THIS CIRCULAR IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION

If you are in any doubt as to any aspect of this circular or as to the action to be taken, you should consult your licensed securities dealer, bank manager, solicitor, professional accountant or other professional adviser.

If you have sold or transferred all your shares in Huabao International Holdings Limited, you should at once hand this circular and the accompanying form of proxy to the purchaser or transferee or to the bank, licensed securities dealer or other agent through whom the sale or transfer was effected for transmission to the purchaser or transferee.

HUABAO INTERNATIONAL HOLDINGS LIMITED

華寶國際控股有限公司 *

(Incorporated in Bermuda with limited liability)

(Stock Code: 336)

VERY SUBSTANTIAL ACQUISITION AND CONNECTED TRANSACTION
PROPOSED CONTINUING CONNECTED TRANSACTIONS
CAPITAL REORGANISATION

Joint Financial Advisers to the Company

Deutsche Bank 德意志銀行

DBS

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

taifook

TAI FOOK CAPITAL LIMITED

A letter from the Independent Board Committee to the Independent Shareholders is set out on page 38 of this circular. A letter from the Independent Financial Adviser to the Independent Board Committee and the Independent Shareholders is set out on pages 39 to 57 of this circular.

A notice convening the SGM of Huabao International Holdings Limited (the "Company") to be held at Tianshan Room, Level 5, Island Shangri-La Hotel, Pacific Place II, Supreme Court Road, Central, Hong Kong at 3:15 p.m. on Wednesday, 26 July 2006 is set out on pages 180 to 186 of this circular. A form of proxy is enclosed to this circular. Whether or not you are able to attend the meeting in person, you are requested to complete and return the enclosed form of proxy in accordance with the instructions printed thereon and deposit at the Company's branch share registrar in Hong Kong, Tengis Limited, at 26/F., Tesbury Centre, 28 Queen's Road East, Hong Kong as soon as possible and in any event not later than 48 hours before the time appointed for holding the meeting. Completion and return of the form of proxy will not preclude you from attending and voting in person at the SGM or any adjournment thereof should you so wish.

* *for identification purposes only*

28 June 2006

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

"Acquisition"	the proposed acquisition by the Company from Ms. Chu of the entire issued share capital of the Target Company pursuant to the Acquisition Agreement
"Acquisition Agreement"	the agreement entered into between Ms. Chu, as the transferor, and the Company, as the transferee, on 7 June 2006 in respect of the acquisition of the entire issued share capital of the Target Company
"Aromascape"	Aromascape Development Centre GmbH, a company incorporated in Germany on 17 February 2006, the registered capital of which is €25,000
"associate(s)"	as defined in the Listing Rules
"Board"	the board of Directors of the Company
"business day(s)"	any day(s), except Saturday, on which banks in Hong Kong are open for business
"Capital Reorganisation"	together, the Share Premium Cancellation and the Share Capital Increase
"Companies Act"	the Companies Act 1981 of Bermuda
"Company"	Huabao International Holdings Limited, a company established in Bermuda on 11 October 1991, the shares of which are listed on the Main Board
"Completion"	closing of the Acquisition
"Connected Person(s)"	as defined in the Listing Rules
"Continuing Connected Transactions"	on-going connected transactions as contemplated by the Framework Agreement
"Director(s)"	director(s) of the Company
"Existing Preference Shares"	a total of 526,900,000 convertible cumulative non-voting preference shares of the Company of HK$0.10 each currently held by Ms. Chu

"Framework Agreement"	the framework agreement entered into between the Target Company and Hongta Tobacco Group dated 1 June 2006
"Future Dragon"	Future Dragon International Limited, a company incorporated in the British Virgin Islands on 12 December 2001 and wholly and beneficially owned by Ms. Chu, which holds 40% equity interests in Yunnan Tianhong
"HKFRS"	Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants
"Group" or "Group Member(s)"	the Company and its subsidiaries, as appropriate and regardless of whether directly or indirectly owned
"Guangzhou Huafang"	Hua Fang Tobacco Flavors Ltd, a sino-foreign joint venture with limited liability established in the PRC on 16 October 1992, the registered capital of which is US$4 million. Symhope holds 51% equity interest and China Tobacco Company Guangdong Company holds 49% equity interest in Guangzhou Huafang
"HK$"	Hong Kong Dollars, the lawful currency of Hong Kong
"Hong Kong"	The Hong Kong Special Administrative Region of the PRC
"Hongta Tobacco Group"	Hongta Tobacco (Group) Limited Liability Company, the predecessor of which was incorporated in 1956 in the PRC, and was converted into a limited liability company in 1995
"Huabao Group"	Huabao Group Limited, a company incorporated in the British Virgin Islands on 12 March 2002 and wholly and beneficially owned by Ms. Chu, which holds 20% equity interests in Weihai Huayuan
"Huabao ITD"	Hua Bao Industrial & Trading Development (HK) Limited, a limited liability company established in Hong Kong on 30 December 1993 with total issued share capital of HK$10,000. It holds 100% equity interests in Huabao Keji. Sino Asia holds 90% equity interest and Target Company holds 10% equity interest in Huabao ITD

"Huabao Keji"	Huabao Xianghua Keji Fazhan (Shanghai) Co. Ltd., a wholly foreign-owned company with limited liability established in the PRC in September 2001, the registered capital of which is US$2.1 million. Huabao ITD holds 100% equity interest in Huabo Keji
"Huabao Kongque"	Shanghai H&K Flavours and Fragrances Co., Ltd., a wholly foreign-owned company with limited liability established in the PRC on 14 April 2004, the registered capital of which is RMB100 million. Smart Sino holds 100% equity interest in Huabao Konque
"Huabao Shanghai"	Huabao Food Flavours & Fragrances (Shanghai) Co. Ltd., a wholly foreign-owned company with limited liability established in the PRC on 5 June 1999, the registered capital of which is US$10 million. Smart Sino holds 100% equity interest in Huabao Shanghai
"Independent Board Committee"	the independent board committee of the Company constituted for the purpose of the Acquisition and the Continuing Connected Transactions, comprising three independent non-executive Directors
"Independent Financial Adviser" or "Tai Fook"	Tai Fook Capital Limited, a licensed corporation under the SFO to carry out type 6 (advising on corporate finance) regulated activity and the independent financial adviser appointed to advise the Independent Board Committee and Independent Shareholders in respect of the Acquisition and the Continuing Connected Transactions
"Independent Shareholder(s)"	in case of the Acquisition, the Shareholders, other than Ms. Chu and her associates, who are not connected nor interested in the Acquisition and related transaction, or not required to abstain from voting at the resolution regarding the Acquisition at the SGM, where in case of the Continuing Connected Transactions, Shareholders, other than Hongta Tobacco Group and its associates, who are not connected nor interested in the Continuing Connected Transactions or not required to abstain from voting at the resolution in respect of the Continuing Connected Transactions at the SGM

"Ingame"	Ingame Technology Limited, a company incorporated in the British Virgin Islands on 28 November 2001 and wholly and beneficially owned by Ms. Chu, which holds 0.01% and 70% equity interests in Smart Sino and Qingdao Huabao respectively
"Latest Practicable Date"	26 June 2006, being the latest practicable date for the purpose of ascertaining certain information contained in this circular prior to its publication
"Listing Rules"	the Rules Governing the Listing of Securities on the Main Board of the Stock Exchange
"Ms. Chu"	Ms. Chu Lam Yiu, a director and beneficial owner of 70.04% shareholding interest in the Company as at the date hereof
"New Convertible Preference Shares"	2,219,731,526 new non-redeemable convertible preference shares of HK$0.10 each to be issued to Ms. Chu upon Completion in consideration for the acquisition of the entire issued share capital of the Target Company
"Nocton"	Nocton International Limited, a company incorporated in the British Virgin Islands on 12 December 2001 and wholly and beneficially owned by Ms. Chu, which holds 20% equity interests in Yunan Tianhong
"PRC"	the People's Republic of China
"Qingdao Huabao"	Qingdao Huabao Flavors and Fragrances Company Limited, a sino-foreign joint venture with limited liability established in the PRC on 6 May 2003, the registered capital of which is HK$3.6735 million. Ingame holds 70% equity interest and Yizhong (Qingdao) Enterprise Company Limited holds 30% equity interest in Qingdao Huabao
"RMB"	Renminbi, the lawful currency of the PRC
"SFO"	the Securities and Futures Ordinance, Chapter 571 of the Laws of Hong Kong
"SGM"	the special general meeting of the Company to be held to consider, among other things, the Acquisition, Continuing Connected Transactions and Capital Reorganisation

"Share(s)" or "Ordinary Shares"	ordinary share(s) of HK$0.10 each in the capital of the Company
"Share Capital Increase"	the proposed increase in the authorised share capital of the Company from HK$337,690,000 to HK$887,690,000 by the creation of an additional 3,000,000,000 Ordinary Shares and 2,500,000,000 New Convertible Preference Shares
"Share Premium Cancellation"	the proposed cancellation of the entire amount standing to the credit of the share premium account of the Company as at the day of Completion
"Shareholder(s)"	holder(s) of Shares
"Sino Asia"	Sino Asia Technology Limited, a company incorporated in the British Virgin Islands on 8 October 2003 and wholly and beneficially owned by Ms. Chu, which holds 90% equity interests in Huabao ITD
"Sino Prospect"	Sino Prospect Holdings Limited, a company incorporated in the British Virgin Islands on 14 July 2005 and wholly and beneficially owned by Ms. Chu, which holds 100% equity interests in Aromascape
"Smart Sino"	Smart Sino International Limited, a company incorporated in Hong Kong with limited liability on 30 April 1997, the total issued share capital of which is HK$10,000, which holds 100% equity interest in Huabao Kongque, Huabao Shanghai, Wuxi Fuhua and Wuxi Jiahua
"Spanby"	Spanby Industrial Limited, a company incorporated in the British Virgin Islands on 12 December 2001 and wholly and beneficially owned by Ms. Chu, which indirectly holds 99.99% equity interests in Smart Sino
"Stock Exchange"	The Stock Exchange of Hong Kong Limited
"Symhope"	Symhope Investment Limited, a company incorporated in the British Virgin Islands on 8 February 2005 and wholly and beneficially owned by Ms. Chu, which holds 51% equity interests in Guangzhou Huafang

"Target Company"	Chemactive Investments Limited, a company incorporated in the British Virgin Islands on 6 April 2006, being an investment holdings company wholly and beneficially owned by Ms. Chu
"Target Group"	Target Company and its subsidiaries
"Track Record Period"	the three financial years ended 31 March 2004, 2005 and 2006
"Warrants"	the warrants attached to the Existing Preference Shares which Ms. Chu is entitled to subscribe for a maximum number of Ordinary Shares of 49,000,000 at HK$0.10 per share before 21 March 2009
"Weihai Huayuan"	Weihai Huayuan Green Industry Co., Ltd., a sino-foreign joint venture company with limited liability established in the PRC on 28 November 1996, the registered capital of which is US$2.1 million. Huabao Group holds 20% equity interest and Mafco Worldwide Corporation and Weihai Lu Se Industrial Technology Company each holds 40% equity interest in Weihai Huayuan
"Wuxi Fuhua"	Wuxi Fuhua Flavour & Fragrance Co., Ltd., a wholly foreign-owned company with limited liability established in the PRC on 28 October 2004, the registered capital of which is US$7 million. Smart Sino holds 100% equity interest in Wuxi Fuhua
"Wuxi Jiahua"	Wuxi Jiahua Flavour & Fragrance Co., Ltd. a wholly foreign-owned company with limited liability established in the PRC on 20 June 2005, the registered capital of which is RMB10 million. Smart Sino holds 100% equity interest in Wuxi Jiahua
"Yunnan Hongta"	Yunnan Hongta Group Limited Company which was incorporated in the PRC in 1993
"Yunnan Tianhong"	Yunnan Tianhong Flavor & Fragrance Co., Ltd., a sino-foreign joint stock company with limited liability established in the PRC on 25 June 2001, the registered capital of which is US$2.25 million

Note: For the purpose of this circular, all foreign currency amounts have been translated into Hong Kong dollars at the rates of HK$1=RMB1.033 or HK$7.80=US$1.

HUABAO INTERNATIONAL HOLDINGS LIMITED
華寶國際控股有限公司 *

(Incorporated in Bermuda with limited liability)
(Stock Code: 336)

Chairman:
Ms. CHU Lam Yiu

Executive Directors:
Mr. CHEN Yong Chang
Mr. POON Chiu Kwok
Mr. WANG Guang Yu

Independent non-executive Directors:
Mr. LEE Luk Shiu
Ms. MA Yun Yan
Mr. MAK Kin Kwong, Peter

Registered office:
Clarendon House
2 Church Street
Hamilton HM 11
Bermuda

Headquarters and principal place of business in Hong Kong:
Suite 1103
Central Plaza
18 Harbour Road
Wanchai
Hong Kong

28 June 2006

To the Shareholders and, for information only, to the holder of Existing Preference Shares

Dear Sir or Madam,

VERY SUBSTANTIAL ACQUISITION AND CONNECTED TRANSACTION
PROPOSED CONTINUING CONNECTED TRANSACTIONS
CAPITAL REORGANISATION

INTRODUCTION

On 7 June 2006, the Company and Ms. Chu entered into the Acquisition Agreement pursuant to which the Company agreed to acquire from Ms. Chu all issued share capital in the Target Company. Pursuant to the Listing Rules, the Acquisition constitutes a very substantial acquisition and connected transaction of the Company. In addition, upon completion of the Acquisition, transactions between the Company and Hongta Tobacco Group will become Continuing Connected Transactions under the Listing Rules. The Shareholders are invited to draw their attention to the relevant announcements published by the Company on 7 June 2006 and 23 June 2006 respectively.

* *for identification purpose only*

The Board also proposes that the Company undergoes the Capital Reorganisation which comprises Share Premium Cancellation and Share Capital Increase. The Share Capital Increase will become effective on the date on which the relevant ordinary resolution has been passed by the Shareholders while the Share Premium Cancellation, subject to Completion, will be conducted on the 20th business day following the Completion, i.e. 28 September 2006, assuming the Completion taking place on 31 August 2006. The Company will make further announcement in respect of the timetable of the Capital Reorganisation before the effective date of the Capital Reorganisation.

The purpose of this circular is to provide particulars of the Acquisition, Continuing Connected Transactions and Capital Reorganisation, including the letter to the Independent Shareholders from the Independent Board Committee, letter from Tai Fook to the Independent Board Committee and Independent Shareholders in respect of the Acquisition and the Continuing Connected Transactions, and the notice convening the SGM for the purpose of the above transactions. The notice of the SGM is set out from pages 180 to 186 of this circular.

This circular appears for information purposes only and does not constitute an invitation or offer to acquire, purchase or subscribe for the securities of the Company.

ACQUISITION AGREEMENT

As at the Latest Practicable Date, Ms. Chu is the controlling Shareholder of the Company holding 70.04% of the issued share capital of the Company. As Ms. Chu also holds 100% issued share capital of the Target Company, the Acquisition is a connected transaction for the Company under the Listing Rules. In addition, as the relevant percentage ratios of the Acquisition calculated in accordance with Rule 14.07 of the Listing Rules exceed 100%, the Acquisition constitutes a very substantial acquisition under the Listing Rules. The principal terms and conditions of the Acquisition Agreement are as follows:

Date

7 June 2006

Parties

Transferor: Ms. Chu

Transferee: The Company

SUBJECT OF THE ACQUISITION

100% issued share capital in the Target Company beneficially and legally held by Ms. Chu.

CONSIDERATION

The consideration for the Acquisition is HK$3,995,516,747, which will be satisfied by the Company by way of the issue and allotment of 2,219,731,526 New Convertible Preference Shares at an issue price of HK$1.80 per New Convertible Preference Share upon completion of the Acquisition to Ms. Chu. The issue of the New Convertible Preference Shares will not result in any change in the controlling interest in the Company. The consideration was arrived at after arm's length negotiation between the Company and Ms. Chu with reference to the business prospect and the financial performance of the Target Group, including its audited combined net profits for the three years ended 31 March 2006 and audited combined net asset value as at 31 March 2006.

The total consideration represents 13.6 times of the audited profit attributable to the shareholder (i.e. Ms. Chu) of the Target Group for the year ended 31 March 2006, amounted to HK$293,788,000, and a premium of approximately 801.1% to the audited combined net asset value of the Target Group attributable to the shareholder (i.e. Ms. Chu) as at 31 March 2006 of approximately HK$443,394,000.

Based on the closing price of the Shares of HK$1.86 per Share as at 6 June 2006, being the last trading day of the Shares immediately prior to the suspension of trading pending the release of the announcement of the Company regarding the Acquisition, the market value of New Convertible Preference Shares amounts to approximately HK$4,128,700,638.

The issue price of HK$1.80 per New Convertible Preference Share was arrived at after arm's length negotiation between the Company and Ms. Chu and represents:

- a discount of approximately 3.2% to the price per Share quoted on the Stock Exchange of HK$1.86 as at 6 June 2006, being the last trading day of the Shares immediately prior to the suspension of trading pending the release of the announcement of the Company regarding the Acquisition;

- a discount of approximately 3.2% to the average of prices per Share quoted on the Stock Exchange of approximately HK$1.86 for the last five trading days up to and including 6 June 2006;

- a discount of approximately 0.6% to the average of prices per Share quoted on the Stock Exchange of approximately HK$1.81 for the last 10 trading days up to and including 6 June 2006; and

- a discount of approximately 1.1% to the average of prices per Share quoted on the Stock Exchange of approximately HK$1.82 for the last 30 trading days up to and including 6 June 2006.

According to the above analysis, the Directors believe that the issue price per New Convertible Preference Share of HK$1.80 and the terms of New Convertible Preference Shares are fair and reasonable.

TERMS OF NEW CONVERTIBLE PREFERENCE SHARES

Number of Shares to be issued upon the Exercise of the Conversion Rights Attaching to the New Convertible Preference Shares in full:	2,219,731,526 Ordinary Shares
Conversion Ratio:	Each New Convertible Preference Share carries the right to convert to one Ordinary Share (subject to adjustment in the following events: alteration to the nominal value of the Ordinary Shares as a result of consolidation or subdivision).
Conversion Rights:	Holders of New Convertible Preference Shares will have the right to convert all or such number of New Convertible Preference Shares in multiples of 1,000,000 New Convertible Preference Shares into Shares at any time. Holders of New Convertible Preference Shares shall not exercise the conversion rights as to such number of New Convertible Preference Shares if upon the conversion thereof, the percentage of the Ordinary Shares held by the public drops to below the minimum public float requirement under Rule 8.08 of the Listing Rules.
Redemption:	Holders of New Convertible Preference Shares are not entitled to request the Company to redeem any of New Convertible Preference Shares.
Dividend Entitlement:	Nil
Voting Rights:	Holders of New Convertible Preference Shares shall be entitled to receive notices of and attend any shareholders' meeting but shall not be entitled to vote at any shareholders' meeting by reason only of being holders of New Convertible Preference Shares save where certain resolutions are proposed, e.g. to wind up the Company or alter the rights attaching to the New Convertible Preference Shares, then the holders of the New Convertible Preference Shares will have the same voting rights as those attaching to the Shares such that one New Convertible Preference Share shall confer one vote in person or by proxy.

Transferability:	The New Convertible Preference Shares are freely transferable.
Ranking:	Ranks in priority to the Shares as to a return of capital on a winding up or otherwise. The Shares converted from the Convertible Preference Shares shall rank pari passu in all respect with all other Ordinary Shares as at the date of conversion.
Listing:	No listing will be sought for New Convertible Preference Shares on the Stock Exchange or any other stock exchange.

The Company will apply to the Stock Exchange for the listing of, and permission to deal in, the underlying Ordinary Shares to be issued as a result of the conversion of the New Convertible Preference Shares. The Company will, subject to Shareholders' approval, amend its bye-laws for the purpose of issuing New Convertible Preference Shares. The issue of New Convertible Preference Shares and the amendments to the bye-laws of the Company will be in compliance with the relevant Bermuda laws, the Company's bye-laws as amended and the requirements under Appendix 13A of the Listing Rules.

CONDITIONS PRECEDENT

Completion of the Acquisition is conditional upon fulfilment of the following:

(i) the warranties provided by Ms. Chu under the Acquisition Agreement were true, accurate and not misleading as at the date of the Acquisition Agreement and will remain so as if repeated up to immediately prior to the Completion;

(ii) the listing committee of the Stock Exchange granting the listing of, and permission to deal in, the underlying Ordinary Shares to be issued as a result of the conversion of the New Convertible Preference Shares;

(iii) the Independent Shareholders granting approval for the Acquisition Agreement and the transactions contemplated therein;

(iv) the Bermuda Monetary Authority granting approval for the allotment and issue of the New Convertible Preference Shares and the underlying Ordinary Shares thereof, if required;

(v) a legal opinion on the Acquisition provided by the Company's PRC lawyer, and acceptable to the Company;

(vi) the obtaining of all such approvals, exemptions, permits, authorisations and permissions from any government or regulatory authority or relevant third party necessary for the execution and performance of the Acquisition Agreement, if any;

(vii) completion of legal and financial due diligence on the Target Group to the satisfaction of the Company; and

(viii) the Acquisition does not constitute a reverse takeover under the Listing Rules.

Except for condition (i) as set out above which can be waived by the Company, neither Ms. Chu nor the Company could waive any other conditions. If any of the conditions precedent are not fulfilled or, in the case of condition (i), waived by the Company in writing, on or before 8 December 2006, or any such later date as may be agreed between the Company and Ms. Chu, the Acquisition Agreement shall be terminated and no person shall have any claim to other parties in respect of any fee, damage, compensation or other matters except for in respect of any previous breach of the Acquisition Agreement. As at the date of this circular, none of the conditions above are fulfilled and Ms. Chu and the Company have no present intention to waive any of the above conditions.

COMPLETION

Completion of the Acquisition shall occur on or before the tenth business day upon fulfilment or, in the case of condition (i) waiver by the Company, of all conditions set out under the paragraph headed “Conditions Precedent” above.

The Directors consider that the terms of the Acquisition Agreement are on normal commercial terms, fair and reasonable and in the interests of the Company and its Shareholders as a whole.

The Company does not anticipate any substantial change in the composition of its board of directors or management as a result of the Acquisition.

SHAREHOLDING STRUCTURE OF THE COMPANY BEFORE AND AFTER COMPLETION

On 22 March 2004, Ms. Chu, through Mogul Enterprises Limited (a company wholly owned by her) subscribed for 173,100,000 Shares (representing 70% of the total issued share capital of the Company), 526,900,000 Existing Preference Shares, and Warrants that entitle Ms. Chu to subscribe for a maximum of 49,000,000 Ordinary Shares pursuant to a subscription agreement dated 17 January 2004. For details, please see the circular issued by the Company on 25 February 2004. Subsequent to such subscription, Ms. Chu further acquired 119,445 Shares from the public (please refer to the announcement issued by the Company on 16 April 2004). As at the Latest Practicable Date, Ms. Chu holds a total of 173,219,445 Shares (representing approximately 70.04% of the issued share capital of the Company), 526,900,000 Existing Preference Shares and Warrants that entitles Ms. Chu to subscribe for a maximum of 49,000,000 Ordinary Shares.

Upon Completion, Ms. Chu will own an additional 2,219,731,526 New Convertible Preference Shares. By full conversion of the New Convertible Preference Shares, an aggregate of 2,219,731,526 underlying new Shares of the Company, representing approximately 897.6% of the existing issued share capital of the Company and approximately 90.0% of the enlarged capital of the Company after conversion, will be issued. It is expected that the controlling interest in the Company will not be subject to any changes immediately after Completion.

Details of the shareholding structure of the Ordinary Shares under different scenarios post Completion are set out below:

Name	Number of Ordinary Shares held directly or indirectly as at the date of this circular	Approximate percentage of the total issued share capital of the Company	Number of Ordinary Shares held directly or indirectly immediately after Completion and full conversion of the Existing Preference Shares and Warrants but before full conversion of the New Convertible Preference Shares	Approximate percentage of the total issued share capital of the Company	Number of Ordinary Shares held directly or indirectly immediately after Completion and full conversion of the Existing Preference Shares, Warrants and New Convertible Preference Shares	Approximate percentage of the total issued share capital of the Company
Ms. Chu	173,219,445	70.04	749,119,445	91.00	2,968,850,971	97.57
Public shareholders	74,089,990	29.96	74,089,990	9.00	74,089,990	2.43
Total	247,309,435	100.0	823,209,435	100.0	3,042,940,961	100.0

As the conversion of the Existing Preference Shares, Warrants and New Convertible Preference Shares by Ms. Chu, either in part or in full, may result in the Company failing to meet the minimum public float requirement as prescribed under Rule 8.08 of the Listing Rules, Ms. Chu has undertaken to the Company that she (and her associates) will and will procure the holders of the Existing Preference Shares, Warrants and New Convertible Preference Shares only exercise the conversion rights as to such number of Existing Preference Shares, Warrants and New Convertible Preference Shares if upon conversion thereof, the percentage of the Shares of held by the public still meets the minimum public float requirement under Rule 8.08 of the Listing Rules.

DILUTION EFFECT

Given that upon full conversion of the Existing Preference Shares, Warrants and New Convertible Preference Shares, Ms. Chu will own approximately 97.57% of the issued ordinary share capital of the Company as enlarged by such conversion, the Company is required to disclose by way of an announcement on the website of the Stock Exchange only all relevant details of the conversion of the Existing Preference Shares, Warrants and New Convertible Preference Shares in the following manner:

(i) the Company will make a monthly announcement (the "Monthly Announcement") on the website of the Stock Exchange. Such announcement will be made on or before the fifth business day following the end of each calendar month following the date of the issue of the Existing Preference Shares, Warrants and New Convertible Preference Shares and will include the following details in a table:

a. whether there is any conversion of the Existing Preference Shares, Warrants and New Convertible Preference Shares during the relevant month (if so, details of the conversion(s), including the conversion date and number of conversion shares issued or, if there is no conversion during the relevant month, a negative statement to that effect);

b. the number of outstanding Existing Preference Shares, Warrants and New Convertible Preference Shares after any conversions;

c. the total number of Ordinary Shares issued pursuant to other transactions, including Ordinary Shares issued pursuant to the exercise of options under any share option scheme(s) of the Company; and

d. the total issued share capital of the Company as at the commencement and the last day of the relevant month;

(ii) in addition to the Monthly Announcement, if the cumulative amount of the Ordinary Shares issued pursuant to the conversion of the Existing Preference Shares, Warrants and New Convertible Preference Shares reaches 5% of the issued share capital of the Company as disclosed in the last Monthly Announcement or any subsequent announcement made by the Company in respect of the Existing Preference Shares, Warrants and New Convertible Preference Shares (as the case may be) (and thereafter in multiples of 5%), the Company will make an announcement on the website of the Stock Exchange including details as stated in (i) above for the period commencing from the date of the last Monthly Announcement or any subsequent announcement made by the Company in respect of the New Convertible Preference Shares (as the case may be) up to the date on which the total amount of Ordinary Shares issued pursuant to the conversion amounted to 5% of the issued share capital of the Company as disclosed in the last Monthly Announcement or any subsequent announcement made by the Company in respect of the Existing Preference Shares, Warrants and New Convertible Preference Shares (as the case may be); and

(iii) if the Company forms the view that any issue of the Ordinary Shares under the New Convertible Preference Shares will trigger a disclosure obligation under Rule 13.09 of the Listing Rules, then the Company will be obliged to make such a disclosure regardless of the issue of any other announcement in relation to the New Convertible Preference Shares.

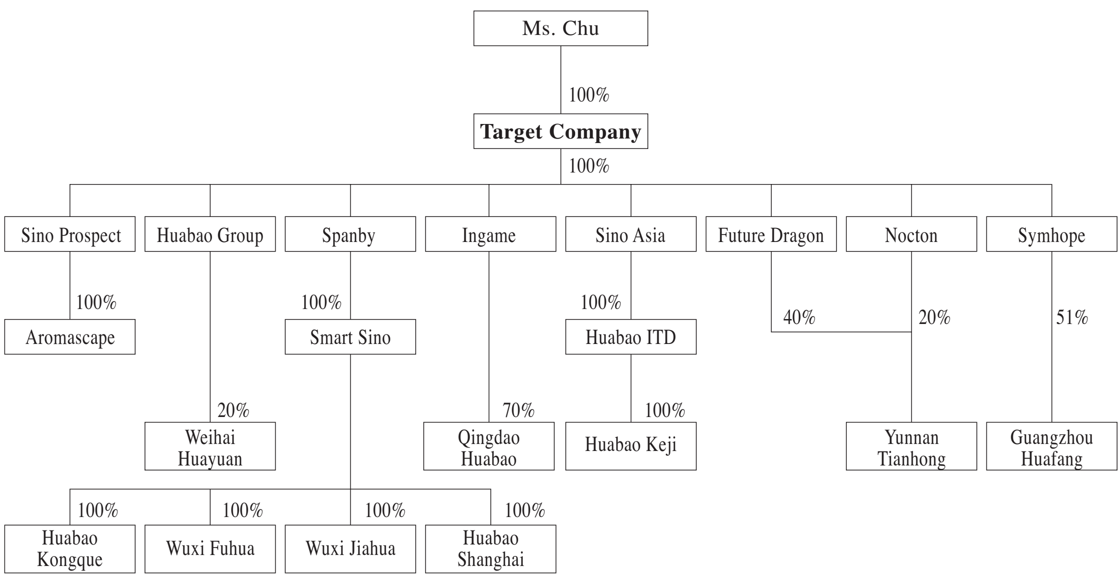
If the New Convertible Preference Shares have been fully converted, the Monthly Announcement requirements set out above will cease immediately.

INFORMATION OF TARGET GROUP

In this circular, information relating to the Target Group has been included based on the information provided by the management of the Target Group. As set out in the section headed "Conditions precedent" above, a legal and financial due diligence on the Target Group will be completed to the satisfaction of the Company prior to Completion and the financial and operational data relating to the Target Group as set out in this circular has been verified with respect to the underlying factual matters as is within the Directors' ability during the due diligence process carried out by the Group.

Structure of the Target Group

As at the date hereof, the corporate structure of the Target Group is as follows:



History of the Target Group

In 1996, Ms. Chu established Huabao Shanghai in Jiading District, Shanghai to engage in the research and development ("R&D"), production and sales of flavours and fragrances. In July 2001, the Target Group and Yuxiyuxing Industrial Development Limited Liability Company jointly established Yunnan Tianhong to engage in the R&D, production and sales of flavours and fragrances for use in tobacco and to provide after-sale services to its customers. As at the date hereof, the Target Company, through its wholly owned subsidiaries, namely Future Dragon and Nocton, holds 60% interest in Yunnan Tianhong while the remaining 40% interest is held by Yunnan Hongta Group. In October 2001, Huabao Keji was established to engage in the R&D of flavours and fragrances, and to transfer its R&D products and provide related technical consulting services for its customers. In February 2003, the Target Group and Qingdao Yizhong Xingri Investment Stock Company Limited jointly established Qingdao Huabao to engage in the production and sales of flavours and fragrances. Currently, Yizhong (Qingdao) Enterprise Company Limited holds 30% equity interest in Qingdao Huabao. In April 2004, the Target Group and Shanghai Kongque Flavours and Fragrances Company Limited jointly established Huabao Kongque to engage in the R&D, production and sales of food and fine flavours and fragrances and food additives. Huabao Kongque is now wholly owned by the Target Company. In October 2004 and June 2005, Wuxi Fuhua and Wuxi Jiahua were set up respectively in Wuxi National High-Tech Industrial Development Zone to engage in the production and sale of flavours and fragrances. In January 2005, the Target Group acquired 20% equity interests in Weihai Maifu Green Industrial Technology Company Limited, which was subsequently renamed as Weihai Huayuan. Mafco Worldwide Corporation and Weihai Lu Se Industrial Technology Company each holds 40% equity interest in Weihai Huayuan. Weihai Huayuan engages in the development, production and sales of flavours and fragrances and base materials, plant extracts and the R&D of food additives and tobacco chemicals. In August 2005, the Target Group acquired 51% equity interests in Guangzhou Huafang, which engages in the R&D, production and sales of fragrances for use in tobacco. China Tobacco Company Guangdong Company holds 49% equity interest in Guangzhou Huafang. In April 2006, the Target Group established Aromascape in Germany to engage in R&D, which the Target Group expects to commence operation by the end of 2006.

Competitive strengths

The Target Group is a leader in the PRC flavours and fragrances industry

According to the Flavours Fragrance and Cosmetic Industry Statistic Information (香料香精化妝品行業統計信息) published in August 1998, 1999 and 2000 by the China Association of Fragrance Flavor and Cosmetic Industry (中國香料香精化妝品工業協會) and the report published by China Chemical Industry Information Association (中國化工情報信息協會) in 2003, the Target Group has been the market leader in terms of sales in the PRC flavours and fragrances industry for many years. Moreover, according to the Flavours Fragrance and Cosmetic Industry Statistic Information, it was one of the largest flavours and fragrances company in terms of sales and profit in the PRC in 2005. Certain members of the Group also take leadership roles in a number of industrial associations, including the vice director (corporate) of China Association of Fragrance Flavor and Cosmetic Industry, China Food Additive Production and Application Industry Association and China Association of Bakery and Confectionary Industry, Head of Flavors and Fragrance Committee of China Food Additive Production and Application Industry Association and Chairman of Shanghai Food Additive Trade Association. In addition, the Target Group has the only State-recognised corporate technical centre in the industry in the PRC.

The Target Group possesses advanced R&D capability and a strong technology research team

In 2003, Huabao Shanghai Corporate Technical Centre (華寶上海企業技術中心) was designated as a State-recognised corporate technical centre by four ministries and commissions, namely the National Development and Reform Commission, the Ministry of Finance, the General Administration of Customs and the State Administration of Taxation. As the only State-recognised technical centre in the PRC flavours and fragrances industry, the technical centre represents the forefront of R&D standard in the industry. In addition, the technical centre was also approved by the Ministry of Personnel as post-doctoral technical research centre (博士後科研工作站). The technical centre undertakes many key technical research projects every year and is highly regarded in the industry.

The Target Group has world-class technical research facilities and a strong technical team with over a hundred domestic and overseas experts, experienced perfumers and application engineers, providing an integrated technology platform of flavours and fragrances research. The corporate technical centre of the Target Group comprises a number of technology research departments, including an analysis and testing centre, a tobacco technology research department, a food technology research department, a high technology research department and a core technology application department. In addition, the Target Group has undertaken various co-operation and technology research projects with renowned enterprises, universities and technical research institutions. Huabao Shanghai was recognised as Exemplary Postgraduate Incubation Centre of Jiangsu Province (江蘇省產學研聯合培養研究生示範基地) under Joint Efforts of Research, Production and Academy Fields by the Jiangsu Provincial Bureau of Education and Jiangsu Provincial Degree Commission in 2004.

The Target Group has established an extensive base of renowned customers and a nationwide distribution network

The Target Group is an industry leader in sales and marketing and is able to continuously innovate its marketing strategies to adapt to the changing market environment. Through its various marketing strategies, the Target Group builds up close partnerships with customers by directly supplying products and perfume blending technique to key customers, providing comprehensive technical solutions for customers and fully cooperating with customers. As a result, the Target Group has effectively secured the loyalty and trust of its customers.

With respect to tobacco flavours, the Target Group has established long-term relationship with its manufacturing customers, some of which has been entering into sales contracts with the Target Group for over five years. The Target Group continues to strengthen cooperation with some of the most influential domestic tobacco manufacturers in the PRC.

With respect to food flavours, the Target Group possesses an extensive distribution network throughout China, except in Tibet, Hong Kong, Macau and Taiwan. In addition, it has established client relationship with many leading domestic and foreign corporations in the PRC for several years.

The Target Group possesses industry leading brand names and product quality

As a rare case in the industry, the Target Group possesses two PRC registered trademarks that are well-recognised in Shanghai. "Kongque" (孔雀) is a long-established food flavours brand name in the PRC, while "Xideng" (喜登) is a renowned brand name of tobacco flavours in the PRC and is the leading tobacco brand name in the industry. According to a certificate issued by China Association of Fragrance Flavor and Cosmetic Industry in 2005, Huabao Shanghai, mainly operating with registered trademark "Xideng" (喜登) was the market leader in terms of the sales and production of tobacco flavours.

The Target Group has set up a comprehensive quality control system covering its overall operation, from human resources and administration to manufacturing and product quality control, and from material procurement and inventory management to sales and after-sale services. Most members of the Target Group have obtained ISO9001 quality control system certifications. Three of the Target Group's members have attained the BSI group's ISO9001 quality certification in the UK.

The senior management of the Target Group has ample experience in the PRC flavours and fragrances industry

The senior management of the Target Group possesses extensive experience in the flavours and fragrances industry, as well as in its operations and financial management. Ms. Chu, the president and founder of the Target Group and Chairman of the Company, is experienced in the flavours and fragrances industry and is the vice chairman of China Association of Fragrance Flavor and Cosmetic Industry and China Food Additive Production and Application Industry Association. Senior management members of the Target Group have worked together for many years and through their collective effort and close cooperation, they have led the Target Group to its current dominant position in the PRC flavours and fragrances industry. They will substantially remain in the Company subsequent to the Acquisition.

The Target Group possesses strong consolidation capability

According to the Annual Report of China Chemical Industry published in 2004/2005, there are over 600 flavours and fragrances companies in the PRC, over 95% of which has sales of less than RMB100 million. As the turnover recorded by the Target Group in each of the past three financial years ended 31 March 2004, 2005 and 2006 was over RMB100 million, it inferred the Target Group was among the top 5% of the companies in the flavours and fragrances industry in the PRC in terms of sales during the respective period. In view of the Target Group's strong position in the industry, its advanced technology research standard and leading market share, the Company believes that the Target Group will be well positioned to capture opportunities and benefit from future industry consolidation.

Business strategies

Leveraging on its strong brand name, technology, production and corporate management, the Target Group aims to provide high quality products and comprehensive technical services to the PRC tobacco, food and household products industries. Adhering to its "market-driven and customer-oriented" philosophy, the Target Group constantly seeks to enhance its customer service quality and establish long-term partnership with its customers to maintain market leadership position.

The Target Group adopts a development strategy that places the core businesses (being the flavours and fragrances business for tobacco, food and household products industries) as the focal point, expanding upstream to the flavours' raw materials segment and downstream to the food additive segment. The upstream and downstream expansion, resulting in a vertical integration, will provide additional growth opportunities for the Target Group.

R&D strategies

The R&D objective of the Target Group is to develop products that meet market's demand and satisfy customers' needs. The principal strategies are set out below:

To focus on fundamental research and carry out research cooperation initiatives

The Target Group places strong emphasis on fundamental technical research. It has initiated a number of research cooperation projects with leading universities and research institutions in the industry. Through operation of the corporate postdoctoral technology research centre and participation in technology research projects organised by the local government, such as the "Little Giant" project, under which Huabao Shanghai would receive financial subsidies from the Economic Committee of Shanghai Jiading District in case that it has obtained certain state-wide and province-wide projects during the period from 2003 and 2005, the Target Group continues to forge ahead in fundamental research and product development.

To acquire and innovate key technology in R&D areas in the industry

As the only State-recognised corporate technical centre in the flavours and fragrances industry in the PRC, the Target Group represents the forefront of R&D standard in the industry. The Target Group will continue to invest and commit more resources in key R&D areas with the aim to attain technological breakthroughs and enhance competitiveness. In addition, the Corporate Technical Centre of the Target Group undertakes many key technical research projects every year and is highly regarded in the industry.

To further strengthen comprehensive technology cooperation with customers by leveraging on the existing technology platform

The requirements for flavours and fragrances vary from one customer to another. The customer will request flavours and fragrances products in the specific taste or smell based on the market trend in their sales regions. The Target Group uses the technical centre and postdoctoral technical centre as a platform to create customized flavours that customers requested, without having the customers actually participating in the centres. Therefore, the Target Group places strong emphasis on strengthening technical cooperation with customers by leveraging its State-recognised technical centre and postdoctoral technical research centre. Working together with customers to develop tailor-made products enables the Target Group to establish and further enhance customer relationship.

