THIS CIRCULAR IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION

If you are in any doubt as to any aspect of this circular, you should consult your stockbroker or other registered dealer in securities, bank manager, solicitor, professional accountant or other professional adviser.

If you have sold or transferred all your shares in Chigo Holding Limited, you should at once hand this circular to the purchaser or transferee or to the bank, stockbroker or other agent through whom the sale or transfer was effected for transmission to the purchaser or transferee.

CHIGO

CHIGO HOLDING LIMITED
志高控股有限公司

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 449)

MAJOR AND CONNECTED TRANSACTION
DISPOSAL OF CERTAIN SHARES IN A SUBSIDIARY

Date: 19 July 2019

CONTENTS

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

"Board"	the board of Directors
"Chigo Precision"	廣東志高精密機械有限公司 (Guangdong Chigo Precision Machinery Co., Ltd*), a company established in the PRC with limited liability and an indirect wholly-owned subsidiary of the Company
"Company"	Chigo Holding Limited, a company incorporated in the Cayman Islands with limited liability, the ordinary shares of which are listed on the main board of the Stock Exchange
"Conditions Precedent"	has the meaning ascribed to it under the section headed "2. Sale and Purchase Agreement – Conditions precedent" of the "Letter from the Board" contained in this circular
"connected person"	has the meaning ascribed thereto under the Listing Rules
"Director(s)"	the director(s) of the Company
"Disposal"	the proposed disposal of the Sale Shares by the Vendor to the Purchasers pursuant to the terms of the Sale and Purchase Agreement
"FE Leasing"	International Far Eastern Leasing Co., Ltd.
"Group"	the Company and its subsidiaries
"HK$"	Hong Kong dollars, the lawful currency of the Hong Kong Special Administrative Region of the PRC
"Independent Third Party"	any party who is not a connected person of the Company and is independent of the Company and its connected person(s)
"JHY Co"	Foshan City Jin He Yi Investment Development Co., Ltd.* (佛山市金和益投資發展有限公司), a limited liability company established in the PRC and a holder of 30% of the issued share capital of the Target Co as at the date of the Sale and Purchase Agreement
"Kechuang"	廣東志高科創銅業有限公司 (Guangdong Chigo Kechuang Copper Co., Limited*), a company established in the PRC with limited liability and an indirect wholly-owned subsidiary of the Company

"Latest Practicable Date"	16 July 2019, being the latest practicable date prior to the printing of this circular for ascertaining certain information contained herein
"Listing Rules"	the Rules Governing the Listing of Securities on the Stock Exchange
"Ms. Ma"	Ma Junxia* (馬俊霞)
"Mr. Tong"	Tong Zhijun* (童志軍)
"Mr. Wang"	Wang Feng* (王峰)
"Mr. Zhang"	Zhang Quan* (張權), a PRC individual
"Parties"	the Vendor and the Purchasers
"Ping An Leasing (Tianjin)"	Ping An International Financial Leasing (Tianjin) Co., Ltd.
"PRC"	the People's Republic of China
"Purchasers"	JHY Co, Ms. Ma, Mr. Tong and Mr. Wang, and Purchaser shall refer to any one of them
"RMB"	Renminbi, the lawful currency of the PRC
"Sale and Purchase Agreement"	the sale and purchase agreement dated 30 March 2019 and entered into between the Parties in relation to the sale of the Sale Shares from the Vendor to the Purchasers
"Sale Shares"	80,000,000 shares in the capital of the Target Co, representing 40% of the issued share capital of the Target Co as at the date of the Sale and Purchase Agreement
"SFO"	the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong)
"Share(s)"	ordinary share(s) of HK$0.01 each in the share capital of the Company
"Shareholder(s)"	the holder(s) of the Share(s)
"Sinopharm Leasing"	Sinopharm Holding (China) Finance Leasing Co., Ltd.
"Stock Exchange"	The Stock Exchange of Hong Kong Limited

"Target Co"	廣東志高暖通設備股份有限公司 (Guangdong Chigo Heating & Ventilation Equipment Co., Ltd.*), a limited company incorporated in the PRC which is held as to 70% by the Vendor prior to completion of the Disposal
"Vendor"	廣東志高空調有限公司 (Guangdong Chigo Air-conditioning Co., Limited*), a company established in the PRC with limited liability and an indirect wholly-owned subsidiary of the Company
"Yaoda Leasing"	廣東耀達融資租賃有限公司 (Yaoda Finance Lease Co., Ltd.*)
"%"	per cent.

* *The English translation is provided for identification purpose only.*

For the purposes of this circular, conversion of RMB into HK$ is based on the approximate exchange rate of HK$1.00 to RMB0.858 for the purpose of illustration only.

CHIGO

CHIGO HOLDING LIMITED
志高控股有限公司

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 449)

Executive Directors:
Mr. Li Xinghao *(Chairman and Chief Executive Officer)*
Ms. Li Xiuhui
Ms. Huang Guijian
Mr. Yang Xiangwen

Independent non-executive Directors:
Mr. Zhang Xiaoming
Mr. Wang Manping
Mr. Pan Mingjun

Registered Office:
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Greenfield Tower (South Tower)
Concordia Plaza
1 Science Museum Road
Tsimshatsui, Kowloon
Hong Kong

19 July 2019

To the Shareholders

Dear Sir or Madam,

MAJOR AND CONNECTED TRANSACTION
DISPOSAL OF CERTAIN SHARES IN A SUBSIDIARY

Reference is made to the announcement of the Company dated 31 March 2019 in relation to the Disposal.

