



MARKET ENVIRONMENT

PRC macroeconomic environment

In the past year, under the PRC Central Government's proactive and prudent macroeconomic policy, the national economy keeps a steady growth, gross domestic product ("GDP") achieved a total of over US\$1 trillion, an increase of approximately 8% over last year. Per capita GDP was more than US\$800, industrial growth increased more than 11.5%. The country's capital investment achieved more than RMB32 trillion, the rate to economic growth kept at approximately 40%. In the consuming sector, demand for housing, investment in securities and holiday spending turned back into a rising trend since the austerity measures implemented in 1993 and the Asian financial crisis outbreak in 1997. The domestic retail amount hit a figure of RMB3 trillion, with a real increase of 11.4% as compared to last year. Furthermore, the government's increased spending in infrastructure and policies in exploring western part of PRC, restructuring of state-owned enterprises also contributed to the positive development of the macroeconomic of PRC.

Industry environment

With the improvement in the living standards of citizens and adjustments in electricity policies, it is expected that the domestic air conditioners market will grow with a substantial percentage of over 20% in 2001. The current air conditioner market still relies on first tier cities, the second and third tier cities are acting as supplement. The overall penetration rate is not more than 30%, basing on this phenomenon, the room for air conditioners is still large and will have a high growth period. Because of this substantial market, it attracted more well-known domestic household electrical appliances manufacturers to enter air conditioner business and thus creating more keen competition in the future.

In analyzing the reasons for the high growth in the export of household electrical appliances, the Group believes that PRC possesses the World largest single market, this enhanced PRC household electrical appliances enterprises to have economy of scale advantage, the relocation of European and Japanese manufacturers into PRC also make PRC emerge as the world's largest manufacturing base.

The penetration rate of refrigerators in urban area's reached as high as above 80%. As PRC's consumption pattern underwent changes and citizens are not expected to have a high rise in the income, demand for replacement of refrigerators in highly penetrated cities will be delayed.

As more than 90% of the population of PRC locates in rural area, with the increasing earnings of farmers and decreasing rate for electricity as well as policies of upgrading rural area into towns, the demand for refrigerators will become large. On the other hand, it will be a trend for European and Japanese household electrical appliances manufacturers to move their refrigerators manufacturing base into PRC, will become the largest refrigerators manufacturing base in the world. In general, the domestic refrigerator market is still moving on the optimistic development stage. We are confident with the future development of refrigerators business.

On the international trade aspect, the PRC household electrical appliances market is still under high growth. The export of household electrical appliances for the year reached approximately US\$5.2 billion, an increase of approximately 30% over last year. The surplus on the export reached approximately US\$3.9 billion, representing approximately 16.5% of the gross trading surplus of PRC for the year, export of refrigerators and air conditioners representing one fifth and one third of the global export.

Moreover, the entry of PRC into World Trade Organization ("WTO") in 2001 will bring opportunities and challenges to the matured household electrical appliances industry in PRC and will bring along more new opportunities.



Industry environment

Financial Highlights

FINANCIAL RESOURCES AND WORKING CAPITAL

The Group's air conditioner and refrigerator products are affected by season and weather. Each April to August period marks the peak sales season. The Group has to start preparing for the peak sales season from the end of each preceding year. Due to the accumulation of inventory, a higher funding level is required. Liquidity improved after the peak sales season due to the collection of sales revenue. As at 31 December, 2000, the borrowings of the Group amounted to approximately HK\$540,402,000, including short-term loans of approximately HK\$457,430,000. All of the borrowings are denominated in Renminbi while cash and bank deposits (including pledged bank deposits) amounted to approximately HK\$194,545,000. Except for short-term foreign exchange facilities for importing of raw materials, the Group has no borrowings in Hong Kong dollars or other currencies. In accordance with lending policy of financial institutions in PRC, the Group's borrowings are mostly arranged in short-term facilities. As the borrowings were made to operating entities of the Group and were cross-guaranteed, all matured short-term loans can be rolled over.