To undertake an active role in setting the industry standards

The Target Group enjoys a dominant position in the domestic flavours and fragrance industry and takes a leading role in various industrial associations, such as China Association of Fragrance Flavor and Cosmetic Industry, China Food Additive Production and Application Industry Association, China Association of Bakery and Confectionary Industry, Flavors and Fragrance Committee of China Food Additive Production and Application Industry Association and Shanghai Food Additive Trade Association. The Target Group plans to leverage its leading position in the industry and advanced technology to actively participate in setting and improving the industry standards.

To place strong emphasis on the research on latest issues

The Target Group places strong emphasis on research that keeps up with the latest issues in the industry, such as in the fields of food safety and hygiene. These research works will not only benefit the product quality and service standard of the Target Group, but also strengthen its technology leadership.

To make special efforts in setting up overseas research institutes

The Target Group places great importance in developing the international market in the future. In line with this strategy, the Target Group seeks to set up its own overseas research institute and further enhances its cooperation with other overseas research institutes. To illustrate, the Target Group recently established a research and development centre in Germany. Through such research initiatives, the Target Group aims to gain better understanding of the overseas market and acquire the latest technologies to produce products that meet the requirements of overseas customers, thus laying a solid foundation for developing the overseas market and ultimately becoming a leader in the global flavours and fragrances industry.

Existing customers

As of 31 March 2006, the five largest customers of tobacco flavours of the Target Group in aggregate accounted for approximately 66% of the total tobacco flavours sales of the Target Group.

The five largest customers of food flavours of the Target Group for the same period in aggregate accounted for approximately 25% of the total food flavours sales of the Target Group.

Product categories

The Target Group specialises in the R&D, production and sales of food and tobacco flavours and fragrances and provision of related services. Flavour products are mixtures of specific aromas and flavours manufactured by blending various natural and synthetic aromatic materials. Food flavours include those used in beverage, dairy food, bakery products, instant food, confectionery products, meat products, oral hygiene products and medicines, flavouring and other products. Tobacco flavours are mainly used in tobacco. Fine fragrances include those used in soaps and detergents, cosmetics, perfumes, household and other products.

	For the financial year ended 31 March 2004 Sales net of tax and inter-segment sales *(RMB'000)*	**For the financial year ended 31 March 2005 Sales net of tax and inter-segment sales** *(RMB'000)*	**For the financial year ended 31 March 2006 Sales net of tax and inter-segment sales** *(RMB'000)*
Tobacco flavours	561,775	685,126	714,819
Food flavours	–	63,871	80,617

Accolades and awards

The Target Group has obtained several accolades and awards since establishment, with the important ones set out below:

1. Shanghai Huabao was approved as a State-recognised corporate technical center jointly by the National Development and Reform Commission, the Ministry of Finance, General Administration of Customs and the State Administration of Taxation;

2. Huabao Kongque was granted the High Quality and Efficient Advanced Light Industry Special Award in the PRC for 2001-2004 (全國輕工業質量效益型先進企業特別獎 (2001-2004 年度)) by the China National Light Industry Council;

3. The "Kongque" (孔雀) trademark was recognised as a famous trademark in Shanghai for 2005-2007 by the Shanghai Municipal Administration of Industry and Commerce;

4. The “Xideng” (喜登) trademark was recognised as a famous trademark in Shanghai for 2005-2007 by the Shanghai Municipal Administration of Industry and Commerce;

5. Shanghai Huabao became the first flavours and fragrances enterprise in Asia Pacific to have passed the ISO9001:2000 certification process of the UK-based BSI Group on 11 December 2001;

6. Shanghai Huabao received a Certificate for Key New Product of Shanghai for Trans-2-Trans-4-Decadienal from the Shanghai Municipal Science and Technology Commission in 2004;

7. Shanghai Huabao was recognised as Exemplary Postgraduate Incubation Center of Jiangsu Province under Joint Efforts of Research, Production and Academy Fields (江蘇省產學研聯合培養研究生示範基地) by the Jiangsu Provincial Bureau of Education and Jinagsu Provincial Degree Commission (江蘇省學位委員會) in 2004;

8. Shanghai Huabao was recognised as one of the top 20 enterprises with the highest income tax per capital by the Shanghai Municipal Foreign Investment Commission (上海市外國投資工作委員會) for three consecutive years from 2002 to 2004;

9. Huabao Keji was recognised as a post-doctoral technical research centre by the Ministry of Personnel in 2004;

10. Huabao Kongque and Huabao Shanghai were recognised as Foreign-invested Advanced Technology Enterprises (外商投資先進技術企業) by the Shanghai Foreign-investment Working Committee and the Shanghai Foreign Economic and Trade Committee in 2004 and 2005;

11. Wuxi Jiahua and Wuxi Fuhua were recognised as Foreign-invested Advanced Technology Enterprise (外商投資先進技術企業) in 2005 by the Jiangsu Province Foreign Trade & Economic Corporation Department;

12. Yunnan Tianhong was recognised as Foreign-invested Advanced Technology Enterprise (外商投資先進技術企業) in 2005 by the Yunnan Department of Commerce;

13. Huabao Shanghai was granted Hi-tech Enterprise status (高新技術企業) by the Shanghai Science and Technology Committee in 2003 and 2005, each with a validity period of two years; and

14. Yunnan Tianhong was granted Hi-tech Enterprise Status (高新技術企業) by the Yunnan Science and Technology Department in 2005.

Property interest

The Target Group owns 7 properties in Yunnan, Shanghai, Guangzhou, and Shenzhen and rents 3 properties in Shandong and Jiangsu. A property valuation prepared by Vigers Appraisal & Consulting Limited is set out in Appendix VI of this circular.

Quality control system

The Target Group exercises product quality control over the entire production process, from acceptance of raw materials, product warehousing to product delivery. Employees at all levels participate in the management of the quality control system. The Target Group implements a quality assurance campaign where each stage of the process is treated as customers of the other stages. As such, a quality control system participated by all employees was established under the leadership of the quality control department, as supplemented by the relevant functional departments. This ensures the implementation of quality control programmes of the Target Group as scheduled under the master plan of the Target Group's system engineering department. In 2001, Shanghai Huabao became the first flavours and fragrances company in the Asia Pacific region to obtain the ISO9001:2000 quality control system certification of the UK-based BSI Group with "no flaw".

(1) Product inspection

The internal product inspection standards of the Target Group comply with the relevant laws and regulations of the PRC and are formulated with reference to relevant internationally accepted quality standards as The Joint FAO/WHO Expert Committee on Food Additives, US Food and Drug Administration and Food Chemicals Codex. The quality standards adopted by the Target Group on raw materials and products are stricter than those required by the State or the industry in terms of tolerance with respect to specifications and scope of inspection.

(2) Process control

Each production process is under quality control. Pursuant to relevant regulations, when receiving delivery of raw materials, there must be two staff members cross checking the model and status of the raw materials being delivered. In addition, the production tools and equipment will not be put into use until after passing the quality inspection.

For delivery of products, the quality and number of products to be delivered are checked against the delivery list.

(3) Production area management

Strict production area management is implemented by creating clearly defined areas and organised environment with distinctive demarcation and processing cards to prevent confusion in the production area.

(4) Control over the inspection, measurement and testing equipment

The Target Group is equipped with advanced and comprehensive testing equipment. It performs regular inspection on such equipment to ensure the accuracy of test results.

Sales and marketing

The Target Group manufactures, sells and distributes tobacco flavours under three brand names, namely "Xideng" (喜登), "Tianhong" (天宏) and "Huafang" (華芳), while food flavours and fine fragrances are manufactured and sold under the brand names of "Huabao" (華寶) and "Kongque" (孔雀). Both "Xideng" (喜登) and "Kongque" (孔雀) were recognised as famous trademarks in Shanghai. These brands names are all registered trademarks in the PRC. The Target Group has been dedicated to providing tailor-made products for specific market segments through differentiated product positioning. Both "Xideng" (喜登) and "Tianhong" (天宏) are positioned to the high-end market, while "Huabao" (華寶) targets the mid- to high-end market, and "Kongque" (孔雀) is mainly for the distributor market. The brand strength of the Target Group reinforced the brand awareness and competitiveness of the Group's products.

The Target Group is committed to providing tailor-made products for its customers. With an emphasis on market research utilising its strong technology capability, the Target Group specialises in the production of customised products based on market trend and different customers' requirements. It also provides comprehensive services to customers, including perfume blending technique and application technology. Fully leveraging on the R&D platform of its national corporate technology centre, the Target Group has established close technology cooperation relationship with key customers on relevant research topics, which further enhances the competitive position of the Target Group in the flavours and fragrances industry.

Tobacco flavour products are sold by way of direct sales through a sales network covering 21 provinces and cities of the PRC. In addition, 10 liaison offices were set up for the provision of products and services to customers. Marketing is primarily conducted through face-to-face communication and liaison with customers to understand the customers' demand for the product. After-sales services and technical support are also provided in relation to the products sold. In view of the general trend of consolidation in the tobacco industry, the Target Group places its focus on engaging major customers of the sector. At present, it has established long-term and stable relationship with most of the leading tobacco manufacturers in the PRC. As the tobacco industry further consolidates, the business of the Target Group will continue to grow.

Food flavours products are sold by way of a combination of distribution and direct sales. Through the setting up of Huabao Kongque, the Target Group completed the establishment of a nationwide sales network spanning various provinces, directly administrated municipalities and autonomous regions except Hong Kong, Macau, Taiwan and Tibet. The network of first-tier distributors covers most of the middle to large-scale cities, while the second-tier and third-tier distributors target the various counties. At the same time, the Target Group has also established close relationship with various major domestic customers and foreign corporations in the PRC. A good distribution network is better suited for serving the small and medium-sized food producers in the PRC, who belong to a market segment characterised by a large number of scattered customers. On the other hand, establishing solid relationship with the major customers will further boost the sales of food flavours.

The Target Group has established a marketing centre for fine fragrances, marketing the products primarily by way of direct sales.

The aromatic raw materials of the Target Group are mainly used in the production of flavour products of the Target Group, so as to ensure the unique features of its products. The Target Group also selectively sells some of its aromatic raw materials.

Major raw material purchase and suppliers

The Target Group uses over 1,000 types of raw materials, including both synthetic and natural raw materials. During the three years ended 31 March 2004, 31 March 2005 and 31 March 2006, the total purchases of the Target Group were approximately RMB395,242,000, RMB516,264,000 and RMB399,515,000 respectively, accounting for approximately 97%, 92% and 97% of the corresponding total cost of sales of the Target Group respectively. The purchase prices of raw materials of the Target Group were determined with reference to market rates. During the same period, all raw materials used by the Target Group were procured from the market and the Target Group had not experienced any major or pro-longed shortage of major raw materials.

During the three years ended 31 March 2004, 31 March 2005 and 31 March 2006, purchases of the Target Group from the five largest suppliers accounted for approximately 93.84%, 63.66% and 80.11% respectively. During the same period, purchases of the Group from the largest supplier accounted for approximately 33.82%, 14.69% and 22.32% of the total purchases of the Group respectively.

Intellectual property rights

Patents

As at the Latest Practicable Date, the Target Group has the following patented technologies:

Serial number	Description	Place of registration	Application date	Validity term
ZL02137575.5	微生物發酵法生產香料苯乙醇的工藝 (a technique of producing the fragrance of phenylethyl alcohol by micro-organism fermentation)	PRC	22 October 2002	From 22 October 2002 to 21 October 2022

Serial number	Description	Place of registration	Application date	Validity term
ZL02145153.2	以煙草浸膏為原料生產煙用香料的方法 (a method of producing tobacco flavours using tobacco concrete as raw material)	PRC	8 November 2002	From 8 November 2002 to 7 November 2022
ZL03115146.9	以紫羅蘭醇酯為原料熱裂解反應精餾生產香料 的方法 (a method of producing fragrances by pyrolysis reaction using violet acetate as raw material)	PRC	24 January 2003	From 24 January 2003 to 23 January 2023
ZL03115147.7	一種巨豆三烯酮香料的 合成方法 (a synthetic method of megastigmatrienone)	PRC	24 January 2003	From 24 January 2003 to 23 January 2023

As at the Latest Practicable Date, the Target Group has applied for patents regarding the following technologies:

Application number	Description	Place of registration	Date of application
200410015998.9	一種穩定的甘草粉或可可粉分散液的製備方法 (a stable method of preparing liquorice powder or cocoa powder dispersion liquid)	PRC	19 January 2004
200410017347.3	一種酶催化生產烯醛類香料的方法 (a method of catalyzing the production of alkene and aldehyde fragrances)	PRC	31 March 2004
200410025194.7	一種含鉀鹽的組合型捲煙添加劑及其製備方法與應用 (a compound tobacco additive with potassium salt and its preparation and application)	PRC	16 June 2004
200510029566.8	利用生物酶製備煙草浸膏 的方法 (a method of preparing tobacco concrete with biotic enzyme)	PRC	12 September 2005
200510029565.3	利用多種生物酶增強和改善煙草浸膏香氣的方法 (a method of enhancing and improving the fragrance of tobacco concrete using various biotic enzymes)	PRC	12 September 2005

Trademarks

As at the Latest Practicable Date, the Target Group had the following trademarks:

Trademark	Classification	Place of registration	Validity period	Areas of application	Registration number
喜登 HEDON	Class 3	PRC	From 7 March 2000 to 6 March 2010	Tobacco flavours, fresheners (fragrance oil), flavours, fragrance oil, flower extracts (fragrances), geraniol, rose oil, beverage flavours (fragrance oil) and toilet soap fragrances.	1370117
	Class 3	PRC	From 21 December 2002 to 20 December 2012	Badian essence, bakery flavours, fragrances for industrial purposes, flower extracts, rose oil, fragrances, fragrance oil of lemon, tobacco flavours, beverage flavours and fragrances.	1903758
	Class 3	PRC	From 7 November 1997 to 6 November 2007	Tobacco flavours, beverage flavours (fragrance oil), bakery fragrances (fragrance oil), bakery flavours (fragrance oil), oil for fragrances and perfumes, fragrance oil of lemon, materials for artificial fragrances (including enanthal, coconut aldehyde, ethyl formate, phenyl acetate, benzoic acid ethyl ester, geraniol, muskine, fragrances for industrial purposes, fragrance for cosmetic purposes, toilet soap fragrances).	1124662
	Class 3	PRC	From 14 March 1998 to 13 March 2008	Tobacco flavours, fragrance oil, fragrances, fresheners (fragrance oil), flower extracts (fragrances), geraniol, rose oil, materials for artificial fragrances (including enanthal, coconut aldehyde, ethyl formate, phenyl acetate, benzoic acid ethyl ester, geraniol, muskine, fragrances for industrial purposes, fragrances for cosmetic purposes, toilet soap fragrances).	1158576

Trademark	Classification	Place of registration	Validity period	Areas of application	Registration number
華寶	Class 3	PRC	From 7 November 1997 to 6 November 2007	Tobacco flavours, beverage flavours (fragrance oil), bakery fragrances (fragrance oil), bakery flavours (fragrance oil), oil for fragrances and perfumes, fragrance oil of lemon, materials for artificial fragrances (including enanthal, coconut aldehyde, ethyl formate, phenyl acetate, benzoic acid ethyl ester, geraniol, muskine, fragrances for industrial purposes, fragrances for cosmetic purposes, toilet soap fragrances).	1124661
	Class 3	PRC	From 7 November 2004 to 6 November 2014	Tobacco flavours, fragrances.	713413
	Class 3	PRC	From 30 May 2000 to 29 May 2010	Food flavours, tobacco flavours, fragrances.	520349
孔雀	Class 3	PRC	From 21 June 2000 to 20 June 2010	Food flavours, food flavours (fragrance oil), tobacco flavours, fragrances.	1410298
孔 雀	Class 1	PRC	From 14 November 1996 to 13 November 2006	Artificial sweeteners (chemical preparations), must fining preparation, chemical substances for preserving food.	
孔 雀	Class 30	PRC	From 28 December 1996 to 27 December 2006	Aromatic preparations for food, food flavours (other than fragrance oil containing ethers), food flavours (other than etheric essences and fragrance oil), vanilla (flavour), vanillin (vanilla substitute), bakery flavours (other than fragrance oil), beverage flavours (other than fragrance oil), mint for confectionery, flavours for alcoholic drinks, flavours for sauce.	922487
孔雀	Class 1	PRC	From 28 July 2000 to 27 July 2010	Must fining preparation, chemical substances for preserving food.	1425009
孔雀	Class 3	PRC	From 30 May 2000 to 29 May 2010	Food flavours, tobacco flavours, fragrances.	384494

Trademark	Classification	Place of registration	Validity period	Areas of application	Registration number
金孔雀	Class 30	PRC	From 21 May 2001 to 20 May 2011	Aromatic preparations for food, food flavours (other than fragrance oil containing ethers), food flavours (other than etheric essences and fragrance oil), vanillin (vanilla substitute), bakery flavours other than fragrance oil, beverage flavours other than fragrance oil, mint for confectionery, vanilla (flavour), preparations for stiffening whipped cream, meat tenderizers for household purposes.	1575413
金孔雀	Class 1	PRC	From 28 January 2001 to 27 January 2011	Bacteriological preparations for acetification, chemical substances for preserving food, chemicals used for wine fermenting, chemicals used for vintage fermenting, saccharin, anti-sprouting preparations for vegetables, beer preserving agents, chemical preparations for smoked meat, milk ferments for chemical purposes, artificial sweeteners (chemical preparations).	1512003
金孔雀	Class 3	PRC	From 28 January 2001 to 27 January 2011	Tobacco flavours, fragrances, bakery fragrances (fragrance oil), oil for fragrances and perfumes, fresheners (fragrance oil), beverage flavours (fragrance oil), fragrances for industrial purposes, fragrances for cosmetic purposes, toilet soap fragrances, fragrance oil.	1512273
綠孔雀	Class 1	PRC	From 7 May 2001 to 6 May 2011	Bacteriological preparations for acetification, chemical substances for preserving food, chemicals used for wine fermenting, chemicals used for vintage fermenting, saccharin, saccharin, chemical preparations for smoked meat, milk ferments for chemical purposes, artificial sweeteners (chemical preparations).	1564070

Trademark	Classification	Place of registration	Validity period	Areas of application	Registration number
綠孔雀	Class 30	PRC	From 14 June 2001 to 13 June 2011	Aromatic preparations for food, food flavours (other than fragrance oil containing ethers), food flavours (other than etheric essences and fragrance oil), vanillin (vanilla substitute), bakery flavours other than fragrance oil, beverage flavours other than fragrance oil, mint for confectionery.	1586862
綠孔雀	Class 3	PRC	From 28 April 2001 to 27 April 2011	Tobacco flavours, fragrances, bakery fragrances (fragrance oil), oil for fragrances and perfumes, fresheners (fragrance oil), beverage flavours (fragrance oil), fragrances for industrial purposes, fragrances for cosmetic purposes, toilet soap fragrances.	1561696
藍孔雀	Class 30	PRC	From 14 June 2001 to 13 June 2011	Aromatic preparations for food, food flavours (other than fragrance oil containing ethers), food flavours (other than etheric essences and fragrance oil), vanillin (vanilla substitute), bakery flavours other than fragrance oil, beverage flavours other than fragrance oil, mint for confectionery.	1586861
藍孔雀	Class 1	PRC	From 7 May 2001 to 6 May 2011	Bacteriological preparations for acetification, chemical substances for preserving food, chemicals used for wine fermenting, chemicals used for vintage fermenting, saccharin, saccharin, chemical preparations for smoked meat, milk ferments for chemical purposes, artificial sweeteners (chemical preparations).	1564071
藍孔雀	Class 3	PRC	From 28 April 2001 to 27 April 2011	Tobacco flavours, fragrances, bakery fragrances (fragrance oil), oil for fragrances and perfumes, fresheners (fragrance oil), beverage flavours (fragrance oil), fragrances for industrial purposes, fragrances for cosmetic purposes, toilet soap fragrances.	1561697

FINANCIAL INFORMATION ON THE TARGET GROUP AND THE GROUP

Set out below is the financial information of the Target Group based on the audited combined financial statements of the Group and based on the published result announcement or financial statements, as restated when appropriate, for the years ended 31 March 2004, 2005 and 2006 prepared under the HKFRS:

	For the year ended 31 March								
	2004			2005			2006		
	Target Group *HK$('000)*	Group *HK$('000)*	% of the Group	Target Group *HK$('000)*	Group *HK$('000)*	% of the Group	Target Group *HK$('000)*	Group *HK$('000)*	% of the Group
Net profit/(loss) before tax	118,837	(7,502)	N/A	123,135	(6,365)	N/A	310,649	(6,763)	N/A
Net profit/(loss) after tax	106,283	(7,502)	N/A	111,827	(6,423)	N/A	300,844	(7,048)	N/A
Net asset value	347,343	(32,228)	N/A	470,835	(38,651)	N/A	497,622	(45,684)	N/A
Gross Profit	150,820	356	42365%	182,549	2,092	8726%	369,565	3,510	10529%
Turnover	543,829	26,723	2035%	725,070	24,703	2935%	770,025	18,563	4148%
Total assets	640,816	16,531	3876%	774,353	10,203	7589%	868,505	7,435	11681%

REASONS FOR AND BENEFITS OF THE ACQUISITION

The potential of the PRC flavour and fragrance industry

The Directors consider that there is substantial growth potential in the PRC flavour and fragrance industry and the Acquisition enables the Company to participate in the future growth and consolidation of this industry.

Unique opportunity of becoming one of the largest flavours and fragrances producers in the PRC

The Target Group was ranked the first for many years in the PRC flavours and fragrances industry. It is one of the largest flavours and fragrances producers in the PRC in terms of sales and profit. In view of the bright growth prospect of the PRC flavour and fragrance industry, the Directors consider that the Acquisition represents an attractive opportunity for the Company and thus enables the Company to become a leading player in the industry.

Instant boost of profitability and net asset value

Based on the track records of the Target Group, the Directors expect the Acquisition to make immediate and substantial contribution to the earnings of the Company. In addition, the net asset value of the Company will be substantially improved, which will in turn enhance the value for and benefits of the Shareholders as a whole.

Based on the above, the Directors believe that entering into the PRC flavour and fragrance industry through the Acquisition will provide stronger growth potential for the Company and substantially enhances its financial performance, which represents better return for the Company and the Shareholders.

NON-COMPETITION

Upon Completion, Ms. Chu will no longer own any business or interest that will compete with the Company. Nevertheless, Ms. Chu has provided the following non-competing undertakings to the Company:

(1) upon Completion, Ms. Chu will no longer own any business or interest that will compete with the Company;

(2) where opportunities arise which may compete with the business of the Company, the Company shall have the first right of refusal to take up such opportunity. Unless the Board of the Company decides to give up such opportunity, Ms. Chu shall not engage in the relevant business and investment; and

(3) in respect of the business and investment engaged by Ms. Chu as referred to (2) above, the Company shall have the right to acquire the same at any time (at fair and reasonable price, terms and conditions) and pre-emptive right (on terms not less favourable than those offered to third parties by Ms. Chu) in case that Ms. Chu offers to sell such business.

The above non-competition undertaking shall continue to be in full force until: (i) Ms. Chu and her associates cease to be the controlling shareholder of the Company; or (ii) the Shares of cease to be listed on the Stock Exchange, whichever is earlier.

IMPLICATIONS OF THE ACQUISITION UNDER THE LISTING RULES

Very substantial acquisition and connected transaction

As the relevant percentage ratios of the Acquisition calculated in accordance with Rule 14.07 of the Listing Rules exceed 100%, the Acquisition constitutes a very substantial acquisition under the Listing Rules which requires approval by the Shareholders.

In addition, since Ms. Chu is a director of the Company and holds 70.04% issued share capital of the Company, she is a connected person of the Company as defined by the Listing Rules. Accordingly, the Acquisition constitutes a connected transaction for the Company under Chapter 14A of the Listing Rules and the resolution regarding the Acquisition is subject to approval by Independent Shareholders voted by way of poll at the SGM.

CONTINUING CONNECTED TRANSACTIONS

As a result of and upon Completion, the substantial shareholders (and their respective associates) of the subsidiaries of the Target Company will become connected persons of the Company under the Listing Rules. The entering into any transactions between the Target Group (including the Target Company and its subsidiaries) and their respective substantial shareholders shall be subject to the reporting, announcement and Independent Shareholders approval requirements (as the case may be) under the Listing Rules.

Yunnan Hongta is wholly owned by Hongta Tobacco Group, which is wholly owned by the State-owned Assets Supervision and Administration Commission of the Yunnan Province People's Government of the PRC. Yunnan Hongta holds 40% equity interest in Yunnan Tianhong. The remaining 60% equity interest in Yunnan Tianhong is held by the Target Company through its two wholly owned subsidiaries, namely, Future Dragon and Nocton. In the premises, Hongta Tobacco Group and its associates are regarded as connected persons to the Company after Completion.

Framework Agreement

On 1 June 2006, the Target Company entered into the Framework Agreement with Hongta Tobacco Group, pursuant to which the Target Company and its subsidiaries will sell tobacco flavours products to Hongta Tobacco Group and its associates on an on-going basis for a period commencing from 1 June 2006 to 31 March 2009. The price for the products manufactured by the Target Group will be agreed from time to time between the parties concerned by reference to the prevailing market price at the relevant time, and the average gross profit margin of sales to be offered by the Target Company and its subsidiaries to Hongta Tobacco Group and its subsidiaries will be no more favourable than those offered by the Target Group to its other independent customers for similar product types in its ordinary and usual course of business. The Framework Agreement was negotiated on an arm's length basis and their terms represent normal commercial terms. For the three financial years ended 31st March 2006, the aggregate sales of tobacco flavours products by the Target Company to Hongta Tobacco Group and its associates amounted to approximately RMB143,241,704, RMB214,635,158, and RMB188,230,752 respectively.

Assuming the Completion taking place on 1 August 2006, the estimated aggregate amount for the sale of tobacco flavours products by the Target Company and its subsidiaries to Hongta Tobacco Group and its associates for the eight months ending 31 March 2007 and two financial years ending 31st March, 2008 and 2009 will not exceed RMB168,000,000, RMB290,000,000 and RMB350,000,000 respectively ("Annual Caps").

Benefit of the Framework Agreement

Hongta Tobacco Group, together with its associates, are the largest tobacco manufacturing group in the PRC, which produces tobacco under a number of well-known brand names, including "Hongtashan (紅塔山)", "Hongmei (紅梅)", "Yuxi (玉溪)" and "Ashima (阿詩瑪)". It is one of the long term customers of the Target Group before the Acquisition. In view of the established relationship, the Board considers that the Continuing Connected Transactions are necessary for the operations of the Company's businesses as an on-going concern, are and will be beneficial for the business operation and expansion of the Company. The Annual Caps are principally derived from the anticipated development and growth of the Company (based on the existing overall scale and operations of the Target Group), and the growth of the sales turnover to Hongta Tobacco Group and its associates in the last three financial years ended 31 March 2006 (as shown above).

The Directors are of the opinion the Continuing Connected Transactions were entered into (i) in the ordinary and usual course of business of the Company; (ii) on normal commercial terms; and (iii) on terms that are fair and reasonable and in the interests of the Company and its shareholders as a whole.

Independent Shareholders' Approval for the Framework Agreement

As the Annual Caps of the Continuing Connected Transactions exceed 2.5% of all applicable percentage ratios as calculated pursuant to Rule 14.07 of the Listing Rules, the Framework Agreement and the Annual Caps shall be subject to the approval of Independent Shareholders by way of a poll and annual review as required under the Listing Rules. Hongta Tobacco Group and its associates, being connected persons in the Continuing Connected Transactions, shall abstain from voting at the resolution in relation thereto. To the best knowledge of the Directors, as at the date of this announcement, Hongta Tobacco Group and its associates do not hold any interest in the shares of the Company.

CAPITAL REORGANISATION

The Directors further propose that the Company undergoes the Capital Reorganisation which comprises Share Premium Cancellation and Share Capital Increase.

Share Premium Cancellation

Under the Share Premium Cancellation, it is proposed that, subject to the fulfillment of the relevant conditions set out in the paragraph headed "Conditions of the Capital Reorganisation" below, the entire amount standing to the credit of the share premium account of the Company as at the day of Completion will be cancelled on the 20th business day after Completion in accordance with the Companies Act, relevant bye-laws of the Company and relevant accounting rules/standards applicable to the Company. The credit arising from the Share Premium Cancellation will be applied to eliminate the audited accumulated losses of the Company as at 31 March 2006 and any of the remaining balance of the credit will be credited to the contributed surplus account of the Company. As at 31 March 2006, the Company's audited accumulated losses amounted to approximately HK$384,791,000, and as at the same date thereof, the amount standing to the credit of the share premium account of the Company is approximately HK$244,588,000.

Share Capital Increase

As at the date hereof, the authorised share capital of the Company includes 2,000,000,000 Ordinary Shares of which 247,309,435 Ordinary Shares were in issue. The Directors propose to increase the authorised share capital of the Company from HK$337,690,000 to HK$887,690,000 by the creation of an additional 3,000,000,000 Ordinary Shares and 2,500,000,000 New Convertible Preference Shares. The Share Capital Increase will take place on the date on which the relevant ordinary resolution are passed by the Shareholders. The Company will make an announcement in this regard before the Share Capital Increase takes effect.

Effects of the Share Premium Cancellation

The Share Premium Cancellation involves the cancellation of the entire amount standing to the credit of the share premium account of the Company as at the day of Completion. As at 31 March 2006, the amount standing to the credit of the share premium account and accumulated losses of the Company amounted to HK$244,588,000 and HK$384,791,000 respectively. After the issuance of the New Convertible Preference Shares upon Completion, the amount standing to the credit of the share premium account of the Company may be increased. It is proposed that all or part of the credit standing to the share premium account of the Company in a maximum sum of HK$384,791,000 will be used to offset the accumulated losses in full and the remaining balance of the credit arising from the Share Premium Cancellation, if any, will be transferred to the contributed surplus account of the Company.

Assuming that the relevant conditions of the Share Premium Cancellation as set out under the paragraph headed "Conditions of the Capital Reorganisation" are fulfilled by or before end of August 2006 and that the Completion would have been completed on 31 August 2006, the Share Premium Cancellation will then take place on 28 September 2006, i.e. the 20th business days following the Completion. The Company will make further announcement in respect of the exact date for the implementation of the Share Premium Cancellation before the effective date of the Share Premium Cancellation.

Other than the expenses to be incurred in relation to the Share Premium Cancellation and the Share Capital Increase, the implementation thereof will not alter the underlying assets, business operations, management or financial position of the Company.

Conditions of the Capital Reorganisation

The Share Premium Cancellation is conditional upon (i) the passing by the Shareholders of a special resolution to approve the Share Premium Cancellation at a special general meeting of the Company; (ii) compliance with the relevant legal procedures and requirements under Bermuda laws to effect the Share Premium Cancellation; and (iii) the Completion of the Acquisition.

The Share Capital Increase is conditional upon (i) the passing by the Shareholders of an ordinary resolution to approve the Share Capital Increase at a special general meeting of the Company; (ii) compliance with the relevant legal procedures and requirements under Bermuda laws to effect the Share Capital Increase; and (iii) the passing by the Shareholders of an ordinary resolution to approve the Acquisition.

The Share Premium Cancellation and the Share Capital Increase are not inter-conditional.

Reasons for the Capital Reorganisation

As at 31 March 2006, the audited accumulated losses of the Company was approximately HK$384,791,000 and, according to Bermuda laws, the Company is not permitted to pay dividends while such accumulated losses remain. The Share Premium Cancellation will eliminate all or part of the accumulated losses of the Company and will enhance the Company's flexibility in its financial structure as well as in declaring dividends to the Shareholders as and when appropriate in the future.

To facilitate the issue of and conversion of New Convertible Preference Shares for the Acquisition, the Directors propose the Share Capital Increase.

To facilitate the Capital Reorganisation, the Boards also propose to amend the Company's memorandum of association and bye-laws to reflect the change of the capital structure of the Company.

SGM

The principal activities of the Company and its subsidiaries include trading and manufacturing of fine chemical and computer related products.

Set out on pages 180 to 186 in this circular is a notice convening the SGM which will be held at 3:15 p.m. on Wednesday, 26 July 2006 at Tianshan Room, Level 5, Island Shangri-La Hotel, Pacific Place II, Supreme Court Road, Central, Hong Kong, at which resolutions will be proposed to approve, among other things, the Acquisition, Continuing Connected Transactions and Capital Reorganisation and the proposed amendments to the bye-laws of the Company incorporating, among other things, the rights, previleges and restrictions attached to the New Convertible Preference Shares. As a connected person having interest in the Acquisition, Ms. Chu and her associates shall abstain from voting at the ordinary resolution regarding the Acquisition. As a connected person having interest in the Continuing Connected Transactions, Hongta Tobacco Group and its associates shall abstain from voting at the ordinary resolution regarding the Continuing Connected Transactions. In respect of the resolutions regarding Capital Reorganisation, no shareholder as at the date hereof is required to abstain from voting thereon.

Enclosed is a form of proxy for use at the SGM. Whether or not you will attend the SGM, you are requested to complete the proxy form in accordance with the instructions printed thereon and return and deposited the same at the Company's branch share registrar in Hong Kong, Tengis Limited, at 26th Floor, Tesbury Centre, 28 Queen's Road East, Hong Kong as soon as possible and in any event, not less than 48 hours before the holding of the SGM. Completion and return of proxy form will not prelude you from attending and voting at the SGM or any adjournment thereof should you so wish.

The Company has established an Independent Board Committee comprising all the independent non-executive Directors to consider and advise the Independent Shareholders with respect to the Acquisition and the Continuing Connected Transactions. The Company has appointed Tai Fook as an independent financial adviser to advise the Independent Board Committee and Independent Shareholders with respect to the Acquisition and the Continuing Connected Transactions.

Deutsche Bank AG, Hong Kong Branch and DBS Asia Capital Limited have been appointed as joint financial advisers to advise the Company with respect to the Acquisition and the Continuing Connected Transactions.

RECOMMENDATION

Your attention is drawn to the letter from the Independent Board Committee set out on page 38 of this circular which contains its advice to the Independent Shareholders regarding the Acquisition and the Continuing Connected Transactions and to the Letter from Tai Fook set out on pages 39 to 57 of this circular which contains its advice to the Independent Board Committee and the Independent Shareholders regarding the Acquisition and the Continuing Connected Transactions as well as the principal factors and reasons taken into consideration in arriving at its advice.

Taking into account the reasons set out above, the Directors (including the independent non-executive Directors) consider that the Acquisition and the Continuing Connected Transactions are fair and reasonable and in the interests of the Company and its Shareholders as a whole, and therefore recommend the Independent Shareholders to vote in favour of the relevant ordinary resolutions to be proposed at the SGM to approve the Acquisition and the Continuing Connected Transactions. You are advised to read the Letter from the Independent Board Committee and the Letter from Tai Fook mentioned above before deciding as to how to vote at SGM.

The Directors also recommend the Shareholders to vote in favour of the relevant resolutions relating to the Capital Reorganisation.

ADDITIONAL INFORMATION

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

On behalf of the Board of
Huabao International Holdings Limited
POON Chiu Kwok
Executive Director

HUABAO INTERNATIONAL HOLDINGS LIMITED
華寶國際控股有限公司 *

(Incorporated in Bermuda with limited liability)
(Stock Code: 336)

28 June 2006

To the Independent Shareholders and, for information only,
to the holders of Existing Preference Shares

Dear Sir or Madam,

VERY SUBSTANTIAL ACQUISITION AND CONNECTED TRANSACTION
PROPOSED CONTINUING CONNECTED TRANSACTIONS

We have been appointed as members of the Independent Board Committee to advise the Independent Shareholders in respect of the Acquisition and Continuing Connected Transactions, details of which are set out in the Letter from the Board in the circular of the Company dated 28 June 2006 (the "Circular"). Terms defined in the Circular bear the same meanings herein unless the context otherwise requires.

Your attention is drawn to the Letter from Tai Fook in the Circular containing the advice of Tai Fook in respect of the Acquisition and Continuing Connected Transactions.

RECOMMENDATION

We have considered the principal factors taken into account by Tai Fook in arriving at its opinion in respect of the Acquisition and the Continuing Connected Transactions. We concur with the views of Tai Fook that the Acquisition and the Continuing Connected Transactions are fair and reasonable so far as the Company and the Independent Shareholders are concerned and in the interests of the Company and the Independent Shareholders as a whole. Accordingly, we recommend the Independent Shareholders to vote in favour of the resolutions in respect of the Acquisition and the Continuing Connected Transactions at the SGM.

Yours faithfully,
Independent Board Committee
Mr. LEE Luk Shiu **Ms. MA Yun Yan** **Mr. MAK Kin Kwong, Peter**

* *for identification purpose only*

The following is the text of a letter from Tai Fook to the Independent Board Committee and the Independent Shareholders in respect of the Acquisition and Continuing Connected Transactions, and is prepared for inclusion in this circular.

taifook
TAI FOOK CAPITAL LIMITED

25th Floor
New World Tower
16-18 Queen's Road Central
Hong Kong

28 June 2006

To the Independent Board Committee and the Independent Shareholders
Huabao International Holdings Limited
Suite 1103, Central Plaza
18 Harbour Road
Wanchai
Hong Kong

Dear Sirs,

VERY SUBSTANTIAL ACQUISITION AND CONNECTED TRANSACTION PROPOSED CONTINUING CONNECTED TRANSACTIONS

INTRODUCTION

We refer to our appointment as the independent financial adviser to the Independent Board Committee and the Independent Shareholders with respect to the terms of the Acquisition and the Continuing Connected Transactions, details of which are set out in the announcements of the Company dated 7 June 2006 and 23 June 2006 and the letter from the Board ("Letter") contained in the circular of the Company dated 28 June 2006 (the "Circular"), of which this letter forms part. Terms used in this letter shall have the same respective meanings as defined in the Circular unless the context otherwise requires.

As referred to in the Letter, on 7 June 2006, the Company entered into the Acquisition Agreement with Ms. Chu, pursuant to which the Company has conditionally agreed to acquire from Ms. Chu and Ms. Chu has conditionally agreed to sell to the Company her 100% interest in the Target Company at a total consideration of HK$3,995,516,747, which will be satisfied by the Company by the issuance of and allotment to Ms. Chu 2,219,731,526 New Convertible Preference Shares at an issue price of HK$1.80 per New Convertible Preference Share.

The Target Group has been selling tobacco flavours products to Hongta Tobacco Group and its associates. Through its two wholly owned subsidiaries, namely Future Dragon and Nocton, the Target Company holds 60% equity interest in Yunnan Tianhong while the remaining 40% equity interest of Yunnan Tianhong is held by Hongta Tobacco Group through its wholly owned subsidiary, Yunnan Hongta. As Hongta Tobacco Group is a substantial shareholder of a subsidiary of the Target Company, Hongta Tobacco Group will become a Connected Person of the Company upon completion of the Acquisition. Accordingly, the sales by the Target Group to Hongta Tobacco Group and its associates will constitute continuing connected transactions of the Company upon completion of the Acquisition. A Framework Agreement dated 1 June 2006 was entered into by the Target Company with Hongta Tobacco Group to govern the Continuing Connected Transactions.

Ms. Chu is a director and the controlling shareholder of the Company, holding 70.04% of the issued share capital of the Company, and therefore is a Connected Person of the Company. The Acquisition constitutes a very substantial acquisition and connected transaction for the Company and each of the Acquisition and the Continuing Connected Transactions is subject to the approval of the Independent Shareholders at the SGM, at which the votes will be taken by poll. Ms. Chu and her associates will abstain from voting on the resolution to approve the Acquisition at the SGM while Hongta Tobacco Group and its associates will abstain from voting on the resolution to approve the Continuing Connected Transactions. As stated in the Letter, as at the Latest Practicable Date, Hongta Tobacco Group and its associates do not have any shares in the Company.

