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If you have sold or transferred all your shares in **HISENSE KELON ELECTRICAL HOLDINGS COMPANY LIMITED**, you should at once hand this circular to the purchaser(s) or transferee(s) or to the bank, licensed securities dealer or other agent through whom the sale or transfer was effected for transmission to the purchaser(s) or the transferee(s).

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Hisense 海信科龙

HISENSE KELON ELECTRICAL HOLDINGS COMPANY LIMITED

海信科龍電器股份有限公司

(a joint stock limited company incorporated in the People's Republic of China with limited liability)
(Stock Code: 00921)

REVISED ANNUAL CAPS AND SUPPLEMENTAL AGREEMENT FOR MAJOR AND CONTINUING CONNECTED TRANSACTIONS

**Independent Financial Adviser to the Independent Board Committee
and the Shareholders**



A letter from the Board is set out on pages 4 to 17 of this circular. A letter from the Independent Board Committee is set out on pages 18 to 19 of this circular. A letter from the Independent Financial Adviser containing its advice to the Independent Board Committee and the Shareholders is set out on pages 20 to 35 of this circular.

A notice of the EGM to be held on 26 September 2016 at 3:00 p.m. at the conference room of the Company's head office, Shunde District, Foshan City, Guangdong Province, the PRC, a proxy form for use at the EGM and a reply slip have been despatched by the Company on 5 August 2016 and are also published on the websites of the Stock Exchange (<http://www.hkexnews.hk>) and the Company (<http://www.kelon.com>) on 3 August 2016. If you are not able to attend the meeting in person, you are requested to complete and return the proxy form in accordance with the instructions printed thereon and to lodge the same with the Company's branch share registrar in Hong Kong, Hong Kong Registrars Limited, at Shops 1712-1716, 17/F, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, not less than 24 hours before the time fixed for holding the EGM or any adjournment thereof (as the case may be). Completion and delivery of the proxy form will not preclude you from attending and voting in person at the EGM or any adjournment thereof (as the case may be) if you so wish.

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DEFINITIONS

In this circular, unless the context otherwise requires, the following expressions have the following meanings:

“A Shares”	domestic ordinary shares of the Company with a nominal value of RMB1.00 each and are listed on the Shenzhen Stock Exchange;
“associates”	has the meaning ascribed to it under the Hong Kong Listing Rules;
“Board” or “Director(s)”	the board of directors of the Company;
“CBRC”	中國銀行業監管管理委員會 (China Banking Regulatory Commission);
“close associates”	has the meaning ascribed to it under the Hong Kong Listing Rules;
“Company”	Hisense Kelon Electrical Holdings Company Limited, a company incorporated in the PRC with limited liability, whose shares are listed on the main board of the Stock Exchange and the Shenzhen Stock Exchange;
“connected person”	has the meaning ascribed to it under the Hong Kong Listing Rules;
“EGM”	the first 2016 extraordinary general meeting of the Company to be held at the conference room of the Company’s head office, Shunde District, Foshan City, Guangdong Province, the PRC on 26 September 2016 at 3:00 p.m. for the approval of the Supplemental Agreement (which stipulates the Revised Annual Caps) and the transactions contemplated thereunder;
“Financial Services Agreement”	the agreement (金融服务協議) entered into between the Company and Hisense Finance dated 10 November 2015 in connection with the provision of financial services by Hisense Finance to the Group;
“Group”	the Company and its subsidiaries;
“H Shares”	overseas listed foreign shares of the Company with a nominal value of RMB1.00 each and are listed on the Stock Exchange;

DEFINITIONS

“Hisense Air-conditioning”	Qingdao Hisense Air-conditioning Company Limited (青島海信空調有限公司), a company incorporated in the PRC with limited liability and a subsidiary of Hisense Group;
“Hisense Finance”	Hisense Finance Co., Ltd. (海信集團財務有限公司), a company incorporated in the PRC with limited liability and a subsidiary of Hisense Group;
“Hisense Group”	Hisense Company Limited (海信集團有限公司), a company incorporated in the PRC with limited liability;
“Hisense HK”	Hisense (Hong Kong) Company Limited, a company incorporated in Hong Kong with limited liability and a subsidiary of Hisense Group;
“Hong Kong”	the Hong Kong Special Administrative Region of the People’s Republic of China;
“Hong Kong Listing Rules”	the Rules Governing the Listing of Securities on the Stock Exchange;
“Independent Board Committee”	an independent board committee of the Company comprising all the independent non-executive Directors, namely Mr. Xu Xiang Yi, Mr. Wang Xin Yu and Mr. Wang Ai Guo;
“Independent Financial Adviser”	VMS Securities Limited, a corporation licensed to carry out Type 1 (dealing in securities), Type 4 (advising on securities), Type 6 (advising on corporate finance) and Type 9 (asset management) regulated activities under the SFO, being the independent financial adviser appointed by the Independent Board Committee to advise the Independent Board Committee and the Shareholders in respect of the Supplemental Agreement (which stipulates the Revised Annual Caps) and the transactions contemplated thereunder;
“Independent Shareholders”	Shareholders other than Hisense Finance and its associates;
“Latest Practicable Date”	2 September 2016, being the latest practicable date prior to the printing of this circular for ascertaining certain information in this circular;

DEFINITIONS

“PRC”	the People’s Republic of China, which for the purposes of this circular, excludes Hong Kong, the Macau Special Administrative Region of the People’s Republic of China and Taiwan;
“Relevant Transactions”	certain continuing connected transactions of the Group contemplated under the Financial Services Agreement (as amended and supplemented by the Supplemental Agreement) as set out in the section headed “Supplemental Agreement” in this circular;
“Revised Annual Caps”	the revised annual caps for the Relevant Transactions for each of the two years ending 31 December 2016 and 2017;
“SFO”	Securities and Futures Ordinance (Cap.571 of the Laws of Hong Kong);
“Share(s)”	share(s) of RMB1.00 each in the capital of the Company, comprising the A Shares and the H Shares;
“Shareholder(s)”	holder(s) of the Shares;
“Shenzhen Listing Rules”	the Rules Governing the Listing of Stocks on the Shenzhen Stock Exchange (深圳證券交易所上市規則);
“Shenzhen Stock Exchange”	The Shenzhen Stock Exchange;
“Stock Exchange”	The Stock Exchange of Hong Kong Limited;
“substantial shareholder”	has the meaning ascribed to it under the Hong Kong Listing Rules;
“Supplemental Agreement”	the supplemental agreement to the Financial Services Agreement entered into between the Company and Hisense Finance dated 3 August 2016, which amends and supplements the Financial Services Agreement;
“HK\$”	Hong Kong dollars, the lawful currency of Hong Kong;
“RMB”	Renminbi, the lawful currency of the PRC;
“%”	per cent.

Hisense 海信科龙
HISENSE KELON ELECTRICAL HOLDINGS COMPANY LIMITED
海信科龍電器股份有限公司
(a joint stock limited company incorporated in the People's Republic of China with limited liability)
(Stock Code: 00921)

Executive Directors:

Mr. Tang Ye Guo
Mr. Liu Hong Xin
Mr. Lin Lan
Mr. Dai Hui Zhong
Mr. Jia Shao Qian
Mr. Wang Yun Li

Registered Office:

No. 8 Ronggang Road
Ronggui
Shunde
Foshan
Guangdong Province
The PRC

Independent non-executive Directors:

Mr. Xu Xiang Yi
Mr. Wang Xin Yu
Mr. Wang Ai Guo

Principal place of business

in Hong Kong:
Room 3101-05
Singga Commercial Centre,
No. 148 Connaught Road West,
Hong Kong

8 September 2016

To the Shareholders

Dear Sir or Madam,

**REVISED ANNUAL CAPS AND SUPPLEMENTAL AGREEMENT FOR
MAJOR AND CONTINUING CONNECTED TRANSACTIONS**

BACKGROUND

Reference is made to the announcement and circular of the Company dated 10 November 2015 and 2 December 2015 respectively in respect of, amongst others, the Financial Services Agreement. The Financial Services Agreement and the transactions contemplated thereunder (subject to the related caps) were approved by the Independent Shareholders at the extraordinary general meeting of the Company held on 28 December 2015.

As disclosed in the announcement of the Company dated 3 August 2016, in view of the substantial improvement of the Company's capital condition due to accelerated capital circulation, reduction of inventories and the better receivable collection in the first half of year 2016, for the purpose of facilitating business development, the Company has entered into the Supplemental Agreement with Hisense Finance to revise the annual caps for each of the two years ending 31 December 2016 and 2017 for some of the transactions contemplated under the Financial Services Agreement.

LETTER FROM THE BOARD

The purpose of this circular is to:–

- (a) provide you with further information on Revised Annual Caps and the Supplemental Agreement;
- (b) set out the letter of advice from the Independent Financial Adviser to the Independent Board Committee and the Shareholders in relation to the Revised Annual Caps and the Supplemental Agreement; and
- (c) set out the recommendation from the Independent Board Committee in relation to the Revised Annual Caps and the Supplemental Agreement.

SUPPLEMENTAL AGREEMENT

Date: 3 August 2016

Parties: The Company;
Hisense Finance

Revision of annual caps:

(1) Deposit service

Pursuant to the Financial Services Agreement, the Company has agreed that the Group shall engage Hisense Finance to provide deposit services as may be required by the Group from time to time upon the terms and conditions of the Financial Services Agreement.

Original annual cap

The existing maximum daily closing balance of the deposits placed by the Group with Hisense Finance at any time during the term of the Financial Services Agreement shall not exceed the annual cap of RMB1,500,000,000 (inclusive of interest) on any given day for each of the two years ending 31 December 2016 and 31 December 2017.

Revised annual cap

Pursuant to the Supplemental Agreement and upon the approval by the Independent Shareholders, the maximum daily closing balance of the deposits placed by the Group with Hisense Finance on any given day for each of the two years ending 31 December 2016 and 31 December 2017 shall be revised to RMB3,000,000,000 (inclusive of interest).

LETTER FROM THE BOARD

Historical figures

For the periods commencing from 10 January 2014 to 31 December 2014, from 1 January 2015 to 31 December 2015 and from 1 January 2016 to 30 June 2016, the maximum daily balance of the deposits placed by the Group with Hisense Finance amounted to approximately RMB795,000,000, RMB799,000,000 and RMB1,498,000,000 respectively.

(2) *Loan and electronic bank acceptance bill service*

Pursuant to the Financial Services Agreement, the Company has agreed that the Group shall engage Hisense Finance to provide loan and electronic bank acceptance bill (電子銀行承兑匯票) services as may be required by the Group from time to time upon the terms and conditions of the Financial Services Agreement.

Original annual cap

The maximum balance of loan and electronic bank acceptance bills provided by Hisense Finance for the Group during the term of the Financial Services Agreement shall not exceed the annual cap of RMB3,000,000,000 (inclusive of interest and service fees) on any given day for each of the two years ending 31 December 2016 and 31 December 2017.

