Net book value as at 31 December 2008 | 194.2 | |
| Add: Additions of construction in progress during the period from 1 January 2009 to 31 March 2009 (unaudited) | 4.3 | |
| Less: Depreciation of buildings during the period from 1 January 2009 to 31 March 2009 (unaudited) | (1.0) | |
| Less: Amortisation of prepayment of rentals for land use rights during the period from 1 January 2009 to 31 March 2009 (unaudited) | (0.4) | |
| Net book value as at 31 March 2009 | | 197.1 |
| Net valuation surplus | | 175.3 |

## UNAUDITED PRO FORMA ADJUSTED NET TANGIBLE ASSETS

The following is an illustrative statement of unaudited pro forma adjusted net tangible assets of the Group attributable to the equity holders of the Company which has been prepared for the purpose of illustrating the effect of the Global Offering as if it had been taken place on 31 December 2008 and based on the audited consolidated net assets of the Group as at 31 December 2008 as shown in the accountants' report set forth in Appendix I to this prospectus and is adjusted as follows:

| | Audited consolidated net tangible assets attributable to the equity holders of the Company as at 31 December 2008(1) | Estimated net proceeds from the Global Offering(2) | Unaudited pro forma adjusted net tangible assets of the Group attributable to the equity holders of the Company | Unaudited pro forma adjusted net tangible asset per Share(3, 4) | |
|---|---|---|---|---|---|
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB* | *HK$* |
| Based on Offer Price of HK$1.50 per Offer Share | 1,375,589 | 58,908 | 1,434,497 | 2.87 | 3.25 |
| Based on Offer Price of HK$2.27 per Offer Share | 1,375,589 | 106,394 | 1,481,983 | 2.96 | 3.36 |

*Notes:*

(1) The audited consolidated net tangible assets attributable to the equity holders of the Company is arrived at after deducting the intangible assets as at 31 December 2008 as set out in the Accountants' Report in Appendix I to this prospectus.

(2) The estimated net proceeds from the Global Offering are based on the Offer Price of HK$1.50 and HK$2.27 per Offer Share, respectively, after deduction of the underwriting fees and other related expenses payable by the Company. No account has been taken of the Shares that may be issued pursuant to any exercise of Over-allotment Option.

(3) The unaudited pro forma adjusted net tangible asset per Share is arrived at after the adjustments referred to in the preceding paragraphs and on the basis of 500,000,000 Shares (being the number of Shares expected to be in issue immediately after the completion of the Global Offering, without taking into account any Shares which may be issued upon the exercise of the Over-allotment Option).

(4) The unaudited pro forma adjusted net tangible asset per Share is translated into HK$ at exchange rate of RMB0.88147 to HK$1. No representation is made that the Renminbi amounts have been, could have been or may be converted to Hong Kong dollars, or vice versa, at that rate.

(5) The Group's property interests at 31 March 2009 were valued by Jones Lang LaSalle Sallmanns Limited, the valuation in respect of which is set out in Appendix III to this prospectus. The Group will not incorporate the revaluation surplus in its financial statements for the year ending 31 December 2009. It is the Group's accounting policy to state its land use rights at cost less accumulated amortisation and property, plant and equipment at cost less accumulated depreciation and any impairment loss in accordance with Hong Kong Accounting Standard 16 rather than at revalued amounts. Pursuant to the valuation performed by Jones Lang LaSalle Sallmanns Limited, the Group's property interests as at 31 March 2009 amounted to approximately RMB372.4 million. Comparing the valuation amount as at 31 March 2009 to the net book value of the property interests as at 31 March 2009, there was a difference of approximately RMB175.3 million which will not be included in the consolidated financial statements for the year ending 31 December 2009. If the revaluation surplus was recorded in the Group's financial statements, the depreciation of property, plant and equipment and amortisation of land use rights would increase by approximately RMB4.5 million per annum.