The Independent Board Committee comprising all independent non-executive Directors, namely Mr. Mak Kin Kwong, Peter, Ms. Ma Yun Yan and Mr. Lee Luk Shiu, has been appointed to advise the Independent Shareholders whether or not to vote in favour of the Acquisition and the Continuing Connected Transactions. In our capacity as the independent financial adviser to the Independent Board Committee and the Independent Shareholders, our role is to provide the Independent Board Committee and the Independent Shareholders with an independent opinion and recommendations as to whether the terms of each of the Acquisition Agreement and the Framework Agreement are fair and reasonable so far as the Independent Shareholders are concerned and whether the Acquisition and the Continuing Connected Transactions are in the interests of the Company and the Independent Shareholders as a whole.

BASIS OF OUR OPINION

In formulating our recommendations, we have relied on the information and facts supplied to us and representations expressed by the Directors and/or management of the Company and have assumed that all such information and facts and any representations made to us, for which they are fully responsible, are true, accurate and complete as at the date hereof. We have been advised by the Directors and/or the management of the Company that all relevant information has been supplied to us and that no material facts have been omitted from the information supplied and representations expressed to us. We have also relied on certain information available to the public so far we consider appropriate and have assumed such information to be accurate and reliable. We have no reason to doubt the completeness, truth or accuracy of the information and facts provided and we are not aware of any facts or circumstances which would render such information provided and representations made to us untrue, inaccurate or misleading. We have also been advised by the Directors and believe that no material facts have been omitted from the Circular.

We consider we have reviewed sufficient information to reach an informed view and to provide a reasonable basis for our opinion. We have not, however, conducted an independent verification of the information nor have we conducted any form of in-depth investigation into the businesses, affairs, financial position or prospects of the Group.

I. THE ACQUISITION

In arriving at our opinion in respect of the terms of the Acquisition, we have considered the following principal factors and reasons:

1. Background to and reasons for the Acquisition

1.1 Background financial information of the Group

The Company has been engaging in the trading of components for computer related products and home video products, such as integrated circuits for DVD drivers and players, and has had a prolonged loss-making track record. In March 2004, Mogul Enterprises Limited ("Mogul"), a company wholly owned by Ms. Chu, became the largest shareholder of the Company holding approximately 70.04% of the issued share capital of the Company. Subsequent to the introduction of Ms. Chu as a new controlling Shareholder, in addition to its business of trading of consumer electronic products, by leveraging on the expertise and experience of Ms. Chu in the fine chemicals industry, the Company has diversified its business into the fine chemicals business which includes the provision and sales of flavours and fragrances. For the two years ended 31 March 2005 and 2006, the fine chemicals business has accounted for approximately 47% and approximately 80% of the Company's total turnover. Set out below is a summary of the audited segmental information for the three years ended 31 March 2006, extracted from the Company's annual reports for each of the financial years ended 31 March 2006 and 2005:

	Year ended 31 March 2006			Year ended 31 March 2005 *(Restated)*			Year ended 31 March 2004		
	Consumer electronic products	Fine chemicals	Consolidated	Consumer electronic products	Fine chemicals	Consolidated	Consumer electronic products	Fine chemicals	Consolidated
					HK$'000				
Revenue	3,717	14,846	18,563	13,069	11,634	24,703	26,723	–	26,723
Segment results	56	665	721	87	385	472	(589)	–	(589)
Operating loss before finance cost			(296)			(416)			(7,502)
Loss for the year			(7,048)			(6,423)			(7,502)

As noted from the above table, after having the fine chemicals business as one of its principal businesses, the operating results of the Company has been improved. The operating loss before finance cost was improved from approximately HK$7.5 million for the year ended 31 March 2004 to approximately HK$0.4 million for the year ended 31 March 2005 and was further improved to approximately HK$0.3 million for the year ended 31 March 2006. As advised by the Directors, the improvement in the operating results of the Company was mainly attributable to the fine chemicals business which has a higher profit margin than the trading of consumer electronic products business. As stated in the Company's annual report for the financial year ended 31 March 2006, due to intense competition in the trading of consumer electronic products business, the Group has decided to scale down such segment of business and as a result the turnover from this segment has dropped by approximately 72% from approximately HK$13.1 million for the year ended 31 March 2005 to approximately HK$3.7 million for the year ended 31 March 2006. On the other hand, the fine chemicals business has been yielding steady income and maintaining a steady growth pace in turnover of approximately 28% from approximately HK$11.6 million for the year ended 31 March 2005 to approximately HK$14.8 million for the year ended 31 March 2006.

Notwithstanding the financial position of the Group has been improved as compared to the financial years before the introduction of Ms. Chu as a new controlling Shareholder, the Group was still making losses which was principally due to the interest expenses in relation to the liability component of the preference shares of the Company calculated by applying the fair dividend rate under the new Hong Kong Financial Reporting Standards. As further stated in the Company's annual report for the year ended 31 March 2006 and advised by the Directors, in view of the smooth development of the Group's fine chemicals business, and the growth in economy in the PRC which in turn improve the living standards of the PRC people, the Directors have great confidence on the fine chemicals market in the PRC and the Company believes that the PRC market has high potential for the development of the Group's fine chemicals business. As such, the Group will continue to pursue the business related to fine chemicals in the long run and will look earnestly for investment opportunities in this industry in order to generate a greater return for its Shareholders.

In light of the above, we concur with the view of the Directors and consider that the Acquisition is consistent with the Group's business strategy to expand its business scope in the PRC for the benefits of the Company and its Shareholders as a whole.

1.2 Information of the Target Group

1.2.1 Background

The Acquisition involves the transfer by Ms. Chu to the Company of her entire legal and beneficial interest in 100% of the issued share capital in the Target Company. Through its subsidiaries, the Target Company is principally engaged in the research and development, production and sales of flavours and fragrances, for use in tobacco, food, and daily consumer goods in the PRC. Upon completion of the Acquisition, the Target Company will become a wholly-owned subsidiary of the Company.

As stated in the Letter contained in the Circular, the Target Group has been engaging in its current business since 1996 and is a leader in the PRC flavours and fragrances industry. According to the Flavours Fragrance and Cosmetic Industry Statistic Information (香料香精化妝品行業統計信息) published in August 1998, 1999 and 2000 by the China Association of Fragrance Flavor and Cosmetic Industry (中國香料香精化妝品工業協會) and the report published by China Chemical Industry Information Association (中國化工情報信息協會) in 2003, the Target Group has been the market leader in terms of sales in the PRC flavours and fragrances industry for many years. In addition, according to the Flavours Fragrance and Cosmetic Industry Statistic Information, the Target Group was one of the largest flavours and fragrances companies in the PRC in 2005 in terms of sales and profit. Moreover, according to the Annual Report of China Chemical Industry published in 2004/2005, there are over 600 flavours and fragrances companies in the PRC, over 95% of which has sales of less than RMB 100 million. As the turnover recorded by the Target Group in each of the past three financial years ended 31 March 2004, 2005 and 2006 was over RMB 100 million, it inferred that the Target Group was among the top 5% of the companies in the flavours and fragrances industry in the PRC in terms of sales during the respective periods.

1.2.2 Financial highlights

Set out below are extracts of audited financial information of the Target Group for each of the financial years ended 31 March 2004, 2005 and 2006, a full set of the financial statements of the Target Group for each of the financial years ended 31 March 2004, 2005 and 2006 is set out in Appendix IV.A to this Circular:

		For the year ended 31 March	
	2006	**2005**	**2004**
		RMB'000	
Turnover			
Tobacco flavours	714,819	685,126	561,775
Food flavours	80,617	63,871	–
	795,436	748,997	561,775
Gross profit	381,761	188,573	155,797
Net profit attributable to equity holders of Chemactive Investments	303,483	109,524	104,170

Products sold by the Target Group comprise tobacco flavours and food flavours. Approximately 90% of the total turnover of the Target Group for the year ended 31 March 2006 was attributable to the sales from tobacco flavours. Turnover of the Target Group has recorded continuous growth during the three years ended 31 March 2004, 2005 and 2006. Total turnover for the year ended 31 March 2004 was approximately RMB561.8 million, which was increased to approximately RMB795.4 million for the year ended 31 March 2006, representing a compound annual growth rate of approximately 19.0%. As advised by the Directors, the growth in the revenue from food flavours was mainly attributable to the Target Group's direct sales strategy targeting high-end customers, as well as the success in improving marketing and distribution strategies; whereas the growth in the revenue from tobacco flavours was mainly attributable to the Target Group's effort in marketing and promotion of new products in each financial year and its gain in market share in tobacco flavours market.

The gross profit margin of the Target Group was approximately 28%, 25% and 48% for each of the three years ended 31 March 2004, 2005 and 2006 respectively. The gross profit margin for the year ended 31 March 2005 was slightly lower than that for the year ended 31 March 2004 which was mainly due to the increase in cost of goods sold as a result of the increase in direct labour costs and direct raw materials costs. The significant increase in the gross profit margin in 2006 was mainly due to the substantial drop in the cost of direct raw materials as a result of the Target Group's up stream integration and research and development in its product chain, which changed its raw material cost structure.

Along with the remarkable growth in turnover, net profit of the Target Group continued to grow in each of the three years ended 31 March 2006. The Target Group recorded net profit attributable to equity holders of Chemactive Investments of approximately RMB104.2 million, RMB109.5 million and RMB303.5 million for each of the three years ended 31 March 2004, 2005 and 2006 respectively, representing a compound annual growth rate of approximately 70.7%.

1.2.3 Prospects of the Target Group

The Directors are optimistic about the fine chemicals market. As set out in details in Appendix I to this Circular, according to the China Statistical Yearbook 2005 issued by National Bureau of Statistics of China, the PRC's gross domestic products per capita increased from approximately RMB3,923 in 1994 to approximately RMB10,561 in 2004, representing a compound annual growth rate of approximately 10.4%. The Directors believe that with the increase in the consumption power of the PRC people, their expectation on the quality of consumer products including food and household necessities will become higher and result in demand for better quality personal care products and more delicious food, which will need better and innovative flavours, including but not limited to food flavours and/or fine fragrances. Moreover, according to the China Chemical Industry Yearbooks, the total annual production output value of flavours and fragrances increased from approximately 138,000 tonnes in 1999 to approximately 180,000 tonnes in 2003, representing a compound annual growth rate of approximately 6.9%.

1.2.4 Management expertise

As stated in the Letter contained in this Circular, Ms. Chu, the Chairman of the Company, is experienced in the flavours and fragrances industry and is the vice chairman of China Association of Fragrance Flavor and Cosmetic Industry and China Food Additive Production and Application Industry Association. Mr. Wang Guang Yu, an executive Director of the Company, possesses extensive experience in the flavours and fragrances industry and is a vice chairman of the fifth executive committee of China Association of Fragrance Flavor and Cosmetic Industry. The Directors have advised us that both of Ms. Chu and Mr. Wang will continue to manage the operation of the business of the Target Group and other senior management of the Target Group will substantially remain subsequent to the Acquisition. The Group as enlarged by the Target Group will therefore have the necessary skills and expertise to manage the operation of the business of the Target Group subsequent to the Acquisition.

Given that (i) the Acquisition is in line with the Company's business development strategy; (ii) the Acquisition will enable the Group to expand its local presence in the PRC, which the Company believes has high potential, by utilizing the Target Group's distribution channels; (iii) the proven track record of the Target Group which may give an instant boost of profitability and net assets value to the Group as a result of the Acquisition; (iv) the potential of the flavours and fragrances industry based on the historical growth trend in respect of the demand for flavours and fragrances products as illustrated above; and (v) Ms. Chu, Mr. Wang and other senior management of the Target Group who have ample experience in the PRC flavours and fragrances industry will continue to manage the operation of the Target Group subsequent to the Acquisition, we are of the view that the Acquisition represents a reasonable business opportunity of the Group to expand its existing fine chemicals business and is beneficial to the Group and the Shareholders as a whole.

2. Principal terms of the Acquisition Agreement

2.1 Consideration for the Acquisition

The consideration for the Acquisition is approximately HK$3,995,516,747, which will be satisfied by the Company by way of the issuance of and allotment to Ms. Chu 2,219,731,526 New Convertible Preference Shares at an issue price of HK$1.80 per New Convertible Preference Share upon completion of the Acquisition. The consideration was arrived at after arm's length negotiation between the Company and Ms. Chu with reference to the business prospect and the financial performance of the Target Group for the three years ended 31 March 2006.

In identifying suitable Hong Kong listed market comparables in our analysis, we noted that only China Flavors and Fragrances Company Limited is engaged in the similar line of business with the Target Group. In view of this, we have extended our analysis to the worldwide stock market and have identified additional seven overseas listed companies (together with China Flavors and Fragrances Company Limited, the "Comparable Companies") that are principally engaged in the flavours and fragrances business. We noted that the products manufactured and sold by the Comparable Companies may not be exactly identical to those of the Target Group, but all of the following Comparable Companies are principally engaged in the flavours and fragrances business and we consider that they are relevant and would have reflected the market's collective valuation for the similar nature of business conducted by the Target Group. The following table illustrates the historical price-to-earnings ratio ("P/E ratios") of the Comparable Companies as at the Latest Practicable Date:

Company name	**Stock Exchange**	**Principal business**	**P/E ratio as at the Latest Practicable Date**
China Flavors and Fragrances Company Limited	Hong Kong	Research and development, manufactures and sales of flavours and fragrances for tobacco, food and daily consumer goods	18.4
International Flavors & Fragrances Inc.	New York	Creates and manufactures flavours and fragrances for food, daily consumer goods, beverages, pharmaceuticals and confectionery products	17.5

Company name	Stock Exchange	Principal business	P/E ratio as at the Latest Practicable Date
Sensient Technologies Corporation	New York	Supplies and manufactures colors, flavours and fragrances such as ink-jet inks, cosmetic and pharmaceutical additives, foods and beverages flavours	16.8
Givaudan SA	Switzerland	Manufactures and markets fragrances and flavours for daily consumer goods, beverages and foods	16.8
Danisco A/S	Denmark	Develops, produces and markets food ingredients including emulsifiers, stabilizers, flavours, and sweeteners.	21.1
Robertet SA	Paris	Develops and manufactures perfumes, perfume ingredients, and flavour additives	18.5
Takasago International Corporation	Tokyo	Produces aroma chemicals for use in cosmetics and soft drinks	25.7
T Hasegawa Co., Ltd.	Tokyo	Manufactures fragrances for cosmetics and toiletries, produces flavorings for beverages and food products	19.3
Average			19.3
Target Group *(Note)*			13.2

Sources: Bloomberg

Note: The calculation of the P/E ratio of the Target Group is based on the consideration for the Acquisition of HK$3,995,516,747 and the audited profit attributable to equity holders of Chemactive Investments of the Target Group for the year ended 31 March 2006 as disclosed in Appendix IV.A to this Circular.

The P/E ratios of the Comparable Companies range from approximately 16.8 to approximately 25.7, with an average P/E ratio of approximately 19.3. Therefore, the P/E ratio of the Target Group of approximately 13.2 falls below the range of the

P/E ratio of the Comparable Companies and is approximately 31.6% lower than the average P/E ratio of the Comparable Companies, which is favourable to the Company and the Independent Shareholders.

Taking into account that the P/E ratio of the Target Group falls below the range of the Comparable Companies, which is favourable to the Company and the Independent Shareholders; and the Company has been loss making for many years and the Acquisition represents a suitable opportunity for the Group to improve its operational and financial performance, we are of the view that the consideration for the Acquisition is fair and reasonable and in the interests of the Company and the Independent Shareholders as a whole.

2.2 Settlement method of the consideration

The Directors consider that the issue of the New Convertible Preference Shares is an appropriate means of settling the consideration for the Acquisition. We are advised by the Directors that they had considered other payment methods, including cash, the issue of Shares and the issue of convertible notes. However, after taking into account that (i) the Group has insufficient cash on hand to settle the entire consideration of approximately HK$3,996 million in view of the audited cash and cash equivalents balance of the Group of approximately HK$4.0 million as at 31 March 2006; (ii) based on the relatively poor historical financial performance and audited net liabilities of the Group as at 31 March 2006, it may be difficult for the Company to obtain the necessary banking facilities to settle the entire consideration and the finance cost involved may be very high; (iii) the issue of the new Shares will result in an immediate dilution of the shareholding of existing Shareholders and insufficient public float; and (iv) although the issue of convertible notes will not result in an immediate dilution of the shareholding of existing Shareholders and will not incur any immediate cashflow pressure to the Group, it will impose potential financial burden on the Group as the Company will be obliged to repay the outstanding principal amount of the convertible notes at the maturity date if Ms. Chu does not exercise the conversion rights attaching to the convertible notes, we consider the issue of the New Convertible Preference Shares, which are non-redeemable by the holder and not entitled to any dividend, is an appropriate means for the Group to settle the consideration for the Acquisition without incurring any cash outlay for the Group and immediate shareholding dilution.

2.3 Principal terms of New Convertible Preference Shares

Pursuant to the Acquisition Agreement, 2,219,731,526 New Convertible Preference Shares will be issued at an issue price of HK$1.80 per New Convertible Preference Share upon completion of the Acquisition.

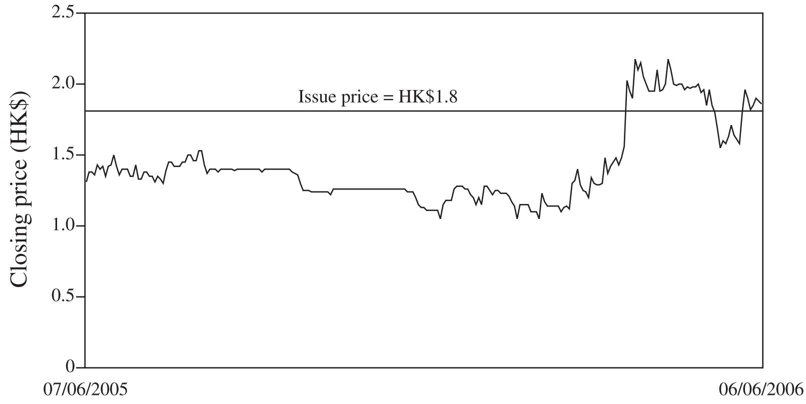
2.3.1 Issue price

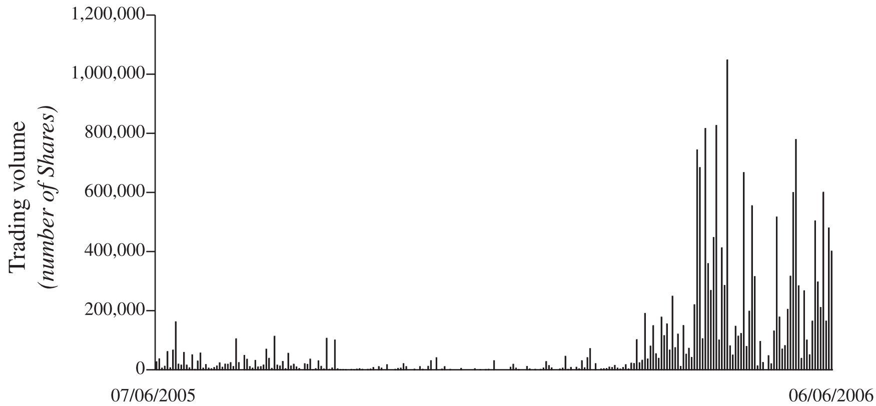
The issue price of HK$1.80 per New Convertible Preference Share was arrived at after arm's length negotiation between the Company and Ms. Chu and the Directors believe that the issue price is fair and reasonable. We will assess the fairness and reasonableness of the issue price by comparing it with the market price of the Shares, earnings per Share and net tangible assets value per Share as illustrated below.

Set out below are the closing prices/average closing prices of the Shares as quoted on the Stock Exchange on the date/during the respective periods and the discounts of the issue price to such prices.

Date/period	**Closing price/average closing price** *(HK$)*	**Discount to the closing price/average closing price**
As at 6 June 2006 (being the last trading day of the Shares immediately prior to the suspension of trading pending the release of the announcement of the Company regarding the Acquisition, "Last Trading Day")	1.86	3.2%
5-day period up to and including the Last Trading Day	1.86	3.2%
10-day period up to and including the Last Trading Day	1.81	0.6%
30-day period up to and including the Last Trading Day	1.82	1.1%

In addition, the following charts illustrate the historical closing prices and the trading volume of the Shares from 7 June 2005 up to 6 June 2006 (the "Review Period"), being the one-year period immediately prior to the Last Trading Day.





Source: Website of the Stock Exchange

Based on the above, it is noted that the issue price of HK$1.80 is very close to the closing price of the Shares as at the Last Trading Day of HK$1.86 and the average closing prices of the Shares for the last 5, 10 or 30-day period up to and including the Last Trading Day, with insignificant discounts ranged from 0.6% to 3.2%. Besides, it is noted that the daily closing prices of the Shares were below the issue price of HK$1.80 from 7 June 2005 to 20 March 2006 and from 12 May 2006 to 24 May 2006 during the Review Period. Regarding the trading volume of the Shares during the Review Period, the highest daily trading volume of the Shares was 1,047,700 Shares on 6 April 2006, representing approximately 0.42% of the issued share capital of the Company as at the Latest Practicable Date. In addition, the average daily trading volume of the Shares for the Review Period was approximately 79,753 Shares, representing approximately 0.03% of the issued share capital of the Company as at the Latest Practicable Date, which was very thin.

Based on the 2006 annual report of the Company, the Group recorded audited net loss of approximately HK$7.0 million for the year ended 31 March 2006, representing a loss per Share of approximately HK$0.03 based on 247,309,435 outstanding Shares as at the Latest Practicable Date. Besides, the audited consolidated net liabilities of the Company as at 31 March 2006 was approximately HK$45.7 million, representing a net deficit per Share of approximately HK$0.18 based on 247,309,435 outstanding Shares as at the Latest Practicable Date. Given the loss per Share and net deficit per Share recorded by the Group as aforesaid, we consider it is not appropriate to compare the issue price with them.

Having considered that (i) it is reasonable to set the issue price at a discount to the prevailing market price in view of the thin trading volume of the Shares and the discount of the issue price of approximately 3.2% to the closing price of the Shares as at the Last Trading Day is insignificant and therefore acceptable; (ii) the Shares were traded at a price below the issue price for most of the time during the Review Period; (iii) the Group recorded audited loss per Share of approximately HK$0.03 for the year ended 31 March 2006 and; (iv) the Group recorded audited net deficit per Share of approximately HK$0.18 as at 31 March 2006, we consider the issue price of HK$1.80 per New Convertible Preference Share is fair and reasonable and in the interests of the Company and the Independent Shareholders as a whole.

2.3.2 Redemption and dividend

The holders of the New Convertible Preference Shares will not be entitled to (i) request the Company to redeem any of the New Convertible Preference Shares; or (ii) receive any dividend. We consider that the non-redeemable (by the holder) and non-dividend entitlement terms of the New Convertible Preference Shares are in the interests of the Company and the Independent Shareholders as it will not impose any cash outlay for the Group and the Group could utilize the surplus funds available to further strengthen its newly acquired flavours and fragrances business instead of paying dividend to Ms. Chu, which is beneficial to the Group's development in the long run.

2.3.3 Conversion rights and dilution of shareholding

The holders of the New Convertible Preference Shares will have the rights to convert all or such number of New Convertible Preference Shares in multiples of 1,000,000 New Convertible Preference Shares into Shares at any time on the basis of one New Convertible Preference Share to one Ordinary Share (subject to adjustment in the following events: alteration to the nominal value of the ordinary Shares as a result of consolidation or subdivision). The following table sets out the shareholding structure of the Company (i) as at the Latest Practicable Date; and (ii) immediately upon full conversion of the Existing Preference Shares, Warrants and New Convertible Preference Shares.

	As at the Latest Practicable Date		**Immediately upon full conversion of the Existing Preference Shares, Warrants and New Convertible Preference Shares**	
	Number of Shares	*%*	*Number of Shares*	*%*
Ms. Chu	173,219,445	70.04	2,968,850,971	97.57
Public Shareholders	74,089,990	29.96	74,089,990	2.43
Total	247,309,435	100.0	3,042,940,961	100.0

Immediately upon full conversion of the Existing Preference Shares, Warrants and New Convertible Preference Shares, the shareholding of existing Shareholders other than Ms. Chu will be diluted by approximately 27.53% from approximately 29.96% to approximately 2.43%.

However, pursuant to the terms of the New Convertible Preference Shares, the holders of the New Convertible Preference Shares shall not exercise the conversion rights as to such number of New Convertible Preference Shares if upon the conversion thereof, the percentage of the Shares held by the public drops to below the minimum public float requirement under Rule 8.08 of the Listing Rules. Besides, Ms. Chu has undertaken to the Company that she (and her associates) will and will procure the holders of the Existing Preference Shares, Warrants and New Convertible Preference Shares only exercise the conversion rights as to such number of Existing Preference Shares, Warrants and New Convertible Preference Shares if upon conversion thereof, the percentage of the Shares held by the public still meets the minimum public float requirement under Rule 8.08 of the Listing Rules.

After taking into account that (i) the Acquisition represents a suitable opportunity for the Group to improve its existing unsatisfactory operational and financial performance; (ii) the issue of the New Convertible Preference Shares is an appropriate means for the Group to settle the consideration for the Acquisition without incurring any cash outlay for the Group and immediate dilution in shareholding as discussed in the paragraph headed "Settlement method of the consideration" above; (iii) the enlargement of the capital base of the Company upon full conversion of the New Convertible Preference Shares; and (iv) the conversion restriction of the New Convertible Preference Shares and the undertaking given by Ms. Chu are effective in ensuring that the minimum public float requirement under Rule 8.08 of the Listing Rules is complied by the Company, we are of the view that the potential dilution of the shareholding of existing Shareholders other than Ms. Chu upon full conversion of the Existing Preference Shares, Warrants and New Convertible Preference Shares is acceptable.

3. Financial effects of the Acquisition on the Group

The following analysis is based on the assumption that there will not be any changes to the total issued share capital of the Company as at the Latest Practicable Date other than the full conversion of the New Convertible Preference Shares.

3.1 Net assets value

Based on the total audited net liabilities of approximately HK$45.7 million as at 31 March 2006 and 247,309,435 outstanding Shares as at the Latest Practicable Date, the net deficits per Share of the Group was approximately HK$0.18 as at 31 March 2006.

Based on the pro forma balance sheet of the Enlarged Group (as defined in Appendix V to the Circular) in Appendix V to the Circular, assuming the Acquisition had taken place on 31 March 2006, the Group would record net assets value of approximately HK$451.9 million as at 31 March 2006. Therefore, if the Acquisition had taken place on 31 March 2006, instead of having net deficits per Share, the Group would have net assets value per Share of approximately HK$1.8 based on 247,309,435 outstanding Shares as at the Latest Practicable Date, and approximately HK$0.18 based on 2,467,040,961 Shares assuming all New Convertible Preference Shares are converted in full. As the net assets value per Share of the Group, after taking into account of the effect of the exercise in full of the conversion rights attaching to the New Convertible Preference Shares, will be improved, we consider that the Acquisition is in the interests of the Company and the Independent Shareholders as a whole.

3.2 Earnings per Share

Based on the audited net loss of approximately HK$7.0 million for the year ended 31 March 2006 and 247,309,435 outstanding Shares as at the Latest Practicable Date, the net loss per Share of the Group was approximately HK$0.03.

Based on the pro forma income statement of the Enlarged Group in Appendix V to the Circular, assuming the Acquisition had taken place on 1 April 2005, the Group would record net profits attributable to Shareholders of approximately HK$283.1 million for the year ended 31 March 2006 and earnings per Share of approximately HK$1.14 based on 247,309,435 outstanding Shares as at the Latest Practicable Date and approximately HK$0.11 based on 2,467,040,961 outstanding Shares, which is the sum of the total number of Shares outstanding as at the Latest Practicable Date and the Shares resulting from the exercise in full of the conversion rights attaching to the New Convertible Preference Shares.

Upon completion of the Acquisition, the results of the Target Group would be consolidated into the Group. In view of the profit generating track record of the Target Group in the past three financial years as illustrated in Appendix IV.A to the Circular, we are of the view that the earnings per Share of the Group will be improved as a result of the Acquisition, which is in the interests of the Company and the Independent Shareholders as a whole.

3.3 Cashflow

Since the consideration of the Acquisition will be satisfied by the issuance of and allotment to Ms. Chu, the New Convertible Preference Shares, the Acquisition will not have any material effect on the cashflow position of the Group except that the cash and cash equivalents balance of the Enlarged Group would be increased by that of the Target Group subsequent to the Acquisition. As at 31 March 2006, the Company has an audited cash and cash equivalents balance of approximately HK$4.0 million. Based on the pro forma cash flow statement of the Enlarged Group in Appendix V to the Circular, assuming the Acquisition had taken place on 1 April 2005, the Group would have a cash and cash equivalents balance of approximately HK$178.7 million as at 31 March 2006. In view of the fact that the cash and cash equivalents balance of the Group will be improved, we are of the view that the Acquisition is in the interests of the Company and the Independent Shareholders as a whole.

3.4 Gearing

Based on the pro forma balance sheet of the Enlarged Group in Appendix V to the Circular, assuming the Acquisition had taken place on 31 March 2006, the total liabilities and net assets value of the Group as at 31 March 2006 would be approximately HK$423.8 million and approximately HK$451.9 million respectively, representing a gearing ratio (expressed as total liabilities to total equity) of approximately 0.94.

As the Group recorded audited net deficit of approximately HK$45.7 million as at 31 March 2006, the gearing ratio of the Group as at 31 March 2006 cannot be computed.

Upon conversion of the New Convertible Preference Shares, the gearing ratio of the Group will remain unchanged as there will not be any effect on the total liabilities and total equity of the Group as a result of the conversion. Therefore, we are of the view that as a result of the Acquisition, together with the issue of the New Convertible Preference Shares, the gearing position of the Group will be improved, which is favourable to the Company and the Independent Shareholders as a whole.

II. POSSIBLE CONTINUING CONNECTED TRANSACTIONS

1. Background and reasons of the Continuing Connected Transactions

The Target Group has been selling tobacco flavours products to Hongta Tobacco Group and its associates which will continue from time to time after completion of the Acquisition. Through its two wholly owned subsidiaries, namely Future Dragon and Nocton, the Target Company holds 60% equity interest in Yunnan Tianhong while the remaining 40% equity interest of Yunnan Tianhong is held by Hongta Tobacco Group through its wholly owned subsidiary, Yunnan Hongta. As Hongta Tobacco Group is a substantial shareholder of a subsidiary of the Target Company, Hongta Tobacco Group will become a Connected Person of the Company upon completion of the Acquisition. As such, the sales of tobacco flavours products by the Target Group to Hongta Tobacco Group and its associates will constitute continuing connected transactions of the Company under the Listing Rules upon completion of the Acquisition. In the circumstances, on 1 June 2006, the Target Company entered into the Framework Agreement with Hongta Tobacco Group which sets out the framework and general terms of the Continuing Connected Transactions for a period commencing from 1 June 2006 to 31 March 2009. Assuming the Completion taking place on 1 August 2006, the estimated annual aggregate amount for the sales of tobacco flavours products by the Target Group to Hongta Tobacco Group for the eight months ending 31 March 2007 and the two financial years ending 31 March 2008 and 2009 respectively under the Framework Agreement may exceed 2.5% of the percentage ratios (other than the profit ratio) and HK$10,000,000. Therefore, the Continuing Connected Transactions to be made in the eight months ending 31 March 2007 and each of the two financial years ending 31 March 2008 and 2009 will constitute non-exempt continuing connected transactions for the Company under Rule 14A.35 of the Listing Rules and will be subject to reporting, announcement and Independent Shareholders' approval.

As stated in the Letter, Hongta Tobacco Group, together with its associates, are the largest tobacco manufacturing group in the PRC, which produces tobacco under a number of well-known brand names, including "Hongtashan (紅塔山)", "Hongmei (紅梅)", "Yuxi (玉溪)" and "Ashima (阿詩瑪)". It is one of the long term customers of the Target Group. For each of the financial years ended 31 March 2004, 2005 and 2006, the aggregate sales of tobacco flavours products by the Target Group to Hongta Tobacco Group and its associates amounted to approximately RMB143.2 million, RMB214.6 million and RMB188.2 million respectively, which represented approximately 25%, 29% and 24% respectively of the total turnover of the Target Group for each of the financial years ended 31 March 2004, 2005 and 2006; and approximately 25%, 31% and 26% respectively of the total turnover derived from sales of tobacco flavours of the Target Group for each of the financial years ended 31 March 2004, 2005 and 2006.

In view of the long term business relationship between the Target Group and Hongta Tobacco Group and the size of the historical transaction amounts, we agree with the Company that the Continuing Connected Transactions are necessary for the operations of the Group's business on an on-going basis and will be beneficial for the business operation and expansion of the Group after completion of the Acquisition.

2. Proposed terms of the Framework Agreement

As stated in the Letter, the Framework Agreement was negotiated between the parties on an arm's length basis and in normal commercial terms. Pursuant to the Framework Agreement, the prices for the tobacco flavours products manufactured by the Target Group and sold to Hongta Tobacco Group will be agreed from time to time between the parties concerned by reference to the prevailing market price at the relevant time, and the average gross profit margin of sales to be offered by the Target Group to Hongta Tobacco Group and its subsidiaries will be no more favourable than those offered by the Target Group to its other independent customers for similar product types in its ordinary and usual course of business.

Based on the above, we are of the view that the pricing mechanism is fair and reasonable.

3. Basis of the Annual Caps

Under the Framework Agreement, assuming the Completion taking place on 1 August 2006, it is expected that the annual aggregate amount for the sales of tobacco flavours products by the Target Group to Hongta Tobacco Group and its associates for the eight months ending 31 March 2007 and the two financial years ending 31 March 2008 and 2009 will not exceed RMB168 million, RMB290 million and RMB350 million respectively. Such estimation of Annual Caps is principally derived from the anticipated development and growth of the Company (based on the existing overall scale and operations of the Target Group), and the growth of the sales turnover to Hongta Tobacco Group and its associates in the last three financial years ended 31 March 2006.

In determining the fairness and reasonableness of the Annual Caps, we have discussed with the Company's management the basis and assumptions underlying the projections of the Annual Caps. We have also reviewed the value of the historical transaction amounts of the sales by the Target Group to Hongta Tobacco Group and its associates for the three years ended 31 March 2006. In addition, we have considered the growth of the gross domestic products per capita in the PRC from approximately RMB3,923 in 1994 to approximately RMB10,561 in 2004 (representing a compound annual growth rate of approximately 10.4%) and the growth of the total annual production output value of flavours and fragrances in the PRC from approximately 138,000 tonnes in 1999 to approximately 180,000 tonnes in 2003 (representing a compound annual growth rate of approximately 6.9%), details of which have been mentioned in the paragraph headed "Prospects of the Target Group" above.

Having considered the basis from which the Annual Caps are determined and the public statistics data available which shows a growing trend in both the gross domestic products per capita and total annual production output value of flavours and fragrances in the PRC in the past few years, we are of the view that the Annual Caps which are expected to increase gradually in the eight months ending 31 March 2007 and the two financial years ending 31 March 2008 and 2009, was made by the Directors after due and careful consideration and therefore, are fair and reasonable.

RECOMMENDATION

Having considered the above principle factors and reasons in respect of the Acquisition and in respect of the Continuing Connected Transactions, we are of the view that (i) the terms of the Acquisition Agreement are fair and reasonable so far as the Independent Shareholders are concerned and the Acquisition is in the interests of the Company and the Independent Shareholders as a whole; (ii) the terms of the Continuing Connected Transactions under the Framework Agreement are on normal commercial terms, in the ordinary and usual course of business of the Group, fair and reasonable and in the interests of the Company and the Independent Shareholders as a whole; and (iii) each of the Annual Caps is fair and reasonable so far as the Company and the Independent Shareholders are concerned. Accordingly, we advise the Independent Board Committee to recommend the Independent Shareholders, and we ourselves recommend the Independent Shareholders, to vote in favour of the ordinary resolutions to be proposed at the SGM to approve the Acquisition Agreement and the transactions contemplated thereunder, the Framework Agreement and the transactions contemplated thereunder and each of the Annual Caps.

Yours faithfully,
For and on behalf of
Tai Fook Capital Limited

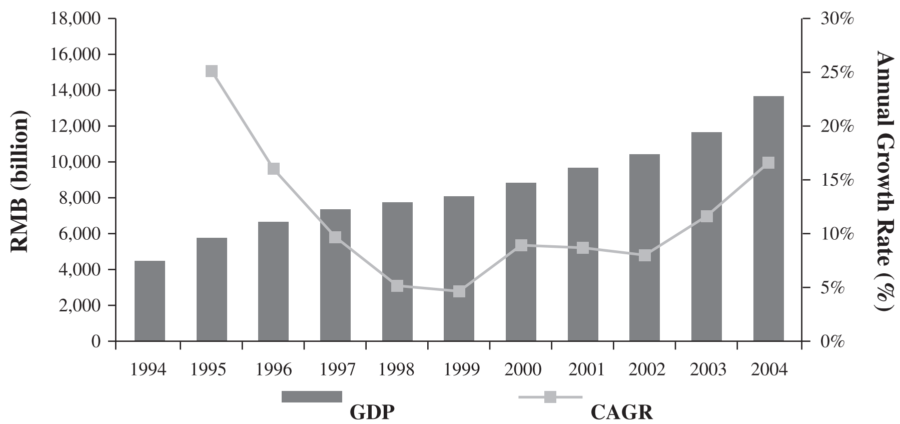
Derek C.O. Chan
Managing Director

April Chan
Executive Director

AN OVERVIEW OF THE PRC ECONOMY

The PRC has the largest population in the world, and has been one of the world's fastest growing economies. According to the statistics provided by National Bureau of Statistics of China, the PRC's population reached approximately 1.3 billion in 2004. The PRC's GDP increased from approximately RMB4,675.9 billion in 1994 to approximately RMB13,687.6 billion in 2004, with a compound annual growth rate (CAGR) of approximately 11.3%. The chart below illustrates the PRC's GDP and its growth rate in the said period:

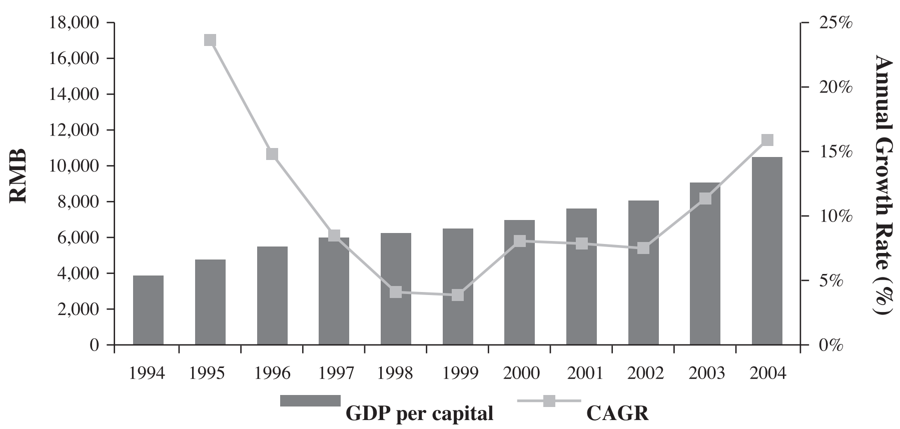
PRC's GDP and its growth rate
(from 1994 to 2004)



Source: China Statistical Yearbook 2005

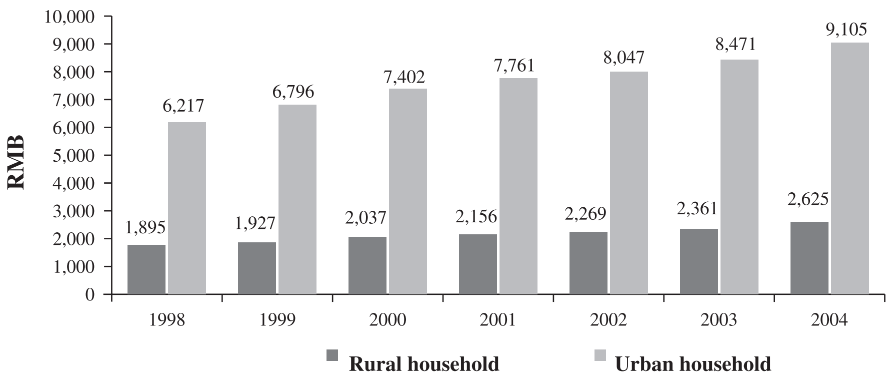
The PRC's GDP per capita increased from approximately RMB3,923 in 1994 to approximately RMB10,561 in 2004, with a CAGR of approximately 10.4%. The chart below illustrates the PRC's GDP per capita and its growth rate in the said period:

PRC's GDP per capita and its growth rate
(from 1994 to 2004)



Source: China Statistical Yearbook 2005

The growth of the PRC economy has resulted in an improvement in the PRC's living standards, which has in turn contributed to the growth in the PRC consumer sector. According to China Statistical Yearbook 2005 prepared by National Bureau Statistics of China and published in September 2005, the expenditures of rural and urban households in the PRC increased from approximately RMB1,895 and RMB6,217, respectively, in 1998 to approximately RMB2,625 and RMB9,105, respectively, in 2004. The following chart illustrates the expenditures of rural and urban households in the PRC in the said period:



Source: China Statistical Yearbook 2005

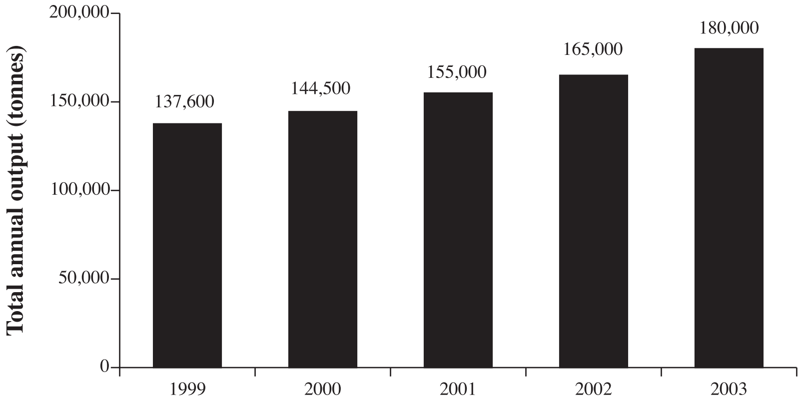
PRC FLAVOUR AND FRAGRANCE INDUSTRY

The flavour and fragrance industry is an indispensable complementary industry for the domestic economy, and is closely related to the daily life of the people. It also provides necessary raw materials to the food industry and other consumer industries. The demand for food flavours and fragrances, and fine fragrances in terms of types, quantity and quality has been driven by the continuing growth of the PRC economy and improvement in the living standard of the people.