1. INTRODUCTION

The Board announced that on 30 March 2019, the Vendor, an indirect wholly-owned subsidiary of the Company, entered into the Sale and Purchase Agreement with JHY Co, Mr. Wang, Ms. Ma and Mr. Tong pursuant to which the Vendor has conditionally agreed to sell, and the Purchasers has agreed to purchase, 40% of the issued share capital of the Target Co together at an aggregate consideration of RMB204 million (equivalent to approximately HK$237,762,000).

The Disposal constitutes a major transaction of the Company under Chapter 14 of the Listing Rules, and is subject to the applicable reporting, announcement and shareholders' approval requirements. The Company has obtained a written approval from Chigo Group Holding Limited, being the controlling Shareholder interested in 4,322,234,210 Shares (representing approximately 51.25% of the issued Shares as at the Latest Practicable Date) pursuant to Rule 14.44 of the Listing Rules for approving the Disposal in lieu of holding a general meeting of the Company.

The Disposal also constitutes a connected transaction between the Group and connected persons at the subsidiary level of the Company on normal commercial terms or better under Chapter 14A of the Listing Rules, and is only subject to the applicable reporting and announcement requirements, but is exempt from the circular, independent financial advice and shareholders' approval requirements pursuant to Rule 14A.101 of the Listing Rules.

The purpose of this circular is to provide you with, among other things, further details of the Disposal and other information in accordance with the Listing Rules.

2. SALE AND PURCHASE AGREEMENT

The principal terms of the Sale and Purchase Agreement are summarised as follows:

Date:	30 March 2019	
Parties:	(1)	the Vendor
	(2)	JHY Co
	(3)	Mr. Wang
	(4)	Ms. Ma
	(5)	Mr. Tong

Assets to be disposed of

The Vendor has conditionally agreed to sell and the Purchasers have agreed to purchase the Sale Shares free from all encumbrances and together with all rights attaching and accruing thereto. The Sale Shares represents 40% of the issued share capital of the Target Co. Further details of the Target Co are set out in the section headed "4. Information on the Target Co" in this letter.

Following completion of the Disposal, the Target Co will be held as to 30% by the Vendor, 55.4% by JHY Co, 8.4% by Mr. Wang, 4.0% by Ms. Ma, and 2.2% by Mr. Tong.

Consideration

The aggregate consideration for the Disposal is RMB204 million (equivalent to approximately HK$237,762,000), which shall be satisfied in the following manner:

(a) the Purchasers has paid the Vendor a sum of RMB102 million (equivalent to approximately HK$118,881,000) in cash on 1 April 2019, which is refundable if the Conditions Precedent referred to below are not satisfied; and

(b) the Purchasers shall pay the Vendor a further sum of RMB102 million (equivalent to approximately HK$118,881,000) in cash within five days after the satisfaction of all the Conditions Precedent referred to below.

The consideration for the Disposal has been determined after arm's length negotiations among the Parties with reference to the audited net asset value of the Target Co as at 31 December 2018.

In determining the consideration of the Disposal, the Parties did not make reference to the price-to-earnings ratio or price-to-book ratio as the basis of consideration. However, taking into account the audited net asset value of the Target Co as at 31 December 2018, the Group's expected unaudited gain of approximately RMB123.0 million as a result of the Disposal, as well as the Group's capital contribution amount of RMB40 million in respect of the Sales Shares upon the formation of the Target Co in 2011, the Board has reached the conclusion that the Disposal represents a satisfactory gain over the acquisition cost of the Company, and that the consideration is fair and reasonable, on normal commercial terms and in the interests of the Company and its shareholders.

Conditions precedent

Completion of the Disposal will only occur upon the satisfaction of the following conditions precedent (the "**Conditions Precedent**"):

(i) all necessary internal approvals of the Disposal having been obtained by the Vendor;

(ii) all relevant procedures and approvals in respect of the Disposal having been completed by the Vendor pursuant to the requirements of the applicable laws;

(iii) all necessary arrangements in respect of operations the Target Co having been executed between the Vendor and the Target Co; and

(iv) the procedures of registration at the relevant authorities in respect of the Disposal having been completed.

If any of the above conditions have not been fulfilled within 60 days after the signing of the Sale and Purchase Agreement, the Sale and Purchase Agreement shall cease and determine and no party to the Sale and Purchase Agreement shall have any obligations and liabilities towards each other thereunder save for any antecedent breaches of the Sale and Purchase Agreement.

3. INFORMATION ON THE PURCHASERS

JHY Co is a company incorporated in the PRC with limited liability. It is principally engaged in investment holdings. JHY Co is a holder of 30% of the issued share capital of the Target Co as at the date of the Sale and Purchase Agreement. JHY Co is also wholly-owned by Mr. Zhang (the chief executive officer and deputy chairman of the board of the Target Co) and his spouse. As such, JHY Co is a subsidiary-level connected person of the Company.

Mr. Wang is a PRC individual and is a director of the Target Co, and is therefore a subsidiary-level connected person of the Company.

Ms. Ma is a PRC individual and is a director of the Target Co, and is therefore a subsidiary-level connected person of the Company.

Mr. Tong is a PRC individual and is a supervisor of the Target Co, and to the best of the Directors' knowledge, information and belief, having made all reasonable enquiries, is an Independent Third Party.

4. INFORMATION ON THE TARGET CO

As at the date of the Sale and Purchase Agreement, the Target Co is held as to 70% by the Vendor and as to 30% by JHY Co. Following completion of the Disposal, the Target Co will be held as to 30% by the Group, 55.4% by JHY Co, 8.4% by Mr. Wang, 4.0% by Ms. Ma, and 2.2% by Mr. Tong, and the Target Co will no longer be accounted for as a subsidiary in the consolidated financial statements of the Company.