Revised annual cap

Pursuant to the Supplemental Agreement and upon the approval by the Independent Shareholders, the maximum balance of loan and electronic bank acceptance bills provided by Hisense Finance for the Group on any given day for each of the two years ending 31 December 2016 and 31 December 2017 shall be revised to RMB4,500,000,000 (inclusive of interest and service fees).

Historical figures

For the periods commencing from 10 January 2014 to 31 December 2014, from 1 January 2015 to 31 December 2015 and from 1 January 2016 to 30 June 2016, the maximum daily balance of the loans and electronic bank acceptance bills provided by Hisense Finance to the Group amounted to approximately RMB1,108,000,000, RMB1,951,000,000 and RMB2,638,000,000 respectively.

The Supplemental Agreement is conditional upon the approval of the Supplemental Agreement (which stipulates, the Revised Annual Caps for the Relevant Transactions as set out above) by the Independent Shareholders.

Save and except for the revision of the annual caps as set out above, all other terms and conditions under the Financial Services Agreement shall remain unchanged.

LETTER FROM THE BOARD

PRICING POLICIES

Deposit service

The interest rate payable for the Group's deposits with Hisense Finance shall not be lower than the rate payable by normal commercial banks in the PRC for comparable deposits. The designated treasury staff of the Group will review and compare the interest rates offered by Hisense Finance with the major commercial banks based on the nature and tenure of such deposits (e.g. the time deposits will be reviewed quarterly and the demand deposits will be reviewed monthly).

Loan and electronic bank acceptance bill service

The interest rate charged for the loans provided to the Group by Hisense Finance shall not be higher than the rate charged by normal commercial banks in the PRC for comparable loans.

The service fees charged for the provision of electronic bank acceptance bill services by Hisense Finance for the Group shall not be higher than the standard service fees charged by normal commercial banks in the PRC for comparable services.

PLEDGING AND OTHER SECURITY

Hisense Finance may require the Group to provide guarantee or security or pledge in respect of the loan services and the electronic bank acceptance bill services rendered, depending on the then circumstances and business needs.

A subsidiary of the Group has provided a charge in favour of Hisense Finance in respect of the provision of electronic bank acceptance bills provided by Hisense Finance to such subsidiary of the Group. Pursuant to the charge, part of the electronic bank acceptance bills held by the Group will be charged to Hisense Finance to form a portfolio of electronic bank acceptance bills. The Group has opened a special account with Hisense Finance for depositing due and charged electronic bank acceptance bills. The pledged amount is the value of the valid electronic bank acceptance bills which have been deposited to form the pledge portfolio multiplied by the pledge rate determined by Hisense Finance pursuant to the relevant regulations set out by the relevant banking supervision department (which is currently 100%). The maximum balance of the electronic bank acceptance bills which Hisense Finance may provide for the Group will then be up to such pledged amount from time to time. It is contemplated that if the Group is required to provide security or pledge to Hisense Finance in respect of the provision of electronic bank acceptance bill services, such security or pledge will be on similar terms with the pledge mentioned above.

As at the Latest Practicable Date, the Group did not obtain any loan from Hisense Finance and therefore no guarantee or security or pledge in respect of loan services was provided by the Group to Hisense Finance. In the future, if the Group is required to obtain loan from Hisense Finance exceeding the credit limit, Hisense Finance may require the Group to provide guarantee or security or pledge in relation to the provision of loan

LETTER FROM THE BOARD

services. In such circumstance, the Group will use electronic bank acceptance bills as security and such security or pledge will be on similar terms with the pledge in respect of the electronic bank acceptance bill services mentioned above.

If the Group is required to provide security or pledge to Hisense Finance in respect of the provision of electronic bank acceptance bill services or loan services which will involve pledging or charging of any assets other than electronic bank acceptance bills or if the maximum balance of the electronic bank acceptance bills services or loans which Hisense Finance may provide for the Group up to is less than 100% of the pledge value for the electronic bank acceptance bills which are deposited by the Group as security for such services or loans, the Company will re-comply with the applicable requirements under Chapter 14A of the Hong Kong Listing Rules.

THE COMPANY'S INTERNAL POLICY REGARDING CONTINUING CONNECTED TRANSACTIONS

Before entering into a definitive transaction, the Company will compare the price of similar existing transactions with or quotations obtained from independent third parties. Commencement of the definitive transaction with the connected party/parties is subject to the Company's assurance that the price of such continuing connected transaction, according to the principles of fairness and reasonableness, is no less favourable to the Group than those offered by independent third parties in order to ensure fairness of the price of the continuing connected transaction as well as the interests of the Company and the Independent Shareholders as a whole.

For such purpose, the Company has adopted an internal policy for managing and monitoring the Relevant Transactions. According to the internal policy, the treasury department of the Group will compare the interest rates on deposits and loan and the service fee for electronic bank acceptance bills offered by Hisense Finance to the Group to those offered by commercial banks in the PRC for opening electronic bank acceptance bills prior to the execution of the relevant transactions. If the treasury department is of the view that the interest rates on deposits and loan and the service fee for electronic bank acceptance bills offered by Hisense Finance to the Group are less favourable to the Group than those offered by commercial banks in the PRC, it will report to the senior management who will negotiate with Hisense Finance on the terms of the relevant transactions. If, after negotiation, Hisense Finance cannot offer terms which are no less favourable to the Group than those offered by commercial banks in the PRC, the Group will not execute the relevant transactions.

The finance and securities department of the Company is responsible for the collection and summarization of all information in relation to the continuing connected transactions from the treasury department and will prepare a summary report regarding the conduct of the continuing connected transactions on a quarterly basis and make timely report to the senior management regarding the operating status of the continuing connected transactions of the Group. It will also conduct a monthly review on the terms of the continuing connected transaction and compare such terms with those of the similar transactions with independent third parties. In addition, the Company conducts annual review on the execution of the continuing connected transactions of the Group.

LETTER FROM THE BOARD

BASIS OF THE REVISED ANNUAL CAPS

Deposit service

The revised annual cap for the deposit services for each of the two years ending 31 December 2016 and 2017 was determined with reference to the actual amounts paid or received by the Group in relation to the deposit services for the 6 months ended 30 June 2016 and the requirement for business development of the Company in the remaining term of the Financial Services Agreement. The historical figures of the deposit services for the 6 months ended 30 June 2016 show that the original annual cap has almost been fully utilised. The Group's maximum daily balance of the monetary capital has reached RMB2,500,000,000 (which was much higher than the annual cap of RMB1,500,000,000 in respect of the deposit services that can be placed by the Group with Hisense Finance under the Financial Services Agreement), resulting in a lot of capital being placed with other third parties. Based on the market data on gross domestic product, consumption and retail sales of the PRC for the first half of 2016, the management of the Company expects that the market of home electrical appliances in the PRC will be improved for the remaining period of 2016 and enhance the business of the Company and the turnaround of the Company's inventories is expected to be improved. Therefore, it is estimated that the original annual cap will not be sufficient to meet the current requirement for business development of the Company and the upward adjustment of the annual cap based on the current maximum daily balance of the monetary capital of RMB2,500,000,000 with an increment of 20% is necessary in order to ensure smooth development of business. The increment of 20% was determined with reference to the actual business situation for the first half of 2016 and the operating practice of the white goods industry (for example the prepayments made by the dealers at the beginning of the fourth quarter of the year).

Loan and electronic bank acceptance bill service

The revised annual cap for the loan and electronic bank acceptance bill services for each of the two years ending 31 December 2016 and 2017 was determined with reference to the actual amounts paid or received by the Group in relation to the loan and electronic bank acceptance bill services for the 6 months ended 30 June 2016 and the requirement for business development of the Company in the remaining term of the Financial Services Agreement. The historical figures of the loan and electronic bank acceptance bill services for the 6 months ended 30 June 2016 show that the original annual cap has almost been fully utilised. Due to the increase in business volume of the Company and the accelerated capital circulation, the Company has increasing needs to procure Hisense Finance to provide electronic bank acceptance bill services. In the first half of 2016, the Company was in need of electronic bank acceptance bill services for approximately RMB3,800,000,000. Based on the market data on gross domestic product, consumption and retail sales of the PRC for the first half of 2016, the management of the Company expects that the market of home electrical appliances in the PRC will be improved for the remaining period of 2016 and enhance the business of the Company and the turnaround of the Company's inventories is expected to be improved. Therefore, it is estimated that the original annual cap will not be sufficient to meet the current requirement for business development of the Company and the upward adjustment of the annual cap based on the current need of electronic bank acceptance bill services for approximately RMB3,800,000,000 with an increment of 20% is

LETTER FROM THE BOARD

necessary in order to ensure smooth development of business. The increment of 20% was determined with reference to the actual business situation for the first half of 2016 and the operating practice of the white goods industry (for example the prepayments to the suppliers at the beginning of the fourth quarter of the year).

As at the Latest Practicable Date, the original annual caps for the Relevant Transactions have not been exceeded.

REASONS FOR THE REVISION OF THE ANNUAL CAPS

Due to the Company's accelerated capital circulation, reduction of inventories and better receivable collection in the first half of 2016, the maximum daily balance of the monetary capital has reached RMB2,500,000,000 (which was much higher than the annual cap of RMB1,500,000,000 in respect of the deposit services that can be placed by the Group with Hisense Finance under the Financial Services Agreement), resulting in a lot of capital being placed with other third parties. Furthermore, due to the increase in business volume of the Company and the accelerated capital circulation abovementioned, the Company has increasing needs to procure Hisense Finance to provide electronic bank acceptance bill services. In the first half of 2016, the Company was in need of electronic bank acceptance bill services for approximately RMB3,800,000,000. However, due to the limitation on the existing annual cap in respect of loan and electronic bank acceptance bill services under the Financial Services Agreement, the Company had to resort to other financial solution such as the indorsement of physical cheques for payment, resulting in the Company's loss of certain revenue from capital as the payment period for electronic bank acceptance bill (being 6 months) is longer than the average payment period for indorsement of physical cheques (being normally 5 months). Therefore, based on the actual situation in the first half of 2016, the Company intends to revise the relevant annual caps of the deposit service and loan and electronic bank acceptance bill service to ensure the optimal utilisation by the Company of the relevant services provided by Hisense Finance to facilitate the business development of the Company.

Given that (i) the interest rates on deposits and loan and the service fee for electronic bank acceptance bills offered by Hisense Finance to the Group will be equal to or more favourable than those offered by commercial banks in the PRC; and (ii) Hisense Finance is expected to provide more suitable and efficient service to the Group based on their better understanding of the operations of the Group, the Company prefers to conduct the Relevant Transactions with size exceeding the original annual caps with Hisense Finance in order to maximize the benefits of the Shareholders, instead of conducting the Relevant Transactions with commercial banks in the PRC to diversify risk.

It was also set out in the Financial Services Agreement that the transactions contemplated thereunder will be conducted in the ordinary and usual course of business of the Company, on normal commercial terms and on terms not less favourable to the Company than terms available to or from (as appropriate) independent third parties.