According to the China Chemical Industry Yearbook 2004/2005 published in June 2005, most of the international leading flavour and fragrance companies have established their production facilities in the PRC. Thus, the domestic markets of the flavour and fragrance industry in the PRC have internationalised. However, 90% of over 600 flavour and fragrance producers in the PRC as at 2004 were small or medium-sized companies. There were only about 20 companies with annual sales revenue of over RMB100 million.

The total annual production output of flavours and fragrances increased from approximately 138,000 tonnes in 1999 to approximately 180,000 tonnes in 2003, with a CAGR of approximately 6.9%. The following chart shows the total annual production output of flavours and fragrances in the PRC during the said period:

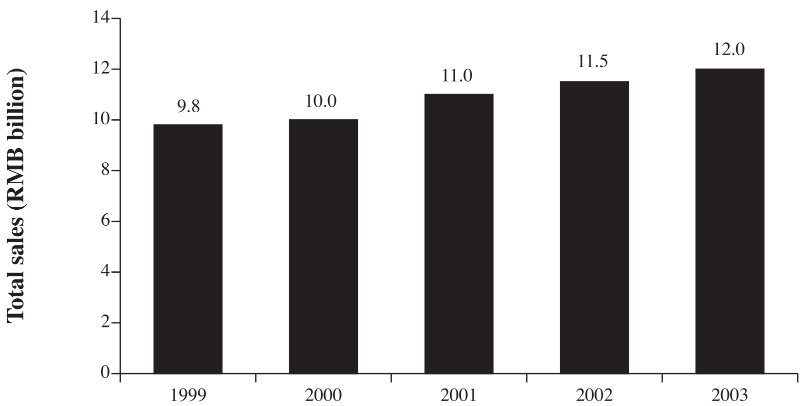
Total annual production output of flavours and fragrances in the PRC (from 1999 to 2003)



Source: China Chemical Industry Yearbooks 2001/2002, 2004 and 2004/2005

The total sales revenue of flavour and fragrance industry in the PRC increased from approximately RMB9.8 billion in 1999 to approximately RMB12.0 billion in 2003, with a CAGR of approximately 5.2%. The following chart shows the total sales revenue of flavour and fragrance industry in the PRC during the said period:

Total sales revenue of flavours and fragrances in the PRC (from 1999 to 2003)



Source: China Chemical Industry Yearbooks 2001/2002, 2004 and 2004/2005

In 2004, the total import of flavours and fragrances in the PRC was approximately 32,000 tonnes, which amounted to approximately US$280 million. In the same year, the total export of flavours and fragrances in the PRC was approximately 81,000 tonnes, which amounted to approximately US$550 million.

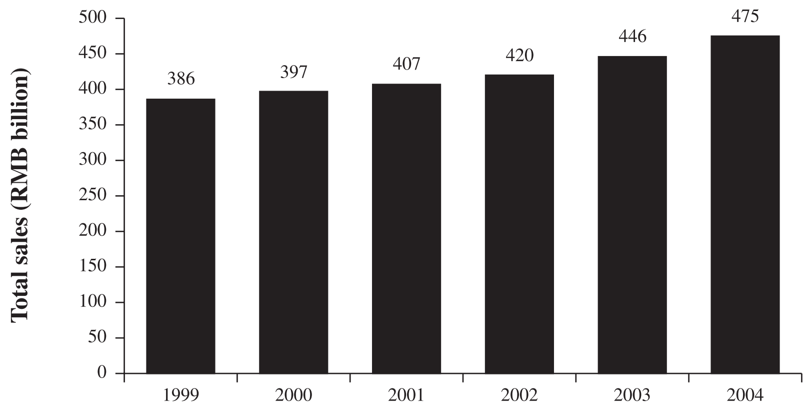
The constant growth in the PRC's flavour and fragrance industry as illustrated above is attributable to the stable development of the tobacco, food and daily consumer goods industries in the PRC. The following is an overview of each of the aforesaid consumer markets in the PRC.

Tobacco market

The tobacco industry in the PRC plays an important role in the domestic economy. According to Consumer China 2006 prepared by a global market research company, Euromonitor International, an independent third party, and published in September, 2005, the total sales of tobacco in the PRC increased from approximately RMB386.3 billion in 1999 to approximately RMB474.7 billion in 2004. In 2005, the total tax revenues from the tobacco industry in the PRC amounted to over RMB240.0 billion.

The following chart illustrates the total sales of tobacco in the PRC in the said period:

Total sales of tobacco in the PRC
(from 1999 to 2004)



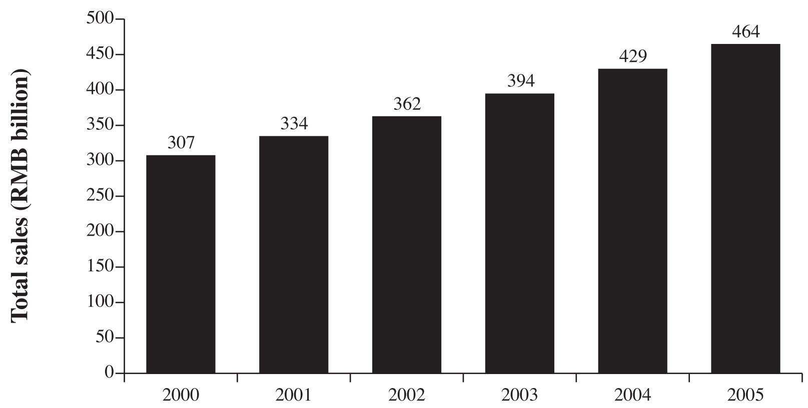
Source: Consumer China 2006, Euromonitor International

Food market

Improvement of the living standard in the PRC has resulted in an increasing individual disposable income and purchasing power. The total size of the retail market in the PRC has, according to the National Bureau of Statistics of China, increased from approximately RMB3,415.3 billion in 2000 to approximately RMB5,395.0 billion in 2004, representing a CAGR of approximately 12.1%. Under such circumstances, people in PRC will demand for higher quality personal care products and more delicious food, which require better and innovative flavours, including but not limited to food flavours and/or fine fragrances.

According to Consumer China 2006, the total sales of packaged food in the PRC increased from approximately RMB307 billion in 2000 to approximately RMB464 billion in 2005, with a CAGR of approximately 8.6%. The following chart illustrates the total sales of packaged food in the PRC in the said period:

Total sales of packaged food in the PRC
(from 2000 to 2005)

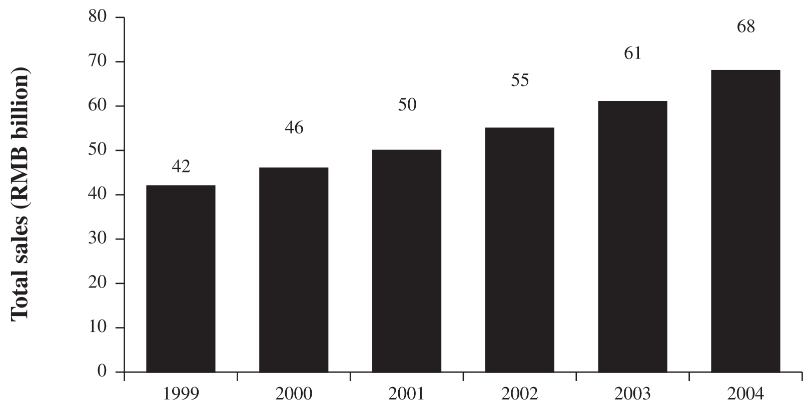


Source: Consumer China 2006, Euromonitor International

Daily consumer goods market

According to Consumer China 2006, the total sales of cosmetics and toiletries in the PRC increased from approximately RMB42.2 billion in 1999 to approximately RMB68.2 billion in 2004, with a CAGR of approximately 10.1%. The following chart illustrates the total sales of cosmetics and toiletries in the PRC in the said period:

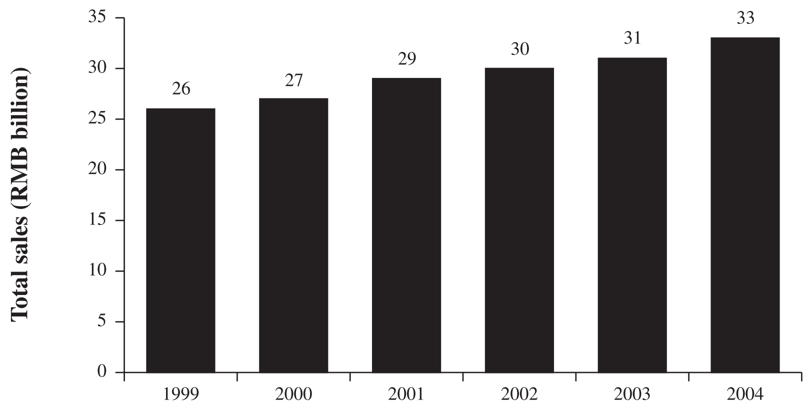
Total sales of cosmetics and toiletries in the PRC
(from 1999 to 2004)



Source: Consumer China 2006, Euromonitor International

According to Consumer China 2006, the total sales of household care products in the PRC increased from approximately RMB25.9 billion in 1999 to approximately RMB32.7 billion in 2004, with a CAGR of approximately 4.7%. The following chart illustrates the total sales of household care products in the PRC in the said period:

Total sales of household care products in the PRC (from 1999 to 2004)



Source: Consumer China 2006, Euromonitor International

APPLICABLE LAWS AND REGULATIONS

Flavours and fragrances

Under 工業產品生產許可證管理辦法 (Administrative Rules Regarding Production Permits for Industrial Products) (the "Administrative Rules") promulgated by 國家品質監督檢驗檢疫總局 (The State Quality Supervision Inspection and Quarantine Bureau) on 19 April 2002 and 香料香精產品換(發)生產許可證實施細則 (Implementation Rules Regarding the Issues and Renewals of Flavours and Fragrances Production Permits) issued by 全國工業產品生產許可證辦公室 (National Industrial Products Production Permit Office) on 2 September 2002, manufacturers of flavours and fragrances in the PRC are required to obtain production permits from the relevant PRC government authorities before they commence the production of flavours and fragrances.

According to 中華人民共和國食品衛生法 (The Law of Food Hygiene in the PRC) implemented on 30 October 1995, enterprises engaged in the manufacturing and sales of food additives (which include food flavours) are required to obtain 衛生許可證 (Hygiene Permit) from the relevant PRC authorities.

ENVIRONMENTAL PROTECTION

PRC manufacturers must comply with the environmental protection laws and regulations (the "Environmental Regulations") including 中華人民共和國環境保護法 (Environmental Protection Law of the People's Republic of China), 中華人民共和國水污染防治法(修正) (Law of the People's Republic of China on the Prevention and Control of Water Pollution (Amendment)), 中華人民共和國大氣污染防治法(修正) (Law of the People's Republic of China on the Prevention and Control of Air Pollution (Amendment)) stipulated by the State and the local environmental protection bureaus, and also comply with the environmental regulations stipulated by the 中華人民共和國固體廢物污染環境防治法 (Law of the People's Republic of China on the Prevention and Control of Environmental Pollution of Solid Waste).

Major risks associated with the Target Group are as follows:

Dependence on the PRC market

During the Track Record Period, all the Target Group's products were sold in the PRC. The sales of the Target Group's products in the PRC will continue to represent a significant proportion of the Target Group's turnover in the near future. As a result, the Group's operating results and financial performance would be affected if there are any adverse changes in economic, political and social conditions in the PRC. There is also no assurance on whether such changes would or would not adversely affect the Group's performance and profitability.

Dependence on the tobacco industry

During the Track Record Period, approximately 100%, 91% and 90% of the Target Group's turnover respectively was attributable to the tobacco flavour enhancer category. Flavour enhancers are developed and produced for tobacco processing in order to enhance its quality. Accordingly, the Target Group's profitability depends largely on the tobacco market in the PRC.

The tobacco market in the PRC is affected by many factors, including anti-smoking campaigns, tobacco taxes, health concern, advertisement restrictions and smoking restrictions. If any of the above factors become significant to affect adversely the tobacco market, the flavour enhancer market and, therefore, the Target Group's turnover and profitability, may consequently be adversely affected.

Taxation in the PRC

Certain of the Target Group's members, including Huabao Kongque, Huabao Shanghai, Wuxi Fuhua, Wuxi Jiahua, Yunnan Tianhong and Weihai Huayuan, as foreign invested manufacturing enterprises, are entitled to tax preferential treatment. The expiry of such preferential tax treatment will increase the tax exposure of the Target Group, and thus could adversely affect the Target Group's profitability. As the PRC is currently the only market of the Target Group's business, any change in the taxation regulations in the PRC could have an adverse impact on the Target Group's business operations.

Competition

The market of the flavour and fragrance industry is highly segmented and competitive. Should the Target Group be unable to cope with the changing market conditions or satisfying its customers' needs by improving its competitiveness, the Target Group's profitability could be adversely affected.

Technology

The development of new flavours and fragrances is essential to the business operation of the Target Group. Should the Target Group fail to develop products that keep up with the latest market trends and technological changes, its business, financial condition and profitability might be adversely affected.

Reliability of statistics

Part of the statistics and the industry information contained in this Letter from the Board are gathered from various governmental official publications. Although reasonable actions have been taken by the Directors to ensure the statistics are extracted accurately from those sources, the Company, the Directors and all other parties involved in the Acquisition have not carried out any independent review of the statistics or the methodology in the gathering, compilation or presentation of such statistics. Accordingly, there is no assurance on the accuracy of such statistics.

1. FINANCIAL SUMMARY ON THE GROUP

Set out below is a summary of the audited consolidated balance sheets and consolidated income statements as at and for the years ended 31 March 2004, 2005 and 2006, as extracted from the audited consolidated financial statements of the Group for the respective years. The audited consolidated financial statements of the Group for the year ended 31 March 2004 have been qualified because the directors were unable to ensure the completeness of the books and the records of certain subsidiaries of the Company which were disposed of during the year ended 31 March 2004. Accordingly, the directors were unable to satisfy themselves as to whether the net liabilities of the Group as at 31 March 2003 and the loss and cash flows of the Group for the year ended 31 March 2004 were free from material misstatements.

	Results of the Group for the years ended 31 March		
	2004	**2005**	**2006**
	HK$'000	*HK$'000*	*HK$'000*
Sales	26,723	24,703	18,563
Taxation	–	(58)	(285)
Loss for the year	(7,502)	(474)	(7,048)
Dividends	–	–	–
Loss per share	*HK cents*	*HK cents*	*HK cents*
Basic	(9.50)	(0.19)	(2.85)
Diluted	NA	NA	NA

	Assets and liabilities of the Group as at 31 March		
	2004	**2005**	**2006**
	HK$'000	*HK$'000*	*HK$'000*
Total assets	16,531	10,203	7,435
Less: Total liabilities	(12,625)	(6,771)	(53,119)
Total net assets	3,906	3,432	(45,684)

Note: For the year ended 31 March 2006, the Group adopted certain new/revised standards and interpretations of Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards, details of which and the financial impact of their application on the Group's consolidated financial statements for the years ended 31 March 2005 and 2006 are described in Note 2.1 to the financial statements for the year ended 31 March 2006 and are also set out below. Due to the qualification as mentioned above, the Directors are not able to determine whether their application will have any material impact on the Group's consolidated financial statements for the year ended 31 March 2004.

2. AUDITED CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2006

The following is the audited consolidated financial statements of the Group for the year ended 31 March 2006, extracted from annual report of the Company for the year ended 31 March 2006:

CONSOLIDATED INCOME STATEMENT

For the year ended 31 March 2006

	Notes	2006 HK$'000	2005 HK$'000 (restated)
Turnover	5	18,563	24,703
Cost of goods sold		(15,053)	(22,611)
Gross profit		3,510	2,092
Other operating income		67	3
Operating expenses		(3,873)	(2,511)
Operating loss before finance costs	7	(296)	(416)
Finance costs	9	(6,467)	(5,949)
Loss before taxation		(6,763)	(6,365)
Taxation	10	(285)	(58)
Loss for the year		(7,048)	(6,423)
		HK cents	HK cents
Loss per share			
Basic	11	(2.85)	(2.60)
Diluted	11	N/A	N/A

CONSOLIDATED BALANCE SHEET

As at 31 March 2006

	Notes	2006 HK$'000	2005 HK$'000 (restated)
Non-current asset			
Property, plant and equipment	*12*	419	24
Current assets			
Inventories	*17*	717	–
Trade and other receivables	*15*	2,327	945
Cash and cash equivalents		3,972	9,234
		7,016	10,179
Current liabilities			
Trade and other payables	*16*	4,034	6,433
Amounts due to related companies	*18*	192	280
Tax payable		343	58
		4,569	6,771
Net current assets		2,447	3,408
Total assets less current liabilities		2,866	3,432
Capital and reserves			
Share capital	*19*	24,731	24,731
Reserves		(70,415)	(63,382)
		(45,684)	(38,651)
Non-current liabilities			
Preference shares	*20*	48,550	42,083
		2,866	3,432

BALANCE SHEET

As at 31 March 2006

	Notes	2006 HK$'000	2005 HK$'000 (restated)
Non-current asset			
Investments in subsidiaries	13	–	–
Current assets			
Prepayments		170	163
Amounts due from subsidiaries	14	3,251	2,716
Cash and cash equivalents		7	820
		3,428	3,699
Current liabilities			
Amount due to a subsidiary	14	663	–
Other payables		343	260
		1,006	260
Net current assets		2,422	3,439
Total assets less current liabilities		2,422	3,439
Capital and reserves			
Share capital	19	24,731	24,731
Reserves	22	(70,859)	(63,375)
		(46,128)	(38,644)
Non-current liabilities			
Preference shares	20	48,550	42,083
		2,422	3,439

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 March 2006

	Ordinary share capital	Preference share capital	Contributed surplus	Share premium account	Capital reserve	Translation reserve	Accumulated losses	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
At 1 April 2004								
– as originally stated	24,731	52,690	51,111	244,588	1,677	–	(370,891)	3,906
– effects of changes in accounting policies	–	(52,690)	–	–	16,556	–	–	(36,134)
– as restated	24,731	–	51,111	244,588	18,233	–	(370,891)	(32,228)
Loss for the year	–	–	–	–	–	–	(6,423)	(6,423)
At 31 March 2005	24,731	–	51,111	244,588	18,233	–	(377,314)	(38,651)
Loss for the year	–	–	–	–	–	–	(7,048)	(7,048)
Exchange gain arising on retranslation of the financial statements of operation outside Hong Kong, recognized directly in equity	–	–	–	–	–	15	–	15
At 31 March 2006	24,731	–	51,111	244,588	18,233	15	(384,362)	(45,684)

CONSOLIDATED CASH FLOW STATEMENT
For the year ended 31 March 2006

	2006	2005
	HK$'000	*HK$'000*
		(restated)
Operating activities		
Loss before taxation	(6,763)	(6,365)
Adjustments for:		
Depreciation	74	6
Exchange gain, net	(22)	–
Finance costs	6,467	5,949
Interest income	(45)	(3)
Operating cash flows before movements in working capital	(289)	(413)
(Increase)/decrease in inventories	(717)	2,673
(Increase)/decrease in trade and other receivables	(1,364)	2,505
Decrease in trade and other payables	(2,402)	(3,317)
(Decrease)/increase in amounts due to related companies	(89)	280
Net cash (used in)/generated from operations	(4,861)	1,728
Interest received	45	3
Net cash (used in)/generated from operating activities	(4,816)	1,731
Cash used in investing activities		
Purchase of property, plant and equipment	(469)	(30)
Cash used in financing activities		
Repayment of amount due to a former shareholder	–	(2,875)
Net decrease in cash and cash equivalents	(5,285)	(1,174)
Cash and cash equivalents at beginning of the year	9,234	10,408
Effects of exchange rate difference on cash and cash equivalents	23	–
Cash and cash equivalents at end of the year	3,972	9,234
Analysis of the balances of cash and cash equivalents		
Cash at bank and in hand	3,972	9,234

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2006

1. GENERAL INFORMATION

Huabao International Holdings Limited (the "Company") was incorporated in Bermuda as an exempted company with limited liability. The address of its registered office is Clarendon House, 2 Church Street, Hamilton HM 11, Bermuda.

The Company acts as an investment holding company. The activities of its subsidiaries are set out in note 27. The Company's ultimate holding company is Mogul Enterprises Limited ("Mogul"), a company incorporated in the British Virgin Islands with limited liability.

The Company has its primary listing on The Stock Exchange of Hong Kong Limited (the "Stock Exchange").

These consolidated financial statements are presented in Hong Kong dollars ("HK$"), unless otherwise stated. These consolidated financial statements have been approved for issue by the board of directors (the "Board") on 30 May 2006.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation

The consolidated financial statements of the Company have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRS"). The consolidated financial statements have been prepared under the historical cost convention.

As at 31 March 2006, the Group and the Company recorded a net liability of HK$45,684,000 and HK$46,128,000 respectively. Out of which HK$48,550,000 was attributable to the recognition of the liability component of the convertible cumulative non-voting preference shares of HK$0.10 each (the "Preference Shares") issued by the Company in March 2004 (see note 20). Pursuant to the terms of the Preference Shares, one-third of the Preference Shares that have not been converted into ordinary shares shall be redeemed at its principal amount during the period between 22 March 2007 and 22 March 2008. However, according to the Companies Act 1981 of Bermuda (as amended) (the "Companies Act"), no redemption of preference shares may be effected if, on the date on which the redemption is to be effected, there are reasonable grounds for believing that the Company is, or after the redemption would be, unable to pay its liabilities as they become due. Moreover, Mogul, the holder of the Preference Shares, has issued a letter to the Board of the Company, stating that Mogul has agreed that the Company may not redeem the Preference Shares in cash pursuant to the terms of the Preference Shares within the next 12 months from 31 March 2006. Accordingly, the financial statements of the Group and the Company are prepared on a going concern basis.

The preparation of financial statements in conformity with HKFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in note 4.

The adoption of new/revised HKFRS

For the year ended 31 March 2006, the Group adopted the new/revised standards and interpretations of HKFRS below, which are relevant to its operations. The 2005 comparatives have been amended, as required, in accordance with the relevant requirements.

HKAS 1	Presentation of Financial Statements
HKAS 2	Inventories
HKAS 7	Cash Flow Statements
HKAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
HKAS 10	Events after the Balance Sheet Date
HKAS 16	Property, Plant and Equipment
HKAS 17	Leases
HKAS 21	The Effects of Changes in Foreign Exchange Rates
HKAS 23	Borrowing Costs
HKAS 24	Related Party Disclosures
HKAS 27	Consolidated and Separate Financial Statements
HKAS 28	Investments in Associates
HKAS 31	Interests in Joint Ventures
HKAS 32	Financial Instruments: Disclosures and Presentation
HKAS 33	Earnings per Share
HKAS 36	Impairment of Assets
HKAS 38	Intangible Assets
HKAS 39	Financial Instruments: Recognition and Measurement
HKAS 40	Investment Property
HKAS-Int 12	Scope of HKAS-Int 12 Consolidation – Special Purpose Entities
HKAS Int 15	Operating Leases – Incentives
HKAS-Int 21	Income Taxes – Recovery of Revalued Non-Depreciable Assets
HKFRS 2	Share-based Payments
HKFRS 3	Business Combinations

The adoption of new/revised HKASs 1, 2, 7, 8, 10, 16, 17, 21, 23, 24, 27, 28, 31, 33, 36, 38 and 40, HKAS-Ints 12, 15 and 21, and HKFRSs 2 and 3 did not result in substantial changes to the Group's accounting policies. In summary:

– HKAS 1 has affected the presentation of minority interests, share of net after-tax results of associates and other disclosures.

– HKASs 2, 7, 8, 10, 16, 17, 23, 27, 28, 31, 33, 36, 38, and 40, HKAS-Ints 12, 15 and 21, and HKFRSs 2 and 3 had no material effect on the Group's policies.

– HKAS 21 had no material effect on the Group's policy. The functional currency of each of the consolidated entities has been re-evaluated based on the guidance to the revised standard.

– HKAS 24 has affected the identification of related parties and some other related-party disclosures.

The adoption of HKASs 32 and 39 has resulted in a change in the accounting policy relating to the classification and measurement of financial assets and financial liabilities that are within the scope of HKAS 39.

All changes in the accounting policies have been made in accordance with the transition provisions in the respective standards, wherever applicable. All standards adopted by the Group require retrospective application.

The adoption of HKASs 32 and 39 resulted in:

Preference shares

HKAS 32 requires an issuer of a compound financial instrument (that contains both financial liability and equity components) to separate the compound financial instrument into its liability and equity components on its initial recognition and to account for these components separately. In subsequent periods, the liability component is carried at amortized cost using the effective interest method. The principal impact of HKAS 32 on the Group is in relation to the Preference Shares (see note 20) that contain both liability and equity components. Previously, the Preference Shares were classified as equity on the balance sheet. Because HKAS 32 requires retrospective application, comparative figures have been restated. Comparative loss for 2005 has been restated in order to reflect the increase in effective interest on the liability component.

Financial assets and financial liabilities other than debt and equity securities

From 1 April 2005 onwards, the Group classifies and measures its financial assets and financial liabilities other than debt and equity securities (which were previously outside the scope of SSAP 24) in accordance with the requirements of HKAS 39. Financial assets under HKAS 39 are classified as "financial assets at fair value through profit or loss", "available-for-sale financial assets", "loans and receivables" or "held-to-maturity financial assets". Financial liabilities are generally classified as "financial liabilities at fair value through profit or loss" or "financial liabilities other than financial liabilities at fair value through profit or loss (other financial liabilities)". "Other financial liabilities" are carried at amortized cost using the effective interest method.

The effects of the adoption of HKFRS on the results for the years ended 31 March 2006 and 2005 are as follows:

	2006	**2005**
	HK$'000	*HK$'000*
Increase in interest expense on the liability component of the Preference Shares under finance costs	6,467	5,949
	HK cents	*HK cents*
Increase in basic loss per share	2.61	2.41

The cumulative effects of application of HKFRS as at 31 March 2006 are summarized below:

	Originally stated	**Applied retrospectively HKAS 32**	**Restated**
	HK$'000	*HK$'000*	*HK$'000*
Effect on liabilities:			
Preference shares	–	48,550	48,550
Effect on equity:			
Share capital	77,421	(52,690)	24,731
Capital reserve	1,677	16,556	18,233
Accumulated losses	(371,946)	(12,416)	(384,362)
	(292,848)	(48,550)	(341,398)

The cumulative effects of application of HKFRS as at 31 March 2005 are summarized below:

	Originally stated	Applied retrospectively HKAS 32	Restated
	HK$'000	*HK$'000*	*HK$'000*
Effect on liabilities:			
Preference shares	–	42,083	42,083
Effect on equity:			
Share capital	77,421	(52,690)	24,731
Capital reserve	1,677	16,556	18,233
Accumulated losses	(371,365)	(5,949)	(377,314)
	(292,267)	(42,083)	(334,350)

The financial effects of the application of HKFRS to the Group's equity as at 1 April 2004 are summarized below:

	Originally stated	Applied retrospectively HKAS 32	Restated
	HK$'000	*HK$'000*	*HK$'000*
Effect on equity:			
Share capital	77,421	(52,690)	24,731
Capital reserve	1,677	16,556	18,233
	79,098	(36,134)	42,964

Certain new standards, amendments and interpretations to existing standards have been published that are mandatory for the Group's accounting periods beginning on or after 1 January 2006 or later periods but which the Group has not early adopted, as follows:

1. HKAS 19 (Amendment), Employee Benefits – Actuarial Gains and Losses Group Plans and Disclosures (effective from 1 January 2006)

2. HKAS 39 (Amendment), Cash Flow Hedge Accounting of Forecast Intragroup Transactions (effective from 1 January 2006)

3. HKAS 39 (Amendment), The Fair Value Option (effective from 1 January 2006)

4. HKAS 39 and HKFRS 4 (Amendment), Financial Guarantee Contracts (effective from 1 January 2006)

5. HKFRS 1 (Amendment), First-time Adoption of Hong Kong Financial Reporting Standards (effective from 1 January 2006)

6. HKFRS 6, Exploration for and Evaluation of Mineral Resources (effective from 1 January 2006)

7. HKFRS 7, Financial Instruments: Disclosures, and a complementary Amendment to HKAS 1, Presentation of Financial Statements – Capital Disclosures (effective from 1 January 2007)

8. HKFRS-Int 4, Determining whether an Arrangement contains a Lease (effective from 1 January 2006)

9. HKFRS-Int 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds (effective from 1 January 2006)

10. HK(IFRIC)-Int 6, Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment (effective from 1 December 2005)

2.2 Consolidation

The consolidated financial statements include the financial statements of the Company and all its subsidiaries made up to 31 March each year.

Subsidiaries are all entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies, generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in the income statement.

Inter-company transactions, balances and unrealized gains on transactions between group companies are eliminated. Unrealized losses are also eliminated but considered an impairment indicator of an impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

In the Company's balance sheet the investments in subsidiaries are stated at cost less provision for impairment losses. The results of subsidiaries are accounted by the Company on the basis of dividend received and receivable.

2.3 Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

2.4 Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in HK$, which is the Company's functional and presentation currency.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the income statement.

(c) Group companies

The results and financial position of all the group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

(i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;

(ii) income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and

(iii) all resulting exchange differences are recognized as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign operations are taken to shareholders' equity. When a foreign operation is sold, exchange differences that were recorded in equity are recognized in the income statement as part of the gain or loss on sale.

2.5 Property, plant and equipment

Property, plant and equipment are stated at historical cost less depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Cost may also include transfers from equity of any gains/losses on qualifying cash flow hedges of foreign currency purchases of property, plant and equipment.

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are expensed in the income statement during the financial period in which they are incurred.

Depreciation of property, plant and equipment is calculated using the straight-line method to allocate cost to their residual values at the following rates per annum after taking into account their estimated useful lives:

– Leasehold improvements	25%
– Plant and equipment	25%
– Office equipment	25% to 33⅓%

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (see note 2.6).

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

2.6 Impairment of non-financial assets

Assets that have an indefinite useful life are not subject to amortization, which are at least tested annually for impairment and are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

2.7 Inventories

Inventories are stated at the lower of cost and net realizable value. Cost is determined using weighted-average method. The cost of finished goods and work in progress mainly comprises raw materials. It excludes borrowing costs. Net realizable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

2.8 Trade and other receivables

Trade and other receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivable. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets.

They are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment. A provision for impairment of trade and other receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the provision is recognized in the income statement.

2.9 Cash and cash equivalents

Cash and cash equivalents include cash in hand and deposits held at call with banks.

2.10 Share capital

Ordinary shares are classified as equity. Mandatorily redeemable preference shares are classified as liabilities (see note 2.11).

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

2.11 Borrowings

Borrowings are recognized initially at fair value, net of transaction costs incurred. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability, including fees and commissions paid to agents, advisers, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Borrowings are subsequently stated at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the income statement over the period of the borrowings using the effective interest method.

Preference shares, which are mandatorily redeemable on a specific date, are classified as liabilities. The dividends on these preference shares are recognized in the income statement as interest expense.

The fair value of the liability portion of preference shares is determined using a market interest rate for an equivalent non-convertible loan. This amount is recorded as a liability on an amortized cost basis until extinguished on conversion or maturity of the preference shares. The remainder of the proceeds is allocated to the conversion option. This is recognized and included in shareholders' equity, net of income tax effects.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

2.12 Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

2.13 Pension obligations

The Group operates the Mandatory Provident Fund Scheme ("MPF Scheme") in Hong Kong which is generally funded through payments to insurance companies under defined contribution plan. It pays contributions to administered pension insurance plans on a mandatory, contractual or voluntary basis. Moreover, all the employees of the Group's entities incorporated in the Mainland of the People's Republic of China (the "Mainland") participate in employee social security plans, including pension, medical, housing and other welfare benefits, organized and administered by the local government. The Group has no further payment obligations once these contributions have been paid. The contributions are recognized as employee benefit expense when they are due and are reduced by contributions forfeited by those employees who leave the scheme prior to vesting fully in the contributions. Prepaid contributions are recognized as an asset to the extent that a cash refund or a reduction in the future payments is available.

2.14 Revenue recognition

Revenue comprises the fair value for the sale of goods and services, net of value-added tax, rebates and discounts and after eliminating sales within the Group. Revenue is recognized as follows:

(a) Sales of goods

Sales of goods are recognized when a group entity has delivered products to the customer, the customer has accepted the products and collectibility of the related receivables is reasonably assured.

(b) Interest income

Interest income is recognized on a time-proportion basis using the effective interest method. When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at original effective interest rate of the instrument, and continues unwinding the discount as interest income. Interest income on impaired loans is recognized using the original effective interest rate.

2.15 Operating lease

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are expensed in the income statement on a straight-line basis over the period of the lease.

3. FINANCIAL RISK MANAGEMENT

The Group's activities expose it to a variety of financial risks: market risk (including currency risk and price risk), credit risk, liquidity risk and cash flow interest rate risk. The Group focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Group's financial performance.

(a) Market risk

(i) Foreign exchange risk

The Group mainly operates in Hong Kong and the Mainland with most of the transactions settled in HK$, U.S. dollars and Renminbi ("RMB"). It did not have significant exposure to foreign exchange risk. Nevertheless, the exchange rate of RMB to foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the Mainland government.

(ii) Price risk

The Group is exposed to commodity price risk. It has not used any commodity futures to hedge its price risk exposure.

(b) Credit risk

The sales to top five customers account for over 70% of the total sales. The Group has policies in place to ensure that sales of products are made to customers with an appropriate credit history.

(c) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash and the availability of funding through an adequate amount of committed credit facilities. The Group controls the level of inventories, closely monitors the turnover days of receivables, and does not have bank and other borrowings. Having considered the redemption clause of the Preference Shares and relevant legislations which can be concluded that going concern of the Group will not be affected by its redemption, management believes that the Group does not have significant liquidity risk.

(d) Cash flow interest rate risk

The Group's interest rate risk arises from bank balances which bear market interest rates. As the Group has no significant interest-bearing assets, the Group's income and operating cash flows are substantially independent of changes in market interest rates.

4. CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Estimate of the effective interest rate of the Preference Shares

In March 2004, the Company issued 526,900,000 Preference Shares (see note 20). In accordance with HKAS 32, the Company accounted for the redemption feature of the preference shares as a liability based on the expected discounted cash outflows for the redemption according to the terms of the subscription agreement. In this regard, the Company has engaged an independent firm of chartered surveyors to perform a valuation on the fair dividend rate (i.e. the discount rate). Taking into consideration the financial position and operating results of the Company, a market approach based primarily upon comparative default risk was adopted. With reference to the valuation results, the directors determined the fair dividend rate as 16.8%.

For information only, should the fair dividend rate increase by 1% from the directors' estimation, the liability component of the Preference Shares at the date of issue will be decreased by HK$1,066,000 and finance costs for the years ended 31 March 2005 and 2006 will be increased by HK$157,000 and HK$226,000 respectively. Should the fair dividend rate decrease by 1% from the directors' estimation, the liability component of the Preference Shares at the date of issue will be increased by HK$1,112,000 and finance costs for the years ended 31 March 2005 and 2006 will be decreased by HK$172,000 and HK$239,000 respectively.

5. TURNOVER

Turnover represents the net amounts received and receivable for goods sold, less returns and allowances, during the year.

6. BUSINESS AND GEOGRAPHICAL SEGMENTS

Primary reporting format – Business segments

For management purposes, the Group is organized into two operating divisions – trading of consumer electronic products and fine chemicals. These principal operating activities are the basis on which the Group reports its primary segment information.

The segment information for the year ended 31 March 2006 is presented below:

	Consumer electronic products *HK$'000*	**Fine chemicals** *HK$'000*	**Total** *HK$'000*
Turnover	3,717	14,846	18,563
Segment results	56	665	721
Unallocated corporate expenses			(1,017)
Operating loss before finance costs			(296)
Finance costs			(6,467)
Loss before taxation			(6,763)
Taxation			(285)
Loss for the year			(7,048)

The segment information for the year ended 31 March 2005 is presented below:

	Consumer electronic products *HK$'000*	**Fine chemicals** *HK$'000*	**Total** *HK$'000* (restated)
Turnover	13,069	11,634	24,703
Segment results	87	385	472
Unallocated corporate expenses			(888)
Operating loss before finance costs			(416)
Finance costs			(5,949)
Loss before taxation			(6,365)
Taxation			(58)
Loss for the year			(6,423)

The segment assets and liabilities as at 31 March 2006 and capital expenditure for the year then ended are as follows:

	Consumer electronic products *HK$'000*	Fine chemicals *HK$'000*	Total *HK$'000*
Assets			
Segment assets	3	7,255	7,258
Unallocated assets			177
			7,435
Liabilities			
Segment liabilities	281	3,945	4,226
Unallocated liabilities			48,893
			53,119
Other information			
Capital expenditure	–	469	469
Depreciation	–	74	74

The segment assets and liabilities as at 31 March 2005 and capital expenditure for the year then ended are as follows:

	Consumer electronic products *HK$'000*	Fine chemicals *HK$'000*	Total *HK$'000* (restated)
Assets			
Segment assets	149	9,071	9,220
Unallocated assets			983
			10,203
Liabilities			
Segment liabilities	480	6,031	6,511
Unallocated liabilities			42,343
			48,854
Other information			
Capital expenditure	–	30	30
Depreciation	–	6	6

Segment assets consist primarily of property, plant and equipment, inventories, trade and other receivables, cash and cash equivalents.

Segment liabilities comprise trade and other payables, amounts due to related companies and tax payable.