The Target Co is a company incorporated in the PRC with limited liability. It is principally engaged in the commercial air-conditioning business. A capital contribution amount of RMB40 million was paid by the Vendor into the Target Co in respect of the Sale Shares upon the formation of the Target Co in 2011.

Set out below is a summary of certain financial information of the Target Co for the year ended 31 December 2018 (audited) and the year ended 31 December 2017 (audited) (prepared in accordance with the generally accepted accounting principles in the PRC):

	For the year ended 31 December 2018 *(RMB'000)* (audited)	**For the year ended 31 December 2017** *(RMB'000)* (audited)
Net profit (before taxation)	75,935	75,075
Net profit (after taxation)	64,628	63,814

The audited net asset value of the Target Co attributable to the Sale Shares (prepared based on the generally accepted accounting principles in the PRC) as at 31 December 2018 is approximately RMB81.0 million.

5. FINANCIAL EFFECT OF THE DISPOSAL

As a result of the Disposal, the Group is expected to record an unaudited gain on the Disposal of approximately RMB123.0 million, which is calculated on the basis of a comparison between the consideration for the Disposal and the audited net asset value of the Target Co attributable to the Sale Shares as at 31 December 2018. Please refer to the section headed "6. Reasons for and benefits of the Disposal" in this letter for more information.

Upon completion of the Disposal, the Target Co will cease to be a subsidiary of the Company and its assets and liabilities and profits and losses will no longer be consolidated into the consolidated financial statements of the Company. Based on the unaudited management accounts of the Company, the Group is expected to derecognized total assets of approximately RMB797 million and total liabilities of approximately RMB668 million (subject to audit and adjustments) upon completion of the Disposal.

6. REASONS FOR AND BENEFITS OF THE DISPOSAL

The Company is an investment holding company and the Group is principally engaged in the design, development, manufacturing and sale of air-conditioning products, which comprise mainly of residential air-conditioners, commercial air-conditioners, as well as parts and components of air-conditioners and other small electrical appliances.

As demands for air-conditioners are usually higher during summer each year, the Group faces a higher pressure to increase production prior to such domestic peak season in order to capture the relevant sales opportunities. In order to facilitate production prior to the domestic peak season and to meet the overseas orders, the Group normally experiences temporarily higher funding requirements in the summer each year. Currently, the Group has financed its working capital requirements through different arrangements including bank loans, discounted bills receivable from customers to financial institutes and finance leases. Whilst the Board anticipates that capital requirement for the upcoming peak season is in fact comparable to that for the previous year, the decline in the retail sales volume and retails sales amount of the industry as a whole in the second half of 2018 is expected to result in a longer recovery period of the existing trade receivables from the Group's customers, which would in turn affect the level of the cash balance of the Group in recent months. Although the Board will continue to pursue such other alternatives to strengthen the funding position of the Group, considering the unsatisfactory performance of the Group in 2018 and the current market conditions, the Board anticipates that financial institutes will be reluctant to increase banking facilities to the Group and hence such alternatives may attract higher financial costs, and may take time for the Company to negotiate for satisfactory terms. On the other hand, the Purchasers of the Disposal, being existing shareholder and/or members of the management of the Target Co, are familiar with the operations of the Target Co and the Group was able to negotiate, on an arms' length basis, acceptable terms of the Disposal on a short period of time.

Against such background, the Group intends to apply the net proceeds from the Disposal as general working capital, which, the Board considers, presents a good opportunity for the Group to strengthen its funding position and improve its liquidity and flexibility in the interim period prior to the peak season, and in turn, prepare the Group in meeting the funding requirements of the upcoming air-conditioning sales peak season. In addition, the Group is able to realise part of its investments through the Disposal, which, the Board considers, by taking into account abovementioned unaudited gain as a result of the Disposal, represents a satisfactory gain over the acquisition cost of the Target Co. The Board also expects that, by retaining the remaining 30% of the issued share capital of the Target Co, the Group would be able to continue to enjoy return and synergy effect from the operation and growth of the Target Co.

Based on the unaudited management accounts of the Company, the Group's current assets and cash balances as at 31 March 2019 amounted to approximately RMB6,125 million and RMB335 million, respectively. The customers of the Group's residential air-conditioners are mainly retail chain operators, distributors and resellers, and the Group normally allows credit periods of between 30 and 180 days, depending upon their relationship with the Group and credit history. Whilst the Board considers, on the assumption that the Group's expected funding requirement for the coming 12 months will be up to approximately 300 million, that its existing cash balance is sufficient to meet with the Group's funding requirement of the upcoming sales peak season, in view of a decline in the retail sales volume and retail sales of the industry as a whole amount in the second half of 2018, such retail chain operators, distributors and resellers also face a challenging business environment, and thus the Board expects that there will be a longer recovery period of the Group's existing trade receivables, in particular, in recent months. Hence, in-line with the funding policy of the Group which is to secure sufficient funding to meet its working capital requirements and to maintain smooth operations, the Board considers that the sale proceeds from the Disposal would strengthen the Group's funding position and increase the Group's flexibility in meeting the funding requirements of the up-coming air-conditioning sales peak season.