LETTER FROM THE BOARD

The Board has considered the risks which may be involved in fully utilising the revised annual cap and assessed the possibility of default for Hisense Finance by:

- (a) reviewing the audited reports of Hisense Finance of the previous two financial years to ascertain the amount of its total assets and has found that its total assets has year-on-year increase and such reports are not qualified nor disclaimed by the auditors;
- (b) preparing “關於在海信集團財務有限公司開展存款金融業務的風險評估報告” (the “**Risk Assessment Reports**”) which has been published by the Company on the website of Shenzhen Stock Exchange on 26 March 2015, 29 March 2016 and 25 August 2016 respectively and in which it was noted that Hisense Finance had complied with certain key regulatory requirements pursuant to the Measures for the Administration of Finance Companies of Enterprise Group as at 31 December 2014, 31 December 2015 and 30 June 2016 and the Board has noted that Hisense Finance has been maintaining a relatively higher standard for the weighted average capital adequacy ratio and current ratio; and
- (c) reviewing the internal regulatory report submitted by Hisense Finance to the Company and the confirmation from Hisense Finance that there was no non-compliance events or deficiencies which resulted in suspension of business or administrative punishment.

Having considered the above findings and the fact that Hisense Finance is only allowed to provide financial services to the group companies of Hisense Group which Hisense Finance shall have better understanding on their financial positions and such focus of client base enables Hisense Finance subject to lower default risk as compared to those commercial banks which with voluminous clients, the Directors are of the view that even with the full utilisation of the revised annual cap, the Company will not be subject to undue default risk by Hisense Finance in light of its relatively sound financial positions and historical compliance with relevant regulatory requirements.

Having reviewing the historical sample deposit rates offered by Hisense Finance and other major commercial banks (for example, China Construction Bank, Industrial and Commercial Bank of China, Bank of China, Bank of Communications and Agricultural Bank of China), the Board has noted that the interest rates offered by Hisense Finance are not less favourable than those offered by major commercial banks for the deposit with the same type and tenure. Moreover, Hisense Finance may offer to the Group tailor-made beneficial deposit mix that can specially cater for the Group’s funding needs which may not be readily available from other commercial banks.

As quite a substantial amount of the Group’s cash and borrowings will be handled by Hisense Finance under the Financial Services Agreement, the Company has adopted risk control measures to mitigate the risks involved by:

- (a) periodically checking the deposit balance placed with Hisense Finance and reviewing the same by the designated treasury staff of the Group;

LETTER FROM THE BOARD

- (b) requesting Hisense Finance to provide monthly deposit transaction record statements to the Group so that the Group can monitor the safety of deposits;
- (c) requesting the designated treasury staff of the Group to ask for quotations and terms from other commercial banks for the deposits and electronic bank acceptance bill services that are comparable to the same provided by Hisense Finance in order to ensure that the terms offered by Hisense Finance are not less favourable than other commercial banks; and
- (d) regularly reviewing the financial statements of Hisense Finance to monitor its financial positions and if there is any extraordinary issues noted (such as the financial positions of Hisense Finance is severely deteriorated), the Group can easily switch to other commercial banks given the non-exclusivity of the Financial Services Agreement.

The Directors, having taken into consideration of the above matters, are of the view that the Group can be benefited from Hisense Finance's better understanding of the operations of the Group which can provide more suitable and efficient service to the Group comparing with those offered by other commercial banks in the PRC and that risk control measures implemented by the Group are sufficient to mitigate the risks involved should the Group fully utilise the revised annual cap.

In view of the above, the Directors (including the independent non-executive Directors) are of the view that Relevant Transactions have been and will be conducted in the ordinary and usual course of business of the Company, on normal commercial terms and on terms not less favourable to the Company than terms available to or from (as appropriate) independent third parties. As such, the Directors (including the independent non-executive Directors) consider that the terms of the Supplemental Agreement and the Revised Annual Caps thereunder are fair and reasonable and in the interest of the Company and the Shareholders as a whole.

REASONS FOR AND BENEFITS OF THE FINANCIAL SERVICES AGREEMENT

The main reasons for the Company to engage Hisense Finance for the provision of the relevant financial services are as follows:

- (i) the interest rates on deposits and loan and the service fee for electronic bank acceptance bills offered by Hisense Finance to the Group will be equal to or more favourable than those offered by commercial banks in the PRC;
- (ii) the Group is expected to benefit from Hisense Finance's better understanding of the operations of the Group which would enable it to provide more suitable and efficient service to the Group comparing with those offered by commercial banks in the PRC; and

LETTER FROM THE BOARD

(iii) Hisense Finance is regulated by the CBRC and engages in the provision of financial services in compliance with the regulations and operational requirements issued by the relevant regulatory authorities. Its primary customers are companies within the Hisense Group. In general, as the risks borne by Hisense Finance are less than those borne by the financial institutions with a broad and unrestricted customer base, Hisense Finance is able to safeguard customers' funds more effectively.

Despite the Company considers that the risk associated with placing deposits with Hisense Finance is minimal, the Group is still facing a risk that the Group may not be able to withdraw all of its deposits from Hisense Finance due to operational problems of Hisense Finance. However, the Company is of the view that such risk can be managed and monitored. On one hand, Hisense Finance will strictly adhere to the risk management guidelines to financial institutions issued by the CBRC and the asset-liability ratio, liquidity ratio and other regulatory indicators of Hisense Finance are in compliance with the relevant requirements of the "Measures for the Administration of Finance Companies of Enterprise Group" issued by the CBRC. On the other hand, the Company has devised a risk management plan to prevent, timely control and resolve the risk involved in the Group's deposit arrangement with Hisense Finance and ensure safety of its capital. To enhance risk assessment and management, during the period when cash is deposited with Hisense Finance, the Company will review the latest available financial reports of Hisense Finance, conduct stress test on deposit every quarter in accordance with the requirements of the China Securities Regulatory Commission, the Guangdong Bureau of the China Securities Regulatory Commission and the Shenzhen Stock Exchange, assess the operational and financial risks of Hisense Finance, issue risk assessment reports to the Directors for their consideration and adoption of necessary measures to prevent the risks identified and ensure the safety and liquidity of the Company's capital and to publish announcement timely. As the Company has been reviewing financial reports of Hisense Finance, conducting stress test on deposit every quarter, assessing the operational and financial risks of Hisense Finance and issuing risk assessment reports to the Directors during the period when cash is deposited with Hisense Finance pursuant to the Financial Services Agreement and taking into consideration the information from the aforesaid review and comparing with the risk portfolio of other independent financial service providers, the Board considers that the risk profile of Hisense Finance, as a financial services provider to the Group, is not greater than that of the independent commercial banks in the PRC.

As at 30 June 2016, approximately 64% of the funds deposited from the Company and other affiliated companies were placed by Hisense Finance with other financial institutions and approximately 30% of such funds deposited was used by Hisense Finance for discount services provided to other companies within the Hisense Group. The loan was lent to other companies within the Hisense Group in strict compliance with regulatory requirements and the delivery of the loan was strictly monitored. As at the Latest Practicable Date, Hisense Finance did not lend the deposit money to its affiliated companies for participating in risky projects.

LETTER FROM THE BOARD

The Directors consider that it is fair and reasonable to place deposits with Hisense Finance as the transactions will be conducted in the ordinary and usual course of business of the Company and the interest rates on deposits offered by Hisense Finance will be equal to or more favourable than those offered by other commercial banks in the PRC to the Group.

FINANCIAL EFFECTS ON THE COMPANY FOR THE USE OF DEPOSIT SERVICES UNDER THE FINANCIAL SERVICES AGREEMENT (AS SUPPLEMENTED BY THE SUPPLEMENTAL AGREEMENT)

The use of deposit services allows the Group to receive interests for its deposits kept in financial institution at a rate that is no less favourable than the interest rates for deposits offered by CBRC for similar deposits. However, the annual interest income only accounts for a small portion of its profits, assets and liabilities. Therefore, the Company expects that its use of deposit services under the Financial Services Agreement (as supplemented by the Supplemental Agreement) will not have any material impact towards the profit, assets and liabilities of the Company.

FINANCIAL EFFECTS ON THE COMPANY FOR THE USE OF LOAN AND ELECTRONIC BANK ACCEPTANCE BILL SERVICES UNDER THE FINANCIAL SERVICES AGREEMENT (AS SUPPLEMENTED BY THE SUPPLEMENTAL AGREEMENT)

The use of the loan and electronic bank acceptance bill services allows the Group to pay interests for the loans and the service fees charged for the provision of electronic bank acceptance bill services at rates that are no less favourable than the interest rates and the standard service fees charged by normal commercial banks in the PRC for comparable loans and services. However, the annual interest expenses and service fees only account for a small portion of its profits, assets and liabilities. Therefore, the Company expects that its use of the loan and electronic bank acceptance bill services under the Financial Services Agreement (as supplemented by the Supplemental Agreement) will not have any material impact towards the profit, assets and liabilities of the Company.

INFORMATION RELATING TO THE COMPANY AND HISENSE FINANCE

The Company is principally engaged in the manufacture and sales of refrigerators and air-conditioners.

Hisense Finance is a non-bank financial institution established with the approval from the CBRC and is regulated by the CBRC and other regulatory authorities in the PRC. Hisense Finance was established in the PRC on 12 June 2008 with a registered capital of RMB900 million. Hisense Finance is owned as to 56.99% by 青島海信通信有限公司 (Hisense Communications Co., Ltd.), 30.89% by Hisense Group and 12.12% by 青島海信電子產業控股股份有限公司 (Qingdao Hisense Electronic (Holdings) Company Limited). Hisense Finance is not a banking company as defined in Rule 14A.10 of the Hong Kong Listing Rules.

The business scope of Hisense Finance includes the following domestic and foreign currency business: providing financial and financing consultation services, credit appraisal and other relevant consultancy and agency services to member companies; assisting member

LETTER FROM THE BOARD

companies in the receipt and payment of transaction proceeds; conducting approved insurance agency services; providing guarantees for member companies; handling of entrusted loans and entrusted investment among member companies; handling of draft acceptance and discount services for member companies; handling of intra-group transfer settlement and other related settlement between member companies and formulating settlement schemes; accepting deposit of member companies; arranging loan and finance leasing to member companies; engaging in lending and borrowing with business counterparts; underwriting corporate bonds for member companies; investing in securities other than investment in secondary markets for stocks; and providing consumer credit and buyer credit for products of member companies and draft discount services approved by State Administration of Foreign Exchange.

IMPLICATIONS UNDER THE HONG KONG LISTING RULES

As at the Latest Practicable Date, (i) Hisense Air-conditioning is a connected person of the Company by virtue of being a substantial shareholder of the Company, holding 44.93% of the issued shares of the Company and (ii) Hisense HK holds 7.13% of the issued shares of the Company. As Hisense Group is the indirect holding company of Hisense Air-conditioning and Hisense HK and Hisense Finance is a subsidiary of Hisense Group, Hisense Finance is a connected person of the Company according to the Hong Kong Listing Rules. As such, the transactions contemplated under the Financial Services Agreement (as supplemented by the Supplemental Agreement) will constitute continuing connected transactions of the Company under the Hong Kong Listing Rules.