Secondary reporting format – Geographical segments

	2006			
	Segment revenue	**Segment results**	**Segment assets**	**Capital expenditure**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Hong Kong	15,269	1,703	4,885	–
Mainland	3,294	(982)	2,550	469
	18,563	721	7,435	469

	2005 (restated)			
	Segment revenue	**Segment results**	**Segment assets**	**Capital expenditure**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Hong Kong	22,927	435	8,137	30
Mainland	1,776	37	2,066	–
	24,703	472	10,203	30

7. OPERATING LOSS BEFORE FINANCE COSTS

Operating loss before finance costs has been arrived at after crediting and charging the following:

	THE GROUP	
	2006	**2005**
	HK$'000	*HK$'000*
Crediting:		
Exchange gains, net	22	–
Interest income	45	3
Charging:		
Auditors' remuneration	350	263
(Increase)/decrease in inventories	(717)	2,673
Depreciation	74	6
Employee benefit expense *(see note 8)*	1,619	1,024
Purchase of goods	15,770	19,938
Operating lease rentals in respect of land and buildings	288	99

8. EMPLOYEES BENEFIT EXPENSE

(a) Retirement scheme benefit

The Group operates a MPF Scheme for all the eligible employees in Hong Kong. The assets of the MPF Scheme are held separately from those of the Group, in funds under the control of trustees.

Under the MPF Scheme, the employees are required to contribute 5% of their monthly salaries up to maximum of HK$1,000 per employee and they can choose to make additional contributions. The employer's monthly contributions are calculated at 5% of each employee's monthly salaries up to a maximum of HK$1,000 (the "mandatory contributions"). The employees are entitled to 100% of the employer's mandatory contributions upon their retirement at the age of 65 years old, death or total incapacity.

Moreover, the Group makes defined contribution to retirement schemes managed by the local government in the Mainland. It is the local government's responsibility to pay the retirement pension to those staff who retired.

Contribution paid or payable to the schemes depicted above by the Group amounted to HK$68,000 (2005: HK$18,000). At 31 March 2006 and 2005, there were no forfeited contributions available to reduce future obligations.

(b) Directors' emoluments

The remuneration of every director for the year ended 31 March 2006 and 2005 is set out below:

	Fees	
	2006	**2005**
Name of director	*HK$'000*	*HK$'000*
Executive Directors:		
Ms. Chu Lam Yiu	–	–
Mr. Chen Yong Chang	5	–
Mr. Poon Chiu Kwok [(1)]	120	120
Mr. Wang Guang Yu	5	–
Independent Non-executive Directors:		
Mr. Lee Luk Shiu [(2)]	–	–
Ms. Ma Yun Yan	48	24
Mr. Mak Kin Kwong, Peter	120	120
	298	264

Notes:

(1) Re-designated from Independent Non-executive Director to Executive Director on 1 May 2006.

(2) Appointed on 1 May 2006.

No directors had waived any emoluments during the year ended 31 March 2006 and 2005.

(c) Five highest paid individuals

The five individuals whose emoluments were the highest in the Group for the year include two (2005: two) directors of the Company whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining three (2005: three) individuals during the year are as follows:

	THE GROUP	
	2006	**2005**
	HK$'000	*HK$'000*
Basic salaries and other benefits	791	717
Contributions to retirement benefit scheme	19	17
Compensation for loss of office	–	26
	810	760

Their emoluments were within the following band:

	Number of employees	
	2006	**2005**
Nil to HK$1,000,000	3	3

9. FINANCE COSTS

	THE GROUP	
	2006	**2005**
	HK$'000	*HK$'000*
		(restated)
Interest expense on preference shares liabilities	6,467	5,949

10. TAXATION

Hong Kong profit tax has been provided at the rate of 17.5% (2005: 17.5%) on the estimated assessable profit for the year. Taxation on the Mainland profits has been calculated on the estimated assessable profit for the year at the rates of taxation prevailing in the respective jurisdiction in the Mainland in which the Group operates. There is no tax charge arising in other jurisdictions during the year.

The tax charge for the year can be reconciled to the loss per the consolidated income statement as follows:

	THE GROUP	
	2006	**2005**
	HK$'000	*HK$'000*
		(restated)
Loss before taxation	(6,763)	(6,365)
Tax calculated at domestic income tax rates applicable to respective group companies	(1,248)	(1,131)
Tax effect of income not subject to tax	(15)	(16)
Tax effect of expenses not deductible for tax purposes	1,132	1,197
Tax effect of tax losses for which no deferred income tax asset was recognized	415	29
Others	1	(21)
Tax charge for the year	285	58

Deferred income tax assets are recognized for tax loss carry-forwards to the extent that the realization of the related tax benefit through the future taxable profits is probable. The Group did not recognize deferred income tax assets in respect of unused tax losses amounting to HK$8,227,000 (2005: HK$5,466,000) that can be carried forward against future taxable income. Unrecognized losses of HK$88,000 (2005: HK$88,000) and HK$857,000 (2005: Nil) will expire in 2009 and 2010 respectively.

11. LOSS PER SHARE

The calculation of the basic and diluted loss per share is based on the Group's loss for the year of HK$7,048,000 (2005: HK$6,423,000) and the number of ordinary shares of 247,309,435 (2005: 247,309,435) outstanding during the year.

No diluted loss per share is presented for both years since the exercise of the outstanding Preference Shares and warrants of the Company would decrease the loss per share.

12. PROPERTY, PLANT AND EQUIPMENT

	THE GROUP			
	Leasehold improvements	**Plant and equipment**	**Office equipment**	**Total**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
At 1 April 2004				
Cost	–	–	–	–
Accumulated depreciation	–	–	–	–
Net book amount	–	–	–	–
Year ended 31 March 2005				
Opening net book amount	–	–	–	–
Additions	–	–	30	30
Depreciation	–	–	(6)	(6)
Closing net book amount	–	–	24	24
At 31 March 2005				
Cost	–	–	30	30
Accumulated depreciation	–	–	(6)	(6)
Net book amount	–	–	24	24
Year ended 31 March 2006				
Opening net book amount	–	–	24	24
Additions	394	68	7	469
Depreciation	(59)	(5)	(10)	(74)
Closing net book amount	335	63	21	419
At 31 March 2006				
Cost	394	68	37	499
Accumulated depreciation	(59)	(5)	(16)	(80)
Net book amount	335	63	21	419

13. INVESTMENTS IN SUBSIDIARIES

	THE COMPANY	
	2006	**2005**
	HK$'000	*HK$'000*
Unlisted investments, at cost	390	390
Less: Impairment loss and allowance	(390)	(390)
	–	–

Particulars of the principal subsidiaries of the Company at 31 March 2006 are set out in note 27.

14. AMOUNTS DUE FROM/TO SUBSIDIARIES

	THE COMPANY	
	2006	**2005**
	HK$'000	*HK$'000*
Amounts due from subsidiaries	3,467	2,932
Less: Impairment loss and allowance	(216)	(216)
	3,251	2,716

The amounts due from/to subsidiaries are unsecured, interest-free and repayable on demand.

15. TRADE AND OTHER RECEIVABLES

The Group allows an average credit period ranging from cash on delivery to 90 days to its trade receivables. The aged analysis of trade receivables is as follows:

	THE GROUP	
	2006	**2005**
	HK$'000	*HK$'000*
Trade receivables:		
0 – 30 days	130	452
31 – 90 days	1,254	275
Over 90 days	593	–
	1,977	727
Other receivables	350	218
	2,327	945

16. TRADE AND OTHER PAYABLES

The aged analysis of trade payables is as follows:

	THE GROUP	
	2006	**2005**
	HK$'000	*HK$'000*
Trade payables:		
0 – 30 days	766	1,799
31 – 90 days	1,189	1,400
Over 90 days	1,206	2,217
	3,161	5,416
Other payables	873	1,017
	4,034	6,433

17. INVENTORIES

	THE GROUP 2006 HK$'000	2005 HK$'000
Raw materials	245	–
Work in progress	57	–
Finished goods	415	–
	717	–

The cost of inventories recognized as expense and included in cost of goods sold amounted to HK$15,053,000 (2005: HK$22,611,000).

18. AMOUNTS DUE TO RELATED COMPANIES

The amounts are unsecured, interest-free and repayable on demand. Ms. Chu Lam Yiu, a director of the Company, has beneficial interest in these companies.

19. SHARE CAPITAL

	THE COMPANY								
	Ordinary shares of HK$0.10 each		Convertible cumulative non-voting preference shares of HK$1.00 each ("Class 2")		Convertible cumulative non-voting preference shares of HK$0.10 each ("Class 1")		Convertible cumulative non-voting preference shares of HK$0.10 each (see note 20)		Total
	Number of shares	*HK$'000*	*Number of shares*	*HK$'000*	*Number of shares*	*HK$'000*	*Number of shares*	*HK$'000*	*HK$'000*
Authorised:									
At 1 April 2004, 31 March 2005 and 31 March 2006	2,000,000,000	200,000	50,000,000	50,000	350,000,000	35,000	526,900,000	52,690	337,690
Issued and fully paid:									
At 1 April 2004 – as originally stated	247,309,435	24,731	–	–	–	–	526,900,000	52,690	77,421
On adoption of HKAS 32	–	–	–	–	–	–	–	(52,690)	(52,690)
At 31 March 2005 and 31 March 2006	247,309,435	24,731	–	–	–	–	526,900,000	–	24,731

Pursuant to an agreement dated 17 January 2004 and a supplemental agreement dated 3 February 2004, 173,100,000 ordinary shares of HK$0.1 each and 526,900,000 Preference Shares of HK$0.1 each were issued to Mogul at a consideration of HK$17,310,000 and HK$52,690,000 respectively on 22 March 2004. Moreover, warrants enabling the holder to subscribe for a maximum number of ordinary shares of 49,000,000 at HK$0.1 each were also issued to Mogul.

According to HKAS 32, equity instruments are instruments that evidence a residual interest in the assets of an entity after deducting all of its liabilities. After deducting the liability component of the Preference Shares of HK$36,134,000 at 22 March 2004 (see note 20), the balance of the total consideration of HK$70,000,000 was allocated amongst the equity feature of ordinary shares, Preference Shares and warrants at the amounts of HK$7,938,000, HK$23,700,000 and HK$2,228,000 respectively. After deducting the liability component of Preference Shares of HK$36,134,000 and the paid-up capital of ordinary shares of HK$17,310,000, the remaining balance of the total consideration, amounting to HK$16,556,000, was credited to capital reserve (see note 22).

20. PREFERENCE SHARES

The Company issued 526,900,000 Preference Shares on 22 March 2004 (the "issue date") with the terms as follows:

(i) The Preference Shares are entitled to a cumulative annual dividend of 5% on the principal amount, payable semi-annually in arrears on the 30 April and 31 October but are not entitled to any further dividend distribution.

(ii) In the case where the listing of the Company's ordinary shares on the Stock Exchange is cancelled or trading of the same on the Stock Exchange is suspended for a period of 20 consecutive trading days or more, the Company shall redeem all but not part of the Preference Shares if such shareholder serves a notice to the Company to redeem the Preference Shares subject to the requirements of the Companies Act.

Additionally, during each of the first, second and final redemption period (being the third to fourth, fourth to fifth (excluding fifth anniversary day) and fifth anniversary day of the first issue date of the Preference Shares respectively), the Company shall redeem the Preference Shares. During each of such period/date (as the case maybe), the Company shall redeem in cash at the principal amount of one-third of the Preference Shares as are in issue on the issue date in respect of which the right of conversion (see (iii) below) has not been exercised, together with shares that have not been redeemed previously and all accrued but unpaid dividend of the Company.

In the event that during the conversion period (i.e. from issue date to final redemption date), the holder converts the Preference Shares, partial redemptions as contemplated above will be impacted so that the proportion or number of the Preference Shares which may be redeemed during the relevant redemption period(s), or at the final redemption date, respectively, shall be down-adjusted or reduced accordingly.

(iii) The holders of such Preference Shares are entitled to convert their shares, at par value, in multiple of 100,000 into ordinary shares at any time prior to the date upon which such Preference Shares are redeemed.

(iv) The holders of such Preference Shares have the same voting rights as those attaching to the ordinary shares of the Company only if there are any accrued dividends overdue for more than 12 months or where a resolution is to be proposed at a general meeting for winding-up the Company or if passed would (subject to any consents required for such purpose being obtained) vary or abrogate the rights or privileges of the holders of the Preference Shares.

With the retrospective application of new HKAS 32 on 1 April 2005, the fair values of the liability component and the equity component were determined at issuance of the Preference Shares.

The fair value of the liability component, included in non-current liability, was calculated making reference to a market interest rate for an equivalent non-convertible loan (see note 4).

The residual amount, representing the value of the equity conversion features of the Preference Shares and the warrants, is included in capital reserve.

The Preference Shares recognized in the balance sheet is calculated as follows:

	HK$'000
Nominal value of the Preference Shares issued on 22 March 2004	52,690
Equity component at date of issue	(16,556)
Liability component on initial recognition at 22 March 2004	36,134
Interest charged up to 31 March 2005	5,949
Liability component at 31 March 2005	42,083
Interest charged for the year ended 31 March 2006	6,467
Liability component at 31 March 2006	48,550

The interest charged is calculated using the effective interest method by applying the effective interest rate of 16.8% to the liability component since the Preference Shares were issued.

The fair value of the liability component of the Preference Shares at 31 March 2006, determined based on the present value of the estimated future cash outflows discounted at the prevailing market rate for an equivalent non-convertible loan at the balance sheet date, approximates the carrying value.

21. SHARE OPTION SCHEME

Pursuant to the share option scheme adopted by the shareholders of the Company on 19 March 2004 (the "Share Option Scheme"), the Board of the Company may for a consideration of HK$1.00 grant options to eligible participants ("Participants" as defined in the circular of the Company dated 25 February 2004) to subscribe for shares of the Company. The purpose of the Share Option Scheme is to provide incentive to motivate Participants to make contribution to, and promote the interests of, the Company and to develop and maintain business relationships with Participants for the benefit of the Group. The subscription price will be determined by the Board and shall be at least the higher of (i) the closing price of the Company's ordinary shares of HK$0.1 each (the "Shares") as stated in the Stock Exchange's daily quotation sheet on the date of the offer of the share options, which must be a trading date; (ii) the average closing price of the Shares as stated in the Stock Exchange's daily quotation sheet for the five trading days immediately preceding the date of the offer; and (iii) the nominal value of the Shares. Each participant must accept the grant of option before a specified date, being a date not later than 30 business days after the date of offer.

The total number of the Shares in respect of which options may be granted shall not exceed 10% of the total issued ordinary share capital of the Company as at the date of approval of the Share Option Scheme unless the Company obtains a fresh approval from the holders of the Shares in general meeting to renew the 10% limit. The total number of Shares issued and to be issued upon exercise of the options granted to each participant (including exercised, cancelled and outstanding options) in any 12-month period must not exceed 1% of the Shares in issue unless the same is approved by shareholders of the Company.

The aggregate maximum number of the Shares in respect of which options may be granted under the Share Option Scheme and other share option scheme(s) of the Company (if any) must not, in aggregate, exceed 30% of the total number of the Shares in issue from time to time.

The Share Option Scheme became effective for a period of ten years commencing 19 March 2004 (the date on which the Share Option Scheme was adopted).

The details and major provisions of the Share Option Scheme were set out in the circular of the Company dated 25 February 2004.

No options under the Share Option Scheme had been granted to any persons since its adoption and up to 31 March 2006.

22. RESERVES

	THE COMPANY				
	Contributed surplus	Share premium account	Capital reserve	Accumulated losses	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
At 1 April 2004					
– as originally stated	51,111	244,588	1,677	(369,863)	(72,487)
– effects of changes in accounting policies *(see note 19)*	–	–	16,556	–	16,556
– as restated	51,111	244,588	18,233	(369,863)	(55,931)
Loss for the year	–	–	–	(7,444)	(7,444)
At 31 March 2005	51,111	244,588	18,233	(377,307)	(63,375)
Loss for the year	–	–	–	(7,484)	(7,484)
At 31 March 2006	51,111	244,588	18,233	(384,791)	(70,859)

The contributed surplus of the Company represents the difference between the consolidated shareholders' funds of the subsidiaries at the date on which the corporate reorganization became effective and the nominal amount of the Company's shares issued under the reorganization.

Under the Companies Act, the contributed surplus of the Company is available for distribution. However, the Company cannot declare or pay a dividend or make a distribution out of contributed surplus if:

(a) it is, or would after the payment be, unable to pay its liabilities as they become due; or

(b) the realisable value of its assets would thereby be less than the aggregate of its liabilities and its issued share capital and share premium account.

At the balance sheet date, in the opinion of the directors, the Company had no reserves available for distribution to shareholders.

23. CAPITAL COMMITMENTS

The Group and the Company had no outstanding capital commitments as at 31 March 2006.

24. OPERATING LEASE COMMITMENTS

At the balance sheet date, the future aggregate minimum lease payments under non-cancellable operating leases are as follows:

	THE GROUP	
	2006	2005
	HK$'000	*HK$'000*
Within one year	277	230
In the second to fifth year inclusive	709	962
	986	1,192

Leases are negotiated for terms ranging from 1 to 5 years with fixed monthly rentals over the terms of the leases.

The Company had no commitments under non-cancellable operating leases at the balance sheet date.

25. CONTINGENT LIABILITIES

The directors noted from an announcement dated 29 April 2002 made by certain former directors that a verbal demand notice was received from one of the creditors demanding immediate settlement of approximately RMB9,600,000 alleged outstanding debts. However, after the directors have reviewed the records of the Company and conducted internal investigations after appointment, the directors do not have any other information available to verify the existence of or the validity of this claim but will continue to monitor and review the situation from time to time.

Save as disclosed above and based on the information available to the directors, the Group and the Company had no contingent liabilities as at 31 March 2006.

26. RELATED PARTY TRANSACTIONS

During the year, the Group has entered into the following transactions with related parties:

	2006	**2005**
	HK$'000	*HK$'000*
Amount charged by a related company for sharing of administrative expenses *(see note a)*	564	374
Repayment to a former shareholder	–	(2,875)
Payments on behalf of a subsidiary of the Company by related companies *(see note b)*	277	–

Notes:

(a) The related company is a company in which a director of the Company, Ms. Chu Lam Yiu, has a beneficial interest. The sharing of administrative expenses was charged based on the actual administrative costs incurred, including share of office premises and corporate expenses, and the basis of which was considered appropriate by the directors.

(b) The related companies are companies in which a director of the Company, Ms. Chu Lam Yiu, has beneficial interests. The amounts represent certain pre-operating expenses and leasehold improvements paid by the related companies on behalf of a subsidiary of the Company.

(c) On 22 March 2004, the Company, Huabao Investment Company Limited ("Huabao Investment"), a wholly-owned subsidiary of the Company, and the ultimate holding company entered into a loan agreement (the "Loan Agreement") which was approved by the shareholders at a special general meeting held on 19 March 2004. Pursuant to the Loan Agreement, the ultimate holding company agreed to grant a revolving loan facility of up to HK$15 million (the "Loan Facility") to the Company and Huabao Investment at an interest rate of 2% over the six-month Hong Kong Interbank Offered Rate. Repayment of the loan and the relevant interests are guaranteed by the Company (limited to HK$15 million) and secured by a first legal fixed charge on the Company's entire shareholding interests in Huabao Investment and a first floating charge on all the assets of Huabao Investment. For the two years ended 31 March 2006, the Group did not make any drawdown under the Loan Facility.

27. PARTICULARS OF SUBSIDIARIES

Particulars of the Company's subsidiaries at 31 March 2006 are as follows:

Name of company	Place of incorporation/ registration	Particulars of issued share capital/ registered capital	Proportion of nominal value of issued capital/ registered capital held by the Company		Principal activities
			Directly	Indirectly	
Asiarim Associates Limited	The British Virgin Islands	50,000 ordinary shares of US$1 each	100%	–	Trading of computer-related products and consumer electronic products
Hero Ace Limited	Hong Kong	1 ordinary share of HK$1each	100%	–	Provision of management services
Huabao Investment Company Limited	The British Virgin Islands	1 ordinary share of US$1 each *(see note 26(c))*	100%	–	Investment holding
Sino Top Trading Limited	Hong Kong	100 ordinary shares of HK$1 each	–	100%	Trading of fine chemicals
華航貿易發展(深圳)有限公司 *(see note)*	Mainland	HK$500,000 Registered capital	–	100%	Trading of fine chemicals
華順香料(上海)有限公司 *(see note)*	Mainland	US$150,000 Registered capital	–	100%	Manufacture and sale of fine chemicals

Note: Both companies are wholly foreign-owned enterprises registered in the Mainland.

3. INDEBTEDNESS

As at 31 May 2006, the latest practicable date prior to the printing of this circular for the purpose of ascertaining information relating to the indebtedness of the Enlarged Group, except for the Existing Preference Shares, the Enlarged Group had no outstanding borrowings.

As at 31 May 2006, the Enlarged Group had a loan facility of approximately HK$15,000,000 from Mogul Enterprises Limited ("Mogul") which is the ultimate holding company of the Company, secured by a first legal fixed charge made over the equity interest of the Company in Huabao Investment Company Limited ("Huabao Investment"), a wholly-owned subsidiary of the Company, and by a first floating charge made over all of Huabao Investment's assets.

As at 31 May 2006, the Enlarged Group had a contingent liability of approximately RMB9,600,000 alleged outstanding debts.

Save as disclosed above, as at the close of business of 31 May 2006, the Enlarged Group had no outstanding mortgages or charges or debentures or other loan capital or bank overdrafts, loans or other similar indebtedness, finance lease commitments, hire purchase commitments, liabilities under acceptance or credits or any guarantees or material contingent liabilities.

4. WORKING CAPITAL

Taking into account the internal generated funds of the Enlarged Group and the loan facility from Mogul Enterprises Limited of HK$15,000,000, the directors of the Company, after due and care enquiry, are of the opinion that the Enlarged Group has sufficient working capital for its present requirements, that is for at least the next 12 months from the date of this circular.

The following discussion of the Group's operating results should be read in conjunction with the combined financial information for the three years ended 31 March 2006 set forth in Appendix III.A to this circular.

Overview

The Group's revenue is primarily derived from the provision and sales of fine chemicals, and trading of consumer electronic products. For the years ended 31 March 2004, 2005 and 2006, turnover of the Group amounted to approximately HK$26.7 million, HK$24.7 million and HK$18.6 million respectively. For the years ended 31 March 2004, 2005 and 2006, net loss of the Group amounted to approximately HK$7.5 million, HK$0.5 million (before restatement) and HK$7.0 million respectively.

Review of past performance

Financial year ended 31 March 2006 compared to financial year ended 31 March 2005

Fine chemicals

For the year ended 31 March 2006, the fine chemicals businesses recorded a turnover of HK$14,846,000, representing an increase of 28% as compared with HK$11,634,000 of the previous year. Of the total, sales in the PRC market increased from HK$1,776,000 in 2005 to HK$3,294,000 in 2006, representing an increase of approximately 85.5%. The segment results of fine chemicals business recorded a profit of HK$665,000 for the year ended 31 March 2006 as compared to the profit of HK$385,000 for the year ended 31 March 2005, representing an increase of approximately 72.7%.

The Group's trading business in Hong Kong has been yielding steady income. Its customers have a stable demand for the flavours and fragrances sourced from Europe and Southeast Asia, and the average gross profit margin for the year improved as compared with the previous year. On the other hand, the Group's trading business in the PRC was still at the start-up stage, so it was carrying out a tough task of cultivating a new market and building a new sales network, and the Group's management continuously reviewed and improved every aspect of its development.

In addition, the Group's plant in Jiading District, Shanghai, has already completed the fundamental fit-out in the year and commenced production and sales after successfully obtaining the Shanghai Hygiene Permit for Specialized Food in December 2005. Its current products consist mainly of colorants and food seasonings. As it is a newly developed business operation, it will take some time to establish a market network and repeated reassessment is needed before a solid foundation can be built.

Trading of consumer electronic products

A turnover of HK$3,717,000 was recorded for the Group's trading of consumer electronic products, representing a decrease of 72% as compared with HK$13,069,000 of the previous year. Due to intense competition, the Group was unable to make a breakthrough in its consumer electronic products trading operation, and hence, the management decided that the Group should gradually scale down from this market.

Financial year ended 31 March 2005 compared to financial year ended 31 March 2004

Fine chemicals

The Group commenced its fine chemicals trading business in August 2004. For the year ended 31 March 2005, sales of fine chemicals mainly involved flavours and fragrances sourced from Europe and Southeast Asia, all of which were imported through suppliers. All the sales in Hong Kong were targeted at local customers, who then distributed the flavours and fragrances to the PRC manufacturers as raw materials for production. During the year under review, the Group also set up a sales base in Shenzhen, and commenced fine chemicals trading business prior to the year end.

The Group's fine chemicals trading business operated for eight months recorded a turnover of HK$11,634,000 for the year ended 31 March 2005, representing 47% of the total turnover, of which, sales to the PRC market amounted to HK$1,776,000. The segment results recorded a profit of HK$385,000, of which the profit from the PRC market amounted to HK$38,000. The PRC, as one of the production base for global products, has a superb market for products like food, tobacco and daily-used chemical products, which also brought about a huge demand for fine chemicals. In addition, the profit margin of fine chemicals trading business was more attractive. Accordingly, the Group was able to achieve remarkable results in the first year of fine chemicals trading.

Trading of consumer electronic products

During the year under review, the Group's consumer electronic products trading business recorded a turnover of HK$13,069,000, which accounted for 53% of the total turnover, representing a decrease of approximately 51.1% compared with HK$26,723,000 of the previous year. The business recorded a profit of HK$87,000 as compared to a loss of HK$589,000 for the year ended 31 March 2004. The average profit margin increased from approximately 1.3% for the year ended 31 March 2004 to approximately 1.4% for the year ended 31 March 2005. The major trading products of this business segment were DVD players, DVD ICs and spare parts. Due to overproduction and the overheated market of relevant products in previous years, there was very strong competition in the industry and profit margin remained low. In order to reduce trade credit risk, the Group took a prudent approach in operating the business during the year. As a result, the turnover was also adversely affected. On the other hand, with the strict cost control measures of the management implemented to cut down operating expenditure last year, the results of this segment improved from a loss recorded for the year ended 31 March 2004 to a profit for the year ended 31 March 2005. The Group continued to monitor and review the market situation and respond accordingly.

Prospects

The economy in the PRC has been experiencing stunning growth, with the people's average income increasing. According to the National Bureau of Statistics of China, the GDP of the nation in 2004 amounted to approximately RMB13,687.6 billion, representing an increase of approximately 16.6% over 2003, while the GDP per capita grew by approximately 15.9% as compared with that of 2003. As the economy grows, people's living standards lift up and their demands and requirements on all sorts of consumer products increase accordingly.

Fine chemicals such as flavours and fragrances, colorants and seasonings, which the Group is now offering, can be used in food and tobacco products to improve the quality and appeal of those products. In view of the huge consumer products production market in the PRC, the Group believes there will be huge chance and space for development of its fine chemicals businesses. The Group looks earnestly for investment opportunities in this industry. The Group is optimistic that, with the valuable experience of its management, the expertise of its staff as well as the reliable relationship with its customers and suppliers, it will be able to secure reasonable returns for its shareholders in the near future.

Liquidity and financial resources

During the year ended 31 March 2004, the Group raised HK$70,000,000 from the issuance of ordinary Shares and Existing Preference Shares to Mogul Enterprises Limited ("Mogul"), the Group's ultimate holding company, which was completed on 22 March 2004. HK$65,000,000 of the proceeds has been used for the redemption of all the Company's preference shares issued in 1996 and 1999 and the settlement of specific liabilities of the Group. The remaining amount of HK$5,000,000 was used as working capital of the Group. Details of the subscription of shares and the redemption of preference shares were set out in the Company's circular dated 25 February 2004.

As at 31 March 2004, 2005 and 2006, the Group had bank balances and cash of HK$10,408,000, HK$9,234,000 and HK$3,972,000 respectively, whereas 15%, 54% and 31% of the balances as at 31 March 2006 were denominated in Hong Kong dollars, U.S. dollars and Renminbi respectively. Each of the current ratio of 2004, 2005 and 2006 was approximately 1.3 times, 1.5 times and 1.5 times respectively.

Due to the application of HKFRS, the liability and equity components of the Existing Preference Shares were separated on its initial recognition and accounted for separately, resulting in negative shareholders' equity. The Board considered that it was not meaningful to publish a gearing ratio for the Group for the three years until the Group is in a positive shareholders' equity position.

As at 31 March 2004, 2005 and 2006, the Group had an undrawn revolving loan facility from Mogul of up to HK$15,000,000 ("Loan Facility"). The facility bore interest at 2% over the six-month Hong Kong Interbank Offered Rate on the outstanding amount calculated on a daily basis, and were secured by a first legal fixed charge made over the equity interest of the Company in Huabao Investment, a wholly-owned subsidiary of the Company, and by a first floating charge made over all of Huabao Investment's assets. Any outstanding loans together with the accrued interest will be due on 22 March 2009. During the three years ended 31 March 2006, the Group did not make any drawdown under the Loan Facility.

Foreign currency exposure

Except for the operations in the PRC where the transactions are denominated in Renminbi, the sales and purchases of the Group are denominated in U.S. dollars and Hong Kong dollars. In view of the relative stability of the exchange rates between Hong Kong dollars, U.S. dollars and Renminbi, the Board considers that the Group is not exposed to any significant exchange risk.

Contingent liabilities

The Board noted from an announcement dated 29 April 2002 made by certain former directors that a verbal demand notice was received from one of the creditors demanding immediate settlement of approximately RMB9,600,000 alleged outstanding debts. However, while the Board has reviewed the records of the Company and conducted internal investigations after their appointment, the Board did not have any other information available to verify the existence of or the validity of this claim but will continue to monitor and review the situation from time to time.

Save as disclosed above and based on the information available to the Board, the Group and the Company had no contingent liabilities as at 31 March 2004, 2005 and 2006.

Management and employees

As at 31 March 2006, the Group had a total of 14 employees and 6 directors. Salaries of employees are primarily based on prevailing market salary levels and year end bonuses are granted at the end of each calendar year. Other employees' benefits include provident fund, medical cover and other insurance.

PRICEWATERHOUSECOOPERS

羅兵咸永道會計師事務所

PricewaterhouseCoopers
22nd Floor, Prince's Building
Central, Hong Kong

28 June 2006

The Directors
Huabao International Holdings Limited

Dear Sirs,

We set out below our report on the financial information relating to Chemactive Investments Limited ("Chemactive Investments") and its subsidiaries (hereinafter collectively referred to as "Chemactive Group") for the three years ended 31 March 2004, 2005 and 2006 (the "Relevant Periods"), for inclusion in the circular of Huabao International Holdings Limited (the "Company") dated 28 June 2006 (the "Circular") in connection with its proposed acquisition (the "Acquisition") of the entire issued share capital of Chemactive Investments pursuant to an agreement (the "Acquisition Agreement") dated 7 June 2006 entered into between Ms. Chu Lam Yiu, the 100% equity holder of Chemactive Investments and the controlling shareholder of the Company, and the Company.

Chemactive Investments was incorporated in the British Virgin Islands (the "BVI") on 6 April 2006 as an exempted company with limited liability. Pursuant to a group reorganization (the "Reorganization"), as detailed in Note 1 of Section II, which was completed on 26 May 2006, Chemactive Investments became the holding company of the subsidiaries now comprising Chemactive Group.

As at the date of this report, Chemactive Investments has direct and indirect interests in the following subsidiaries, all of which were incorporated as limited liability companies.

Company name	Place and date of incorporation	Authorized/ registered capital	Issued and fully paid share capital/ paid-in capital	Attributable equity Interest Direct	Attributable equity Interest Indirect	Principal activities and place of operation
Ingame Technology Ltd. ("Ingame")	BVI 28 November 2001	US$50,000	US$1	100%		Investment holding Hong Kong
Spanby Industrial Ltd. ("Spanby")	BVI 12 December 2001	US$50,000	US$1,195	100%		Investment holding Hong Kong
Nocton International Ltd. ("Nocton")	BVI 12 December 2001	US$50,000	US$1	100%		Investment holding Hong Kong
Future Dragon International Ltd. ("Future Dragon")	BVI 12 December 2001	US$50,000	US$1	100%		Investment holding Hong Kong
Huabao Group Ltd. ("Huabao Group")	BVI 12 March 2002	US$50,000	US$1	100%		Investment holding Hong Kong
Sino Asia Technology Ltd. ("Sino Asia")	BVI 8 October 2003	US$50,000	US$98	100%		Investment holding Hong Kong

Company name	Place and date of incorporation	Authorized/ registered capital	Issued and fully paid share capital/ paid-in capital	Attributable equity Interest Direct	Indirect	Principal activities and place of operation
Symhope Investment Ltd. ("Symhope")	BVI 8 February 2005	US$50,000	US$100	100%		Investment holding Hong Kong
Sino Prospect Holdings Ltd. ("Sino Prospect")	BVI 14 July 2005	US$1	US$1	100%		Investment holding Hong Kong
Aromascape Development Centre GmbH (1) ("Aromascape")	Germany 17 February 2006	€25,000	€25,000		100%	Research and development of flavours and fragrances Germany
Hua Bao Industrial & Trading Development (HK) Ltd. ("Huabao ITD")	Hong Kong 30 December 1993	HK$10,000	HK$10,000		100%	Investment holding Hong Kong
Smart Sino International Ltd. ("Smart Sino")	Hong Kong 30 April 1997	HK$10,000	HK$10,000		100%	Investment holding Hong Kong
Hua Fang Tobacco Flavors Ltd. (2) ("Guangzhou Huafang")	The People's Republic of China (the "PRC") 16 October 1992	US$4,000,000	US$4,000,000		51%	Production and sale of tobacco flavours and fragrances The PRC
Huabao Food Flavours & Fragrances (Shanghai) Co., Ltd. ("Huabao Shanghai")	The PRC 5 June 1996	US$10,000,000	US$10,000,000		100%	Production and sale of tobacco flavours and fragrances The PRC
Yunnan Tianhong Flavor & Fragrance Co., Ltd. ("Yunnan Tianhong")	The PRC 25 June 2001	US$2,250,000	US$2,250,000		60%	Production and sale of tobacco flavours and fragrances The PRC
Huabao Xianghua Keji Fazhan (Shanghai) Co. Ltd. ("Huabao Keji")	The PRC 14 September 2001	US$2,100,000	US$2,100,000		100%	Research and development of flavours and fragrances The PRC
青島華寶香精香料有限公司 Qingdao Huabao Flavors & Fragrances Co., Ltd.* (3) ("Qingdao Huabao")	The PRC 6 May 2003	HK$3,673,500	HK$3,673,500		51%	Production and sale of tobacco flavours and fragrances The PRC
Shanghai H&K Flavours & Fragrances Co., Ltd. ("Huabao Kongque")	The PRC 14 April 2004	RMB100,000,000	RMB100,000,000		100%	Production and sale of food flavours and fragrances The PRC
Wuxi Fuhua Flavour & Fragrance Co., Ltd. ("Wuxi Fuhua")	The PRC 28 October 2004	US$7,000,000	US$7,000,000		100%	Production and sale of tobacco flavours and fragrances The PRC
Wuxi Jiahua Flavour & Fragrance Co., Ltd. ("Wuxi Jiahua")	The PRC 20 June 2005	RMB10,000,000	RMB10,000,000		100%	Production and sale of tobacco flavours and fragrances The PRC

* *The English name of this company represents management's best efforts in translating the Chinese name as no English name has been registered.*

(1) The entity became a subsidiary of Chemactive Group on 7 April 2006 *(Note 28(b))*.

(2) The entity became a subsidiary of Chemactive Group on 25 July 2005 *(Note 26(b))*.

(3) The entity was previously an associate and became a subsidiary of Chemactive Group on 11 June 2004 *(Note 26(a))*.

All companies incorporated in the BVI now comprising Chemactive Group have adopted 31 March as their financial year end date. All companies now comprising Chemactive Group incorporated in Hong Kong and the PRC have adopted 31 December as their financial year end date.

No audited accounts have been prepared for companies incorporated in the BVI, including Chemactive Investments, as they are not subject to any statutory audit requirement in the BVI. The statutory audited accounts of the companies incorporated in Hong Kong and the PRC for which there is a statutory audit requirement have been prepared in accordance with the relevant accounting principles generally accepted in their respective places of incorporation. The names of the auditors of the audited accounts of these companies are set out below:

Company	**Accounts for the years ended**	**Auditors**
Huabao ITD	31 December 2003	Ho & Ip CPA Ltd.
Smart Sino	31 December 2003	Ho & Ip CPA Ltd.
	31 December 2004	Raymond S. W. Ho & Co.
Guangzhou Huafang	31 December 2005	廣州市南方會計師事務所有限公司 Guangzhou Nanfang Certified Public Accountants Co., Ltd.*
Huabao Shanghai	31 December 2003, 2004 and 2005	上海佳華會計師事務所有限公司 Shanghai Jiahua Certified Public Accountants Co., Ltd.*
Yunnan Tianhong	31 December 2003, 2004 and 2005	玉溪滙勵會計師事務所有限公司 Yuxi Huili Certified Public Accountants Co., Ltd.*
Huabao Keji	31 December 2003	上海同誠會計師事務所有限公司 Shanghai Tongcheng Certified Public Accountants Co., Ltd.*
	31 December 2004	上海佳瑞會計師事務所有限公司 Shanghai Jiarui Certified Public Accountants Co., Ltd.*
	31 December 2005	上海正道會計師事務所有限公司 Shanghai ZDCPA Co., Ltd.*
Qingdao Huabao	31 December 2003	青島琴島有限責任會計師事務所 Qingdao Qindao Certified Public Accountants Co., Ltd.*

Company	Accounts for the years ended	Auditors
	31 December 2004 and 2005	山東大地有限責任會計師事務所 Shandong Dadi Certified Public Accountants Co., Ltd.*
Huabao Kongque	31 December 2004 and 2005	上海正道會計師事務所有限公司 Shanghai ZDCPA Co., Ltd.*
Wuxi Fuhua	31 December 2004 and 2005	無錫太湖會計師事務所有限公司 Wuxi Taihu Certified Public Accountants Co., Ltd.*
Wuxi Jiahua	31 December 2005	無錫寶光會計師事務所有限公司 Wuxi Baoguang Certified Public Accountants Co., Ltd.*

* *The English names of these auditors represent management's best efforts in translating the Chinese names of these auditors as no English names have been registered.*

For the purpose of this report, the directors of the companies now comprising Chemactive Group have prepared their respective management accounts for the Relevant Periods or from their respective dates of incorporation to 31 March 2006, whichever is a shorter period, in accordance with Hong Kong Financial Reporting Standards ("HKFRS") issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA") (these accounts are collectively referred to as the "HKFRS Management Accounts"). The directors of the companies now comprising Chemactive Group are responsible for preparing the HKFRS Management Accounts, which give a true and fair view. In preparing these accounts, it is fundamental that appropriate accounting policies are selected and applied consistently. We have performed independent audit procedures on the HKFRS Management Accounts in accordance with Hong Kong Standards on Auditing issued by the HKICPA.

The financial information as set out in Sections I to III below (the "Financial Information") has been prepared based on the HKFRS Management Accounts, on the basis set out in Note 1 of Section II below, after making such adjustments as are appropriate. We have examined the Financial Information and have carried out such additional procedures as are necessary in accordance with the Auditing Guideline "Prospectuses and the Reporting Accountant" issued by the HKICPA.

The directors of the Company and Chemactive Investments are responsible for the Financial Information. It is our responsibility to form an independent opinion, based on our examination, on the Financial Information and to report our opinion.

In our opinion, the Financial Information, for the purpose of this report, and prepared on the basis as set out in Note 1 of Section II below, gives a true and fair view of the combined state of affairs of Chemactive Group as at 31 March 2004, 2005 and 2006 and of the combined results and cash flows of Chemactive Group for the years then ended.