The Company intends to apply the proceeds of the Disposal in the following manner:

- approximately 90% of the net proceeds (approximately RMB183.6 million) will be used for the purchase of raw materials for production purposes

- approximately 10% of the net proceeds (approximately RMB20.4 million) will be used to settle operating expenses and other expenses

The sales of residential air-conditioners and commercial air-conditioners accounted for approximately 78.7% and 21.3%, respectively, of the total sales of air-conditioners for the year ended 31 December 2018. Although the commercial air-conditioning business recorded a net profit of RMB65 million in 2018, the residential air-conditioning products continue to be the major source of income of the Group. According to an independent research report on the central air-conditioning industry in 2018 in the PRC, Chigo's market share in the Chinese central air-conditioning industry market is about 1.07% and ranked 18th among the regional brands for the year ended 31 December 2018. According to the said report, the leading position of the top brands was even further strengthened in 2018. Model companies of Chinese brands have shown a high-profile development trend in recent years, in respect of technology, products, after-sale services and brand image. Although the said report also mentioned that Chigo achieved a significant breakthrough in 2018, the Directors believe that the current market share of the Group in the commercial air-conditioning market is still lower than those of the mainstream brands, therefore, if the Target Co was not sold, the Group might need to invest a lot of resources to further enhance its brand awareness. According to the abovementioned research report, compared with 10.60% in 2016 and 17.24% in 2017, China's central air-conditioning market has a growth rate of only 4.88% in 2018. The homogenization of central air-conditioning products has seriously led to the low profit of dealers and the pressure on dealers to survive. In the case of a sluggish retail market, some brands adopt price reduction strategies to stimulate the market, but the effect is not obvious, which also leads to a further compression of channel profits and increasingly fierce market competition. In the case of rising costs, for the dealers, the profit of many commercial air-conditioning products is getting thinner.

According to the Company's annual reports, the gross profit margin of the Group's commercial air-conditioning segment for the four years ended 31 December 2018 were: 2015: 28.8%, 2016: 27.9%; 2017: 23.9% and 2018: 21.9%, respectively. The Board also notes that the profit margin of the Group's commercial air-conditioning products has been declining in recent years. It is expected that a lot more resources will be needed for the commercial air-conditioning business to stay competitive. In comparison, the Group has economies of scale in the manufacture of residential air conditioners and a wide coverage of the sales network. In view of the uncertainty of the global economic environment which will inevitably continue to bring fluctuations to the air-conditioning industry, the Board considers it important for the Group to focus its resources on its main business, namely, the development, manufacturing and sale of residential air-conditioning products. In light of the above, the Board decided to place the focus of the Group's future development in the residential air conditioning sector, which, together with the prospect of replenishing liquidity of the Group as set out above, lead to its decision of the Disposal.

In light of the above, the Directors (including the independent non-executive Directors) considers that the terms of the Sale and Purchase Agreement are fair and reasonable, on normal commercial terms, and in the interests of the Company and the Shareholders as a whole.

7. LISTING RULES IMPLICATIONS

As the highest applicable percentage ratio calculated in accordance with the Listing Rules in respect of the Disposal is more than 25% but all of which are less than 75%, the Disposal constitutes a major transaction of the Company under the Listing Rules. Further, given that JHY Co, Ms. Ma and Mr. Wang are, as detailed in the section headed "3. Information on the Purchasers" in this letter, subsidiary-level connected persons of the Company under Chapter 14A of the Listing Rules, the Disposal also constitutes a connected transaction of the Company under Chapter 14A of the Listing Rules.

To the best of the Directors' knowledge, information and belief, having made all reasonable enquiries, no Shareholder has a material interest in the Disposal, and accordingly no Shareholder is required to abstain from voting if the Company were to convene a general meeting for approving the resolution in respect of the Sale and Purchase Agreement and the transactions contemplated thereunder. The Company has obtained a written approval from Chigo Group Holding Limited, being the controlling Shareholder interested in 4,322,234,210 Shares (representing approximately 51.25% of the issued Shares as at the Latest Practicable Date) pursuant to Rule 14.44 of the Listing Rules for approving the Disposal in lieu of holding a general meeting of the Company.

Further, given (i) JHY Co, Ms. Ma and Mr. Wang are connected persons of the Company at the subsidiary level; (ii) the Board has approved the Disposal and considers that the Disposal is on normal commercial terms; and (iii) the independent non-executive Directors have confirmed that the terms of the Disposal are fair and reasonable, on normal commercial terms, and in the interests of the Company and the Shareholders as a whole, the Disposal is exempt from the circular, independent financial advice and shareholders' approval requirements pursuant to Rule 14A.101 of the Listing Rules.

In light of the above, no general meeting of the Company will be convened to approve the Sale and Purchase Agreement and the transactions contemplated thereunder.

8. RECOMMENDATION

The Directors (including the independent non-executive Directors) are of the opinion that the Sale and Purchase Agreement and the transactions contemplated thereunder are fair and reasonable and in the interests of the Company and the Shareholders as a whole. Accordingly, the Board recommends that the Shareholders support, and if a physical general meeting were to be held, vote in favour of the relevant resolution(s) to approve the Disposal. As disclosed above under the section headed "7. Listing Rules implications" in this letter, the Company has obtained a written approval from Chigo Group Holding Limited to approve the Disposal, and hence no general meeting will be convened to approve the Sale and Purchase Agreement and the transactions contemplated thereunder.

9. FURTHER INFORMATION

Your attention is drawn to the additional information set out in the appendices to this circular.