As the applicable percentage ratios for the transactions contemplated under the Financial Services Agreement (as supplanted by the Supplemental Agreement) exceed 5%, the Supplemental Agreement and the Revised Annual Caps are subject to the reporting, announcement, annual review and shareholders' approval requirements under Chapter 14A of the Hong Kong Listing Rules.

Furthermore, the provision of deposit services to the Group under the Financial Services Agreement (as supplemented by the Supplemental Agreement) also constitutes the provision of financial assistance by the Group to Hisense Finance under Rule 14.04(1)(e) of the Hong Kong Listing Rules. Since the consideration ratio for the provision of such deposit services is more than 25% but less than 75%, it will constitute a major transaction of the Company under Chapter 14 of the Hong Kong Listing Rules and is subject to the reporting, announcement and shareholders' approval requirements thereunder.

In view of the interests of Hisense Finance in the Financial Services Agreement (as supplemented by the Supplemental Agreement), Hisense Finance and its associates will abstain from voting in relation to the resolution to approve the Supplemental Agreement (which stipulates the Revised Annual Caps) and the transactions contemplated thereunder at the EGM. As such, Hisense Air-conditioning, which held 612,316,909 Shares (representing approximately 44.93% of the issued share capital of the Company) and Hisense HK, which held 97,202,000 Shares (representing approximately 7.13% of the issued share capital of the Company) as at the Latest Practicable Date, will abstain from voting in relation to the relevant resolution at the EGM. Each of Hisense Air-conditioning and Hisense HK controls or is entitled to exercise control of the voting rights in respect of their Shares.

LETTER FROM THE BOARD

GENERAL

Mr. Tang Ye Guo, Mr. Liu Hong Xin, Mr. Lin Lan and Mr. Dai Hui Zhong, being Directors, have abstained from voting on the relevant board resolution(s) for approving the Supplemental Agreement (which stipulates the Revised Annual Caps) and the transactions contemplated thereunder in view of their interest therein as set out below:—

- (a) Mr. Tang Ye Guo, Mr. Liu Hong Xin, Mr. Lin Lan and Mr. Dai Hui Zhong are also directors or senior management of Hisense Group and/or some of its subsidiaries; and
- (b) Mr. Tang Ye Guo and Mr. Liu Hong Xin are also directors of Hisense Finance.

EGM

The EGM will be held at the conference room of the Company's head office, Shunde District, Foshan City, Guangdong Province, the PRC at 3:00 p.m. on 26 September 2016, Monday at which ordinary resolution will be proposed to approve the Supplemental Agreement and the transactions contemplated thereunder by poll.

A notice of the EGM, a proxy form for use at the EGM and a reply slip have been despatched by the Company on 5 August 2016 and are also published on the websites of the Stock Exchange (<http://www.hkexnews.hk>) and the Company (<http://www.kelon.com>) on 3 August 2016. If you are not able to attend the meeting in person, you are requested to complete and return the proxy form in accordance with the instructions printed thereon and to lodge the same with the Company's branch share registrar in Hong Kong, Hong Kong Registrars Limited, at Shops 1712-1716, 17/F, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, not less than 24 hours before the time fixed for holding the EGM or any adjournment thereof (as the case may be). Completion and delivery of the proxy form will not preclude you from attending and voting in person at the EGM or any adjournment thereof (as the case may be) if you so wish.

In accordance with article 8.27 of the articles of association of the Company, a poll may be demanded in any general meeting of the Company by:

- (a) the chairman of the meeting; or
- (b) at least two Shareholders in person or by proxy entitled to vote at the general meeting; or
- (c) one or more Shareholder(s) present in person or by proxy and individually or in aggregate representing 10% or more of all Shares carrying the voting rights at the general meeting.

LETTER FROM THE BOARD

Pursuant to Rule 13.39(4) of the Hong Kong Listing Rules, all votes casted at the EGM must be taken by poll (except those which relate purely to a procedural or administrative matter) and the chairman of the meeting will make such demand at the EGM and the results of the poll will be announced in the manner prescribed under Rule 13.39(5) of the Hong Kong Listing Rules.

The register of members of the Company has been closed from 27 August 2016 (Saturday) until 26 September 2016 (Monday) (both days inclusive). In order to qualify for attending the EGM, all transfer documents of H Shares together with the relevant share certificates must have been lodged with the Company's branch share registrar in Hong Kong, Hong Kong Registrars Limited at Shops 1712-1716, 17/F, Hopewell Centre, 183 Queen's Road East, Wan Chai, Hong Kong not later than 4:30 p.m. on 26 August 2016 (Friday) for registration.

RECOMMENDATION

The Independent Board Committee, having taken into account the advice of the Independent Financial Adviser, considers that the Supplemental Agreement, the Revised Annual Caps and the transactions contemplated thereunder are on normal commercial terms and in the ordinary course of business of the Group and are in the interest of the Company and the Shareholders as a whole and are fair and reasonable so far as the Shareholders are concerned. The Independent Board Committee therefore recommends the Shareholders to vote in favour of the relevant ordinary resolution to be proposed in the EGM to approve the Supplemental Agreement (which provides for the revisions to the relevant annual caps in relation to the Relevant Transactions).

ADDITIONAL INFORMATION

Your attention is drawn to the letters from the Independent Board Committee and the Independent Financial Adviser in relation to the Supplemental Agreement (which provides for the revisions to the relevant annual caps in relation to the Relevant Transactions) and the transactions contemplated thereunder which are respectively set out on pages 18 to 19 and pages 20 to 35 of this circular. Additional information is also set out in the appendices to this circular for your information.

Yours faithfully,
By Order of the Board of
Hisense Kelon Electrical Holdings Company Limited
Tang Ye Guo
Chairman

LETTER FROM THE INDEPENDENT BOARD COMMITTEE

Hisense 海信科龙
HISENSE KELON ELECTRICAL HOLDINGS COMPANY LIMITED
海信科龍電器股份有限公司
(a joint stock limited company incorporated in the People's Republic of China with limited liability)
(Stock Code: 00921)

8 September 2016

To the Shareholders

Dear Sir or Madam,

**REVISED ANNUAL CAPS AND SUPPLEMENTAL AGREEMENT FOR
MAJOR AND CONTINUING CONNECTED TRANSACTIONS**

We refer to the circular issued by the Company to the Shareholders dated 8 September 2016 (the “**Circular**”) of which this letter forms part. Terms defined in the Circular shall have the same meanings in this letter unless the context otherwise requires.

We have been appointed by the Board as the members of the Independent Board Committee to consider the terms of the Supplemental Agreement and the Revised Annual Caps in relation thereto as to the fairness and reasonableness of the same. VMS Securities Limited has been appointed as the independent financial adviser to advise the Independent Board Committee and the Shareholders in this regard.

RECOMMENDATION

We wish to draw your attention to the letter from the Board and the letter from the Independent Financial Adviser as set out on pages 4 to 17 and pages 20 to 35 of the Circular respectively. Having considered the principal factors and reasons considered by, and the advice of the Independent Financial Adviser as set out in its letter of advice, we concur with the views of the Independent Financial Adviser and consider that the terms of the Supplemental Agreement and the Revised Annual Caps in relation thereto are on normal commercial terms and in the ordinary course of business of the Group and are in the interests of the Company and the Shareholders as a whole and are fair and reasonable so far as the Shareholders are concerned.

LETTER FROM THE INDEPENDENT BOARD COMMITTEE

Accordingly, we recommend the Shareholders to vote in favour of the resolution to be proposed at the EGM to approve the Supplemental Agreement (which provides for the revisions to the relevant annual caps in relation to the Relevant Transactions).

Yours faithfully,
For and on behalf of the Independent Board Committee
Xu Xiang Yi Wang Xin Yu Wang Ai Guo
Independent non-executive Directors
Hisense Kelon Electrical Holdings Company Limited

LETTER FROM VMS SECURITIES LIMITED

The following is the text of the letter of advice from VMS Securities Limited to the Independent Board Committee and the Shareholders in relation to the Supplemental Agreement prepared for the purpose of incorporation in this circular.



VMS Securities
鼎珮證券

VMS Securities Limited
49/F, One Exchange Square
8 Connaught Place, Central, HK
香港中環康樂廣場8號交易廣場1期49樓
Tel/電話: (852) 2996 2100
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8 September 2016

*To: The Independent Board Committee and the Shareholders of
Hisense Kelon Electrical Holdings Company Limited*

Dear Sirs,

MAJOR AND CONTINUING CONNECTED TRANSACTIONS IN RELATION TO THE REVISED ANNUAL CAPS

INTRODUCTION

We refer to our appointment as the independent financial adviser to the independent board committee of the Company (the “**Independent Board Committee**”) and the Shareholders in respect of the Supplemental Agreement on the Revised Annual Caps for certain financial services which constitute major and continuing connected transactions of the Company, details of which are set out in the circular to the Shareholders dated 8 September 2016 (the “**Circular**”), of which this letter forms part. This letter contains our advice to the Independent Board Committee and the Shareholders in respect of the Supplemental Agreement (stipulating the Revised Annual Caps). Unless otherwise stated, terms defined in the Circular have the same meanings in this letter.

As disclosed in the Letter from The Board, in view of the substantial improvement of the Company’s capital condition due to accelerated capital circulation, reduction of inventories and the better receivable collection in the first half of 2016, the original annual caps for the (i) deposit service and (ii) loan and electronic bank acceptance bill service under the Finance Services Agreement were unable to fully cover the Group’s demand for the relevant services in the first half of 2016. To cater for the business needs, the Supplemental Agreement is proposed to adjust upward the annual caps of the deposit service and loan and electronic bank acceptance bill service for the two years ending 31 December 2016 and 2017. Save and except for the revision of the above annual caps, all other terms and conditions under the Financial Services Agreement shall remain unchanged.

As at the Latest Practicable Date, (i) Hisense Air-conditioning is a connected person of the Company by virtue of being a substantial shareholder of the Company, holding 44.93% of the issued shares of the Company; and (ii) Hisense HK holds 7.13% of the issued shares of the Company. As Hisense Group is the indirect holding company of Hisense Air-conditioning and Hisense HK and Hisense Finance is a subsidiary of Hisense Group,

LETTER FROM VMS SECURITIES LIMITED

Hisense Finance is a connected person of the Company according to the Hong Kong Listing Rules. As such, the (i) deposit service and (ii) loan and electronic bank acceptance bill service contemplated under the Financial Services Agreement (supplemented by the Supplemental Agreement) constitute continuing connected transactions of the Company under the Hong Kong Listing Rules.

As the applicable percentage ratios for the transactions contemplated under the Financial Services Agreement (supplemented by the Supplemental Agreement) exceed 5%, the Supplemental Agreement (stipulating the Revised Annual Caps) are subject to reporting, announcement, annual review and shareholders' approval requirements under Chapter 14A of the Hong Kong Listing Rules.

Also, the Group's utilization of the deposit service provided by Hisense Finance under the Financial Services Agreement (supplemented by the Supplemental Agreement) constitutes provision of financial assistance by the Group to Hisense Finance under Rule 14.04(1)(e) of the Hong Kong Listing Rules. Since the consideration ratio for the provision of such deposit service is more than 25% but less than 75%, it constitutes a major transaction of the Company under Chapter 14 of the Hong Kong Listing Rules and is subject to reporting, announcement and shareholders' approval requirements thereunder.