I. COMBINED FINANCIAL STATEMENTS

Combined balance sheets

The following is a summary of the combined balance sheets of Chemactive Group as at 31 March 2004, 2005 and 2006 prepared on the basis as set out in Note 1 of Section II below, after making such adjustments as are appropriate:

		As at 31 March		
	Section II,	**2004**	**2005**	**2006**
	Note	*RMB'000*	*RMB'000*	*RMB'000*
ASSETS				
Non-current assets				
Property, plant and equipment	*6*	69,708	86,718	149,486
Land use rights	*7*	10,903	10,666	14,578
Interests in associates	*8*	1,151	4,383	4,054
Intangible assets	*9*	–	325	12,744
Deferred income tax assets	*10*	1,409	669	1,792
		83,171	102,761	182,654
Current assets				
Inventories	*11*	171,196	133,998	128,053
Trade and other receivables	*12*	312,457	401,737	373,732
Term deposits with original maturity over 3 months	*13*	–	–	30,000
Cash and cash equivalents	*14*	95,139	161,411	182,727
		578,792	697,146	714,512
Total assets		661,963	799,907	897,166

		As at 31 March		
	Section II, Note	**2004** *RMB'000*	**2005** *RMB'000*	**2006** *RMB'000*
EQUITY				
Capital and reserves attributable to Chemactive Investments' equity holders				
Share capital	*15*	11	12	12
Reserves	*16*	36,119	42,887	53,859
Retained earnings		299,055	402,104	404,155
		335,185	445,003	458,026
Minority interests		23,620	41,370	56,018
Total equity		358,805	486,373	514,044
Current liabilities				
Trade and other payables	*17*	299,107	306,988	380,228
Current income tax liabilities		4,051	6,546	2,894
		303,158	313,534	383,122
Total equity and liabilities		661,963	799,907	897,166
Net current assets		275,634	383,612	331,390
Total assets less current liabilities		358,805	486,373	514,044

Combined income statements

The following is a summary of the combined income statements of Chemactive Group for the Relevant Periods, prepared on the basis as set out in Note 1 of Section II below, after making such adjustments as are appropriate:

		Years ended 31 March		
	Section II,	**2004**	**2005**	**2006**
	Note	*RMB'000*	*RMB'000*	*RMB'000*
Sales	*5*	561,775	748,997	795,436
Cost of goods sold	*19*	(405,978)	(560,424)	(413,675)
Gross profit		155,797	188,573	381,761
Other income – net	*18*	9,832	6,263	19,654
Selling and marketing expenses	*19*	(16,412)	(27,357)	(33,398)
Administrative expenses	*19*	(26,335)	(40,260)	(46,788)
Operating profit		122,882	127,219	321,229
Share of losses of associates	*8*	(123)	(21)	(329)
Profit before income tax		122,759	127,198	320,900
Income tax expense	*21*	(12,969)	(11,681)	(10,128)
Profit for the year		109,790	115,517	310,772
Attributable to:				
Equity holders of Chemactive Investments		104,170	109,524	303,483
Minority interests		5,620	5,993	7,289
		109,790	115,517	310,772

Combined statements of changes in equity

The following is a summary of the combined statements of changes in equity of Chemactive Group for the Relevant Periods, prepared on the basis as set out in Note 1 of Section II below, after making such adjustments as are appropriate:

	Attributable to the equity holders of Chemactive Investments				
	Share capital *RMB'000*	**Reserves** *RMB'000*	**Retained earnings** *RMB'000*	**Minority interests** *RMB'000*	**Total** *RMB'000*
Balance at 1 April 2003	11	27,139	203,865	22,532	253,547
Profit for the year	–	–	104,170	5,620	109,790
Dividends paid to minority shareholders	–	–	–	(4,532)	(4,532)
Appropriations from net profit *(Note 16)*	–	8,980	(8,980)	–	–
Balance at 31 March 2004	11	36,119	299,055	23,620	358,805
Issuance of share capital *(Note 15)*	1	–	–	–	1
Capital injection to an associate which then became a subsidiary *(Note 26 (a))*	–	293	–	1,735	2,028
Capital injection by a minority shareholder	–	–	–	15,000	15,000
Profit for the year	–	–	109,524	5,993	115,517
Dividends paid to minority shareholders	–	–	–	(4,978)	(4,978)
Appropriations from net profit *(Note 16)*	–	6,475	(6,475)	–	–
Balance at 31 March 2005	12	42,887	402,104	41,370	486,373
Acquisition of a subsidiary *(Note 26(b))*	–	–	–	23,665	23,665
Profit for the year	–	–	303,483	7,289	310,772
Appropriations from net profit *(Note 16)*	–	9,666	(9,666)	–	–
Dividends declared *(Note 23)*	–	–	(291,766)	–	(291,766)
Purchase of additional interests in a subsidiary from a minority shareholder *(Note 26 (c))*	–	1,306	–	(16,306)	(15,000)
Balance at 31 March 2006	12	53,859	404,155	56,018	514,044

Combined cash flow statements

The following is a summary of the combined cash flow statements of Chemactive Group for the Relevant Periods prepared on the basis as set out in Note 1 of Section II below, after making such adjustments as are appropriate:

		Years ended 31 March		
		2004	**2005**	**2006**
	Note	*RMB'000*	*RMB'000*	*RMB'000*
Cash flows from operating activities				
Cash generated from operations	*25*	109,288	91,783	352,072
Income tax paid		(8,864)	(8,446)	(14,903)
Net cash generated from operating activities		100,424	83,337	337,169
Cash flows from investing activities				
Acquisition of subsidiary, net of cash acquired	*26*	–	1,084	(16,227)
Acquisition of an associate		–	(4,404)	–
Purchase of additional interests in a subsidiary from a minority shareholder	*26*	–	–	(15,000)
Purchase of property, plant and equipment		(16,150)	(24,891)	(51,521)
Purchase of land use rights		–	–	(1,845)
Purchase of intangible assets		–	–	(9,437)
Interest received		569	1,124	2,818
Increase in term deposits with original maturity over 3 months		–	–	(30,000)
Net cash used in investing activities		(15,581)	(27,087)	(121,212)
Cash flows from financing activities				
Contributions from a minority shareholder to a subsidiary		–	15,000	–
Dividends paid		(4,532)	(4,978)	(194,641)
Net cash (used in)/generated from financing activities		(4,532)	10,022	(194,641)
Net increase in cash and cash equivalents		80,311	66,272	21,316
Cash and cash equivalents at beginning of the year		14,828	95,139	161,411
Cash and cash equivalents at end of the year		95,139	161,411	182,727

II. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the years ended 31 March 2004, 2005 and 2006

1. CHEMACTIVE GROUP REORGANIZATION AND BASIS OF PREPARATION

1.1 Formation of Chemactive Group and its business

Chemactive Investments was incorporated in the BVI on 6 April 2006 as an exempted company with limited liability and has not carried out any business since its incorporation, except for the following Reorganization:

On 26 May 2006, pursuant to an agreement between Ms. Chu Lam Yiu and Chemactive Investments, the entire equity interests of Ingame, Spanby, Nocton, Future Dragon, Huabao Group, Symhope, Sino Asia and Sino Prospect, which were all directly held by Ms. Chu Lam Yiu (hereinafter collectively referred to as the "Relevant Companies"), were transferred to Chemactive Investments. The above transfers were settled by the issuance of 1 ordinary share with par value of US$1 each by Chemactive Investments to Ms. Chu Lam Yiu. Consequently, Chemactive Investments became the holding company of Chemactive Group.

Chemactive Group principally manufactures, distributes and sells flavours and fragrances in the PRC.

1.2 Basis of preparation

Since Ms. Chu Lam Yiu controlled Chemactive Investments and the Relevant Companies before and after the completion of the Reorganization, the Reorganization has been accounted for as a reorganization of entities under common control.

For the purpose of this report, the combined income statements, combined cash flow statements and combined statements of changes in equity of Chemactive Group for the Relevant Periods, include the financial information of the companies now comprising Chemactive Group as a result of the Reorganization as if the current group structure had been in existence throughout the Relevant Periods, or since their respective dates of incorporation or effective date of acquisition, whichever is a shorter period.

The combined balance sheets of Chemactive Group as at 31 March 2004, 2005 and 2006 have been prepared to present the assets and liabilities of Chemactive Group as at these dates as if the current group structure had been in existence at these dates. As at 31 March 2006, the Reorganization has not yet been completed. Accordingly, the owners' equity of Chemactive Group as at 31 March 2004, 2005 and 2006 represents the combined equities of the Relevant Companies, which, upon the completion of the Reorganization, are directly held by Chemactive Investments.

Minority interests represent the interests of shareholders outside Chemactive Group in the operating results and net assets of the subsidiaries.

Under purchase accounting, the financial information of Qingdao Huabao and Guangzhou Huafang has been included in the combined financial statements of Chemactive Group from the date on which control was obtained from third parties.

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

As at 31 March 2006, Chemactive Investments has not been incorporated yet. Accordingly, no financial information was presented for the Relevant Periods.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Financial Information has been prepared under the historical cost convention and in accordance with HKFRS, which has been consistently applied throughout the Relevant Periods. HKFRS 1 "First-time Adoption of Hong Kong Financial Reporting Standards" has been applied in preparing the Financial Information.

The preparation of the Financial Information in conformity with HKFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying Chemactive Group's accounting policies.

2.1 Consolidation

(a) Subsidiaries

Subsidiaries are all entities over which Chemactive Group has the power to govern the financial and operating policies, generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether Chemactive Group controls another entity.

The purchase method of accounting is used to account for the acquisition of subsidiaries by Chemactive Group from parties not under common control. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interests. The excess of the cost of acquisition over the fair value of Chemactive Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in the income statements.

Inter-company transactions, balances and unrealized gains on transactions between Chemactive Group companies are eliminated. Unrealized losses are also eliminated but considered as an impairment indicator of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by Chemactive Group.

(b) Associates

Associates are all entities over which Chemactive Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting and are initially recognized at cost. Chemactive Group's investments in associates include goodwill (net of any accumulated impairment loss) identified on acquisition (see Note 2.5).

Chemactive Group's share of its associates' post-acquisition profits or losses is recognized in the income statements, and its share of post-acquisition movements in reserves is recognized in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When Chemactive Group's share of losses in an associate equals or exceeds its interest in the associate, Chemactive Group does not recognize further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealized gains on transactions between Chemactive Group and its associates are eliminated to the extent of Chemactive Group's interest in the associates. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by Chemactive Group.

2.2 Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

2.3 Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements of each of Chemactive Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The combined financial statements are presented in Renminbi (the "RMB"), which is Chemactive Investments' functional and Chemactive Group's presentation currency.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchanges rates of monetary assets and liabilities denominated in foreign currencies are recognized in the income statements.

2.4 Property, plant and equipment

Construction in progress is property, plant and equipment on which construction work has not been completed and is stated at cost. Cost includes acquisition and construction expenditure incurred, interest and other direct costs attributable to the development.

All other property, plant and equipment are stated at historical cost less depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to Chemactive Group and the cost of the item can be measured reliably. All other repairs and maintenance are expensed in the income statements during the financial period in which they are incurred.

Depreciation of property, plant and equipment is calculated using the straight-line method to allocate cost to their residual values over their estimated useful lives as follows:

Buildings	20 years
Plant and machinery	5 – 10 years
Motor vehicles	5 years
Furniture, fixtures and equipment	5 – 10 years
Leasehold improvements	2 – 5 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 2.6).

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statements.

2.5 Intangible assets

(a) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of Chemactive Group's share of the net identifiable assets of the acquired subsidiary and associate at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in "intangible assets". Goodwill on acquisitions of associates is included in "interests in associates". Separately recognized goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose.

(b) Trademarks

Trademarks are shown at historical cost. They have a finite useful life and are carried at cost less accumulated amortization. Amortization is calculated using the straight-line method to allocate the cost of trademarks over their estimated useful lives of 10 years.

(c) Computer software

Acquired computer software licences are capitalized on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortized over their estimated useful lives (3-5 years).

2.6 Impairment of non-financial assets

Assets that have an indefinite useful life are not subject to amortization, which are at least tested annually for impairment and are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

2.7 Inventories

Inventories are stated at the lower of cost and net realizable value. Cost is determined using the weighted average method. The cost of finished goods and work in progress comprises raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). It excludes borrowing costs. Net realizable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

2.8 Trade and other receivables

Trade and other receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment. A provision for impairment of trade and other receivables is established when there is objective evidence that Chemactive Group will not be able to collect all amounts due according to the original terms of receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganization, and default or delinquency in payments are considered indicators that the trade receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the provision is recognized in the income statements within administrative expenses.

2.9 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less.

2.10 Share capital

Ordinary shares are classified as equity.

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

2.11 Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

2.12 Employee benefits

Chemactive Group contributes on a monthly basis to various defined contribution plans organized by the relevant governmental authorities. Chemactive Group has no legal or constructive obligations to pay further contributions if the plans do not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior years. The contributions are recognized as employee benefit expenses when they are due.

2.13 Research and development costs

Research expenditures are expensed as incurred. Costs incurred on development projects relating to the design and testing of new or improved products are recognized as an intangible asset where the technical feasibility and intention of completing the product under development have been demonstrated and the resources are available to do so, costs can be measured reliably and there is an ability to sell or use the asset that will generate probable future economic benefits. Such development costs are recognized as an asset and amortized on a straight-line basis over a period of not more than 5 years to reflect the pattern in which the related economic benefits are recognized. Development costs that do not meet the above criteria are expensed as incurred. Development costs previously recognized as an expense are not recognized as an asset in a subsequent period.

2.14 Revenue recognition

Revenue comprises the fair value of the consideration received or receivable, for the sales of goods, net of value-added tax, returns, rebates and discounts and after eliminating sales within Chemactive Group.

(a) Sales of goods

Sales of goods are recognized when a Chemactive Group entity has delivered products to the customer, the customer has accepted the products, the amount of revenue can be measured reliably and collectibility of the related receivables is reasonably assumed.

(b) Interest income

Interest income is recognized on a time-proportion basis using the effective interest method. When a receivable is impaired, Chemactive Group reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at original effective interest rate of the instrument, and continues unwinding the discount as interest income.

2.15 Operating leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged in the income statements on a straight-line basis over the period of the lease.

2.16 Dividend distribution

Dividend distribution to the then shareholders of the companies now comprising Chemactive Group is recognized as a liability in Chemactive Group's combined financial statements in the period in which the dividends are approved by the shareholders of the respective companies.

2.17 Government grants

Grants from the government are recognized at their fair value, where there is a reasonable assurance that Chemactive Group will comply with the conditions attaching with them and that the grants will be received.

Government grants relating to costs are deferred and recognized in the income statements over the period necessary to match them with the costs they are intended to compensate.

Government grants relating to the purchase of property, plant and equipment are included in non-current liabilities as deferred income and are recognized in the income statements on a straight-line basis over the expected lives of the related assets.

3. FINANCIAL RISK MANAGEMENT

3.1 Financial risk factors

Chemactive Group's activities expose it to a variety of financial risks: market risk (including foreign exchange risk and price risk), credit risk, liquidity risk and cash flow interest rate risk. Chemactive Group focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on Chemactive Group's financial performance.

(a) Market risk

(i) Foreign exchange risk

Chemactive Group mainly operates in the PRC with most of the transactions settled in RMB. Except for certain cash and bank balances, Chemactive Group's receivables and payables were mainly denominated in RMB. Management believes that Chemactive Group does not have significant foreign currency exchange risk. However, the conversion of RMB into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC government.

(ii) Price risk

Chemactive Group is exposed to commodity price risk, especially for raw materials which are the major cost of Chemactive Group. It has not used any commodity futures to hedge its price risk exposure.

(b) Credit risk

The sales to top five customers account for about 60% of total sales during the Relevant Periods. Chemactive Group has policies to ensure that sales of products are made to customers with an appropriate credit history.

(c) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash and the availability of funding through an adequate amount of committed credit facilities. Chemactive Group controls the level of inventories, closely monitors the turnover days of receivables, and does not have bank and other borrowings. Management believes that Chemactive Group does not have significant liquidity risk.

(d) Cash flow interest rate risk

Chemactive Group's interest rate risk arises from bank balances which bear market rates. As Chemactive Group has no significant interest-bearing assets, Chemactive Group's income and operating cash flows are substantially independent of changes in market interest rates.

3.2 Fair value estimation

The nominal value less impairment provision of trade receivables and payables are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to Chemactive Group for similar financial instruments.

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Chemactive Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. No estimates and assumptions are considered to have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

5. SEGMENT INFORMATION

(a) Primary reporting format – business segments

Chemactive Group is organized into two main business segments:

(1) Production and sale of tobacco flavours; and

(2) Production and sale of food flavours.

Other Chemactive Group operations mainly comprise the provision of research and development services which do not constitute separately reportable segments.

The segment results for the Relevant Periods are as follows:

	Year ended 31 March 2004			
	Tobacco flavours	**Food flavours**	**Unallocated**	**Total**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
Turnover, gross	561,775	–	–	561,775
Inter-segment sales	–	–	–	–
Turnover, net	561,775	–	–	561,775
Operating profit/(loss)	126,679	–	(3,797)	122,882
Share of losses of an associate *(Note 8)*				(123)
Profit before income tax				122,759
Income tax expense *(Note 21)*				(12,969)
Profit for the year				109,790
Segment assets	652,372	–	7,031	659,403
Deferred income tax assets				1,409
Interest in an associate *(Note 8)*				1,151
Total assets				661,963
Segment liabilities	298,497	–	610	299,107
Current income tax liabilities				4,051
Total liabilities				303,158
Capital expenditure *(Note 6)*	16,072	–	78	16,150
Depreciation *(Note 6)*	7,508	–	438	7,946
Amortization *(Note 7)*	237	–	–	237
Impairment provision for trade receivables	1,431	–	–	1,431

	Year ended 31 March 2005			
	Tobacco flavours	**Food flavours**	**Unallocated**	**Total**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
Turnover, gross	688,792	63,904	3,500	756,196
Inter-segment sales	(3,666)	(33)	(3,500)	(7,199)
Turnover, net	685,126	63,871	–	748,997
Operating profit/(loss)	128,123	4,381	(5,285)	127,219
Share of losses of an associate *(Note 8)*				(21)
Profit before income tax				127,198
Income tax expense *(Note 21)*				(11,681)
Profit for the year				115,517
Segment assets	664,815	121,660	8,380	794,855
Deferred income tax assets				669
Interest in an associate *(Note 8)*				4,383
Total assets				799,907
Segment liabilities	287,276	18,972	740	306,988
Current income tax liabilities				6,546
Total liabilities				313,534
Capital expenditure *(Notes 6 and 9)*	21,380	4,507	483	26,370
Depreciation *(Note 6)*	7,972	373	459	8,804
Amortization *(Note 7)*	237	–	–	237
Reversal of impairment provision for trade receivables	(409)	–	–	(409)

	Year ended 31 March 2006			
	Tobacco flavours	Food flavours	Unallocated	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
Turnover, gross	714,880	80,651	3,500	799,031
Inter-segment sales	(61)	(34)	(3,500)	(3,595)
Turnover, net	714,819	80,617	–	795,436
Operating profit/(loss)	316,443	10,356	(5,570)	321,229
Share of losses of an associate *(Note 8)*				(329)
Profit before income tax				320,900
Income tax expense *(Note 21)*				(10,128)
Profit for the year				310,772
Segment assets	753,635	131,111	6,574	891,320
Deferred income tax assets				1,792
Interest in an associate *(Note 8)*				4,054
Total assets				897,166
Segment liabilities	361,806	18,263	159	380,228
Current income tax liabilities				2,894
Total liabilities				383,122
Capital expenditure *(Notes 6, 7 and 9)*	69,201	23,544	672	93,417
Depreciation *(Note 6)*	10,129	508	613	11,250
Amortization *(Notes 7 and 9)*	746	–	–	746
Reversal of impairment provision for trade receivables	(711)	–	–	(711)

Segment assets consist primarily of property, plant and equipment, land use rights, intangible assets, inventories, trade and other receivables and operating cash. They exclude interests in associates and deferred income tax assets.

Segment liabilities comprise operating liabilities. They exclude items such as taxation.

Capital expenditure comprises additions to property, plant and equipment (Note 6), land use rights (Note 7) and intangible assets (Note 9), including additions resulting from acquisitions through business combinations (Notes 6, 7, 9 and 26).

(b) Secondary reporting format – geographical segments

More than 90% of Chemactive Group's activities are carried out in the PRC and more than 90% of Chemactive Group's assets and liabilities are located in the PRC for the Relevant Periods. Accordingly, no analysis of geographical segments for the Relevant Periods is presented.

6. PROPERTY, PLANT AND EQUIPMENT

	Buildings	Plant and machinery	Motor vehicles	Furniture, fixtures and equipment	Leasehold improvements	Construction in progress	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
At 1 April 2003							
Cost	42,586	4,954	9,245	19,696	547	–	77,028
Accumulated depreciation	(4,980)	(1,029)	(3,279)	(6,189)	(7)	–	(15,484)
Net book amount	37,606	3,925	5,966	13,507	540	–	61,544
Year ended 31 March 2004							
Opening net book amount	37,606	3,925	5,966	13,507	540	–	61,544
Additions	8,635	710	1,916	748	366	3,775	16,150
Transfers	1,541	–	–	124	–	(1,665)	–
Disposals	–	–	(40)	–	–	–	(40)
Depreciation	(2,025)	(542)	(1,880)	(3,174)	(325)	–	(7,946)
Closing net book amount	45,757	4,093	5,962	11,205	581	2,110	69,708
At 31 March 2004							
Cost	52,762	5,664	11,016	20,568	913	2,110	93,033
Accumulated depreciation	(7,005)	(1,571)	(5,054)	(9,363)	(332)	–	(23,325)
Net book amount	45,757	4,093	5,962	11,205	581	2,110	69,708
Year ended 31 March 2005							
Opening net book amount	45,757	4,093	5,962	11,205	581	2,110	69,708
Acquisition of a subsidiary *(Note 26(a))*	–	935	181	38	–	–	1,154
Additions	878	1,451	2,012	4,399	678	15,473	24,891
Transfers	12,262	227	–	3,277	–	(15,766)	–
Disposals	–	(140)	–	(91)	–	–	(231)
Depreciation	(2,372)	(742)	(2,024)	(3,340)	(326)	–	(8,804)
Closing net book amount	56,525	5,824	6,131	15,488	933	1,817	86,718
At 31 March 2005							
Cost	65,902	8,144	13,221	28,074	1,591	1,817	118,749
Accumulated depreciation	(9,377)	(2,320)	(7,090)	(12,586)	(658)	–	(32,031)
Net book amount	56,525	5,824	6,131	15,488	933	1,817	86,718
Year ended 31 March 2006							
Opening net book amount	56,525	5,824	6,131	15,488	933	1,817	86,718
Acquisition of a subsidiary *(Note 26(b))*	21,101	3,300	82	336	–	–	24,819
Additions	531	887	7,378	1,124	252	41,349	51,521
Transfers	–	1,244	–	853	–	(2,097)	–
Disposals	–	(870)	(303)	(1,149)	–	–	(2,322)
Depreciation	(4,006)	(1,131)	(2,131)	(3,683)	(299)	–	(11,250)
Closing net book amount	74,151	9,254	11,157	12,969	886	41,069	149,486
At 31 March 2006							
Cost	99,778	15,751	20,698	30,045	1,843	41,069	209,184
Accumulated depreciation	(25,627)	(6,497)	(9,541)	(17,076)	(957)	–	(59,698)
Net book amount	74,151	9,254	11,157	12,969	886	41,069	149,486

Depreciation was expensed in the following categories in the combined income statements:

	Years ended 31 March		
	2004	**2005**	**2006**
	RMB'000	*RMB'000*	*RMB'000*
Cost of goods sold	1,402	1,649	2,366
Selling and marketing expenses	488	497	755
Administrative expenses	6,056	6,658	8,129
Total depreciation *(Note 19)*	7,946	8,804	11,250

7. LAND USE RIGHTS

Chemactive Group's interests in land use rights represent prepaid operating lease payments and their net book values are analyzed as follows:

	As at 31 March		
	2004	**2005**	**2006**
	RMB'000	*RMB'000*	*RMB'000*
Outside Hong Kong, held on:			
Leases between 10 to 50 years	10,903	10,666	14,578

	Years ended 31 March		
	2004	**2005**	**2006**
	RMB'000	*RMB'000*	*RMB'000*
Beginning of the year	11,140	10,903	10,666
Additions	–	–	1,845
Acquisition of a subsidiary *(Note 26(b))*	–	–	2,411
Amortization	(237)	(237)	(344)
End of the year	10,903	10,666	14,578

8. INTERESTS IN ASSOCIATES

	Years ended 31 March		
	2004	**2005**	**2006**
	RMB'000	*RMB'000*	*RMB'000*
Beginning of the year	1,274	1,151	4,383
Share of associates' results	(123)	(21)	(329)
Capital injection to an associate which then became a subsidiary *(Note 26(a))*	–	(1,151)	–
Additions	–	4,404	–
End of the year	1,151	4,383	4,054

Chemactive Group's interests in its associates, all of which are unlisted, as at 31 March 2004, 2005 and 2006 were as follows:

Name	Country of incorporation	Paid-up capital	Assets *RMB'000*	Liabilities *RMB'000*	Revenues *RMB'000*	Net loss *RMB'000*	% Interests held	Principal activities
31 March 2004:								
Qingdao Huabao	PRC	HKD3,673,500	1,156	5	167	(123)	40	Production and sale of flavours and fragrances
31 March 2005:								
Weihai Huayuan Green Industry Co., Ltd. ("Weihai Huayuan")	PRC	USD2,100,000	4,796	413	160	(21)	20	Production and sale of flavours and fragrances
31 March 2006:								
Weihai Huayuan	PRC	USD2,100,000	5,794	1,740	443	(329)	20	Production and sale of flavours and fragrances

Qingdao Huabao became a subsidiary of Chemactive Group in June 2004.

9. INTANGIBLE ASSETS

	Trademarks *RMB'000*	Computer software *RMB'000*	Goodwill *RMB'000*	Total *RMB'000*
Year ended 31 March 2005				
Opening net book amount	–	–	–	–
Acquisition of a subsidiary *(Note 26(a))*	–	–	325	325
Closing net book amount	–	–	325	325
At 31 March 2005				
Cost	–	–	325	325
Accumulated amortization	–	–	–	–
Net book amount	–	–	325	325
Year ended 31 March 2006				
Opening net book amount	–	–	325	325
Additions	9,320	117	–	9,437
Acquisition of a subsidiary *(Note 26(b))*	–	–	3,384	3,384
Amortization	(389)	(13)	–	(402)
Closing net book amount	8,931	104	3,709	12,744
At 31 March 2006				
Cost	9,320	117	3,709	13,146
Accumulated amortization	(389)	(13)	–	(402)
Net book amount	8,931	104	3,709	12,744

Amortization of approximately RMB402,000 for year ended 31 March 2006 is included in administrative expenses in the combined income statement.

Trademarks represent the 孔雀 Peacock* trademarks, which were purchased from 上海孔雀香精香料有限公司 Shanghai Peacock Flavors & Fragrances Co., Ltd.* ("Shanghai Kongque"). Expenditure on acquired trademarks is capitalized and amortized using the straight-line method over their estimated useful lives of 10 years.

* *The English names represent management's best efforts in translating the Chinese names as no English names have been registered.*

During the year ended 31 March 2006, management of Chemactive Group considered that there is no impairment of goodwill.

For the purpose of impairment testing, goodwill has been allocated to 2 individual cash generating units ("CGU"). The carrying amount of goodwill as at 31 March 2006, which is allocated to the significant CGU in comparison with the total carrying amount of goodwill, was RMB3,384,000 in respect of Guangzhou Huafang.

The recoverable amount of Guangzhou Huafang was determined based on value in use calculations. Value in use calculations use cash flow projections based on financial forecasts approved by management covering a 5-year period, and a discount rate of 11.09%. Cash flow projections during the forecast period for Guangzhou Huafang are based on the expected gross margins during the forecast period. Forecast gross margins have been determined based on past performance and management's expectations for the market development.

10. DEFERRED INCOME TAX ASSETS

Deferred income tax assets are recognized for the unrealized intra-group profits from intra-group sales, calculated in respect of temporary differences under the liability method using the tax rate which are enacted or substantively enacted by the balance sheet date.

The movement in the deferred income tax assets is as follows:

	Unrealized intra-group profits arising from intra-group sales *RMB'000*
At 1 April 2003	1,463
Recognized in the income statement	(54)
At 31 March 2004	1,409
Recognized in the income statement	(740)
At 31 March 2005	669
Recognized in the income statement	1,123
At 31 March 2006	1,792

(a) The deferred income tax assets are expected to be recovered within 12 months from the balance sheet dates.

(b) Chemactive Group did not recognize deferred income tax assets of approximately RMB1,407,000, RMB2,053,000 and RMB2,740,000 in respect of tax losses of certain Chemactive Group companies as at 31 March 2004, 2005 and 2006 respectively after considering the expected future taxable income of these companies.

(c) Chemactive Group did not have other material unrecognized deferred income tax assets.

11. INVENTORIES

	As at 31 March		
	2004	**2005**	**2006**
	RMB'000	*RMB'000*	*RMB'000*
At cost:			
Raw materials	144,830	90,829	66,963
Work in progress	120	556	266
Finished goods	26,246	42,613	60,824
	171,196	133,998	128,053

The cost of inventories recognized as expense and included in cost of goods sold for the years ended 31 March 2004, 2005 and 2006 amounted to approximately RMB401,492,000, RMB553,462,000 and RMB405,460,000 respectively.

12. TRADE AND OTHER RECEIVABLES

		As at 31 March		
		2004	**2005**	**2006**
	Note	*RMB'000*	*RMB'000*	*RMB'000*
Trade and bills receivables	*(b)*	295,797	342,736	368,521
Less: impairment provision on receivables		(5,432)	(5,023)	(4,312)
Trade and bills receivables – net		290,365	337,713	364,209
Prepayments		853	5,284	1,207
Due from related parties *(Note 27)*		19,104	54,992	1,398
Advances to staff		492	1,924	2,361
Others		1,643	1,824	4,557
		312,457	401,737	373,732

(a) The carrying amounts of trade and other receivables approximate their fair values.

(b) The credit period generally granted to customers ranges from 0 to 180 days. The ageing analysis of the trade and bills receivables as at the balance sheet dates is as follows:

	As at 31 March		
	2004	**2005**	**2006**
	RMB'000	*RMB'000*	*RMB'000*
0 – 90 days	198,307	299,738	325,713
91 – 180 days	53,192	19,436	33,825
181 – 360 days	31,232	11,995	2,800
Over 360 days	13,066	11,567	6,183
	295,797	342,736	368,521

13. TERM DEPOSITS WITH ORIGINAL MATURITY OVER 3 MONTHS

	As at 31 March		
	2004	**2005**	**2006**
	RMB'000	*RMB'000*	*RMB'000*
Term deposits with original maturity over 3 months	–	–	30,000

The effective interest rate on term deposits with original maturity over 3 months was 2.25% for the year ended 31 March 2006. These deposits were denominated in RMB, placed with banks in the PRC and had a maturity of 1 year. Chemactive Group did not place any term deposits as at 31 March 2004 and 2005.

14. CASH AND CASH EQUIVALENTS

	As at 31 March		
	2004	**2005**	**2006**
	RMB'000	*RMB'000*	*RMB'000*
Cash at bank and in hand	95,139	148,411	182,727
Short-term bank deposits with original maturity less than three months	–	13,000	–
	95,139	161,411	182,727

The effective interest rate on short-term bank deposits was 1.62% for the year ended 31 March 2005.

15. SHARE CAPITAL

Chemactive Investments was not incorporated as at 31 March 2004, 2005 and 2006. Share capital of Chemactive Group as at 31 March 2004, 2005 and 2006 represented the combined capitals of the Relevant Companies, which were directly held by Chemactive Investments upon the completion of the Reorganization.

	As at 31 March		
	2004	**2005**	**2006**
	RMB'000	*RMB'000*	*RMB'000*
Companies			
Ingame	–	–	–
Spanby	10	10	10
Nocton	–	–	–
Future Dragon	–	–	–
Huabao Group	–	–	–
Symhope	–	1	1
Sino Asia	1	1	1
Sino Prospect	–	–	–
	11	12	12

16. RESERVES

	Reserve fund	Enterprise expansion fund	Surplus reserve	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
	(Note (a))	*(Note (a))*		
At 1 April 2003	26,449	690	–	27,139
Appropriations from net profit	8,383	597	–	8,980
At 31 March 2004	34,832	1,287	–	36,119
Appropriations from net profit	6,083	392	–	6,475
Capital injection to an associate which then became a subsidiary *(Note 26(a))*	–	–	293	293
At 31 March 2005	40,915	1,679	293	42,887
Appropriations from net profit	6,611	3,055	–	9,666
Purchase of additional interest in a subsidiary from a minority shareholder *(Note 26(c))*	–	–	1,306	1,306
At 31 March 2006	47,526	4,734	1,599	53,859

(a) In accordance with relevant rules and regulations on foreign investment enterprises incorporated in the PRC, all PRC established subsidiaries of Chemactive Group should make appropriations from the net profit to the reserve fund and the enterprise expansion fund, after offsetting accumulated losses from prior years, and before profit distributions to the shareholders. The appropriation for the reserve fund is no less than 10% of the net profit and it will cease to accrue when the accumulated appropriation exceeds 50% of the registered capital of Chemactive Group companies. The percentages to be appropriated to the enterprise expansion fund are determined by the board of directors of respective Chemactive Group companies in the PRC.

Upon approval from the board of directors of respective Chemactive Group companies, the reserve fund can be used to offset accumulated losses or to increase capital; the enterprise expansion fund can be used to expand production or to increase capital.

17. TRADE AND OTHER PAYABLES

		As at 31 March		
		2004	2005	2006
	Note	*RMB'000*	*RMB'000*	*RMB'000*
Trade payables	*(a)*	224,134	220,151	159,198
Due to related parties *(Note 27)*		54,597	55,299	80,527
Dividends payable *(Note 23)*		–	–	97,125
Wages payable		1,226	1,565	1,511
Advances from customers		3,559	2,462	–
Other taxes payable		9,489	20,720	31,109
Accrued expenses		95	208	3,182
Other payables		6,007	6,583	7,576
		299,107	306,988	380,228

(a) The ageing analysis of the trade payables as at the balance sheet dates is as follows:

	As at 31 March		
	2004	**2005**	**2006**
	RMB'000	*RMB'000*	*RMB'000*
0 – 90 days	220,209	209,539	148,168
91 – 180 days	3,912	4,299	6,552
181 – 360 days	13	6,313	4,478
	224,134	220,151	159,198

18. OTHER INCOME – NET

	Years ended 31 March		
	2004	**2005**	**2006**
	RMB'000	*RMB'000*	*RMB'000*
Interest income – bank deposits	569	1,124	2,818
Government grant – tax refund for reinvestment *(a)*	8,618	4,551	14,610
Others	645	588	2,226
	9,832	6,263	19,654

(a) In accordance with the PRC tax laws for foreign investment enterprises, subject to the approval by relevant tax authorities, certain percentage of the enterprise income tax paid by a foreign invested enterprise will be refunded to its foreign investors if the latter use the dividends received from that foreign invested enterprise to re-invest in that enterprise or establish other foreign investment enterprises. The amounts represent the income tax refund for re-investment in subsidiaries of Chemactive Group by way of capitalization of dividends during the Relevant Periods.

19. EXPENSES BY NATURE

Expenses included in cost of goods sold, selling and marketing expenses and administrative expenses are analyzed as follows:

	Years ended 31 March		
	2004	**2005**	**2006**
	RMB'000	*RMB'000*	*RMB'000*
Depreciation *(Note 6)*	6,565	7,023	7,826
Amortization *(Notes 7 and 9)*	237	237	746
Employee benefit expenses, excluding the amounts included in research and development *(Note 20)*	8,801	21,689	21,731
Changes in inventories of finished goods and work in progress	1,469	(16,803)	(17,921)
Raw materials and consumables used	400,023	570,265	423,381
Impairment provision for/(reversal of provision for) trade receivables	1,431	(409)	(711)
Lease expenses	1,753	2,501	2,374
Auditors' remuneration	129	120	86
Travelling expenses	6,317	8,304	10,263
Entertainment expenses	4,069	7,823	10,005
Research and development			
– Employee benefit expenses *(Note 20)*	1,251	1,614	3,711
– Depreciation *(Note 6)*	1,381	1,781	3,424
– Others	3,573	4,808	3,906

20. EMPLOYEE BENEFIT EXPENSES

	Years ended 31 March		
	2004	**2005**	**2006**
	RMB'000	*RMB'000*	*RMB'000*
Wages, allowances and bonuses	7,621	16,409	18,220
Retirement scheme contributions *(Note (a))*	1,824	4,847	3,155
Others	607	2,047	4,067
	10,052	23,303	25,442

(a) Chemactive Group makes defined contribution to retirement schemes managed by local government in the PRC based on certain percentage of the basic salary of eligible staff. It is the local government's responsibility to pay the retirement pension to those staff who retired.

(b) Director's emoluments

Ms. Chu Lam Yiu is the only director of Chemactive Investments and received no emoluments.

(c) Five highest paid individuals

The emoluments payable to the five highest paid individuals of Chemactive Group during the Relevant Periods are as follows:

	Years ended 31 March		
	2004	**2005**	**2006**
	RMB'000	*RMB'000*	*RMB'000*
Basic salaries, housing allowance, other allowances and benefits in kind	723	1,328	1,568
Retirement scheme contributions	120	76	103
	843	1,404	1,671

The emoluments to the five highest paid individuals in Chemactive Group in the Relevant Periods were all less than RMB1,033,000 (approximately HK$1,000,000) per person.

(d) During the Relevant Periods, no emolument was paid by Chemactive Group to any of the above director or the five highest paid individuals as an inducement to join or upon joining Chemactive Group or as compensation for loss of office.

21. INCOME TAX EXPENSE

The amount of taxation charged to the income statements represented:

	Years ended 31 March		
	2004	**2005**	**2006**
	RMB'000	*RMB'000*	*RMB'000*
Current taxation:			
– PRC enterprise income tax	12,915	10,941	11,251
Deferred income tax *(Note 10)*	54	740	(1,123)
	12,969	11,681	10,128

(a) Hong Kong profits tax has not been provided as Chemactive Group did not generate any assessable profits in Hong Kong during the Relevant Periods.

(b) PRC enterprise income tax is provided on the basis of the profit as reported in the statutory accounts of Chemactive Group's companies operating in the PRC, which are prepared using the accounting rules and regulations applicable to PRC enterprises, adjusted for income and expenses items, which are not assessable or deductible for income tax purpose. Details of the applicable tax rates for PRC Chemactive Group companies are as follows:

(i) Huabao Shanghai, Huabao Kongque, Wuxi Fuhua and Wuxi Jiahua were qualified as foreign investment production enterprises incorporated in the coastal economic development zone. Accordingly, they are subject to enterprise income tax of 24% and local income tax of 3%.

(ii) Huabao Keji was a foreign investment enterprise incorporated in the coastal economic development zone. Accordingly, it is subject to enterprise income tax of 24% and local income tax of 3%.

(iii) Qingdao Huabao was a foreign investment production enterprise incorporated in Qingdao State Hi-Tech Industrial Zone. Accordingly, Qingdao Huabao is subject to enterprise income tax of 15% and local income tax of 3%.

(iv) Yunnan Tianhong was qualified as foreign investment production enterprise in Yunnan province. According to the PRC income tax law, enterprises incorporated in the provinces of the western part of the PRC are subject to enterprise income tax of 15% and exempted from the local income tax.

(v) Guangzhou Huafang was a foreign investment production enterprise incorporated in Guangzhou Economic & Technical Development Zone. Accordingly, Guangzhou Huafang is subject to enterprise income tax of 30% and exempted from the local income tax.

In accordance with the relevant applicable tax regulations, Huabao Shanghai, Huabao Kongque, Wuxi Fuhua, Wuxi Jiahua, Qingdao Huabao and Yunnan Tianhong and Guangzhou Huafang were entitled to full exemption from enterprise income tax for the first two years and 50% reduction in enterprise income tax for the next three years, commencing from the first profitable year after offsetting all unexpired tax losses carried forward from the previous years. Local income taxes for all of these companies are exempted during the tax holiday periods. Guangzhou Huafang started to derive taxable income in the PRC in the fiscal year ended 31 December 1994; Huabao Shanghai started to derive taxable income in the PRC in the fiscal year ended 31 December 1999; Yunnan Tianhong started to derive taxable income in the PRC in the fiscal year ended 31 December 2001; Huabao Kongque, Wuxi Fuhua and Wuxi Jiahua started to derive taxable income in the PRC in the fiscal year ended 31 December 2005. In 2004, Huabao Shanghai was approved by the local tax bureau to entitle to enterprise income tax reduction of 50% for the three years from 2004.