As at 31 December, 2000, the Group's accounts receivable balance was approximately HK\$201,263,000, representing 11.1% of this year's turnover of approximately HK\$1,815,247,000. This is a further improvement over last year's figure of 14.28%. This is the result of the Group's progressive approach to credit control. Low accounts receivable balance will mitigate the risk of bad debts, strengthen liquidity and reduce interest expenses. The interest coverage ratio, calculation based on profit from operations before finance cost, taxation, depreciation and amortization and after adjusting for share of loss of associates and minority interests divided by total net interest expenses, was 4.85 times and 3.30 times for the current year and prior year respectively.



Profit and Loss Highlights

(HK\$ Mn)	1997	1998	1999	2000	99/00 Change
Turnover	884	1,208	1,197	1,815	52%
Gross Profit	137	316	386	472	22%
Profit/(loss) Attributable to shareholders	(176)	(92)	55	90	64%
Gross Margin	15%	26%	32%	26%	19%
Earnings/(losses) per share (HK cents)	(21.9)	(9.2)	4.7	7.7	64%
Net Margin	(20%)	(8%)	5%	5%	–

Balance Sheet Highlights

(HK\$ Mn)	1997	1998	1999	2000	99/00 Change
Non-current Assets	726	844	728	758	4%
Inventories	521	477	455	627	38%
Accounts Receivable	153	125	171	201	18%
Cash and bank deposits (including pledged bank deposits)	86	64	91	194	88%
Bank borrowings	666	561	529	540	2%
Shareholders' Equity	355	441	508	601	18%

The Group is currently conducting the construction of the second phase production facilities at the air conditioner factory and mini-refrigerator factory. The funding of RMB40,000,000 and RMB4,000,000, required at the respective locations, will be fulfilled with internal resources and bank loans.

CAPITAL STRUCTURE

During the year, the Board and certain employees were granted options to subscribe for 90,120,000 shares in the Company. The options can be exercised for 10 years from the date of grant and the subscription prices were between HK\$0.211 and HK\$0.244 per share for ordinary share of HK\$0.10 each. During the year, 4,600,000 shares were issued pursuant to the exercise of the options. As at 31 December, 2000, the outstanding balance of options was for 92,100,000 shares. Particular of movement are set out in Note 26 to the accompanying financial statements.

As at 31 December, 2000, the shareholders' equity of the Group was approximately HK\$601,086,000, a growth of 18.26% over prior year. As at the closing date, the debt to equity ratio, calculation based on total of short-term and long-term bank loans against consolidated shareholders' equity, was 0.90, a significant improvement over prior year's figure of 1.04.

PLEDGE OF ASSETS

The Group's banking facilities were approximately HK\$540,402,000 which were secured against the Group's interests in the refrigerator and air conditioner business and charged over certain fixed assets. There was no guarantee granted by any of the shareholders of the Company. As at 31 December, 2000, all banking facilities were utilized by the Group. Except for the guarantee granted by the Company to subsidiaries for their operations, the Company has no other contingent liabilities.

EMPLOYEES' REMUNERATION POLICY

As at 31 December, 2000, the Group employed approximately 2,500 full time management, administrative and production staff in Hong Kong and PRC. As a structured business enterprise, the Group follows research report on remuneration which was prepared by professional consultants in PRC to determine employee remunerations based on employee performance, experience and industry practice. The Company has set up share options plan and provided free housing to staff in the PRC. Particulars of the remuneration of directors and staff are set out in Note 5 and 6 to the accompanying financial statements.

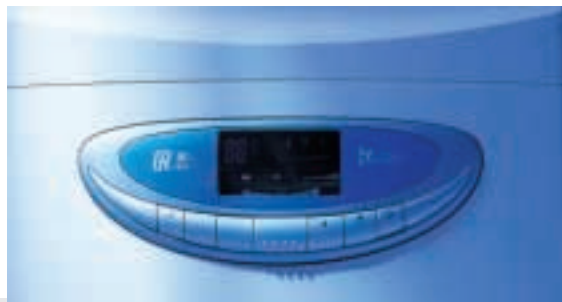
Financial Highlights

Financial Ratio Highlights

(HK\$ Mn)	1997	1998	1999	2000	99/00 Change
Current Ratio (current assets/ current liabilities)	0.75	0.71	0.83	0.95	14%
Debt/Equity Ratio	1.88	1.27	1.04	0.90	(14.29%)
Accounts Receivable/ Turnover ratio	17.34%	10.31%	14.28%	11.09%	(22%)

Debt/Equity: Bank loans/Shareholders' equity

Business Performance



AIR CONDITIONER BUSINESS

During the year under review, the Group's air conditioner business has achieved significant growth, the number of units sold reached approximately 422,000, an increase of 82% as compared to year 1999 and is the principal source of profit of the Group. The increase in sales in term of units achieving economy of scale of the production facilities which in turn generating significant profits income.