The Independent Board Committee, comprising all the independent non-executive Directors, has been established to advise the Shareholders on (i) whether the Supplemental Agreement (stipulating the Revised Annual Caps) are fair and reasonable, on normal commercial terms or better, in the ordinary and usual course of business of the Group and in the interests of the Company and the Shareholders as a whole; and (ii) how the Shareholders should vote on the relevant resolution to approve the Supplemental Agreement. As the independent financial adviser, our role is to give an independent opinion on the above matters to the Independent Board Committee and the Shareholders.

As at the Latest Practicable Date, we were independent from and not connected with the Group under Rule 13.84 of the Hong Kong Listing Rules, and accordingly, qualified to give the independent advice regarding the Supplemental Agreement (stipulating the Revised Annual Caps). Apart from the normal advisory fee payable to us in connection with our appointment as the independent financial adviser to the Independent Board Committee and the Shareholders, no arrangement exists whereby we shall receive any other fees or benefits from the Company.

During the past two years, VMS Securities Limited had been engaged as the independent financial adviser for the continuing connected transactions in relation to the Financial Services Agreement (see Company's circular dated 2 December 2015 for details). The professional fees for the aforesaid appointment have already been fully settled. We are not aware of the existence of or change in any circumstances that would affect our independence. As such, we consider that we are eligible to give independent advice on the Supplemental Agreement (stipulating the Revised Annual Caps).

LETTER FROM VMS SECURITIES LIMITED

BASIS OF OUR OPINION

In formulating our advice, we have relied solely on the statements, information, opinions and representations contained in the Circular and the information and representations provided to us by the Group and/or the management (the “**Management**”, including the Directors and/or the senior management staff of the Company). We have assumed that all such statements, information, opinions and representations contained or referred to in the Circular or otherwise provided or made or given by the Company and/or the Management for which it is/they are solely responsible were true and accurate and valid at the time they were made and given and continue to be true and valid as at the Latest Practicable Date. We have assumed that all the opinions and representations made or provided by the Management contained in the Circular have been reasonably made after due and careful enquiry. We have also sought and obtained confirmation from the Company and/or the Management that no material facts have been omitted from the information provided and referred to in the Circular.

We consider that we have reviewed all information and documents which are made available to us to enable us to reach an informed view and to justify our reliance on the information provided so as to provide a reasonable basis for our advice. We have no reason to doubt the truth, accuracy and completeness of the statements, information, opinions and representations provided to us by the Company and/or its Management and their respective advisers or to believe that material information has been withheld or omitted from the information provided to us or referred to in the aforesaid documents. We have not, however, carried out any independent verification of the information provided, nor have we conducted any independent investigation into the business and affairs of the Group or Hisense Finance.

INFORMATION ON THE GROUP AND HISENSE FINANCE

1. The Group

The Company was incorporated in the PRC on 16 December 1992 and, together with its subsidiaries, is principally engaged in the manufacture of refrigerators and air-conditioners. As stated in the Company’s annual report for the year ended 31 December 2015 (the “**2015 Annual Report**”), approximately 65.4% of the Group’s turnover for the year ended 31 December 2015 was derived from the PRC market and the rest was derived from overseas markets.

Set out below is a summary of the Group’s consolidated operating results and financial position as extracted from the 2015 Annual Report and the announcement of the Company’s interim results for the six months ended 30 June 2016 (the “**2016 Interim Results**”):

LETTER FROM VMS SECURITIES LIMITED

<i>In RMB million, approximately</i>	For the year ended		For the six months	
	31 December		ended 30 June	
	2015	2014	2016	2015
Revenues				
– Sales of refrigerators & washing machines	11,555.8	11,864.0	6,041.3	6,136.7
– Sales of air-conditioners	8,986.1	11,342.5	5,416.9	5,793.1
– Sales of others products	<u>1,261.8</u>	<u>1,164.5</u>	<u>702.7</u>	<u>558.0</u>
Revenue from principal operations	21,803.7	24,371.0	12,160.9	12,487.8
Revenue from other operations	<u>1,667.9</u>	<u>2,163.4</u>	<u>962.1</u>	<u>1,123.3</u>
Total operating revenue (a)	23,471.6	26,534.4	13,123.0	13,611.1
Operating costs	(18,440.7)	(20,784.7)	(10,044.3)	(10,800.7)
Business taxes and surcharges	(97.2)	(98.4)	(54.0)	(30.8)
Selling and distribution expenses	(4,308.9)	(4,388.7)	(2,172.4)	(2,210.8)
General and administrative expenses	(905.2)	(856.9)	(458.1)	(430.2)
Financial income/(expenses)	71.4	4.0	33.4	24.8
Impairment losses on assets	<u>(4.7)</u>	<u>(58.6)</u>	<u>14.0</u>	<u>(20.9)</u>
Total operating costs (b)	(23,685.3)	(26,183.3)	(12,681.4)	(13,468.6)
(Loss)/gain from changes in fair value (c)	(2.5)	(74.3)	9.1	53.1
Investment income (d)	<u>530.2</u>	<u>375.5</u>	<u>190.6</u>	<u>290.5</u>
Operating profits (a+b+c+d)	<u>314.0</u>	<u>652.3</u>	<u>641.3</u>	<u>486.1</u>
Non-operating income	326.9	124.3	56.9	101.7
Non-operating expenses	<u>(17.2)</u>	<u>(5.4)</u>	<u>(1.6)</u>	<u>(9.4)</u>
Profit before tax	<u>623.7</u>	<u>771.2</u>	<u>696.6</u>	<u>578.4</u>
Income tax expenses	<u>(79.4)</u>	<u>(59.7)</u>	<u>(106.0)</u>	<u>(64.3)</u>
Net profit for the year/period	<u>544.3</u>	<u>711.5</u>	<u>590.6</u>	<u>514.1</u>
Attributable to:				
– Owners of the Company	580.3	672.5	559.3	505.7
– Minority interests	(36.0)	39.0	31.3	8.4

LETTER FROM VMS SECURITIES LIMITED

<i>In RMB million, approximately</i>	As at 31		
	December		As at 30 June
	2015	2016	2015
Non-current assets	5,760.3	5,677.5	5,548.8
Current assets	8,532.5	11,919.4	10,629.8
Non-current liabilities	373.1	333.6	430.8
Current liabilities	9,446.0	12,425.1	11,300.5
Total shareholders' equity	4,473.8	4,838.2	4,447.3

The Group's total operating revenue decreased by approximately 11.5% from approximately RMB26,534.4 million for the year ended 31 December 2014 to RMB23,471.6 million for the year ended 31 December 2015. According to the 2015 Annual Report, the decrease was mainly due to the decrease in sales of air-conditioners, refrigerators and washing machines. Owing to the global economic slowdown, high inventory level in the industry, slower growth in the real estate market, etc., development of the white good industry was affected accordingly. Total operating costs for the year ended 31 December 2015 decreased roughly in the same line with the decrease in the total operating revenue for the same year. Investment income for the year ended 31 December 2015, however, increased by approximately RMB154.7 million (or 41.2%). Such increase was due to the gain recognized for disposal of a long-term listed equity investment. Also, non-operating income for the year ended 31 December 2015 increased by approximately RMB202.6 million (or 163.0%) which was mainly due to the increase in the government grants.

For the six months ended 30 June 2016, the Group's export sales increased to approximately RMB4,628.3 million for the six months ended 30 June 2016, representing a year-on-year increase of approximately 13.3% which partially offset the slight decrease of domestic sales during the same period. The Group's unaudited net profit was approximately RMB590.6 million (representing an increase of approximately 14.9% from approximately RMB514.1 million for the corresponding period).

As at 30 June 2016, the Group's net current liabilities position was improved from approximately RMB913.5 million as at 31 December 2015 to approximately RMB505.7 million as at 30 June 2016 which was mainly driven by the increase in cash at bank and on hand as well as the accounts and notes receivable resulted from better collection of capital from the customers during the first half of 2016. Its total equity was further strengthened by roughly the amount of the net profit earned for the period and adjusted by the dividend payables of approximately RMB204.4 million for the year ended 31 December 2015 of which the balance increased from approximately RMB4,473.8 million as at 31 December 2015 to approximately RMB4,838.2 million as at 30 June 2016, representing an increase of approximately 8.1%

LETTER FROM VMS SECURITIES LIMITED

2. Hisense Finance

Hisense Finance is a non-bank financial institution established with the approval from CBRC and is regulated by CBRC and other regulatory authorities in the PRC. Hisense Finance was established in the PRC on 12 June 2008 with a registered capital of RMB900 million. Hisense Finance is owned as to 56.99% by 青島海信通信有限公司 (Hisense Communications Co., Limited), 30.89% by Hisense Group and 12.12% by 青島海信電子產業控股股份有限公司 (Qingdao Hisense Electronic (Holdings) Company Limited). Hisense Finance is not a banking company as defined in Rule 14A.10 of the Hong Kong Listing Rules.

The business scope of Hisense Finance includes the following domestic and foreign currency business: providing financial and financing consultation services, credit appraisal and other relevant consultancy and agency services to member companies; assisting member companies in the receipt and payment of transaction proceeds; conducting approved insurance agency services; providing guarantees for member companies; handling of entrusted loans and entrusted investment among member companies; handling of draft acceptance and discount services for member companies; handling of intra-group transfer settlement and other related settlement between member companies and formulating settlement schemes; accepting deposit of member companies; arranging loan and finance leasing to member companies; engaging in lending and borrowing with business counterparts; underwriting corporate bonds for member companies; investing in securities other than investment in secondary markets for stocks; and providing consumer credit and buyer credit for products of member companies and draft discount services approved by State Administration of Foreign Exchange.

PRINCIPAL FACTOR CONSIDERED

In formulating our opinion regarding the Supplemental Agreement (stipulating the Revised Annual Caps), we have taken into consideration the following:

Reasons for and benefits of Supplemental Agreement

As disclosed in the Letter from the Board, the existing annual caps for the (i) deposit service and (ii) loan and electronic bank acceptance bill service under the Finance Services Agreement were unable to fully cover the Group's demand for the deposit service and loan and electronic bank acceptance bill service in the first half of 2016. To cater for the business needs, the Supplemental Agreement is proposed to adjust upward the annual caps of the relevant services for the two years ending 31 December 2016 and 2017.

The Management advised that the main reasons for the election by the Company to use more of the (i) deposit service and (ii) loan and electronic bank acceptance bill service provided by Hisense Finance are:

- the interest rates on deposits and loan and the service fee for electronic bank acceptance bills offered by Hisense Finance to the Group will be not less favourable than those offered by commercial banks in the PRC;

LETTER FROM VMS SECURITIES LIMITED

- the Group is expected to benefit from Hisense Finance's better understanding of the operations of the Group which would enable it to provide more suitable and efficient service to the Group comparing with those offered by commercial banks in the PRC; and
- Hisense Finance is regulated by the CBRC and engages in the provision of financial services in compliance with the regulations and operational requirements issued by the relevant regulatory authorities. Its primary customers are companies within the Hisense Group. In general, as the risks borne by Hisense Finance are less than those borne by the financial institutions with a broad and unrestricted customer base, Hisense Finance is able to safeguard customers' funds more effectively.