By order of the Board
Chigo Holding Limited
Li Xinghao
Chairman

1. STATEMENT OF INDEBTEDNESS

At the close of business on 31 May 2019, being the latest practicable date for the purpose of ascertaining the indebtedness of the Group prior to the printing of this circular. The Group had outstanding indebtedness as follows:

Bank borrowings, other borrowings, loan from the controlling shareholder, payables to third parties and loan from a related party:

At 31 May 2019, the Group had:

(a) bank borrowings of RMB1,617,867,000 which were unsecured and unguaranteed;

(b) bank borrowings of RMB46,364,000 which were unguaranteed and secured by bank acceptance bills of the Group;

(c) bank borrowings of RMB548,000,000 which were unsecured and guaranteed by controlling shareholder;

(d) bank borrowings related to bills discounted with recourse of RMB534,898,000, which were unguaranteed and secured by bills receivables of the Group;

(e) other borrowings of RMB48,329,000 which were unsecured and unguaranteed;

(f) other borrowing of RMB48,923,000 which was secured by a refundable security deposit of the Group and guaranteed by the Company;

(g) other borrowing of RMB28,016,000 which was secured by a refundable security deposit of the Group and unguaranteed;

(h) loan from the controlling shareholder of RMB110,000,000 which was unsecured and unguaranteed;

(i) payables to third parties of RMB65,000,000 which were unsecured and unguaranteed; and

(j) loan from a related party of RMB20,000,000 which was unsecured and unguaranteed.

Lease liabilities:

As at 31 May 2019, we, as a lessee, had outstanding lease payments which represented undiscounted unpaid lease payments for the remaining terms of relevant lease agreements (excluding our contingent rental arrangements) in an aggregate amount of RMB1,580,941,000, of which RMB218,483,000 is secured by rental deposits and guaranteed by the Company or a subsidiary of the

Company, RMB1,215,095,000 is secured by rental deposits and unguaranteed, RMB5,286,000 is unsecured and guaranteed by the Company, and the remaining RMB142,077,000 is unsecured and unguaranteed.

Financial guarantee:

As at 31 May 2019, the Group provided a financial guarantee in respect of a convertible bond issued by a related party of approximately RMB20,000,000, representing the amount that could be required to be paid if the guarantee was called upon in entirety by the convertible bond holders.

Save as disclosed above and apart from intra-group liabilities, the Group did not have any loan capital issued and outstanding or authorised or otherwise created but unissued, bank overdrafts or other similar indebtedness, liabilities under acceptances (other than normal trade bills), acceptance credits, debentures, mortgages, charges, hire purchase commitments or contingent liabilities at the close of business on 31 May 2019.

The Directors confirm that there are no material changes in the indebtedness or contingent liabilities of the Group since 31 May 2019.

2. WORKING CAPITAL

The Directors have reviewed the Group's cash flow projections which cover a period of not less than twelve months from the date of this circular. The Directors are of the opinion that, after taking into account the cash flows generated from the operating activities, the financial resources presently available to the Group, including available facilities, the assumptions regarding the renewal of financing arrangements of banking facilities, and the estimated net proceeds from the proposed disposal of the properties by the Group to a purchaser pursuant to the terms of the transfer agreement and the relocation compensation agreement entered into by the Group on 21 May 2019, the Group has sufficient working capital for its requirements for at least twelve months from the date of this circular.

3. FINANCIAL AND TRADING PROSPECTS OF THE GROUP

As disclosed in the section headed "6. Reasons for and benefits of the Disposal" of the "Letter from the Board" contained in this circular, the Group is principally engaged in the design, development, manufacturing and sale of air-conditioning products, which comprise mainly of residential air-conditioners, commercial air-conditioners, as well as parts and components of air-conditioners and other small electrical appliances.

As disclosed in the Management Discussion and Analysis section of the Company's 2018 annual report. In the first half of 2018, China's air-conditioning products became more and more popular in the third and fourth-tier markets, and the market saw a continued increase in demand. In China, consumers' demands and choices for air-conditioning products were also more refined than before. Air-conditioning manufacturers took advantage of this opportunity to develop new consumer networks and end-user markets. Through adopting relevant promotional activities and brand publicity means, such products maintained growth in the domestic market, and recorded a year-on-year sales growth compared to last year. However, the air-conditioning product market witnessed a growth slowdown due to two important factors, namely, the lack of widespread hot weather and the underperformance of China's real estate market due to purchase restrictions. The air-conditioning products market witnessed a favourable operating environment at the beginning of 2018. However, after entering the second half, this environment reversed. Due to the continuous control over the real estate market by the Chinese government and the uncertain impact of trade friction between China and the United States, consumers and customers were not optimistic about the market. Consumption intentions and order-placing plans suddenly became cautious and conservative, resulting in a decline in the market performance. Due to the worsening market climate, competition in the air-conditioning industry became increasingly fierce, which generated a pressure on the price of air-conditioning products, resulting in a slight year-on-year decline in annual sales.

In view of the dramatic changes in the business environment in 2018, the domestic sales team of the Group adopted flexible business strategies and continued to adhere to promoting "monthly promotions and weekly discounts" activities, so as to reduce inventories and stimulate sales. The Group also strived to open up new consumer networks and end-user markets, while starting new retail markets at the same time. During the reporting period, in order to promote sales, the Group has implemented a pilot online wholesale strategy in some parts of the country.

As to export of air-conditioning products, according to market data, the Chinese overall market registered a year-on-year growth both in export volume and export sales in 2018.

For the year ended 31 December 2018, the continuous increase in labour costs, raw material costs and logistics costs has caused the Group to increase its export price of air-conditioning products. This has prevented the growth of sales to some extent. In addition, air-conditioning products relied heavily on raw materials. The rising prices of raw materials in China has also increased business risks and pressure. Furthermore, changes in the structure of air-conditioning products, low-price competition among enterprises and other factors have also led to a decline in the average export price. The rising costs and falling export prices have further narrowed air-conditioning export enterprises' profit margins.