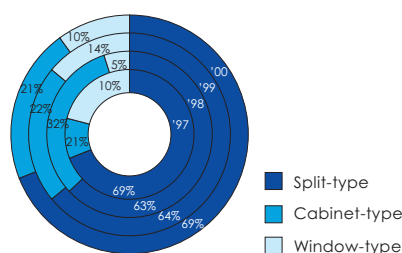
In 2000, the Group's air conditioner subsidiary set up professional export business division, with the corresponding export business product research division. The combination of organizational and technological support caused a surge in the export business development. In 2000, the number of units of air conditioners exported reached approximately 62,000, an increase of 200% as compared to last year.

In order to achieve market diversification and to raise the international awareness of HUALING brand, the Group expects the percentage of export will be higher in the future.

In the process of market competition and development, it is inevitable to have price adjustment. In these circumstances, in the business of air conditioner, the Group put management focus on new market development, new product development and cost control and thus achieved the consistent market position of "HUALING" brand air conditioner, even there were substantial price downwards adjustments in the past three years, the Group could maintain a high level profitability. Judging from the last year, the Group's air conditioner business can maintain the advantage of high profitability over other market players.

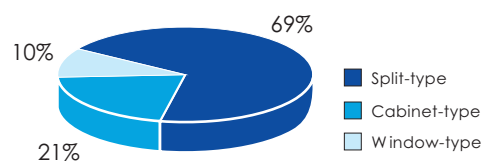
Turnover by Product Types of Air Conditioner

For Years Ended 31 December 1997-2000



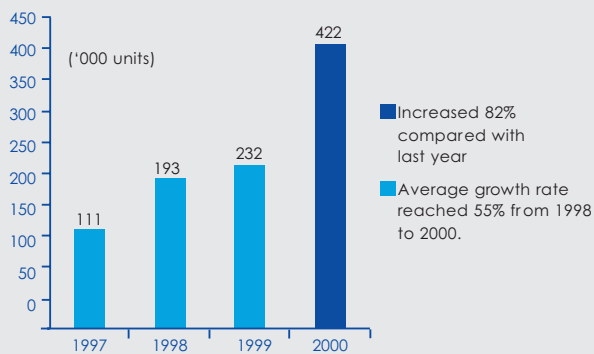
Turnover by Product Types of Air Conditioner