According to the Letter from the Board, the Company is of the view that the default risk associated with placing deposits with Hisense Finance can be managed and monitored. On one hand, Hisense Finance will strictly adhere to the risk management guidelines to financial institutions issued by the CBRC. The asset-liability ratio, liquidity ratio and other regulatory indicators of Hisense Finance are in compliance with the relevant requirements of the "Measures for the Administration of Finance Companies of Enterprise Group" issued by the CBRC. On the other hand, the Company has devised a risk management plan to prevent, timely control and resolve the risk involved in the Group's deposit arrangement with Hisense Finance and ensure safety of its capital. To enhance risk assessment and management, during the period when cash is deposited with Hisense Finance, the Company will review the latest available financial reports of Hisense Finance, conduct stress test on deposit every quarter in accordance with the requirements of the China Securities Regulatory Commission, the Guangdong Bureau of the China Securities Regulatory Commission and the Shenzhen Stock Exchange, assess the operational and financial risks of Hisense Finance, issue risk assessment reports to the Directors for their consideration and adoption of necessary measures to prevent the risks identified and ensure the safety and liquidity of the Company's capital and to publish announcement timely.

In order to assess the possibility of default for Hisense Finance, we have carried out the followings:

- (i) We have reviewed the PRC audited reports of Hisense Finance for the two years ended 31 December 2014 and 2015 (the "**PRC Audited Reports**"). Based on the PRC Audited Reports, the total assets of Hisense Finance amounted to approximately RMB8,708.9 million as at 31 December 2014, represented a year-on-year increase of approximately 38.5%. The total assets of Hisense Finance had been further increased to approximately RMB9,075.3 million as at 31 December 2015, represented an increase of approximately 4.21%. We had also noted from the PRC Audited Reports that the auditor of Hisense Finance did not issue any qualified or disclaimer audit opinion regarding Hisense Finance's financial positions and operation results for the two years ended 31 December 2014 and 2015;

LETTER FROM VMS SECURITIES LIMITED

(ii) We have reviewed the reports entitled “關於在海信集團財務有限公司開展存款金融業務的風險評估報告” (the “**Risk Assessment Reports**”) dated 26 March 2015, 29 March 2016 and 25 August 2016 respectively published by the Company on the website of Shenzhen Stock Exchange and noticed from the Risk Assessment Reports, Hisense Finance had complied with certain key regulatory requirements pursuant to the “Measures for the Administration of Finance Companies of Enterprise Group” as at 31 December 2014, 31 December 2015 and 30 June 2016 respectively. The details are set out below:

Relevant indicators	Requirements for finance companies	Hisense Finance as at 31 December 2014	Hisense Finance as at 31 December 2015	Hisense Finance as at 30 June 2016
Capital adequacy ratio	Shall not be lower than 10%	75.81%	28.08%	25.87%
Current ratio	Shall not be lower than 25%	52.15%	64.45%	79.54%
Inter-bank borrowing balances over the total registered capital of relevant finance company	Shall not exceed the total registered capital	2.7% (not higher than the registered capital)	0% (not higher than the registered capital)	12.84% (not higher than the registered capital)
Short-term securities investment to total capital ratio	Shall not be higher than 40%	0%	0%	0%
Outstanding guaranteed amount over the total capital	Shall not exceed the total capital	35.29% (not higher than the total capital)	92.54% (not higher than the total capital)	74.17% (not higher than the total capital)
Long-term investment to total capital ratio	Shall not be higher than 30%	0%	0%	0%
Self-owned fixed assets to total capital ratio	Shall not be higher than 20%	0.08%	0.06%	0.05%

As illustrated above, Hisense Finance has been continuously maintaining the requisite ratios at a higher standard than the regulatory requirements as at 31 December 2014, 31 December 2015 and 30 June 2016 respectively;

Meanwhile, according to the notices dated 15 February 2016 and 10 August 2016 respectively issued by the CBRC in relation to the major regulatory indicators data for the fourth quarter of 2015 and the second quarter of 2016, the weighted

LETTER FROM VMS SECURITIES LIMITED

average capital adequacy ratio and current ratio of commercial banks (excluding branches of overseas banks) was 13.45% and 48.01% respectively as at the end of the fourth quarter of 2015 and the same ratios were 13.11% and 48.14% respectively as at the end of the second quarter of 2016. Based on the above illustrations, Hisense Finance has maintained a relatively higher standard for these two ratios;

- (iii) Upon our enquiry with the Management, we understand that Hisense Finance is required to comply with all the rules and operational requirements of the CBRC. We have reviewed the internal regulatory report submitted by Hisense Finance to the Company and Hisense Finance confirmed that there was no non-compliance events or deficiencies which resulted in suspension of business or administrative punishment; and
- (iv) Based on our discussions with the Management, Hisense Finance is only allowed to provide financial services to the group companies of Hisense Group which Hisense Finance shall have better understanding on their financial positions. The focus of clients enables Hisense Finance subject to lower default risk as compared to those commercial banks which with voluminous clients.

We have also extracted the financial highlights of Hisense Finance from the PRC Audited Reports and the highlights are set out as below:

	For the year ended 31 December	
	2015 (Audited)	2014 (Audited)
<i>(approximate RMB million)</i>		
Operating revenue	279.4	248.1
– Net interest income	265.6	234.6
Net profit	183.6	172.8
 Total assets	 9,075.3	 8,708.9
– Cash and money deposited into central bank	548.3	903.4
– Deposits placed into same industry and other financial companies	5,440.5	6,293.7
– Loans and advances granted	3,051.2	1,484.8
– Interest receivable	29.9	21.6
– Other assets	5.4	5.4
 Total liabilities	 7,405.5	 7,042.7
– Deposits received	7,356.4	6,954.6
– Financial assets sold for repurchase	–	45.4
– Deferred revenue	8.7	5.5
– Other payables	40.4	37.2

LETTER FROM VMS SECURITIES LIMITED

In view of the above financial highlights, given that (i) the revenue and profit of Hisense Finance for the year ended 31 December 2015 had been increased to approximately RMB279.4 million and RMB183.6 million, representing a year-on-year increase of approximately 12.6% and 6.3% respectively, indicating a growing trend of business; (ii) the total assets had been increased to approximately RMB9,075.3 million as at 31 December 2015 from approximately RMB8,708.9 million for the previous year; and (iii) Hisense Finance had been maintaining an increasing trend of current ratio ranging from approximately 52.15% to 79.54% as mentioned above and far exceeded the statutory requirement of 25%, we have no reason to believe that the credit risk to be exposed to the Group in relation to the deposits placed with Hisense Finance would be higher than the credit risk associated with other finance companies.

Given the above factors, we concur with the Directors' views that the default risk by Hisense Finance may not be high in light of its relatively sound financial positions and historical compliance with relevant regulatory requirements.

In assessing the risk control measures adopted by the Group for utilising the deposit service and loan and electronic bank acceptance bill service with Hisense Finance, we have also reviewed the Risk Assessment Reports and discussed with the Management. Based on our review and discussions, we understand that the Group had continuously established the following risk control measures:

- (i) periodically check the deposit balance placed with Hisense Finance and reviewed by the designated treasury staff of the Group;
- (ii) request Hisense Finance to provide monthly deposit transaction record statements to the Group so that the Group can monitor the safety of deposits;
- (iii) request the designated treasury staff of the Group to ask for quotations and terms from other commercial banks for the deposits and electronic bank acceptance bill services that are comparable to the same provided by Hisense Finance in order to ensure that the terms offered by Hisense Finance are not less favourable than other commercial banks; and
- (iv) regularly review the financial statements of Hisense Finance to monitor its financial positions and if there is any extraordinary issues noted (such as the financial positions of Hisense Finance is severely deteriorated), the Group can easily switch to other commercial banks given the non-exclusivity of the Financial Services Agreement.

In view that (i) the above risk control measures; (ii) the continuous compliance of regulatory requirements by Hisense Finance in the past; and (iii) those transactions contemplated pursuant to the Financial Services Agreement had been reviewed by the independent non-executive Directors and the auditor of the Company who had confirmed that they were conducted in the ordinary course of business of the Group and on normal commercial terms and have not exceeded the annual caps, we concur with the Directors' views that the risk control measures implemented by the Group are sufficient to mitigate the default risk arising from the transactions with Hisense Finance.

LETTER FROM VMS SECURITIES LIMITED

In assessing the deposit interest rates offered by Hisense Finance, we have also reviewed the historical sample deposit rates offered by Hisense Finance and other major commercial banks (e.g. China Construction Bank, Industrial and Commercial Bank of China, Bank of China, Bank of Communications and Agricultural Bank of China) and noted that the interest rates offered by Hisense Finance are not less favourable than those offered by the major commercial banks for the deposits with the same type and tenure. As discussed with the Management, we understand that the designated treasury staff will review and compare the interest rates offered by Hisense Finance with the major commercial banks based on the nature and tenure of such deposits (e.g. the time deposits will be reviewed quarterly and the demand deposits will be reviewed monthly).

We also note from the Company's annual reports for each of the three years ended 31 December 2013 to 2015 (the "**Annual Reports**"), the Company had engaged Ruihua Certified Public Accountants (the "**PRC Auditor**") to perform independent audit on the effectiveness of the Company's internal control for the three years ended 31 December 2015 and the PRC Auditor was of the view that the Company had maintained effective internal control related to financial reporting as at 31 December 2013, 2014 and 2015, respectively. In addition, as disclosed in the Annual Reports, those transactions contemplated pursuant to the Financial Services Agreement and other continuing connected transactions had been reviewed by the independent non-executive Directors and the auditor of the Company who had confirmed that they were conducted in the ordinary course of business of the Group and on normal commercial terms and have not exceeded the annual caps. In this regard, we concur with the Directors' views that the scope of checking adopted by the Group as a part of its internal control measures in relation to the deposit service with Hisense Finance shall be sufficient.

As mentioned above, the Group can be beneficial from Hisense Finance's better understanding of the operations of the Group such as more suitable and efficient service to the Group comparing with those offered by other commercial banks in the PRC. In particular, the tailor-made beneficial deposit mix that can specially cater for the Group's funding needs which may not readily available from other commercial banks.

Having considered the above, we concur with the Directors' views that it is fair and reasonable to place deposits with Hisense Finance as the transactions will be conducted in the ordinary and usual course of business of the Company; the default risk of Hisense Finance is not comparably higher than other commercial banks; and the interest rates on deposits offered by Hisense Finance will be not less favourable than those offered by other commercial banks in the PRC to the Group.

Terms of Supplemental Agreement

The term of the Supplemental Agreement shall commence from the date of approval of the Supplemental Agreement by the Shareholders at the EGM until 31 December 2017.

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Revised Annual Cap for deposit service

Under the Supplemental Agreement, the maximum daily closing balance of the deposits placed by the Group with Hisense Finance on any given day for each of the two years ending 31 December 2016 and 2017 shall be revised to RMB3,000,000,000 (inclusive of interest).