Since the beginning of 2018, the fluctuation of RMB exchange rate has brought more challenges to export enterprises. In the short run, the depreciation of RMB (the decline in exchange rate) will bring certain price advantages to the export of household air-conditioning products. In the short run, it can enlarge the profit margin in the export of household air-conditioning products, enhance the international competitiveness of such products, and thus to a certain extent, expand the export volume which may, in turn, increase export orders. However, in the long run, the continued depreciation of RMB will increase the bargaining pressure of export enterprises, which is not conducive to the long-term planning of enterprises, and will cause the cost of overseas importers to rise.

In addition, the uncertainty of the areas to which air-conditioning products were exported during the reporting period, such as political changes in the Middle-East, also hindered the development of the local market, resulting in a year-on-year decline in the volume of air-conditioning products exported to the region.

The main business strategies adopted by the Group in export include (1) giving priority to profits and taking into account the scale of sales; quickly adjusting its price strategy and appropriately reducing orders which will bring loss, especially through strengthening the control over the number of orders from low-price regions; (2) strengthening the products, and maintaining investment. The Group saw a significantly-increased sales share of its new series products. According to the different consumption habits and energy efficiency requirements of the markets of different countries, the Group continuously increased investments in research and development of inverter technology, speeded up research and development of environmentally-friendly refrigerant products, and developed more suitable products for different markets; (3) optimizing the layout to ensure the completion of the key tasks. The Group, in a timely manner, made adjustments to its marketing strategy and market layout to maintain its sales in Latin American and North American markets; (4) enhancing brand image and promoting development. The Group developed more diversified independent brand products to enhance brand influence, which had driven the rise of the gross profit and the increase in original equipment manufacturing ("**OEM**") brand sales; and (5) strengthening internal capability and enhancing management. The Group has always regarded quality as the lifeline of enterprises, and its goal is to create world-class quality. In recent years, through the help of production system and the improvement of product quality system, the quality of the Group's product has improved comprehensively.

Residential air-conditioning products are the major source of income of the Group and accounted for 68.9% of the total revenue for the year ended 31 December 2018. As the average sales prices increased slightly, but the sales volume of residential air-conditioners decreased remarkably during the reporting period, sales of residential air-conditioners of the Group decreased by 20.1% during the year ended 31 December 2018.

Due to the relative increase in the prices of major raw materials and keen market competition during the year ended 31 December 2018, the gross margin of the Group's residential air-conditioning products dropped from 15.2% in 2017 to 10.3% for the reporting period.

During the year ended 31 December 2018, sales volume of the Group's residential air-conditioning products decreased by 21.0% as compared to that of 2017. In total, the Group sold approximately 4,330,000 units/sets of air-conditioners within the reporting period.

As the domestic market conditions reversed and competition in the air-conditioning industry became fiercer during the year, average selling prices of the Group's residential air-conditioning products increased slightly by 1.1%.

For the year ended 31 December 2018, the Group had more than 1,200 domestic and overseas customers. The sales revenue of the top 5 customers accounted for approximately 23.4% of the total revenue.

The market economy in 2019 is still uncertain. In order to respond to this situation, the Group has implemented internal reforms, such as establishing six profit centres and business departments for the purpose of breaking bad habits in product research and development and internal management and optimizing its operation strategy and costs, in order to boost the confidence of the teams and customers in the development of the Group and to prove itself through performance.

As to overseas markets, the Group expects that local trade risks still exist. The adjustment of the tariff policy resulting from Sino-US trade war has a certain negative impact on China's air-conditioning manufacturers. However, China is the global manufacturing centre of the air-conditioning industry. It is expected that China's air-conditioning industry will not be shaken by these trade frictions in this market position. Chinese brands have comprehensive advantages in technology, products, market, pipeline and manufacturing. The development of Sino-US trade frictions has also brought great uncertainty to the fluctuation of exchange rate. Since the beginning of 2019, the RMB has been appreciating, which will increase the pressure on air-conditioning export enterprises.

In order to respond to all the above situations, the Group will increase research and development investment overseas. Also, the Group will focus on standardized, smart and customized air-conditioning products in the future under the technology development trend, which will be increasingly energy-saving and environmentally-friendly. In addition, under the changing macro-demand, the Group will upgrade from its traditional output capacity, foreign exchange earnings, and OEM model to one focusing on self-brand promotion, technological innovation, local adaptation and so on.

The Group will also closely monitor market trends and explore potential business collaboration opportunities with various domestic and international well-known enterprises.

The Directors believe that the Disposal represents an opportunity for the Group to realise part of its investment given the current uncertainties on the global market environment and operation conditions. The Group intends to apply the net proceeds from the Disposal as general working capital, which would enable the Group to strengthen its funding position in anticipation of the upcoming air-conditioning sales peak season. In addition, the Group is able to realise part of its investments through the Disposal, which, the Board considers, by taking into account abovementioned unaudited gain as a result of the Disposal, represents a satisfactory gain over the acquisition cost of the Target Co. The Board also expects that, by retaining the remaining 30% of the issued share capital of the Target Co, the Group would be able to continue to enjoy return and synergy effect from the operation and growth of the Target Co. With a focus on the business development of the residential air-conditioning business and an increase in liquidity of the Group following the Disposal, the Group will re-organise and integrate its supply chain, rectify existing domestic air-conditioning manufacturing lines and production process, and remove redundant and low-efficiency production links to reduce production costs. In addition, in terms of sales, the Group will reorganise customer orders, optimise sales teams, reduce expenses and strive to improve profitability. The Group expects that through the aforementioned measures, the operating performance in respect of residential air-conditioners will improve and in turn lead the Group back on the right track of positive operating income and performance as soon as possible. At present, since it is the traditional peak season for the residential air-conditioning industry, the Group's manufacturing facilities are focused on production and pilling up inventories to meet customers' orders and demand in the next few months. The Directors expect to conduct a comprehensive review of the Group's production facilities and customer base for the residential air-conditioning business after the current refrigeration year (expected to be in the fourth quarter of 2019) with the view to formulating a specific development plan relating to its principal business in the future.