For Year Ended 31 December 2000



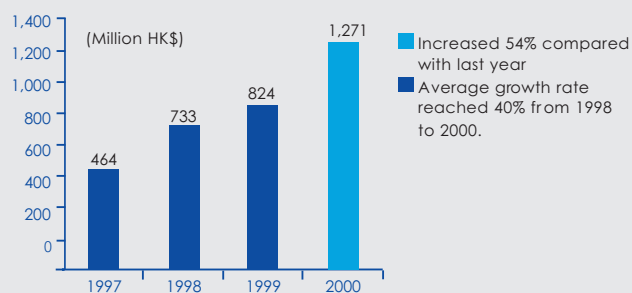
Sales Quantity by Air Conditioner

For Years Ended 31 December 1997-2000



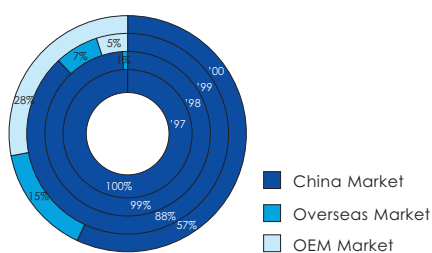
Sales Value by Air Conditioner

For Years Ended 31 December 1997-2000



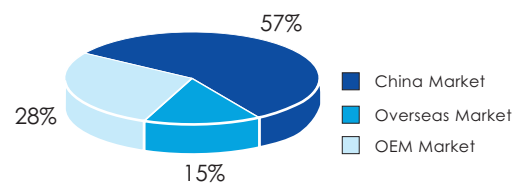
Turnover by Markets of Air Conditioner

For Years Ended 31 December 1997-2000

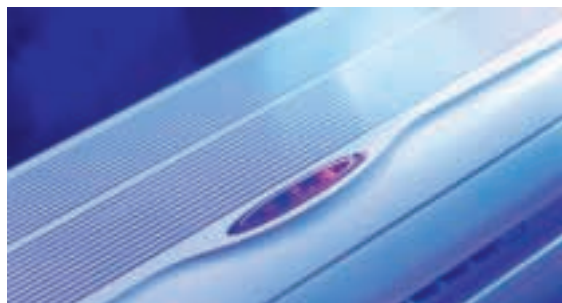


Turnover by Market of Air Conditioner

For Year Ended 31 December 2000

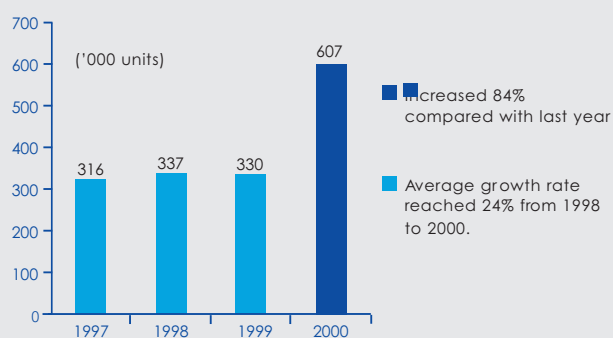


Business Performance



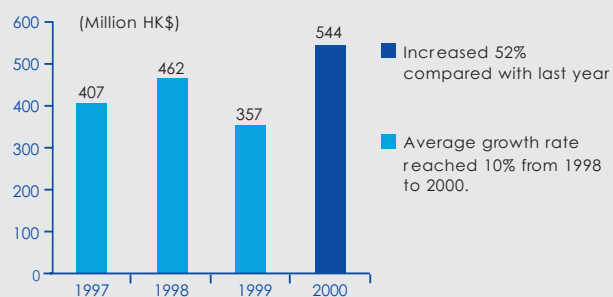
Sales Quantity by Refrigerator

For Years Ended 31 December 1997-2000



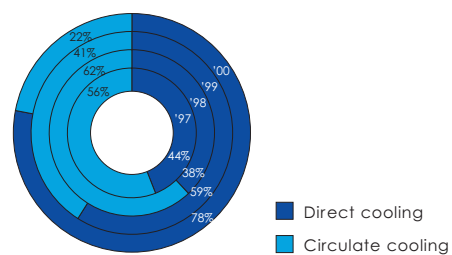
Sales Value by Refrigerator

For Years Ended 31 December 1997-2000



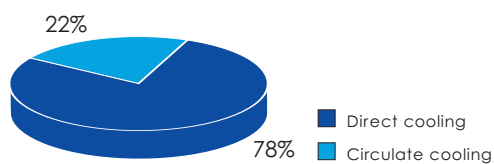
Turnover by Product Types of Refrigerator

For Years Ended 31 December 1997-2000



Turnover by Product Types of Refrigerator

For Year Ended 31 December 1997-2000



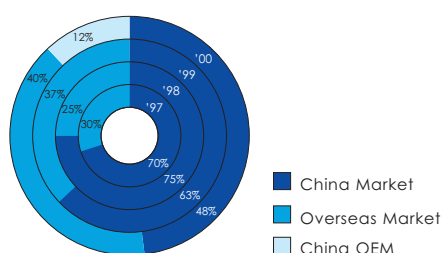
REFRIGERATOR BUSINESS

During this year under review, as there already existed severe over-supply within the refrigerator industry and the continuous entrance of new players into the industry by utilizing abundant facilities of manufacturers, this resulted in fierce price competition. Even though there is an increase of 84% of the units sold during the year, the Group's overall refrigerator business is not performing satisfactorily.