Revised Annual Cap for loan and electronic bank acceptance bill service

Under the Supplemental Agreement, the maximum balance of loan and electronic bank acceptance bills provided by Hisense Finance for the Group on any given day for each of the two years ending 31 December 2016 and 2017 shall be revised to RMB4,500,000,000 (inclusive of interest and service fees).

Save and except for the revision of the annual caps as set out above, all other terms and conditions under the Finance Services Agreement shall remain unchanged, the key terms of which were extracted from the Company's circular dated 2 December 2015 as stated below for easy reference:

Pricing of deposit service

The interest rate payable for the Group's deposits with Hisense Finance shall not be lower than the rate payable by normal commercial banks in the PRC for comparable deposits.

Pricing of loan and electronic bank acceptance bill service

The interest rate charged on the loans provided to the Group by Hisense Finance shall not be higher than the rate charged by normal commercial banks to the PRC for comparable loans.

The service fees charged on the provision of electronic bank acceptance bill service by Hisense Finance to the Group shall not be higher than the standard service fees charged by normal commercial banks in the PRC for comparable services.

Other terms

The implementation of the provision of (i) deposit service and (ii) loan and electronic bank acceptance bill service under the Financial Services Agreement (supplemented by the Supplemental Agreement) shall be subject to the definitive contract(s) to be entered into between the Group and Hisense Finance.

The Group may obtain (i) deposit service and (ii) loan and electronic bank acceptance bill service contemplated under the Finance Services Agreement (supplemented by the Supplemental Agreement) from other financial institutions in addition to Hisense Finance, as it sees fit.

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The (i) deposit service and (ii) loan and electronic bank acceptance bill service contemplated under the Finance Services Agreement (supplemented by the Supplemental Agreement) will be conducted in the ordinary and usual course of business of the Company, on normal commercial terms and on terms not less favourable to the Company than terms available from independent third parties.

Based on our review of the principal terms of the Supplemental Agreement as stated above, we consider (i) the non-exclusivity of the financial services to be provided (i.e. the Group has option to obtain such financial services from other financial institutions as it sees fit); and (ii) the condition that the actual terms of such financial services shall not be less favourable than those offered by other normal commercial banks and financial institutions to be the most important terms in safeguarding the interests of the Company and the Shareholders.

On the basis that all the terms and conditions (except for the Revised Annual Caps) under the Financial services Agreement shall remain unchanged that (i) the transactions under the Supplemental Agreement will be conducted in the ordinary and usual course of business of the Group and on terms no less favourable to the Company than terms available from other normal commercial banks and financial institutions; (ii) the non-exclusive arrangement provides the Company with flexibility without any commitment or obligation for the Company to procure such services from Hisense Finance; and (iii) the Group has conducted similar transactions in the past, we are of the view that the terms of the Supplemental Agreement are in the interests of the Company and the Shareholders as a whole, on normal commercial terms and fair and reasonable.

Rationale for determining the Revised Annual Caps

The Revised Annual Caps for each of the two years ending 31 December 2016 and 2017 were determined with reference to (i) the actual amounts paid or received by the Group in relation to (a) deposit service and (b) loan and electronic bank acceptance bill service for the six months ended 30 June 2016; (ii) the requirement for business development of the Group in the remaining term of the Financial Services Agreement; (iii) the historical maximum daily amounts of bank balance and electronic bank acceptance bills amounts recorded by the Group during the first half of 2016; and (iv) the expected improving business operations of the Company in the coming periods. It is estimated that the original annual caps will not be sufficient to meet the current requirement for business development of the Group.

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Deposit service (inclusive of interest)	Loan and electronic bank acceptance bill service (inclusive of interest and service fees)
Original annual cap (a)	RMB1,500,000,000
Historical actual amount incurred (being maximum daily balance from 1 January 2016 to 30 June 2016) (b)	RMB1,498,000,000
Actual utilization rate (b/a)	99.9%
Historical maximum daily amount of bank balance and electronic bank acceptance bill balance for the period from 1 January 2016 to 30 June 2016 (c)	RMB2,500,000,000
Revised Annual Caps (d)	RMB3,000,000,000
Buffer for the Revised Annual Caps (c/d-1)	16.7%
	15.6%

As disclosed in the Letter from the Board, due to the Company's accelerated capital circulation resulting from better inventory turnaround and receivable collection and better receivable collection, the maximum daily balance of the monetary capital (which represents the maximum daily bank balances of the Group) has reached RMB2,500 million during the first half of 2016 (which was much higher than the annual cap of RMB1,500 million in respect of the deposit service that can be placed by the Group with Hisense Finance under the Financial Services Agreement), resulting in a lot of capital being placed with other third parties. Furthermore, due to the accelerated capital circulation as stated above, the Company has increasing needs to procure Hisense Finance to provide electronic bank acceptance bill service.

As advised by the Management, the usage of electronic bank acceptance bill service is directly related to the notes payables amount which was mainly arisen from the Group's purchases. The Group mainly utilizes the electronic bank acceptance bill service with Hisense Finance as the Group can better manage its capital given the long-term business relationship with Hisense Finance, better understanding of the Group's operations, efficient processing time and less handling and service fees charged by Hisense Finance. As disclosed in the 2015 Annual Report, the Company and its subsidiaries did not have any loan balance but notes payables of approximately RMB1,862.1 million with Hisense Finance which represents approximately 63.5% of the total notes payables as at 31 December 2015. In the first half of 2016, the Group's need for electronic bank acceptance bill services reached the maximum daily amount of approximately RMB3,800 million. However, due to the limitation on the existing annual cap of RMB3,000 million in respect of loan and electronic bank acceptance bill service under the Financial Services Agreement, the Company had to resort to other financial solution, including but not limited to immediate repayment to the counterparties, arrange short-term bank facilities for settlement and the indorsement of physical cheques for payment, resulting in the Company's loss of certain revenue from capital as the Group suffered from relative shorter credit periods for the above-mentioned

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settlement methods. Therefore, based on the actual situation in the first half of 2016, the Company needs to enter into the Supplemental Agreement with Hisense Finance in order to adjust upward the annual caps of the (i) deposit service and (ii) loan and electronic bank acceptance bill service to ensure optimal utilisation by the Group of the relevant services provided by Hisense Finance to facilitate the business development of the Group.

Since the maximum daily amount of the Group's bank balance and electronic bank acceptance bill balances reached RMB2,500 million and RMB3,800 million respectively, during the first half of 2016 and given the existing annual caps not being sufficient to cover the current and future business needs of the Group resulting from the expected improvement on industry, the Group may suffer from less favourable deposit interest rates and higher transaction costs and handling fees offered by other commercial banks. In this regard, we are of the view that it is commercially justifiable to adjust the annual caps to cater for the increasing needs of the relevant services.

Based on the Company's 2015 Annual Report and the 2016 Interim Results, (i) the net cash flow from operating activities improved from net cash outflow of approximately RMB199.2 million for the six months ended 30 June 2015 to net cash inflow of approximately RMB1,066.7 million for the six months ended 30 June 2016; (ii) the cash received from product sales and rendering of services had significantly increased from approximately RMB6,227.8 million for the six months ended 30 June 2015 to approximately RMB9,029.7 million for the six months ended 30 June 2016; and (iii) the operating revenue will be increased from approximately RMB23,471.6 million for the year ended 31 December 2015 to approximately RMB26,246.0 million annualized for the year ending 31 December 2016, based on the revenue recorded for the six months ended 30 June 2016. The above financial information is consistent with the Management's representation on the driving factors leading to the high actual utilization rate for the original annual caps for the (i) deposit service and (ii) loan and electronic bank acceptance bill service for the six months ended 30 June 2016. The fact of the nearly full-utilization of the original annual caps speaks for itself in relation to the genuine need for the upward revision of the annual caps for the relevant services.

As disclosed in the 2016 Interim Results, the Group's cash at bank and on hand had further increased to approximately RMB2,086.5 million as at 30 June 2016, representing an increase of approximately 105.7% as compared to the amount as at 31 December 2015. The Group's notes payables had also increased by approximately 51.6% to approximately RMB4,444.5 million as at 30 June 2016 comparing to the same amount as at 31 December 2015. Given the increased cash and bank balance and notes payables, it is not unusual to expect that the Group's demand for deposit service and loan and electronic bank acceptance bill service with Hisense Finance will be increased.

Furthermore, the Management expects that the market of home electrical appliances in China will be improved for the remaining period of 2016 and enhance the business of the Company and the turnaround of the Company's inventories is expected to be improved. According to the National Bureau of Statistics of China, the gross domestic product ("GDP") for the first half of 2016 was approximately RMB34,063.7 billion, representing an increase of approximately 6.7% from the corresponding period of the last year. For retail sales of consumer goods, for the first half of 2016, it rose approximately 10.3% year-on-year

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to approximately RMB15,613.8 billion. The sales amount of home electrical appliances and audio and visual equipment for the first half of 2016 was approximately RMB407.6 billion, representing a year-on-year increase of approximately 7.3%. The above market data on GDP consumption and retail sales indicates a positive economic landscape for the industry which provides a reasonable ground for the above Management's expectation. The optimistic expectation on the home electrical appliance market future entails the need to adjust upward for the annual caps for the deposit service and the loan and electronic bank acceptance bill service.

Based on the historical amount in need for deposit service and loan and electronic bank acceptance bill service for the first half of 2016 and the Revised Annual Caps, the buffer for the Revised Annual Caps for the (i) deposit service was 16.7%; and (ii) loan and electronic bank acceptance bill service was 15.6%. Given the historical increase in bank balances and notes payables as well as the expected positive outlook for the industry, we consider that the buffer for the Revised Annual Caps in a level of roughly 20% is acceptable and the amount for the Revised Annual Caps were reasonable but not excessive.

RECOMMENDATION

Based on the above, we are of the opinion that the transactions contemplated under the Supplement Agreement are (i) with fair and reasonable terms; (ii) on normal commercial terms or better and in the ordinary and usual course of business of the Group; and (iii) in the interests of the Company and the Shareholders as a whole. Accordingly, we recommend the Independent Board Committee advising the Shareholders to vote in favour of the relevant resolution to approve the Supplemental Agreement (stipulating the Revised Annual Caps) and the transactions contemplated thereunder at the relevant general meeting of the Company.

Yours faithfully
For and on behalf of
VMS Securities Limited
Nick Man
Managing Director Corporate Finance

Note: Mr. Nick Man is a licensed person registered with the Securities and Futures Commission and regarded as a responsible officer of VMS Securities Limited to carry on Type 6 (advising on corporate finance) regulated activity under the SFO. Mr. Nick Man has over 10 years of experience in the corporate finance industry and has participated in the provision of independent financial advisory services for connected transactions involving companies listed in Hong Kong.