(c) No provision for income tax in other jurisdictions has been made as Chemactive Group has no income assessable for income tax in those jurisdictions during the Relevant Periods.

(d) The taxation on Chemactive Group's profit before income tax differs from the theoretical amount that would arise using the PRC taxation rates applicable to respective Chemactive Group companies as follows:

	Years ended 31 March		
	2004	**2005**	**2006**
	RMB'000	*RMB'000*	*RMB'000*
Profit before income tax	122,759	127,198	320,900
Tax calculated at taxation rates applicable to respective Chemactive Group companies	29,300	29,613	90,701
Effect of tax holidays	(18,128)	(19,146)	(82,165)
Expenses not deductible for taxation purposes	721	565	956
Utilization of previously unrecognized tax losses	–	–	(110)
Tax losses for which no deferred income tax asset was recognized	1,076	649	746
Income tax expense	12,969	11,681	10,128

22. EARNINGS PER SHARE

No earnings per share information is presented as its inclusion, for the purpose of this report, is not considered meaningful due to the Reorganization and the preparation of the results for the Relevant Periods on the combined basis as disclosed in Note 1 of Section II above.

23. DIVIDENDS

No dividend has been declared by Chemactive Investments since its incorporation. The dividends disclosed for the year ended 31 March 2006 represented the dividends declared by Spanby, Nocton and Future Dragon, to its then shareholders.

24. COMMITMENTS

(a) Capital commitments

Capital commitments of Chemactive Group at the balance sheet dates are as follows:

		As at 31 March	
	2004	**2005**	**2006**
	RMB'000	*RMB'000*	*RMB'000*
Contracted but not provided for			
Property, plant and equipment	4,045	13,420	2,071
Intangible assets	–	4,500	–
Land use rights	–	1,845	–
Authorised but not provided for property, plant and equipment	–	–	381
	4,045	19,765	2,452

(b) Operating lease commitments

Chemactive Group leases various plants and warehouses under non-cancellable operating lease agreements. Chemactive Group had future aggregate minimum lease payments as follows:

		As at 31 March	
	2004	**2005**	**2006**
	RMB'000	*RMB'000*	*RMB'000*
Not later than 1 year	259	773	1,065
Later than 1 year and not later than 5 years	113	1,013	3,956
	372	1,786	5,021

25. CASH GENERATED FROM OPERATIONS

	Years ended 31 March		
	2004	2005	2006
	RMB'000	*RMB'000*	*RMB'000*
Profit for the year	109,790	115,517	310,772
Adjustments for:			
– Income tax expense *(Note 21)*	12,969	11,681	10,128
– Depreciation *(Note 6)*	7,946	8,804	11,250
– Amortization *(Notes 7 and 9)*	237	237	746
– Interest income *(Note 18)*	(569)	(1,124)	(2,818)
– Share of losses of associates *(Note 8)*	123	21	329
– Impairment provision for/(reversal of provision for) trade receivables *(Note 19)*	1,431	(409)	(711)
– Loss on disposal of property, plant and equipment	40	231	2,322
Changes in working capital:			
– Inventories	(8,750)	37,357	8,904
– Trade and other receivables	11,476	(88,423)	36,680
– Trade and other payables	(25,405)	7,891	(25,530)
Net cash generated from operations	109,288	91,783	352,072

The conversion of RMB into foreign currencies and the remittance of bank balances and cash out of the PRC are subject to the rules and regulations of foreign exchange control promulgated by the PRC government.

26. BUSINESS COMBINATION

(a) In June 2004, Ingame, and Qingdao Etsong Sunrise Investment Co., Ltd ("Qingdao Etsong"), the former controlling shareholder of Qingdao Huabao, entered into a capital injection agreement, pursuant to which Ingame increased its shareholdings in Qingdao Huabao, formerly an associate of Ingame, from 40% to 51% by injection of capital amounting to RMB714,000. The capital injection was completed on 11 June 2004 and Qingdao Huabao became a subsidiary of Ingame.

The acquired business contributed revenues of approximately RMB637,000 and led to a net loss of approximately RMB679,000 to Chemactive Group for the period from 11 June 2004 to 31 March 2005.

If the acquisition had occurred on 6 May 2003, the incorporation date of Qingdao Huabao, Chemactive Group's turnover for the years ended 31 March 2004 and 2005 would have been increased by approximately RMB417,000 and RMB659,000 respectively and net profit for these years would have been decreased by approximately RMB307,000 and RMB713,000 respectively.

As a result of the acquisition of additional interests in Qingdao Huabao, Chemactive Group also recorded a revaluation increase (approximately RMB293,000) of the previously held 40% interests in Qingdao Huabao's net assets from its carrying amount to fair value.

Details of net assets acquired and goodwill are as follows:

	Qingdao Huabao
	RMB'000
Capital injection	714
Fair value of identifiable net assets acquired – shown as below	(389)
Goodwill *(Note 9)*	325

The assets and liabilities arising from the acquisition are as follows:

	Fair value	Acquiree's carrying amount
	RMB'000	*RMB'000*
Share of net assets after capital injection:		
Property, plant and equipment *(Note 6)*	1,154	1,140
Trade and other receivables	443	443
Inventories	159	156
Cash and cash equivalents	1,084	1,084
Trade and other payables	(14)	(14)
Net assets before capital injection	2,826	2,809
Capital injection	714	
Net assets after capital injection	3,540	
Net assets acquired (11%)	389	
Total cash paid for capital injection		(714)
Cash and cash equivalents in subsidiary acquired after the capital injection		1,798
Net cash inflow on acquisition		1,084

(b) In July 2005, Symhope, China Tobacco Import and Export Corporation Guangzhou Branch and International Flavors & Fragrances entered into an equity transfer agreement, pursuant to which, Symhope acquired 51% equity interests of Guangzhou Huafang at a cash consideration of approximately RMB28,014,000. The acquisition was completed on 25 July 2005 and Guangzhou Huafang became a subsidiary of Chemactive Group.

The acquired business contributed revenues of approximately RMB29,625,000 and net profit of approximately RMB3,201,000 to Chemactive Group for the period from 25 July 2005 to 31 March 2006.

If the acquisition had occurred on 1 April 2003, at the beginning of the Relevant Periods, Chemactive Group's revenues would have been increased by approximately RMB38,530,000, RMB41,236,000 and RMB45,728,000 for the Relevant Periods; Chemactive Group's net profit would have been increased by approximately RMB1,577,000 and RMB2,552,000 for the years ended 31 March 2004 and 2006 respectively and decreased by approximately RMB2,524,000 for the year ended 31 March 2005.

Details of net assets acquired and goodwill are as follows:

	Guangzhou Huafang
	RMB'000
Purchase consideration paid	28,014
Fair value of identifiable net assets acquired – shown as below	(24,630)
Goodwill *(Note 9)*	3,384

The goodwill is mainly attributed to the expected high profitability of the acquired subsidiary.

The assets and liabilities arising from the acquisition are as follows:

	Fair value	Acquiree's carrying amount
	RMB'000	*RMB'000*
Property, plant and equipment *(Note 6)*	24,819	23,721
Land use rights *(Note 7)*	2,411	1,101
Trade and other receivables	7,964	7,964
Inventories	2,959	2,882
Cash and cash equivalents	11,787	11,787
Trade and other payable	(1,511)	(1,511)
Current income tax liabilities	(134)	(134)
Net assets	48,295	45,810
Net assets acquired (51%)	24,630	
Purchase consideration settled in cash		28,014
Cash and cash equivalents in subsidiary acquired		(11,787)
Net cash outflow on acquisition		16,227

(c) Huabao Kongque was a 85% subsidiary of Smart Sino from 14 April 2004, the incorporation date of Huabao Kongque, to 10 November 2005. On 11 November 2005, Chemactive Group purchased the remaining 15% equity interests from Shanghai Kongque, the minority shareholder, at a cash consideration of RMB15,000,000. The share of the carrying amount of net assets acquired was approximately RMB16,306,000. The excess of share of carrying amount of net assets acquired over the consideration, amounting to approximately RMB1,306,000, was credited to surplus reserve.

27. RELATED PARTY TRANSACTIONS

(a) Name and relationship with related parties

Name	Relationship
Chu Lam Yiu	The ultimate controlling equity holder of Chemactive Group
Mo Shuzhen	A close family member of Ms. Chu Lam Yiu
Champion International Limited ("Champion International")	A company directly controlled by a close family member of Ms. Chu Lam Yiu
Huabao International Limited ("Huabao International")	A company directly controlled by Ms. Chu Lam Yiu
深圳市盈潤投資發展有限公司 Yingrun Investment Development Co. Ltd.* ("Yingrun")	A company directly controlled by Ms. Mo Shuzhen
Hua Kang Industrial & Trading Development Limited ("Huakang")	A company directly controlled by Ms. Chu Lam Yiu
Weihai Huayuan	An associate of Chemactive Group, indirectly controlled by Ms. Chu Lam Yiu

* *The English name of the company represents management's best efforts in translating the Chinese name of the company as no English name has been registered.*

(b) Transactions with related parties

During the Relevant Periods, Chemactive Group had the following significant transactions with related parties.

	Years ended 31 March		
	2004	**2005**	**2006**
	RMB'000	*RMB'000*	*RMB'000*
Sales of goods, net of value-added tax, to:			
– Weihai Huayuan	–	–	6,387
Purchase of raw materials from:			
– Weihai Huayuan	20	191	6,784
Loans to Yingrun:			
Beginning of the year	–	19,100	54,100
Additions	19,100	35,000	–
Repayments	–	–	(54,100)
End of the year	19,100	54,100	–

(c) Balances with related parties

	As at 31 March		
	2004	**2005**	**2006**
	RMB'000	*RMB'000*	*RMB'000*
Balances due from related parties:			
Included under trade receivables			
– Weihai Huayuan	–	–	7,245
Non-trade balances due from *(Note 12)*			
– Yingrun	19,100	54,100	–
– The Company	–	289	198
– Huabao International	–	23	14
– Huakang	–	572	337
– Weihai Huayuan	–	–	76
– Champion International	–	–	764
– Chu Lam Yiu	4	8	9
	19,104	54,992	1,398
Balances due to related parties:			
Included under trade payables			
– Weihai Huayuan	20	190	4,636
Non-trade balances due to *(Note 17)*			
– Weihai Huayuan	–	137	–
– Yingrun	–	55	–
– Huabao International	–	40	–
– Mo Shuzhen	500	114	232
– Chu Lam Yiu	54,097	54,953	80,295
	54,597	55,299	80,527

All the balances with related parties were unsecured, non-interest bearing and repayable on demand.

(d) Key management compensation

	Years ended 31 March		
	2004	**2005**	**2006**
	RMB'000	*RMB'000*	*RMB'000*
Basic salaries, housing allowance, other allowances, benefits in kind and retirement scheme contributions	843	1,404	1,671

28. SUBSEQUENT EVENTS

(a) Subsequent to 31 March 2006, Chemactive Group completed the Reorganization, the details of which are set out in Note 1 of Section II of this report.

(b) On 7 April 2006, Sino Prospect entered into an agreement with HP-rido GmbH, a third party, to acquire 100% equity interests in Aromascape at a consideration of approximately RMB244,000. Upon the completion of the acquisition, Aromascape became a wholly owned subsidiary of Chemactive Group. Aromascape has not commenced operations since 17 February 2006, the date of its incorporation.

(c) On 22 April 2006, Ingame entered into an agreement with Qingdao Etsong, a minority shareholder, to acquire additional 19% equity interests in Qingdao Huabao, at a consideration of approximately RMB726,000. The transaction was completed in April 2006 and Qingdao Huabao became a 70% owned subsidiary of Chemactive Group.

The share of carrying amount of net assets acquired was approximately RMB405,000. The excess of the consideration over the share of carrying amount of net assets acquired, amounting to RMB321,000, was debited to surplus reserve.

(d) On 30 May 2006, Yunnan Tianhong declared a final dividend of RMB13,710,000 for the year ended 31 December 2005.

III. SUBSEQUENT ACCOUNTS

No audited accounts have been prepared for Chemactive Investments and any of the subsidiaries in respect of any period subsequent to 31 March 2006. Also, save as disclosed in Note 28(d) under Section II, no dividend or other distribution has been declared, made or paid by Chemactive Investments or its subsidiaries in respect of any period subsequent to 31 March 2006.

Yours faithfully,
PricewaterhouseCoopers
Certified Public Accountants
Hong Kong

The following discussion of the Target Group's operating results should be read in conjunction with the combined financial information for the three financial years ended 31 March 2006 set forth in the accountants' report, the text of which is set forth in Appendix IV.A to this circular.

Overview

The Target Group is a leader in the PRC flavours and fragrances industry. The Target Group's revenue is primarily derived from the research and development ("R&D"), production and sales of flavours and fragrances. In line with the growth of the PRC flavours and fragrances market, the Target Group has achieved growth in both revenue and gross profit. For each of the three financial years ended 31 March 2006, revenue of the Target Group amounted to approximately RMB562 million, RMB749 million and RMB795 million respectively, with a compound annual growth rate of approximately 19.0%. For each of the three financial years ended 31 March 2006, gross profit of the Target Group amounted to approximately RMB156 million, RMB189 million and RMB382 million respectively, with a compound annual growth rate of approximately 56.5%. For each of the three financial years ended 31 March 2006, net profit of the Target Group amounted to approximately RMB110 million, RMB116 million and RMB311 million respectively, with a compound annual growth rate of approximately 68.1%.

Financial operations overview

The following is a brief overview of the major revenues and expenses in the Target Group's operating results.

Revenue

The Target Group generates its revenue from the sales of flavours and fragrances in the PRC market. Sales of goods are recognised when the Target Group has delivered products to the customer, and the customer has accepted the products, the amount of revenue can be measured reliably and collectibility of the related receivables is reasonably assured.

Cost of goods sold

Cost of goods sold of the Target Group represented the costs of direct materials, direct labour cost and other manufacturing overheads, such as the depreciation of the production facilities and manufacturing equipment.

Other revenues

Other revenues mainly consisted of interest income, tax refund for re-investment and other revenues.

Selling and marketing expenses

Selling and marketing expenses comprised mainly salaries for the selling and marketing staff, entertainment, traveling expenses, office administrative expenses, advertisement expenses, transportation, and other marketing and promotion expenses.

Administrative expenses

Administrative expenses mainly included staff salaries, staff welfare, R&D, rent, entertainment, public facilities expenses and depreciation for office equipment, etc.

Tax

Pursuant to the relevant taxation laws and regulations in the PRC, the subsidiaries of the Target Group are subject to the PRC income tax at rates ranging from 0% to 33%, depending on the business locations of the subsidiaries and the national and local government preferential tax policies.

Review of past performance

Financial year ended 31 March 2006 compared to financial year ended 31 March 2005

Revenue

Revenue of the Target Group increased from approximately RMB749 million for the financial year ended 31 March 2005 to approximately RMB795 million for the financial year ended 31 March 2006, with a growth of approximately 6.1%. The growth in revenue was mainly attributable to the substantial growth in the sales of tobacco and food flavours. For the financial year ended 31 March 2006, the Target Group's revenue of tobacco flavours grew about 4.4% to approximately RMB715 million whereas that of food flavours grew about 26.2% to approximately RMB80,617,000. The distinct growth in the revenue of food flavours was a result of the growth in revenue achieved by the Target Group's direct sales strategy targeting high-end customers in the reviewed year, as well as the success in improving marketing and distribution strategies. The growth in the revenue of tobacco flavours was attained by the Target Group's further expansion in the market and the promotion of new products in the reviewed year.

Cost of goods sold

The Target Group's cost of goods sold decreased from approximately RMB560 million for the financial year ended 31 March 2005 to approximately RMB414 million for the financial year ended 31 March 2006, with a drop of approximately 26.1%. The drop in cost of goods sold was mainly due to the Target Group's upstream integration and R&D in its product chain, which changed its raw material cost structure, leading to a significant decrease in direct raw material costs. For the financial year ended 31 March 2006, direct raw material costs included in the cost of goods sold was approximately RMB405 million, a decrease of 26.8% from the previous financial year.

Gross profit

Gross profit of the Target Group increased from approximately RMB189 million for the financial year ended 31 March 2005 to approximately RMB382 million for the financial year ended 31 March 2006, with a growth of approximately 102.1% while the gross margin of the Target Group soared from 25.2% last year to 48.0% this year. The remarkable growth in gross margin was attributable to the substantial decrease in cost of goods sold this year.

Other revenues

Other revenues of the Target Group increased from approximately RMB6,263,000 for the financial year ended 31 March 2005 to approximately RMB19,654,000 for the financial year ended 31 March 2006, with a growth of approximately 213.8%. The significant increase in the Target Group's tax refund for re-investment was the main source of the increase in other revenues. Tax refund for re-investment surged from approximately RMB4,551,000 for the financial year ended 31 March 2005 to approximately RMB14,610,000 for the financial year ended 31 March 2006, with an increase of approximately 221.0%.

Selling and marketing expenses

Selling and marketing expenses of the Target Group increased from approximately RMB27,357,000 for the financial year ended 31 March 2005 to approximately RMB33,398,000 for the financial year ended 31 March 2006, with a growth of approximately 22.1%, representing 3.7% and 4.2% of the total revenue of the said years respectively. Selling and marketing expenses comprised mainly traveling expenses, entertainment, transportation cost, salaries and office expenses. For the financial year ended 31 March 2006, the aforesaid five expenses increased by approximately 25.5%, 16.5%, 45.8%, 12.6% and 68.1% respectively as compared with those for the financial year ended 31 March 2005. The major cause of such increases was the Target Group's strengthened efforts in direct sales of food flavours and marketing in tobacco flavours.

Administrative expenses

Administrative expenses of the Target Group increased from approximately RMB40,260,000 for the financial year ended 31 March 2005 to approximately RMB46,788,000 for the financial year ended 31 March 2006, with a growth of approximately 16.2%, representing 5.4% and 5.9% of the total revenue of the said years respectively. Administrative expenses mainly included staff salaries, R&D, depreciation, office expenses and public facilities fees, etc. For the financial year ended 31 March 2006, R&D, office expenses and public facilities fees increased by 34.6%, 31.3% and 98.5% respectively as compared with those for the financial year ended 31 March 2005.The increases were mainly attributable to the two newly added subsidiaries of the Target Group, which brought about increases in daily expenses and R&D.

Operating profit

In view of the above major factors, operating profit of the Target Group increased from approximately RMB127 million for the financial year ended 31 March 2005 to approximately RMB321 million for the financial year ended 31 March 2006, with a growth of approximately 152.8%, and the operating margin of the Target Group grew from 17.0% last financial year to 40.4% this financial year.

Taxation

Taxation expenses of the Target Group decreased from approximately RMB11,681,000 for the financial year ended 31 March 2005 to approximately RMB10,128,000 for the financial year ended 31 March 2006, at effective income tax rates of approximately 9.2% and 3.2% respectively. The reduction in effective income tax rate was mainly the result of the preferential tax treatment enjoyed by various subsidiaries of the Target Group in various cities. In addition, three newly invested enterprises were in tax holiday.

Net profit

Based on the overall impact of the aforesaid issues, net profit of the Target Group increased from approximately RMB116 million for the financial year ended 31 March 2005 to approximately RMB311 million for the financial year ended 31 March 2006, with a growth of approximately 168.1%, and net profit margin of the Target Group grew from 15.4% last financial year to 39.1% this financial year.

Financial year ended 31 March 2005 compared to financial year ended 31 March 2004

Revenue

Revenue of the Target Group increased from approximately RMB562 million for the financial year ended 31 March 2004 to approximately RMB749 million for the financial year ended 31 March 2005, with a growth of approximately 33.3%. The growth in revenue was mainly attributable to the growth in the revenue of tobacco flavours and entrance into the food flavours market through establishing Huabao Kongque with Shanghai Kongque, which resolution was passed by the Target Group. For the financial year ended 31 March 2005, the Target Group's revenue of tobacco flavours grew about 21.9% to approximately RMB685 million whereas that of food flavours amounted to approximately RMB63,871,000. Revenue of tobacco flavours increased because (i) the Target Group gained further market share in tobacco flavours market as its customers expanded their market share through the restructuring of the PRC tobacco industry; and (ii) the Target Group dedicated efforts in marketing and promotion in the reviewed year. In 2004, the Target Group and Shanghai Kongque jointly established Huabao Kongque and successfully entered into the food flavours market, thereby acquiring a new income source.

Cost of goods sold

The Target Group's cost of goods sold increased from approximately RMB406 million for the financial year ended 31 March 2004 to approximately RMB560 million for the financial year ended 31 March 2005, with a growth of approximately 37.9%. The increase in cost of goods sold was mainly due to the increase in direct raw material costs and direct labour costs. For the financial year ended 31 March 2005, the Target Group's direct raw material costs included in the cost of goods sold amounted to approximately RMB553 million, representing an increase of approximately 37.9% from the previous financial year. In 2004, the Target Group and Shanghai Kongque jointly established Huabao Kongque and successfully entered into the food flavours market. Food flavours product categories and number of staff were thus increased and led to the significant surge in direct raw material costs and direct labour costs.

Gross profit

Gross profit of the Target Group increased from approximately RMB156 million for the financial year ended 31 March 2004 to approximately RMB189 million for the financial year ended 31 March 2005, with a growth of approximately 21.2% while the gross margin of the Target Group fell from 27.8% in 2004 to 25.2% in 2005. The drop in gross margin was mainly attributable to the increase in cost of goods sold in the reviewed year.

Other revenues

Other revenues of the Target Group decreased from approximately RMB9,832,000 for the financial year ended 31 March 2004 to approximately RMB6,263,000 for the financial year ended 31 March 2005, with a reduction of approximately 36.3%. The reduction in the Target Group's tax refund for re-investment was the major cause of decrease in other revenues. Tax refund for re-investment fell from approximately RMB8,618,000 for the financial year ended 31 March 2004 to approximately RMB4,551,000 for the financial year ended 31 March 2005, with a reduction of approximately 47.2%.

Selling and marketing expenses

Selling and marketing expenses of the Target Group increased from approximately RMB16,412,000 for the financial year ended 31 March 2004 to approximately RMB27,357,000 for the financial year ended 31 March 2005, with a growth of approximately 66.7%, representing 2.9% and 3.7% of the total revenue of the said years respectively. Selling and marketing expenses comprised mainly traveling expenses, entertainment, transportation cost, salaries and office expenses. For the financial year ended 31 March 2005, the aforesaid five expenses increased by approximately 40.8%, 109.6%, 81.5%, 215.8% and 48.6% respectively as compared with those for the financial year ended 31 March 2005. Such increases were attributable to the newly established Huabao Kongque and strengthened endeavors in marketing and promotion by the Target Group.

Administrative expenses

Administrative expenses of the Target Group increased from approximately RMB26,335,000 for the financial year ended 31 March 2004 to approximately RMB40,260,000 for the financial year ended 31 March 2005, with a growth of approximately 52.9%, representing 4.7% and 5.4% of the total revenue of the said years respectively. Administrative expenses mainly included staff salaries, R&D, depreciation, office expenses and public facilities fees, etc. For the financial year ended 31 March 2005, staff salaries, R&D and public facilities fees increased by 179.3%, 32.2% and 76.8% respectively as compared with those for the financial year ended 31 March 2004. The increases were mainly attributable to the three newly added subsidiaries of the Target Group, which brought about increases in daily expenses and R&D.

Operating profit

In light of the foregoing major factors, operating profit of the Target Group increased from approximately RMB123 million for the financial year ended 31 March 2004 to approximately RMB127 million for the financial year ended 31 March 2005, with a growth of approximately 3.3%, and the operating margin of the Target Group fell from 21.9% in 2004 to 17.0% in 2005.

Taxation

Taxation expenses of the Target Group decreased from approximately RMB12,969,000 for the financial year ended 31 March 2004 to approximately RMB11,681,000 for the financial year ended 31 March 2005, with effective income tax rates of approximately 10.6% and 9.2% respectively. The reduction in effective income tax rate was mainly the result of the preferential tax treatment enjoyed by various subsidiaries of the Target Group in various cities. In addition, two newly invested enterprises were in tax holiday.

Net profit

Based on the overall impact of the aforesaid issues, net profit of the Target Group increased from approximately RMB110 million for the financial year ended 31 March 2004 to approximately RMB116 million for the financial year ended 31 March 2005, with a growth of approximately 5.2%, and net profit margin of the Target Group fell from 19.5% in 2004 to 15.4% in 2005.

Liquidity and capital resources

The Target Group finances both its working capital and capital expenditure requirements principally through cash flow from operations. The following table summarizes the Target Group's cash flows for the period indicated:

	For the financial year ended 31 March		
	2004	**2005**	**2006**
	RMB'000	*RMB'000*	*RMB'000*
Net cash generated from operating activities	100,424	83,337	337,169
Net cash used in investing activities	(15,581)	(27,087)	(121,212)
Net cash (used in)/generated from financing activities	(4,532)	10,022	(194,641)
Net increase in cash and cash equivalents	80,311	66,272	21,316
Cash and cash equivalents at the beginning of the financial year	14,828	95,139	161,411
Cash and cash equivalents at the end of the financial year	95,139	161,411	182,727

Operating activities

The Target Group's net cash inflow from operating activities increased from approximately RMB100 million for the financial year ended 31 March 2004 to approximately RMB337 million for the financial year ended 31 March 2006. During the same period, operating profit of the Target Group increased from approximately RMB123 million for the financial year ended 31 March 2004 to approximately RMB321 million for the financial year ended 31 March 2006, with a compound annual growth rate of approximately 61.5%. For each of the three financial years ended 31 March 2006, the differences between the net cash inflow from operating activities and operating profit were mainly the result of change in working capital, as well as tax refund. For the financial year ended 31 March 2004, net cash inflow from operating activities was approximately RMB100 million, including approximately RMB109 million cash inflow from operating activities and approximately RMB8,864,000 income tax paid. For each of the financial years ended 31 March 2005 and 2006, net cash inflow from operating activities amounted to approximately RMB83 million and RMB337 million respectively. They were in line with the increase and decrease of operating profit.

Investing activities

Investing activities of the Target Group were primarily related to the purchase of fixed assets and merger and acquisition activities. For each of the three financial years ended 31 March 2006, net cash outflow spent on investing activities amounted to approximately RMB15,581,000, RMB27,087,000 and RMB121,212,000 respectively. For the financial year ended 31 March 2005, net cash flow spent on investing activities soared by 73.8% as compared with that for the financial year ended 31 March 2004. This was mainly because the Target Group acquired the equity interest of Weihai Huayuan and increased investment in fixed assets in the reviewed year. For the financial year ended 31 March 2006, net cash flow spent on investing activities soared by 347.5% as compared with that for the financial year ended 31 March 2005. This was mainly because the Target Group acquired the equity interest of Guangzhou Huafang and Huabao Kongque and increased investment in fixed assets and time deposits in the reviewed year.

Financing activities

For each of the financial years ended 31 March 2004 and 2006, net cash flow spent on financing activities amounted to approximately RMB4,532,000 and RMB195 million respectively while for the financial year ended 31 March 2005, net cash generated from financing activities amounted to approximately RMB10,022,000. The increase in cash flow from financing activities for the financial year ended 31 March 2005 was the result of the cash contribution from a minority shareholder to a subsidiary of the Target Group. On the other hand, the increase in cash flow spent on financing activities for the financial year ended 31 March 2006 was due to the increase in the Target Group's dividend payment.

Net current assets

As at 31 March 2006, the Target Group had net current assets of approximately RMB331 million. The current assets included cash of approximately RMB183 million, inventories of approximately RMB128 million, trade and other receivables of approximately RMB374 million, as well as deposits of approximately RMB30,000,000. Current liabilities included trade and other payables of approximately RMB380 million and income tax payable of approximately RMB2,894,000.

Save as internal financing within the Group, the Target Group did not have any other borrowings as at 31 March 2006. The Target Group's gearing ratio as at 31 March 2004, 2005 and 2006 was zero, based on the Target Group's interest bearing debts over total equity interest as at 31 March 2006. The Target Group did not have any bank borrowings for the three years ended 31 March 2006.

Selected balance sheet items

Debtors' turnover period

The calculation of debtors' turnover period is based on the average amount of trade and bills receivables net of provision as at the beginning and end of the relevant year divided by total turnover of the corresponding financial year and multiplied by 365. The Target Group generally offers its customers credit terms of 0-180 days, depending on the business volume and the history of relationship with its customers. For each of the three financial years ended 31 March 2006, the Target Group's average debtors' turnover period were 197 days, 153 days and 161 days respectively. For the financial year ended 31 March 2005, debtor's turnover period decreased substantially as the Target Group strengthened its credit control. For the financial year ended 31 March 2006, the debtors' turnover period increased as a result of longer credit period granted to major long-term customers by the Target Group.

As at 31 March 2004, 31 March 2005 and 31 March 2006, the Target Group's trade and bills receivables net of provision for bad debt were approximately RMB290 million, RMB338 million and RMB364 million respectively, accounting for approximately 43.8%, 42.3% and 40.6% of the Target Group's total assets as at 31 March 2004, 31 March 2005 and 31 March 2006 respectively and approximately 80.8%, 69.5% and 70.8% of the Target Group's net assets respectively. As at 31 March 2004, 31 March 2005 and 31 March 2006, provision for bad debt of trade and bills receivables amounted to approximately RMB5,432,000, RMB5,023,000 and RMB4,312,000 respectively.

The Directors believed that bad debt occurred in the said financial periods had no material impact on the Target Group's working capital or current assets. In addition, subject to the bad debts foregoing, the Target Group met no significant difficulties when collecting due trade receivables.

Creditors' turnover period

The calculation of creditors' turnover period is based on the average amount of trade payables as at the beginning and end of the relevant year divided by cost of goods sold of the corresponding financial year and multiplied by 365. Credit terms granted by suppliers to the Target Group ranged from 0 to 180 days. For each of the three financial years ended 31 March 2006, the Target Group's average creditors' turnover period were 213 days, 145 days and 167 days respectively. For the financial year ended 31 March 2005, creditors' turnover period decreased substantially, mainly because the supplying period was shortened to minimize the impact of price fluctuation in the raw material market during the period. For the financial year ended 31 March 2006, creditors' turnover period increased as longer credit periods were obtained from suppliers.

Inventory turnover period

As at 31 March 2004, 31 March 2005 and 31 March 2006, the Target Group's inventories amounted to approximately RMB171 million, RMB134 million and RMB128 million respectively whereas cost of goods sold amounted to approximately RMB406 million, RMB560 million and RMB414 million in the relevant financial periods. Inventory turnover periods, calculated based on the average amount of inventories as at the beginning and end of the relevant financial year divided by cost of goods sold of the corresponding financial year and multiplied by 365, were 150 days, 99 days and 116 days respectively. The Target Group's inventory turnover period for the financial year ended 31 March 2005 decreased substantially, mainly attributable to the stringent inventory control policies and management implemented by the Target Group. For the financial year ended 31 March 2006, inventory turnover period increased as the Target Group increased inventory as appropriate for timely supply to its major customers.

Treasury management

The Target Group implements a stringent budgetary system to strengthen its treasury management and carries out a relatively conservative financial policy. Its budget plans are prepared regularly to ensure punctual repayment of liabilities and sufficient cash flows for various operating activities. The Target Group places part of its cash in time deposits of various maturities in accordance with its budget plan as to optimize its capital efficiency.

Future plan and prospect

The Target Group adopts a development strategy that places the core businesses of tobacco and food flavours and fine fragrances as the focal point, and at the same time aggressively expanding upstream to the raw materials segment to further enhance the competitiveness and profitability of its products, and downstream to such products as food additives. With the two-pronged growth strategy of organic growth and external acquisition, the Target Group will leverage on its PRC business foundation to expand into the international market, so as to develop itself into an internationally renowned and vertically-integrated flavours and fragrances corporation.

Employees and remuneration

For the financial year ended 31 March 2006, the Target Group had 589 employees in the PRC. The Target Group provides attractive remuneration to its employees and provides comprehensive provident fund schemes and medical insurance by regularly contributing to social security organizations in compliance with relevant government requirements.

Foreign exchange and exchange rate risks

For the financial year ended 31 March 2006, the principal businesses of the Target Group were located in the PRC. Most of the business transactions were denominated in RMB and exposure to foreign exchange risk was not significant. During the year, there was no significant pressure for the depreciation of RMB and thus the Target Group's exposure to exchange rate risk was relatively limited.

No material adverse change

The Directors are not aware of any material adverse change in the financial or trading position or prospects of the Target Group since 31 March 2006, being the date to which the latest audited combined financial statements of the Target Group were made up.

A UNAUDITED PRO FORMA FINANCIAL INFORMATION

The following is an illustrative and pro forma consolidated balance sheet, income statement and cash flow statement of the Enlarged Group, which have been prepared on the basis of the notes set out below for the purpose of illustrating the effect of the Acquisition as if it had taken place on 31 March 2006 for the pro forma consolidated balance sheet and on 1 April 2005 for the pro forma consolidated income statement and cash flow statement. This pro forma financial information has been prepared for illustrative purposes only and because of its hypothetical nature, it may not give a true picture of the financial position and financial results of the Enlarged Group had the Acquisition been completed as at 31 March 2006 and 1 April 2005 respectively or at any future date.

I. UNAUDITED PRO FORMA BALANCE SHEET OF THE ENLARGED GROUP

		Pro forma adjustments			
	Unadjusted consolidated balance sheet of the Group as at 31/03/2006	**Combined balance sheet of the Target Group as at 31/03/2006**	**Other adjustments #1**	**Other adjustments #2**	**Unaudited pro forma consolidated balance sheet of the Enlarged Group**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
	(Note 2)	*(Note 3(a))*	*(Note 3(b))*	*(Note 3(c))*	
ASSETS					
Non-current assets					
Property, plant and equipment	419	144,711	–	–	145,130
Investments in a subsidiary	–	–	443,394	(443,394)	–
Land use rights	–	14,112	–	–	14,112
Interests in associates	–	3,924	–	–	3,924
Intangible assets	–	12,337	–	–	12,337
Deferred income tax assets	–	1,735	–	–	1,735
	419	176,819	443,394	(443,394)	177,238
Current assets					
Inventories	717	123,961	–	–	124,678
Trade and other receivables	2,327	361,793	–	(192)	363,928
Term deposits with original maturity of over 3 months	–	29,042	–	–	29,042
Cash and cash equivalents	3,972	176,890	–	–	180,862
	7,016	691,686	–	(192)	698,510
Total assets	7,435	868,505	443,394	(443,586)	875,748

		Pro forma adjustments			
	Unadjusted consolidated balance sheet of the Group as at 31/03/2006	**Combined balance sheet of the Target Group as at 31/03/2006**	**Other adjustments #1**	**Other adjustments #2**	**Unaudited pro forma consolidated balance sheet of the Enlarged Group**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
	(Note 2)	*(Note 3(a))*	*(Note 3(b))*	*(Note 3(c))*	
EQUITY					
Capital and reserves attributable to the Company's equity holders					
Share capital	24,731	12	221,973	(12)	246,704
Reserves	313,947	52,138	221,421	(443,382)	144,124
(Accumulated losses)/retained earnings	(384,362)	391,244	–	–	6,882
	(45,684)	443,394	443,394	(443,394)	397,710
Minority interests	–	54,228	–	–	54,228
Total equity	(45,684)	497,622	443,394	(443,394)	451,938
LIABILITIES					
Non-current liabilities					
Preference shares	48,550	–	–	–	48,550
Current liabilities					
Trade and other payables	4,034	368,081	–	–	372,115
Amounts due to related companies	192	–	–	(192)	–
Current income tax liabilities	343	2,802	–	–	3,145
	4,569	370,883	–	(192)	375,260
Total liabilities	53,119	370,883	–	(192)	423,810
Total equity and liabilities	7,435	868,505	443,394	(443,586)	875,748
Net current assets	2,447	320,803	–	–	323,250
Total assets less current liabilities	2,866	497,622	443,394	(443,394)	500,488

II. UNAUDITED PRO FORMA INCOME STATEMENT OF THE ENLARGED GROUP

		Pro forma adjustment	
	Unadjusted consolidated income statement of the Group for the year ended 31/03/2006	**Combined income statement of the Target Group for the year ended 31/03/2006**	**Unaudited pro forma income statement of the Enlarged Group**
	HK$'000	*HK$'000* *(Note 3(a))*	*HK$'000*
Sales	18,563	760,455	779,018
Cost of goods sold	(15,053)	(395,483)	(410,536)
Gross profit	3,510	364,972	368,482
Other income – net	67	18,790	18,857
Selling and marketing expenses	–	(31,929)	(31,929)
Administrative expenses	(3,873)	(44,730)	(48,603)
Operating (loss)/profit before finance costs	(296)	307,103	306,807
Finance costs	(6,467)	–	(6,467)
Share of losses of associates	–	(315)	(315)
(Loss)/profit before income tax	(6,763)	306,788	300,025
Income tax expense	(285)	(9,683)	(9,968)
(Loss)/profit for the year	(7,048)	297,105	290,057
Attributable to:			
Equity holders of the Company	(7,048)	290,137	283,089
Minority interests	–	6,968	6,968
	(7,048)	297,105	290,057

III. UNAUDITED PRO FORMA CASH FLOW STATEMENT OF THE ENLARGED GROUP

		Pro forma adjustment	
	Unadjusted consolidated cash flow statement of the Group for the year ended 31/03/2006	**Combined cash flow statement of the Target Group for the year ended 31/03/2006**	**Unaudited pro forma cash flow statement of the Enlarged Group**
	HK$'000	*HK$'000* *(Note 3(a))*	*HK$'000*
Cash flows from operating activities			
Cash (used in)/generated from operations	(4,861)	336,589	331,728
Income tax paid	–	(14,248)	(14,248)
Net cash (used in)/generated from operating activities	(4,861)	322,341	317,480
Cash flows from investing activities			
Acquisition of subsidiary, net of cash acquired	–	(15,513)	(15,513)
Purchase of additional interest in a subsidiary from a minority shareholder	–	(14,340)	(14,340)
Purchase of property, plant and equipment	(469)	(49,255)	(49,724)
Purchase of land use rights	–	(1,764)	(1,764)
Purchase of intangible assets	–	(9,022)	(9,022)
Interest received	45	2,694	2,739
Increase in term deposits with original maturity over 3 months	–	(28,681)	(28,681)
Net cash used in investing activities	(424)	(115,881)	(116,305)
Cash flows from financing activities			
Dividends paid	–	(186,081)	(186,081)
Net cash used in financing activities	–	(186,081)	(186,081)

	Unadjusted consolidated cash flow statement of the Group for the year ended 31/03/2006	Pro forma adjustment	Unaudited pro forma cash flow statement of the Enlarged Group
		Combined cash flow statement of the Target Group for the year ended 31/03/2006	
	HK$'000	*HK$'000*	*HK$'000*
		(Note 3(a))	
Net (decrease)/increase in cash and cash equivalents	(5,285)	20,379	15,094
Effects of exchange rate difference on cash and cash equivalents	23	–	23
Cash and cash equivalents at beginning of the year	9,234	154,312	163,546
Cash and cash equivalents at end of the year	3,972	174,691	178,663

IV. NOTES TO UNAUDITED PRO FORMA FINANCIAL INFORMATION OF THE ENLARGED GROUP

1. Pursuant to the Acquisition Agreement, the Company will issue New Convertible Preference Shares as consideration for the Acquisition. As both the Company and the Target Company are under common control of Ms. Chu Lam Yiu prior to the Acquisition, the Acquisition will be treated for accounting purpose as a "combination of entities under common control". Under a combination of entities under common control, equity interest of the Target Company acquired by the Company will be accounted for on the basis of merger accounting.

2. The consolidated balance sheet of the Group as at 31 March 2006 and the consolidated income statement and cashflow statement of the Group for the year ended 31 March 2006 were extracted from the audited consolidated financial statements of the Group for the year ended 31 March 2006.