During the year under review, the Group's refrigerator facilities located at Guangzhou and Hefei both recorded a high growth. Although Guangzhou China Refrigeration Industry Co., Ltd achieved results in cost control, it invested substantial resources in the long-term brand building and market development. The market share was increased, however, the results was not satisfactory and still could not turnaround. Hefei Hualing Electric Co., Ltd.'s mini-refrigerator had approximately 76% being exported, accompanies by successful cost control, economy of scale and market strategies, it contributed promising results to the Group. Nevertheless, the overall refrigerator business was still operating at a loss.

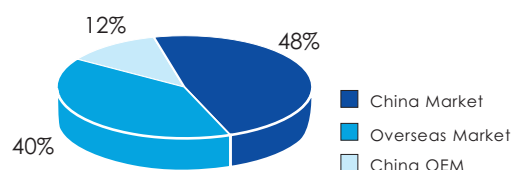
Turnover by Markets of Refrigerator

For Years Ended 31 December 1997-2000



Turnover by Markets of Refrigerator

For Year Ended 31 December 2000



Operation Performance

Last year, the Group faced fierce market competition. Therefore, the Group emphasized on technology innovation and market development, strengthened cost control and quality assurance, expanding products export and raising internal management efficiency and quality. These ensured the Group's operation targets were achieved and resulted in a substantial growth and further enhanced a strong foundation for continuous future development.

PRODUCT DEVELOPMENT

The management believes that strengthening new product development with continuous technology innovation is the driving force of overall enterprise competitive power. Under the direction of the Group's "low costs combined with product differentiation" operation strategy, the Group strengthens its cooperation with universities, research centers for technology innovation development. The continuous upgrading of products, researching and manufacturing series of market and consumers lead products laid a strong foundation for a bigger market share. On the other hand, the Group achieved a cost effective research and development expenses. According to statistic report, a total of 74 new products were introduced to the market during the year. Sales of new products accounted for 80% of turnover. The new products output results were satisfactory.

In addition, the Group founded :Hualing Engineering Centre of Technology in early 2000 and is funded by provincial and municipal government in order to facilitate research and development.

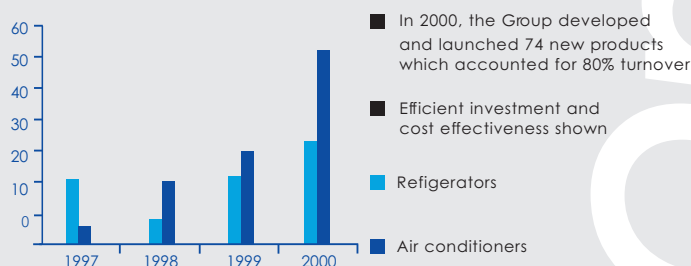
EXPLORATION OF MARKET

In order to aggressively explore market and increase products competitive strength, the Group has made certain adjustments to sales and marketing policies to have closer relationship with distributors in building up a comprehensive sales network. The Group has cooperated with one of PRC's largest household electrical appliance distributors, China Suning Household Appliances Co., Ltd., by setting up a joint venture unit in Beijing for exploring the Northern market of PRC.

Product Development

For Years Ended 31 December 1997-2000

(Product Types)





Guangdong Province has been the Group's fundamental market. During the year, the Group continued its aggressive marketing in Guangdong in order to stabilize its advantages in sales. Sales quantity of HUALING products reached 410,000 units in Guangdong for the year, 78% over prior year. In targeting the markets outside Guangdong, the Group has developed more economical products to meet and demand and attained reasonable sales results. The sales for the year to provinces outside Guangdong improved by 228% over prior year.

While adjusting the sales approach, the Group is constantly adding resources to strengthen the sales network, particularly for the exploration of new and non-traditional markets. Currently, the Group has 1,040 sales distributors in PRC, 308 units more than 1999, representing an increase of 42.1%.

With regard to the international markets, the Group has increased its export ability in order to be more competitive in the international arena. The annual export quantity enjoyed a significant growth over prior year. The number of air conditioners exported was 3 times that of year 1999. The quantity of refrigerators exported was 240,000 units, 2.1 times that of year 1999. The combined export sales were US\$42,281,000, an increase of 128% over prior year.