1. FINANCIAL INFORMATION OF THE GROUP

Financial information of the Group for each of the three financial years ended 31 December 2013, 2014 and 2015 are disclosed in the following documents which have been published on the websites of the Stock Exchange (www.hkex.com.hk) and the Company (<http://www.kelon.com>):

- (a) on pages 61 to 191 of the annual report for the year ended 31 December 2013 published on 24 April 2014;
- (b) on pages 63 to 203 of the annual report of the Company for the year ended 31 December 2014 published on 22 April 2015; and
- (c) on pages 69 to 199 of the annual report of the Company for the year ended 31 December 2015 published on 20 April 2016.

2. INDEBTEDNESS

As at the close of business on 31 July 2016, being the latest practicable date for the purpose of ascertaining the information contained in this indebtedness statement prior to the printing of this circular, the Group had outstanding bank loan of approximately RMB159,460,000, which is secured by a charge against certain factories, machinery and land use rights of the Group and the assets of the subsidiaries of the Company. The bank loan is not guaranteed by third parties.

Save as aforesaid or as otherwise disclosed herein, and apart from intra-group liabilities, the Group did not have any debt securities issued and outstanding, or authorised or otherwise created but unissued, any other term loans, any other borrowings or indebtedness in the nature of borrowing (including but not limited to bank overdrafts and liabilities under acceptance), acceptance credits, finance lease or hire purchase commitments, which are either guaranteed, unguaranteed, secured or unsecured, any other mortgages and charges or any other material contingent liabilities or guarantees.

3. WORKING CAPITAL

The Directors are of the opinion that, after due and careful enquiry, taking into account the effect of the transactions contemplated under the Supplemental Agreement and the cash flow generated from the operating activities, financial resources available to the Group, including internally generated funds and the available credit financing, the Group has sufficient working capital to meet its requirements for at least the next 12 months from the date of this circular, in the absence of unforeseeable circumstances.

4. FINANCIAL AND TRADING PROSPECTS OF THE GROUP

As at 31 December 2015, unfavourable factors such as global economic slowdown, sluggish demand, increasing downward pressure on the economy, high inventory level in the industry, slower growth in the real estate market, etc. continued affecting the development of the white goods industry. Both the sales volume and amount of refrigerators and air-conditioners have decreased and the difficult operating condition for white goods enterprises continued. As consumers have high demand for product function, quality and design, “demand for improvement” has undoubtedly become the new growth point in the demand for household appliances market. Therefore, accompanying the development in mobile internet technologies and the upgrading of public consumption demand, “living room economics” has become the consensus for development of various white goods enterprises. White goods are further heading towards intelligentization, artization and high-end development. The Company upheld the operating directions of “building product advantages, enhancing sales capability, improving service quality, improving system efficiency and ensuring scale and efficiency” in performing various tasks. However, due to influence of factors such as weak market demand, high inventory level of the air-conditioner industry, slow improvement in the qualities of the Company’s channels and inadequate optimization of product structure, the economies of scale of the Company showed a decline.

In 2016, the Company will firmly uphold the operating strategies of “adhering to high-end awareness, highlighting product advantages, consolidating market network, enhancing system efficiency, exploring international market and ensuring economies of scale” to capture the opportunities of sector technical upgrades and functional upgrades of products in order to strive for steady increase in its scale, performance and market share through implementation of the followings: to adhere to the development strategy of high-end products and highlight the advantage of product differentiation; to increase the sales capability; to take “customer satisfaction” as our fundamental starting point, set appraisal indicators of process and improve the NPS management system; to strive to expand the overseas market; to continue the work of improving production efficiency; strictly control overdue account receivables and abnormal appropriation, reduce capital risk, accelerate capital flow and strengthen cost control.

1. RESPONSIBILITY STATEMENT

This circular, for which the Directors collectively and individually accepts full responsibility, includes particulars given in compliance with the Hong Kong Listing Rules for the purpose of giving information with regard to the Company. The Directors, having made all reasonable enquires, confirm that to the best of their knowledge and belief the information contained in this circular is accurate and complete in all material respects and not misleading or deceptive, and there are no other matters the omission of which would make any statement contained herein or this circular misleading.

2. DISCLOSURE OF INTERESTS

Interests of Directors, supervisors and chief executive of the Company in the securities of the Company

As at the Latest Practicable Date, the interests and short positions of the Directors, supervisors and chief executive of the Company in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which he was taken or deemed to have under such provisions of the SFO) or which were required, pursuant to section 352 of the SFO, to be entered in the register maintained by the Company referred to therein, or which were required pursuant to the Model Code for Securities Transactions by Directors of Listed Companies of the Hong Kong Listing Rules (the “**Model Code**”) to be notified to the Company and the Stock Exchange were as follows:

Long position in the Shares

Name of Director/ Supervisor	Nature of interest	Number of A Shares	Approximate percentage of issued A Shares (%)	Approximate percentage of total issued share capital of the Company (%)
Mr. Tang Ye Guo	Beneficial owner	831,600	0.092	0.061
Mr. Jia Shao Qian	Beneficial owner	539,060	0.060	0.040
Mr. Wang Yun Li	Beneficial owner	52,120	0.006	0.004

Save as disclosed above, as at the Latest Practicable Date, none of the Directors, supervisors and chief executive of the Company had interests and short positions in the shares, underlying shares and/or debentures (as the case may be) of the Company or any of its associated corporations (within the meaning of the SFO) which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which any such Director, supervisor or chief executive was taken or deemed to have under such provisions of the SFO) or which were required pursuant to section 352 of the SFO, to be entered into the register maintained by the Company referred to therein or which were required, pursuant to the Model Code to be notified to the Company and the Stock Exchange.

Other interests

As at the Latest Practicable Date:

- (a) none of the Directors or supervisors of the Company had any interest, direct or indirect, in any asset which have been, since 31 December 2015, being the date to which the latest published audited financial statements of the Group were made up, acquired or disposed of by or leased to any member of the Group or which were proposed to be acquired or disposed of by or leased to any member of the Group;
- (b) none of the Directors or supervisors of the Company was materially interested in any contract or arrangement entered into by any member of the Group subsisting as at the Latest Practicable Date and which was significant in relation to the business of the Group; and
- (c) Mr. Tang Ye Guo, Mr. Lin Lan, Mr. Liu Hong Xin and Mr. Dai Hui Zhong, being Directors, are also directors or senior management of Hisense Group or some of its subsidiaries. Hisense Group was deemed to have an interest in the Shares which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO.

3. SERVICE AGREEMENTS

As at the Latest Practicable Date, none of the Directors or supervisors of the Company had any existing or proposed service contract with any member of the Group (excluding contracts expiring or determinable by the Group within one year without payment of compensation (other than statutory compensation)).

4. COMPETING BUSINESS

As at the Latest Practicable Date, the following Directors or their respective close associates had interests in the following businesses which were considered to compete or were likely to compete, either directly or indirectly, with the businesses of the Group other than those businesses where the Directors were appointed as directors to represent the interests of the Company and/or the Group pursuant to the Hong Kong Listing Rules:

Name of Director	Name of entity which business is considered to compete or likely to compete with the business of the Group	Description of business of the entity which is considered to compete or likely to compete with the business of the Group	Nature of interest of the Director in the entity
Mr. Tang Ye Guo	The subsidiaries of Hisense Group	Production of air-conditioning/ electrical products	Director
Mr. Lin Lan	Hisense Group or Hisense Electric Co., Ltd.	Production of air-conditioning/ electrical products	Director and/or senior management
Mr. Liu Hong Xin	Hisense Group or Hisense Electric Co., Ltd.	Production of air-conditioning/ electrical products	Director and/or senior management
Mr. Dai Hui Zhong	Hisense Group or Hisense Electric Co., Ltd.	Production of air-conditioning/ electrical products	Director and/or senior management

As at the Latest Practicable Date, save as disclosed above, none of the Directors or their respective close associates had interests in the businesses which competed or were likely to compete, either directly or indirectly, with the businesses of the Group.

5. LITIGATION

As at the Latest Practicable Date, there was no litigation, arbitration or claims of material importance known to the Directors to be pending or threatened by or against the Company or any member of the Group.

6. MATERIAL CONTRACTS

During the two years immediately preceding the date of this circular, no contract (not being contracts entered into in the ordinary course of business) has been entered into by the Company and/or members of the Group and is or may be material.

7. NO MATERIAL ADVERSE CHANGE

As at the Latest Practicable Date, none of the Directors was aware of any material adverse change in the financial or trading position of the Group since 31 December 2015 (being the date to which the latest published audited financial statements of the Group were made up).

8. EXPERT

The following sets out the qualifications of the expert which has given its opinion or advice as contained in this circular:

Name	Qualifications
VMS Securities Limited	a corporation licensed under the SFO to carry out Type 1 (dealing in securities), Type 4 (advising on securities), Type 6 (advising on corporate finance) and Type 9 (asset management) regulated activities under the SFO

As at the Latest Practicable Date, the Independent Financial Adviser:–

- (a) did not have any shareholding in any member of the Group or any right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in any member of the Group;
- (b) did not have any interest, direct or indirect, in any assets which have been, since 31 December 2015, being the date to which the latest published audited financial statements of the Group were made up, acquired or disposed of by or leased to any member of the Group, or which were proposed to be acquired or disposed of by or leased to any member of the Group; and
- (c) has given and has not withdrawn its written consent to the issue of this circular with the inclusion of and references to its name and letter in the form and context in which they are included.

The letter of advice given by the Independent Financial Adviser to the Independent Board Committee and the Shareholders are given as of the date of this circular for incorporation herein.

9. GENERAL

- (a) The registered office of the Company is at No. 8 Ronggang Road, Ronggui, Shunde, Foshan, Guangdong Province, the PRC. The Company's head office and principal place of business in Hong Kong is situated at Room 3101-05, Singga Commercial Centre, No. 148 Connaught Road West, Hong Kong.

- (b) The secretary of the Company is Ms. Wong Tak Fong, who is a fellow member of the Hong Kong Institute of Chartered Secretaries and the Institute of Chartered Secretaries and Administrators in the United Kingdom, a certified tax adviser and a fellow member of the Taxation Institute of Hong Kong. She acted as the managing director of General Bright Consultants Ltd. since November 1994 to May 2014. She has been the chief financial controller of DIAMOND DRAGON FASHION LTD (星薈亞洲有限公司) since December 2010.
- (c) In case of inconsistency, the Chinese text of this circular shall prevail over its English text.

10. DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents are available for inspection at the Company's principal place of business in Hong Kong at Room 3101-05, Singga Commercial Centre, No. 148 Connaught Road West, Hong Kong during normal business hours from the date of this circular up to and including 15 October 2016:

- (a) the articles of association of the Company;
- (b) the letter from the Independent Financial Adviser dated 8 September 2016;
- (c) the letter from the Independent Board Committee dated 8 September 2016;
- (d) the Financial Services Agreement;
- (e) the Supplemental Agreement;
- (f) the resolutions passed by the ninth session of the Board on 3 August 2016;
- (g) the prior approval and independent opinion of the independent non-executive Directors dated 3 August 2016 in relation to the connected transaction;
- (h) the annual reports and consolidated audited accounts of the Company for the two years ending 31 December 2015;
- (i) the consent letter issued by the Independent Financial Adviser referred to in the paragraph headed "Expert" in this appendix; and
- (j) this circular.