The Group had been conducting a strategic review of the utilisation, potential and value of its non-core and under-utilised assets, in particular with respect to certain parcels of land which constitute non-operating assets of the Group and are currently designated as spare storage capacity and used for warehouse purpose, and had entered into an agreement on the transfer of land use rights on 21 May 2019, further details of which are set out in the Company's announcement dated 21 May 2019. Save as disclosed, the Group has not entered into any agreement, arrangement or undertaking, and has no intention to (i) acquire any new business or (ii) dispose of and/or downsize its existing business or material operating assets.

Market participants are relatively cautious about the short-term situation in the residential air-conditioning market. In 2019, the situation is not optimistic regarding both the external macro environment or the development cycle of residential air-conditioning industry. The total inventory of residential air-conditioning industry reached a new historical high.

Despite the poor market sentiment, the Directors believe that accurately judging and seizing opportunities while avoiding risks will be the key to success in 2019. In view of the volatility of the market in 2019 and the continued impact of the trade war, the sales team of the Group has slightly lowered the marketing growth goal of residential air-conditioning business in 2019, and plans to increase sales by improving product structure and lowering cost, in order to increase average price and gain greater gross margins.

The Directors believe that, after the Disposal and sale of certain non-core assets recently, the Group has obtained sufficient financial resources to cope with and mitigate the short-term market volatility, and allows the Group to execute the aforementioned business strategies of (i) improving product structure to increase average price; and (ii) picking profitable orders and reduce customer bargaining to improve profitability.

On the other hand, with funding in place, the Group could also increase its bargaining power and reduce the risk of unreasonable price increases and interrupted supply by suppliers. By raising prices while reducing procurement costs, the Group's financial performance and profitability are expected to improve accordingly.

For the year ended 31 December 2018, the Group's sales of residential air conditioners segment (including parts and other products) amounted to approximately RMB7,456 million. The Directors believe that, having such a scale of residential air-conditioning business and lower base of gross margin in 2018, the Group's financial performance and profits would be improved through the above plans and business strategies.

1. RESPONSIBILITY STATEMENT

This circular, for which the Directors collectively and individually accept full responsibility, includes particulars given in compliance with the Listing Rules for the purpose of giving information with regard to the Company. The Directors, having made all reasonable enquiries, 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 herein or this circular misleading.

2. DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS IN SECURITIES

As at the Latest Practicable Date, the interests and short positions of the Directors and chief executive of the Company in the shares, underlying shares and debentures of the Company and its associated corporations (within the meaning of Part XV of the SFO) which were required to be (i) notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which the Directors or, the chief executive of the Company were taken or deemed to have under such provisions of the SFO); or (ii) recorded in the register kept by the Company pursuant to section 352 of the SFO; or (iii) notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers contained in the Listing Rules were as follows:

Long positions in the Shares

Name of Director	Capacity	Number of Shares held (1)	Approximate percentage of shareholding (2)
Mr. Li Xinghao	Interest of controlled corporation (3)	4,322,234,210	51.25%
	Beneficial owner	1,494,000	0.02%
Ms. Li Xiuhui	Beneficial owner	25,256,000	0.30%
Ms. Huang Guijian	Beneficial owner	2,700,000	0.03%

Notes:

(1) All the above Shares are held in long position (as defined under Part XV of the SFO).

(2) The percentages disclosed were calculated based on the total number of issued Shares of the Company as at the Latest Practicable Date, i.e. 8,434,178,000 Shares.

(3) Mr. Li Xinghao held 99.46% equity interest in Chigo Group Holding Limited. Under the SFO, Mr. Li Xinghao was deemed to be interested in all the Shares held by Chigo Group Holding Limited.

Long positions in the shares of associated corporation

Name of Director	Associated corporation	Capacity	Number of issued ordinary shares held	Approximate percentage of shareholding
Mr. Li Xinghao	Chigo Group Holding Limited	Beneficial owner	9,946.1036	99.46%

Save as disclosed above, as at the Latest Practicable Date, none of the Directors and chief executive of the Company had any interests or short positions in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which, (a) were required to be notified to the Company and the Stock Exchange pursuant to provisions of Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which the Directors have taken or deemed to have under such provisions of the SFO); or (b) were required, pursuant to section 352 of the SFO, to be entered in the register referred to therein; or (c) were required, pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers contained in the Listing Rules to be notified to the Company and the Stock Exchange.

3. SUBSTANTIAL SHAREHOLDERS' INTERESTS IN SECURITIES

As at the Latest Practicable Date, so far as was known to any Director or chief executive of the Company, the following persons (other than the Directors and chief executive of the Company) had interests or short positions in the Shares or underlying Shares which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, or who was, directly or indirectly, interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any other member of the Group or had any options in respect of such capital:

Long positions in the Shares

Name of Shareholder	Capacity	Number of Shares held (1)	Approximate percentage of shareholding (2)
Chigo Group Holding Limited	Beneficial owner	4,322,234,210	51.25%

Notes:

(1) All the above Shares were held in long position (as defined under Part XV of the SFO).

(2) The percentages disclosed were calculated based on the total number of issued Shares of the Company as at the Latest Practicable Date, i.e. 8,434,178,000 Shares.

Save as disclosed herein, as at the Latest Practicable Date, so far as was known to the Directors or chief executive of the Company, there was no other person, other than the Directors or chief executive of the Company and (in the case of the other members of the Group) other than the Company, who had an interest or short position in the Shares and underlying Shares which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, or, who were, directly or indirectly, interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any other member of the Group.