In addition, the exploration of OEM market enroute to the Group's attainment of economy of scale in production, which is one of the Group's important operating strategies. The Group fully utilized the advantages of product quality and cost structures and established a task unit for OEM business. The Group will selectively work with various well-known household electrical appliance enterprises for their OEM products. The Group's production capacity will be better utilized and effectively lower the average fixed costs. Through our quality control, cost management, research and development, management believe that OEM manufacturing will grow substantially in the coming year and achieve the Group's target of an evenly distributed sales of domestic market, OEM market and export market.

During the past three years, the Group has aggressively explored the OEM and export markets and speeded up the development. Thus, the Group's risk of reliance on a single market will be reduced. The Group expects that export sales will reach one third of the Group's sales within the next three years.

Performance

Brand Building

BRAND BUILDING

For the Group's brand building, professional company was engaged to plan and implement the Group's overall image and marketing strategies. Through participating in large-scale exhibition, the Group increased its public awareness. During the year, the Group centralized the promotion of HUALING brand in areas where Hualing was not highly recognized, especially in the Northern territories, the results were satisfactory.

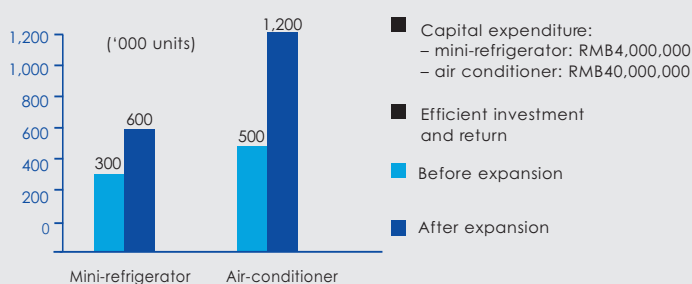


EXPANSION OF PRODUCTION CAPACITY

Following the growth of air conditioners and refrigerators market, the Group has expanded the production capacity of Hualing Air conditioning and Hefei Hualing in order to meet the market demand. The Group stressed the principle of "Low cost, high benefit, few input and more output" and obtained good results. Hualing Air conditioning underwent the second phase construction, which increased annual capacity from 500,000 units to 1,200,000 units, and invested only RMB40,000,000 for the expansion. The construction is expected to be completed by April 2001, right before the start of the peak sales season. Hefei Hualing's 600,000 units annual production first phase technical development plan has been approved by the National Commerce Department with export special project funding granted. Hefei Hualing increased production capacity from 300,000 units to 600,000 units through an investment of only RMB4,000,000. This is a fulfillment of the principle of few input and more output.

Production Capacity

To cope with the demand for increasing capacity upon market development



COST CONTROL

Strengthening cost control is a key component of the Group's operation management. In the year under review, the Group implemented thorough cost control and management into product research and design, global purchasing, inventory management and manufacturing process functions. Management made effort to achieve the best combination of product quality and cost control in order to improve product competitiveness. In 2000, overall production cost attained a 8% cut.

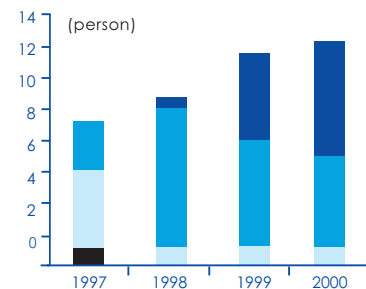
HUMAN RESOURCES MANAGEMENT

The Group is consistently emphasized on human resources management, adopting "right person for right post" principle, applying using ethical mentality and working ability as standards in recruiting talents. In performance appraisal, the operating results are the standard in judging management ability. Moreover, according to modern human resources management requirements, the Group implements "Performance Evaluation Scheme", through a fair assessment to motivate all employees.

On the side of worker training, it is more focused on technical skills, to the middle level management, the focuses are on decision-making and management methodology. Despite the consistent requirement of upper level management has to attend Master of Business Administration programmes, China Refrigeration cooperated with Guangdong College of Commerce for training programme and plan to offer 30 middle level management Master of Business Administration programme. A systematic training scheme can effectively raise the management quality and posted the Group with a strong foundation in human resources to face the more and more fierce market competition.

Qualification Profile for Senior Management

For Years Ended 31 December 1997-2000



Post-graduate	0	1	5	7
University graduate	3	7	5	4
Diploma	3	1	1	1
Below University	1	0	0	0