As at the Latest Practicable Date, so far as is known to the Directors, the following Directors held offices in the substantial Shareholders set out above:

Name of Director	Position held in the relevant substantial Shareholders
Li Xinghao	Director of Chigo Group Holding Limited

4. ARRANGEMENTS AND MATTERS CONCERNING DIRECTORS

(a) None of the Directors has entered or proposed to enter into any service contract with the Group, which is not expiring or determinable by the Group within one year without payment of compensation (other than the payment of statutory compensation).

(b) As at the Latest Practicable Date, none of the Directors was interested, directly or indirectly, in any assets which, since 31 December 2018, being the date to which the latest published audited consolidated financial statements of the Group were made up, had been acquired or disposed of by or leased to any member of the Group, or were proposed to be acquired or disposed of by or leased to any member of the Group.

(c) As at the Latest Practicable Date, none of the Directors was materially interested in any contract or arrangement subsisting at the Latest Practicable Date and entered into by the Group since 31 December 2018, being the date to which the latest published audited consolidated financial statements of the Group were made up, and which was significant in relation to the business of the Group.

(d) As at the Latest Practicable Date, none of the Directors or their respective close associates had any interest in a business which competed or might compete with the business of the Company.

5. LITIGATION

As at the Latest Practicable Date, no member of the Group was involved in any litigation or claims of material importance nor was any litigation or claims of material importance known to the Directors to be pending or threatened against any member of the Group.

6. MATERIAL CONTRACTS

The following contracts (not being contracts entered into in the ordinary course of business) have been entered into by members of the Group within the two years immediately preceding the date of this circular and are or may be material:

(a) the equipment purchase agreement and the finance lease contract dated 11 October 2017 entered into between FE Leasing and the Vendor, pursuant to which FE Leasing had conditionally agreed to purchase certain machinery and equipment from the Vendor at an aggregate consideration of RMB46,082,000 and lease the machinery and equipment back to the Vendor for a period of 36 months;

(b) the finance lease contract dated 13 October 2017 entered into between Ping An Leasing (Tianjin) and the Vendor, pursuant to which Ping An Leasing (Tianjin) had conditionally agreed to purchase certain machinery and equipment from Vendor at a consideration of RMB60,000,000 and lease the machinery and equipment back to the Vendor for a period of 36 months;

(c) the equipment purchase agreement and the finance lease contract dated 9 February 2018 entered into between FE Leasing and Chigo Precision, pursuant to which FE Leasing had conditionally agreed to purchase certain machinery and equipment from Chigo Precision at an aggregate consideration of RMB31,572,000 and lease the machinery and equipment back to Chigo Precision for a period of 36 months;

(d) the finance lease contract dated 27 August 2018 entered into between Yaoda Leasing and Chigo Precision, pursuant to which Yaoda Leasing had conditionally agreed to purchase certain machinery and equipment from Chigo Precision at a consideration of RMB20,000,000 and lease the machinery and equipment back to Chigo Precision for a period of 36 months;

(e) the equipment purchase agreement and the finance lease contract dated 10 September 2018 entered into between Sinopharm Leasing and Kechuang, pursuant to which Sinopharm Leasing had conditionally agreed to purchase certain machinery and equipment from Kechuang at an aggregate consideration of RMB50,000,000 and lease the machinery and equipment back to Kechuang for a period of 36 months;

(f) the finance lease contract dated 4 January 2019 entered into between Yaoda Leasing and the Vendor, pursuant to which Yaoda Leasing had conditionally agreed to purchase certain machinery and equipment from the Vendor at a consideration of RMB30,000,000 and lease the machinery and equipment back to the Vendor for a period of 36 months;

(g) the Sale and Purchase Agreement;

(h) the transfer agreement dated 21 May 2019 entered into between 粵港澳大灣區產融資產管理有限公司 (Greater Bay Area Chanrong Asset Management Company Limited*) and the Vendor, pursuant to which the Vender had conditionally agreed to sell certain properties located in Foshan City, Guangdong Province, the PRC, at the disposal consideration of RMB450,000,000; and

(i) the relocation compensation agreement dated 21 May 2019 entered into between 粵港澳大灣區產融資產管理有限公司 and the Vendor, pursuant to which 粵港澳大灣區產融資產管理有限公司 had conditionally agreed to pay a relocation compensation in the amount of RMB358,000,000 to the Vendor for the relocation.

7. DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents will be available for inspection during normal business hours on any weekday (except public holidays) at the principal place of business of the Company in Hong Kong at Unit 01, 9th Floor, Greenfield Tower (South Tower), Concordia Plaza, 1 Science Museum Road, Tsimshatsui, Kowloon, Hong Kong, from 22 July 2019 to 5 August 2019 (both days inclusive):

(a) the memorandum and articles of association of the Company;

(b) the material contracts as referred to in the section headed "6. Material contracts" in this appendix;

(c) the annual reports of the Company for the two years ended 31 December 2017 and 2018, respectively;

(d) the written approval dated 30 March 2019 from Chigo Group Holding Limited; and

(e) this circular.

8. MISCELLANEOUS

(a) The company secretary of the Company is Mr. Leung Hon Man, who is a fellow member of the Hong Kong Institute of Certified Public Accountants, and a certified practising accountant of CPA Australia.

(b) The Hong Kong branch share registrar of the Company is Tricor Investor Services Limited, at Level 54, Hopewell Centre, 183 Queen's Road East, Hong Kong.

(c) In the event of any inconsistency, the English text of this circular shall prevail over the Chinese text.