3. The pro forma adjustments represent:

   (a) The combined balance sheet of the Target Group as at 31 March 2006 and the combined income statement and cash flow statement of the Target Group for the year ended 31 March 2006 were originally presented in RMB as shown in the accountants' report of the Target Group set out in Appendix IV to this circular. For the purpose of preparing the unaudited pro forma financial information, translation of amounts in RMB into HK$ has been made at the exchange rates of HK$1 = RMB1.033, the closing rate, for the balance sheet, and HK$1 = RMB1.046, the average exchange rate, for the income statement and cash flow statement, respectively.

   (b) As the Acquisition will be accounted for by the Company under merger accounting, the New Convertible Preference Shares issued by the Company as consideration for the Acquisition are to be accounted for at deemed investment cost of HK$443,394,000, being the net asset value of the Target Group as at 31 March 2006. The share capital of the 2,219,731,526 new non-redeemable Convertible Preference Shares with par value of HK$0.1 each of HK$221,973,000 is to be credited as share capital of the Company. The difference between the deemed investment cost and the share capital of the convertible preference shares, amounting to HK$221,421,000, will be credited to share premium account upon the issuance of the convertible preference shares.

   (c) On consolidation, the related investment cost of the Company in the Target Group will be eliminated against the share capital of the Target Company and a reserve of HK$443,382,000 will be recorded accordingly. Moreover, the inter-company balances of HK$192,000 between the Group and the Target Group are eliminated.

   For the purpose of preparing the unaudited pro forma consolidated balance sheet of the Enlarged Group, the net assets value of the Target Group as at 31 March 2006 is applied in the calculation of the Company's investment cost in the Target Company and the reserve arising on consolidation. Since the net asset value of the Target Group at the date of the Completion may be substantially different from its net asset value used in the preparation of the unaudited pro forma consolidated balance sheet of the Enlarged Group presented above, the actual amounts of the Company's investment cost in the Target Company and the reserve arising on consolidation may be different from the amounts shown in this unaudited pro forma consolidated balance sheet of the Enlarged Group.

4. No adjustment has been made to reflect any trading result or other transaction of the Group and the Target Group entered into subsequent to 31 March 2006.

B LETTER FROM PRICEWATERHOUSECOOPERS ON THE UNAUDITED PRO FORMA FINANCIAL INFORMATION

PRICEWATERHOUSECOOPERS

羅兵咸永道會計師事務所

PricewaterhouseCoopers
22nd Floor, Prince's Building
Central, Hong Kong

28 June 2006

The Directors
Huabao International Holdings Limited

Dear Sirs,

We report on the unaudited pro forma financial information of Huabao International Holdings Limited (the "Company") and its subsidiaries (hereinafter collectively referred to as the "Group") set out on pages 145 to 150 under the heading of "Unaudited Pro Forma Financial Information" (the "unaudited pro forma financial information") in Appendix V of the Company's circular dated 28 June 2006 in connection with the proposed acquisition of Chemactive Investments Limited by the Company (the "Circular"). The unaudited pro forma financial information has been prepared by the Directors of the Company, for illustrative purposes only, to provide information about how the proposed acquisition, which will result in the formation of an enlarged group (the "Enlarged Group"), might have affected the relevant financial information of the Group.

Respective Responsibilities of Directors of the Company and Reporting Accountants

It is the responsibility solely of the Directors of the Company to prepare the unaudited pro forma financial information in accordance with paragraph 4.29 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") and Accounting Guideline 7 "Preparation of Pro Forma Financial Information for Inclusion in Investment Circulars" issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA").

It is our responsibility to form an opinion, as required by paragraph 4.29(7) of the Listing Rules, on the unaudited pro forma financial information and to report our opinion to you.

Basis of Opinion

We conducted our engagement in accordance with Hong Kong Standard on Investment Circular Reporting Engagements 300 "Accountants' Reports on Pro Forma Financial Information in Investment Circulars" issued by the HKICPA. Our work, which involved no independent examination of any of the underlying financial information, consisted primarily of comparing the audited consolidated balance sheet of the Group as at 31 March 2006, and the audited consolidated income statement and cash flow statement of the Group for the year ended 31 March 2006 with the audited accounts of the Group for the year ended 31 March 2006, considering the evidence supporting the adjustments and discussing the unaudited pro forma financial information with the Directors of the Company.

We planned and performed our work so as to obtain the information and explanations we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the unaudited pro forma financial information has been properly compiled by the Directors of the Company on the basis stated, that such basis is consistent with the accounting policies of the Group and that the adjustments are appropriate for the purposes of the unaudited pro forma financial information as disclosed pursuant to paragraph 4.29(1) of the Listing Rules.

The unaudited pro forma financial information is for illustrative purposes only, based on the judgements and assumptions of the Directors of the Company, and because of its hypothetical nature, it does not provide any assurance or indication that any event will take place in the future and may not be indicative of:

– the financial position of the Enlarged Group as at 31 March 2006 or any future date, or

– the results and cash flows of the Enlarged Group for the period covered by the pro forma financial information or any future periods.

OPINION

In our opinion:

(a) the unaudited pro forma financial information has been properly compiled by the Directors of the Company on the basis stated;

(b) such basis is consistent with the accounting policies of the Group; and

(c) the adjustments are appropriate for the purposes of the unaudited pro forma financial information as disclosed pursuant to paragraph 4.29(1) of the Listing Rules.

Yours faithfully,
PricewaterhouseCoopers
Certified Public Accountants
Hong Kong

VIGERS
威格斯

28 June 2006

The Directors
Huabao International Holdings Limited
Room 1130, Central Plaza
18 Harbour Road
Wanchai
Hong Kong

Dear Sirs,

In accordance with your instructions for us to value the property interests in connection with a proposed acquisition of Chemactive Investments or its subsidiaries (the "Group") by Huabao International Holdings Limited (the "Company"), we confirm that we have carried out inspections, made relevant enquiries and obtained such further information as we consider necessary for the purpose of providing you with our opinion of the market value of such property interests as at 31 March 2006 (the "date of valuation") for incorporating into the circular.

Our valuation is our opinion of the market value of the property interest which we would define as intended to mean "the estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion".

In valuing Properties 1 to 4, due to the nature of the buildings and structure, we have adopted a combination of the market and depreciated replacement cost approaches in assessing the land portions of the properties and the buildings and structures standing on the land respectively. The sum of the two results represents the market value of the properties as a whole. In the valuation of the land portions, reference has been made to the standard land prices in the relevant cities and the sales evidences in the locality as available to us.

The depreciated replacement cost approach considers the cost to reproduce or replace in new condition the property appraised in accordance with current construction costs for similar property in the locality, with allowance for accrued depreciation as evidenced by observed condition or obsolescence present, whether arising from physical, functional or economic causes. The depreciated replacement cost approach generally furnishes a reliable indication of value for property in the absence of a known market based on comparable sales. It is subject to adequate potential profitability of the business or of the whole entity.

For Properties 5 to 7, we have estimated the value of the properties by the Comparison Approach by making reference to comparable sales evidences or offerings as available in the relevant locality. Properties in Group II have been ascribed no commercial value due to either the short-term nature of their tenancies or the lack of substantial profit rent.

We have not caused title searches to be made for the property interests at the relevant government bureau in the PRC. We have been provided with certain extracts of title documents relating to the property interests. However, we have not inspected the original documents to verify the ownership, encumbrances or the existence of any subsequent amendments which may not appear on the copies handed to us. In undertaking our valuation of the properties, we have relied on the legal opinion provided by the Company's PRC legal adviser, Jingtian & Gongcheng, Attorneys at Law.

Our valuation has been made on the assumption that the owners sell the property interests on the market without the benefit of deferred term contracts, leasebacks, joint ventures, management agreements or any similar arrangements which would serve to increase the value of the property interests. In addition, no forced sale situation in any manner is assumed in our valuation. Unless otherwise stated, the valuation represents the value of the entire property interest described in the valuation certificate and not the value of a share of it. Other assumptions in respect of each property, if any, have been set out in the footnotes of the valuation certificates for the respective properties.

We have relied to a considerable extent on information provided by the Company and have accepted advice given to us on such matters as planning approvals, statutory notices, easements, tenure, occupation, lettings, site and floor areas, development plan, construction costs, identification of the properties and other relevant matters. We have also been advised by the Company that no material facts had been concealed or omitted in the information provided to us. All documents have been used for reference only.

All dimensions, measurements and areas included in the valuation certificates are based on information contained in the documents provided to us by the Company and are approximations only. No on-site measurement has been taken.

We have inspected the exterior and, where possible, the interior of the properties. However, no structural survey has been made and we are therefore unable to report whether the properties are free from rot, infestation or any other structural defects. No tests were carried out on any of the services.

We have not carried out investigations on site to determine the suitability of ground conditions and services etc. for any future development, nor have we undertaken any ecological or environmental surveys. Our valuation is prepared on the assumption that these aspects are satisfactory and that no extraordinary expenses or delays will be incurred during construction period.

No allowance has been made in our valuation for any charges, mortgages or amounts owing on the property interests nor for any expenses or taxation which may be incurred in effecting a sale. Unless otherwise stated, it is assumed that the property interests are free from encumbrances, restrictions and outgoings of an onerous nature which could affect their values.

In valuing the property interests, we have complied with the requirements set out in Chapter 5 and Practice Note 12 to the Rules Governing the Listing of Securities issued by The Stock Exchange of Hong Kong Limited and the HKIS Valuation Standards on Properties (First Edition 2005) published by the Hong Kong Institute of Surveyors ("HKIS").

Unless otherwise stated, the exchange rate used in valuing the property interests in the PRC as at the date of valuation was HK$1 = RMB1.033. There has been no significant fluctuation in exchange rate between that date and the date of this letter.

We enclosed herewith a summary of our valuation and the valuation certificates.

Yours faithfully,
For and on behalf of
Vigers Appraisal & Consulting Limited
Raymond Ho Kai Kwong
Registered Professional Surveyor
MRICS MHKIS MSc(e-com)
Executive Director

Note: Raymond K.K. Ho, Chartered Surveyor, MRICS, MHKIS has over nineteen years' experience in undertaking valuations of properties in Hong Kong and Macau and has over twelve years' experience in the valuation of properties in the PRC. Mr. Ho has been working with Vigers Group since 1989.

SUMMARY OF VALUATION

Group I – Property interests held and occupied by the Group

	Property	Capital value in existing state as at 31 March 2006
1.	An industrial complex located at Lot K-(Y)-3, Upper Xiushan Road, Yuxi Hi-tech Development Zone, Yuxi City, Yunnan Province, The PRC	RMB21,200,000 (equivalent to approximately HK$20,523,000)
2.	A parcel of land located at Lot Y, Upper Xiushan Road, Yuxi Hi-tech Development Zone, Yuxi City, Yunnan Province, The PRC	No commercial value
3.	An industrial complex located at No. 1299 Yecheng Road, Jiading Industrial Zone, Jiading District, Shanghai, The PRC	RMB19,000,000 (equivalent to approximately HK$18,393,000)
4.	An industrial complex located at No. 7 Jinhua 'Er Street, Guangzhou Economic and Technological Development District, Guangzhou City, The PRC	RMB21,000,000 (equivalent to approximately HK$20,329,000)
5.	Duplex Unit D on the Third and Forth Level No. 77 Huayang Street, Tiyudong Road, Tianhe District, Guangzhou City, The PRC	RMB2,100,000 (equivalent to approximately HK$2,033,000)

	Property	Capital value in existing state as at 31 March 2006
6.	Office Units 2101, 2101 and 2102, Shenzhen Kerry Centre, Renmin South Road, Shenzhen City, The PRC	RMB8,300,000 (equivalent to approximately HK$8,035,000)
7.	Unit 1, Block 10, Dianchi Mingguwu, Kunming Dianchi Tourism Resort, Kunming City, Yunnan Province, The PRC	No commercial value
	Sub-total:	RMB71,600,000 (equivalent to approximately HK$69,313,000)

Group II – Property interests rented by the Group

	Property	**Capital value in existing state as at 31 March 2006**
8.	An industrial complex located at No. 18 Huishui Road, Wangjiaxiahe Village, Licang District, Qingdao City, Shandong Province, The PRC	No commercial value
9.	North Portion of No. 2 Standard Workshop, Meicun Industry Zone, Wuxi National Hi-tech Industry Development Zone, Wuxi City, Jiangsu Province, The PRC	No commercial value
10.	Standard Workshop No. 7, Lot No. B61, Wuxi National Hi-tech Industry Development Zone, Wuxi City, Jiangsu Province, The PRC	No commercial value
	Sub-total:	Nil
	Grand-total:	**RMB71,600,000 (equivalent to approximately HK$69,313,000)**

VALUATION CERTIFICATES

Group I – Property interests held and occupied by the Group

	Property	Description	Particulars of occupancy	Capital value in existing state as at 31 March 2006
1.	An industrial complex located at Lot K-(Y)-3, Upper Xiushan Road, Yuxi Hi-tech Development Zone, Yuxi City, Yunnan Province, The PRC	The property comprises a parcel of land having a site area of approximately 28,043 sq.m. together with 5 buildings and associated structures erected thereon. The buildings having a total gross floor area of approximately 9,228.4 sq.m. were completed in 2002. The buildings and structures mainly include workshop, office, reception center, boiler and transformer house, roadwork and fence. The property is held with land use rights for a term expiring on 17 April 2050.	The property is currently occupied by the Group for production and ancillary purpose.	RMB21,200,000 (equivalent to approximately HK$20,523,000)

Notes:

1. Pursuant to the State-owned Land Use Rights Certificate Yu Guo Yong (2002) 095 (玉國用(2002)字第095號), the land use rights of the property having a site area of approximately 28,043 sq.m. have been granted to Yunnan Tianhong Flavours and Fragrances Company Limited. (雲南天宏香精香料有限公司) ("Yunnan Tianhong") for industrial use for a term expiring on 17 April, 2050.

2. Pursuant to the Building Ownership Certificates Yu Fang Quan Zhen Shi No. 2002001074 (玉房權證市字第2002001074號), the title of the buildings having a total area of approximately 9,228.40 sq.m. is vested in Yunnan Tianhong. Further details are as follows:

No.	Building	Number of storey	Gross floor area *(in sq.m)*
1.	Reception center	2	2,237.25
2.	Administrative building	3	2,709.19
3.	Workshop	2	3,968.44
4.	Guard house	1	70.69
5.	Boiler house	1	242.83
		Total:	**9,228.40**

3. The PRC legal opinion states, inter alia, as follows:

   i. Yunnan Tianhong legally and effectively owns the land use rights as stated in the land use rights certificate together with the buildings erected thereon. It has acquired all the necessary approvals from the relevant government bureaus and fully settled the land use rights premium.

   ii. Yunnan Tianhong may use the land and the buildings erected thereon in accordance with their designated uses within the granted year term of the land use rights.

   iii. No guarantee, mortgage or other encumbrance against the property has been found.

   iv. Yunan Tianhong is entitled to lease, assign, mortgage or dispose of the property within the granted year term of the land use rights.

   v. Yunan Tianhong is a joint venture company established on 25 June 2001 for an operating period of 30 years. The current shareholders comprise Yunnan Hongta Group (40%), Future Dragon International Limited at (40%) and Nocton International Limited (20%). The joint venture is operated with Business Licence No. Qi He Dian Yu Zong Zi (企合滇玉總字) No.000039 and has passed the annual renewal approval for the licence for the year 2005. The shareholders are entitled to share the profit earned by the joint venture in accordance with their share ratio in the joint venture.

	Property	Description	Particulars of occupancy	Capital value in existing state as at 31 March 2006
2.	A parcel of land located at Lot Y, Upper Xiushan Road, Yuxi Hi-tech Development Zone, Yuxi City, Yunnan Province, The PRC	The property comprises a parcel of land having a site area of approximately 24,596 sq.m. The land is held with land use rights for a term expiring on 1 September 2055.	The property is currently vacant and held for future expansion.	No commercial value

Notes:

1. Pursuant to the State-owned Land Use Rights Certificate Yu Guo Yong (2005) 10716 (玉國用 (2005) 字第10716號) dated 27 October, 2005, the land use rights of the property having a site area of approximately 24,596 sq.m. have been granted to Yunnan Tianhong Flavours and Frangrances Company Limited (雲南天宏香精香料有限公司) ("Yunnan Tianhong") for industrial use for a term expiring on 1 September, 2055. According to the remarks stated on the certificate, the certificate is valid for two years and the land user have to register with the Land and Resources Bureau within 30 days from the completion of construction project.

2. Pursuant to a State-owned Land Use Rights Grant Contract dated 8 September, 2005, the Land and Resource Bureau of Yuxi City agreed to grant the land use rights of a site having an area of approximately 24,597 sq.m. to Yunnan Tianhong for industrial use for a year term of 50 years from the date of site delivery at a land premium of RMB12,415,134. Further details on the requirements of the land use are as follows:

(a)	Major construction	Production workshops and warehouse
(b)	Ancillary construction	Office
(c)	Plot ratio	More than or equal to 0.6
(d)	Site coverage	More than or equal to 35%
(e)	Building height	6 storey
(f)	Greenery ratio	Less than or equal to 30%

   Pursuant to a Supplemental Agreement on State-owned Land Use Rights Grant Contract entered into between Management Committee of Yuxi Hi-technology Development Zone ("the committee") and Yunnan Tianhong dated 5 July 2005, the committee agreed to grant the land use rights of the property at an adjusted land premium at RMB1,844,775 in the condition that the development has to be commenced within half year from the date of agreement and completed in two years.

   According to the Company, the property was acquired on 5 July 2005 and the total cost of the acquisition and cost expended on the property is RMB1,844,775.

3. The PRC legal opinion states, inter alia, as follows:

   i. Yunnan Tianhong legally and effectively owns the land use rights as stated in the land use rights certificate. It has acquired all the necessary approvals from the relevant government bureaus and fully settled the land use rights premium.

   ii. Yunnan Tianhong may use the land in accordance with the designated uses within the granted year term of the land use rights.

   iii. No guarantee, mortgage or other encumbrance against the property has been found.

   iv. Yunan Tianhong is entitled to lease, assign, mortgage or dispose of the property within its granted year term of the land use rights.

v. Yunan Tianhong is a joint venture company established on 25 June 2001 for an operating period of 30 years. The current shareholders comprise Yunnan Hongta Group (40%), Future Dragon International Limited at (40%) and Nocton International Limited (20%). The joint venture is operated with Business Licence No. Qi He Dian Yu Zong Zi (企合滇玉總字) No.000039 and has passed the annual renewal approval for the licence for the year 2005. The shareholders are entitled to share the profit earned by the joint venture in accordance with their share ratio in the joint venture.

4. For indicative purposes, the capital value of the subject property in existing state as at 31 March 2006 would be in the region of RMB5,700,000 had over 25% of the total investment cost of the development been completed.

	Property	Description	Particulars of occupancy	Capital value in existing state as at 31 March 2006
3.	An industrial complex located at No. 1299 Yecheng Road, Jiading Industrial Zone, Jiading District, Shanghai, The PRC	The property comprises two parcels of land having a total site area of approximately 27,564 sq.m. and the buildings erected thereon. Four of the buildings having a total area of approximately 4,797 sq.m. were completed in between 1997 and 2000. Six other buildings having a total area of approximately 19,354 sq.m. were completed in between 2005 and 2006 (for the valuation of these six buildings, please see note 2 below). The two parcels of land are respectively held for the term expiring on 7 July 2046 and 24 March 2051.	The property is occupied by the Group as production workshop and administrative office.	RMB19,000,000 (equivalent to approximately HK$18,393,000) (see also Note 2 below)

Notes:

1. Pursuant to the Realty Title Certificate Wu Fang Di Shi Zi (2000) 002630 (滬房地市字(2000)第002630號), the land use rights of the property having a site area of 8,967 sq.m. and 4 blocks of buildings having a total gross floor area of approximately 4,797.43 sq.m. are vested in Huabao Food Flavour & Fragrance (Shanghai) Co., Ltd. (華寶食用香精香料(上海)有限公司) ("Huabao Food Flavour") for industrial uses for a land use rights term of 50 years from 4 February 1997 to 7 July 2046.

   Pursuant to the Realty Title Certificate Wu Fang Di Shi Zi (2001) 004206 (滬房地市字(2001)第004206號), the land use rights of the property having an area of 18,597 sq.m. has been granted to Huabao Food Flavour for industrial uses for a term of 50 years from 25 March 2001 to 24 March 2051.

2. Pursuant to the Construction Planning Permit Wu Jia Jian (2004) 0753 (滬嘉建(2004) 0753號) and Wu Jia Jian (2004) 0051 (滬嘉建(2004) 0051號), 2003-447, the planning permission on the construction of the 6 other building blocks having a total gross floor area of approximately 19,354 sq.m. have been granted. According to the Company, application for the granting of the realty title certificates of these buildings is in progress. We have ascribed no commercial value to these buildings deal to the current absence of title certificates. Had the Group obtained a realty title certificate for the buildings, the capital value of these buildings in existing state as at 31 March 2006 would be in the region of RMB32,400,000.

   We have also ascribed no commercial value to two other completed buildings on the site having a total area of approximately 1,402 sq.m. deal to the absence of title certificates. Had the Company obtained a realty title certificate for the two buildings, the capital value of them in existing state would be in the region of RMB670,000.

3. The PRC legal opinion states, inter alia, as follows

   i. Huabao Food Flavour legally and effectively owns the land use rights as stated in the land use rights certificate together with the buildings erected thereon. It has acquired all the necessary approvals from the relevant government bureaus and fully settled the land use rights premium.

   ii. Huabao Food Flavour may use the land and the buildings erected thereon in accordance with their designated uses within the granted year term of the land use rights.

   iii. No guarantee, mortgage or other encumbrance against the property has been found.

   iv. Huabao Food Flavour is entitled to lease, assign, mortgage or dispose of the property within the granted year term of the land use rights.

	Property	Description	Particulars of occupancy	Capital value in existing state as at 31 March 2006
4.	An industrial complex located at No. 7 Jinhua 'Er Street, Guangzhou Economic and Technological Development District, Guangzhou City, The PRC	The property comprises a parcel of land having a total site area of approximately 10,202 sq.m. together with the various buildings and the associated structures erected thereon. The buildings having a total gross floor area of approximately 7,052.96 sq.m. were completed in 1996. The buildings and structures mainly include production workshop, administrative building, warehouse, transformer room, pump house, roadwork and fence. The property is held with land use rights for a term expiring on 18 December 2017.	The property is occupied by the Group as a production complex.	RMB21,000,000 (equivalent to approximately HK$20,329,000)

Notes:

1. Pursuant to the Land Use Rights Certificate Sui Di Zhen Zi No. 0070381 (穗地證字第0070381號) dated 22 September, 1994, the land use rights of the property having a site area of approximately 10,202 sq.m. have been granted to Huafang Tobacco Flavour Company (華芳煙用香料有限公司) ("Huafang") for industrial use for a term expiring on 18 December 2017.

2. Pursuant to the Realty Title Certificate Sui Fang Di Zhen No. 214438 (穗房地證字第 214438號) dated 21 April 1998, the title of the buildings having a total area of approximately 7,052.96 sq.m. are vested in Huafang in publicly-owned nature. Further details are as follows:

Building no.	Uses	Number of storey		Gross floor area *(in sq.m.)*
1.	Administrative building	4		2,564.90
2.	Workshop	2		3,805.13
3.	Pump house and transformer room	1		292.15
4.	Warehouse	1		335.43
5.	Meter room	1		12.07
6.	Guard house	1		22.68
7.	Guard house	1		20.60
			Total:	**7,052.96**

3. The PRC legal opinion states, inter alia, as follows:

   i. Huafang legally and effectively owns the land use rights as stated in the land use rights certificate together with the buildings erected thereon. It has acquired all the necessary approvals from the relevant government bureaus and fully settled the land use rights premium.

   ii. Huafang may use the land and the buildings erected thereon in accordance with the designated uses within the granted year term of land use rights.

   iii. No guarantee, mortgage or other encumbrance against the property has been found.

   iv. Huafang is entitled to lease, assign, mortgage or dispose of the property within the granted year term of the land use rights.

   v. Huafang is a joint venture company established on 16 October 1992 for an operating period of 25 years. The current shareholders comprise China Tobacco Company Guangdong Company (中國煙草總公司廣東省公司) (49%) and Symhope Investment Limited (51%). The joint venture is operated with Business Licence No. Qi He Yue Sui Zong Zi (企合粵穗總字) No.100031 and has passed the annual renewal approval for the licence for the year 2005. The shareholders are entitled to share the profit earned by the joint venture in accordance with their share ratio in the joint venture.

	Property	Description	Particulars of occupancy	Capital value in existing state as at 31 March 2006
5.	Duplex Unit D on the Third and Forth Level, No. 77 Huayang Street, Tiyudong Road, Tianhe District, Guangzhou City, The PRC	The property comprises a duplex residential unit on the 3rd and 4th levels of a 8-storey residential block completed in the 1990s'. The property has a gross floor area of approximately 249.52 sq.m. The property is held with land use rights for a term expiring on 9 November 2065.	The property is currently occupied by the Group as staff quarters.	RMB2,100,000 (equivalent to approximately HK$2,033,000)

Notes:

1. Pursuant to the Realty Title Certificate Sui Fang Di Zhen No. 258092 dated 6 December 1995, the title of the property having a gross floor area of approximately 249.52 sq.m. is vested in Huafang Tobacco Flavour Company (華芳煙用香料有限公司) ("Huafang").

2. The PRC legal opinion states, inter alia, as follows:

   i. Huafang legally and effectively owns the title of the property. It has acquired all the necessary approvals from the relevant government bureaus.

   ii. Huafang may use the property with the designated uses within the granted year term of land use rights.

   iii. No guarantee, mortgage or other encumbrance against the property has been found.

   iv. Huafang is entitled to lease, assign, mortgage or dispose of the property within the granted year term of the land use rights.

   v. Huafang is a joint venture company established on 16 October 1992 for an operating period of 25 years. The current shareholders comprise China Tobacco Company Guangdong Company (中國煙草總公司廣東省公司) (49%) and Symhope Investment Limited (51%). The joint venture is operated with Business Licence No. Qi He Yue Sui Zong Zi (企合粵穗總字) No.100031 and has passed the annual renewal approval for the licence for the year 2005. The shareholders are entitled to share the profit earned by the joint venture in accordance with their share ratio in the joint venture.

	Property	Description	Particulars of occupancy	Capital value in existing state as at 31 March 2006
6.	Office Units 2101, 2102 and 2110 Shenzhen Kerry Centre, Renmin South Road, Shenzhen City, The PRC	The property comprises three office units on the 21st level of a 35-storey plus 2 basement level office building completed in about 1997. The property has a gross floor area of approximately 616.44 sq.m. The property is held with land use rights for a term expiring on 27 June 2043.	The property is currently occupied by the Group as office.	RMB8,300,000 (equivalent to approximately HK$8,035,000)

Notes:

1. Pursuant to the Realty Title Certificates Shen Fang Di Zi Nos. 2000098496 dated 10 May 2002 (according to the Company, also as the date of acquisition), 2000175622 and 2000175624 both dated 11 December 2003 (according to the Company, also as the date of acquisition), the title of the three office units having a total gross floor area of approximately 616.44 sq.m. is vested in Huabao Food Flavour & Fragrance (Shanghai) Co., Ltd. (華寶食用香精香料(上海)有限公司) ("Huabao Food Flavour") at the purchase price of RMB8,500,000 (according to the Company, also as the total acquisition cost of the Units) for Units 2101 and 2102, and HK$2,060,200 (according to the Company, also as the total acquisition cost of the Unit) for Unit 2110.

2. The PRC legal opinion states, inter alia, as follows:

   i. Huabao Food Flavour legally and effectively owns the title of the property. It has acquired all the necessary approvals from the relevant government bureaus.

   ii. Huabao Food Flavour may use the property with its designated uses within the granted year term of its land use rights.

   iii. No guarantee, mortgage or other encumbrance against the property has been found.

   iv. Huabao Food Flavour is entitled to lease, assign, mortgage or dispose of the property within the granted year term of the land use rights.

	Property	Description	Particulars of occupancy	Capital value in existing state as at 31 March 2006
7.	Unit 1 in Block 10, Dianchi Mingguwu, Kunming Dianchi Tourism Resort, Kunming City, Yunnan Province, The PRC	The property comprises a 3-storey semi-detached villa having a gross floor area of approximately 247.77 sq.m. completed in 2006. The property is held with land use rights for a term expiring on 16 August 2072.	The property is currently vacant.	No commercial value

Notes:

1. Pursuant to a Commodity House Sale Agreement entered into between 雲南隆圖屋業有限公司 (the seller) and Yunnan Tianhong Flavours and Fragrances Company Limited (雲南天宏香精香料有限公司) (the purchaser) ("Yunnan Tianhong") on 28 April 2005, the property with a gross floor area of 247.77 sq.m. was agreed to be sold to the purchaser at a consideration of RMB1,328,900 plus an utility provision fee RMB15,800. According to the Company, the property was acquired on 28 April 2005. The total cost of the acquisition and cost expended on the property is RMB1,344,700.

2. We have ascribed no commercial value to the property deal to the absence of the realty title certificate. Had the Group obtained a realty title certificate for it, the capital value of the property in existing state as at 31 March 2006 would be in the region of RMB1,360,000.

3. The PRC legal opinion states, inter alia, as follows:

   i. According to a registration form provided by the Company, the Commodity House Sale Agreement has been registered with Housing Bureau of Xishan City, Kumming. According to the payment receipt provided by the Company, the consideration for the purchase of the property has been fully settled.

   ii. Based on the sale agreement entered, Yunnan Tianhong is entitled to acquire the property and may lease, assign, mortgage or dispose of the property.

   iii. Yunan Tianhong is a joint venture company established on 25 June 2001 for an operating period of 30 years. The current shareholders comprise Yunnan Hongta Group (40%), Future Dragon International Limited at (40%) and Nocton International Limited (20%). The joint venture is operated with Business Licence No. Qi He Dian Yu Zong Zi (企合滇玉總字) No.000039 and has passed the annual renewal approval for the licence for the year 2005. The shareholders are entitled to share the profit earned by the joint venture in accordance with their share ratio in the joint venture.

Group II – Property interests rented by the Group

	Property	Description	Particulars of occupancy	Capital value in existing state as at 31 March 2006
8.	An industrial complex located at No. 18 Huishui Road, Wangjiaxiahe Village, Licang District, Qingdao City, Shandong Province, The PRC	The property comprises a single-storey workshop, a 2-storey office, a transformer room, and a toilette completed in about 2002. The property has a gross floor area of approximately 810 sq.m.	The property is rented by the Group from an independent third party for a term of 5 years from 9 February, 2004 at a yearly rent of RMB64,800, exclusive of utility services charges. It is currently occupied by the Group as production workshop.	No commercial value

	Property	Description	Particulars of occupancy	Capital value in existing state as at 31 March 2006
9.	North Portion of Standard Workshop No. 2, Meicun Industry Zone, Wuxi National Hi-tech Industry Development Zone, Wuxi City, Jiangsu Province, The PRC	The property comprises a portion of a single-storey standard workshop completed in about 2004. The property has a gross floor area of approximately 2,035 sq.m.	The property is rented by the Group from an independent third party for a term of 5 year at a quarterly rent of RMB48,840 inclusive of management fee. It is currently occupied by the Group for workshop and office uses.	No commercial value

Note: According to the PRC legal opinion, the lease agreement is legal and effective.

	Property	Description	Particulars of occupancy	Capital value in existing state as at 31 March 2006
10.	Standard Workshop No. 7, Lot No. B61, Wuxi National Hi-tech Industry Development Zone, Wuxi City, Jiangsu Province, The PRC	The property comprises a single-storey standard workshop having a gross floor area of approximately 3,950 sq.m. The property was completed in about 2005.	The property is rented by the Group from an independent third party via two leases. The north portion is rented for a term from 1 April 2005 to 31 March 2010 and the south portion from 1 January, 2006 to 31 December, 2010. The total quarterly rental is RMB95,985, inclusive of management fee but exclusive of service and utilities charges. The property is currently occupied by the Group for workshop and office uses.	No commercial value

Note: According to the PRC legal opinion, the lease agreement is legal and effective.

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 Group. The Directors, having made all reasonable enquiries, confirm that, to the best of their knowledge and belief:

a. the information contained in this circular is accurate and complete in all material respects and not misleading;

b. there are no other matters the omission of which would make any statement in this document misleading; and

c. all opinions expressed in this document have been arrived at after due and careful consideration and are founded on bases and assumptions that are fair and reasonable.

In this circular, information relating to the Target Group has been included based on the information provided by the management of the Target Group. As set out in the paragraph headed "Conditions precedent" in the Letter from the Board, a legal and financial due diligence on the Target Group will be completed to the satisfaction of the Purchaser prior to Completion and the financial and operational data relating to the Target Group as set out in this circular has been verified with respect to the underlying factual matters as is within the Directors' ability during the due diligence process carried out by the Group.

2. DISCLOSURE OF INTERESTS

As at the Latest Practicable Date, the interests of the Directors and their associates in the shares, underlying shares and debentures of the Company and its associated corporations (within the meaning of Part XV of the SFO), as recorded in the register maintained by the Company under Section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short position which he/she is taken or deemed to have under such provisions of the SFO), or the Model Code for Securities Transactions by Directors of Listed Issuers contained in Listing Rules, were as follows:

Long positions

(a) Ordinary Shares

Name of director	Capacity	Number of issued ordinary shares held	Percentage of the issued ordinary share capital of the Company
Chu Lam Yiu	Held through a controlled corporation*	173,219,445	70.04%

(b) *Existing Preference Shares*

Name of director	**Capacity**	**Number of preference shares held**	**Number of underlying ordinary shares**	**Percentage of the issued preference shares of the Company**
Chu Lam Yiu	Held through a controlled corporation*	526,900,000	526,900,000	100%

(c) *Warrants*

Name of director	**Capacity**	**Number of warrants held**	**Number of underlying ordinary shares held under equity derivatives**
Chu Lam Yiu	Held through a controlled corporation*	49,000,000	49,000,000

* *173,219,445 Ordinary Shares, 526,900,000 Existing Preference Shares and 49,000,000 warrants in the Company are held by Mogul Enterprises Limited. Ms. Chu Lam Yiu is the sole beneficial owner of Mogul Enterprises Limited.*

Save as disclosed above, at the Latest Practicable Date, none of the Directors nor their associates had any interests or short positions in any shares, underlying shares or debentures of the Company or any of its subsidiaries or associated corporations as defined in the SFO.

So far as is known to the Directors of the Company as at the Latest Practicable Date, no person (not being a Director or chief executive of the Company) had an interest or a short position in shares or underlying shares of the Company 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 is, 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.

None of the Directors is materially interested in any contract or arranging subsisting at the date of this circular which is significant in relation to the Group's business.

3. MATERIAL CONTRACTS

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

– the Acquisition Agreement.

4. EXPERTS AND CONSENTS

The following are the qualifications of the experts who have issued letters which are contained in this circular:

Name	Qualification
Tai Fook	Licensed corporation under the SFO to conduct type 6 (advising on corporate finance) regulated activity
PricewaterhouseCoopers	Certified Public Accountants
Vigers Appraisal & Consulting Limited	Property valuers

Vigers Appraisal & Consulting Limited, PricewaterhouseCoopers and Tai Fook have given and have not withdrawn their respective written consents to the issue of this circular with the inclusion herein of their respective letters and reports (as the case may be) and references to their respective names, in the form and context in which they respectively appear.

As at the Latest Practicable Date, none of Vigers Appraisal & Consulting Limited, PricewaterhouseCoopers and Tai Fook was beneficially interested in the share capital of any member of the Group, nor did they have any rights (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in any member of the Group, nor did they have any interest, either direct or indirect, in any assets which had been since 31 March 2006 (being the date to which the latest published audited accounts of the Company 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.

5. SERVICE CONTRACTS

As at the Latest Practicable Date, none of the Directors had entered into any service contracts with any member of the Group which were not expiring or determinable by the employer within one year without payment of compensation other than statutory compensation.

6. LITIGATION

As at the Latest Practicable Date, none of the members of the Group was engaged in any litigation or claims of material importance pending or threatened against any member of the Group.

7. COMPETING INTERESTS

Save as disclosed in this circular, as at the Latest Practicable Date, none of the Directors and his/her respective associates was considered to have an interest in a business which competes or is likely to compete with the business of the Group.

In addition, none of the Directors and his/her respective associates have any interest, either direct or indirect, in any assets which had been since 31 March 2006 (being the date to which the latest published audited accounts of the Company 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.

8. NO MATERIAL ADVERSE CHANGE

The Directors believe that there has been no material adverse change in the Group's financial or trading position since 31 March 2006.

9. PROCEDURE BY WHICH THE SHAREHOLDERS MAY DEMAND A POLL

Pursuant to the Bye-laws, a resolution put to the vote of a general meeting of the Company shall be decided on a show of hands unless voting by way of a poll is required by the rules of the designated stock exchange or (before or on the declaration of the result of the show of hands or on the withdrawal of any other demand for a poll) a poll is demanded:

(i) by the chairman of the general meeting of the Company; or

(ii) by at least three Shareholders present in person (or in the case of a Shareholder being a corporation by its duly authorised corporate representative) or by proxy for the time being entitled to vote at the general meeting of the Company; or

(iii) by a Shareholder or Shareholders present in person (or in the case of a Shareholder being a corporation by its duly authorised corporate representative) or by proxy and representing not less than one-tenth of the total voting rights of all Shareholders having the right to vote at the general meeting of the Company; or

(iv) by a Shareholder of Shareholders present in person (or in the case of a Shareholder being a corporation by its duly authorised corporate representative) or by proxy and holding shares in the Company conferring a right to vote at the general meeting being shares on which an aggregate sum has been paid up equal to not less than one-tenth of the total sum paid up on all the shares conferring that right; or

(v) if required by the rules of the designated stock exchange, by any Director or Directors who, individually or collectively, hold proxies in respect of shares representing five per cent. or more of the total voting rights at the general meeting.

The Company will procure the chairman of the special general meeting to demand for voting on a poll. Tengis Limited, the Hong Kong branch share registrar of the Company, will serve as the scrutineer for the vote-taking.

10. MISCELLANEOUS

(i) The company secretary and the qualified accountant is Mr. CHU Tak Shun.

(ii) Biographies of Directors are as follows:

Executive Directors

Ms. CHU Lam Yiu, aged 36, has been serving as the Chairman of the Company since March 2004. Ms. Chu owns and controls various investments in the PRC and in Hong Kong, including businesses engaging in the research and development, manufacture and sale of fine chemicals. Ms. Chu is currently the vice chairlady of the China Association of Fragrance Flavor and Cosmetic Industry (中國香料香精化妝品工業協會) and China Food Additive Production Application Industry Association (中國食品添加劑生產應用工業協會). Ms. Chu is experienced in formulating strategies and making executive decision in respect of business operation, investments and market development.

Mr. CHEN Yong Chang, aged 56, has been serving as an Executive Director of the Company since March 2004. He holds a Master's Degree in Economics. Mr. Chen has experience in the research, investment banking and international affairs of an established financial institution in the PRC for years. He has ample experience in business strategy formulation and business management including the development of business co-operations with international investment institutions and professional institutions.

Mr. POON Chiu Kwok, aged 44, served as an Independent Non-executive Director of the Company since March 2004. He has been re-designated as an Executive Director of the Company with effect from 1 May 2006. Mr. Poon has been in the financial and securities sector for about 20 years. He has broad experience in listed companies corporate governance, commercial banking, and investment banking. He has also lead-managed a number of major listings and has played a substantial advisory role in various corporate transactions for companies listed on the Stock Exchange. Mr. Poon holds a Master's Degree in International Accounting, a Bachelor's Degree with Honours in Business Studies and a Bachelor's Degree with Honours in Laws. He is a member of the Hong Kong Securities Institute, associate members of the Institute of Chartered Secretaries and Administrators, and the Hong Kong Institute of Chartered Secretaries. Mr. Poon currently serves as an Independent Non-executive Director of three other companies listed on the Main Board of the Stock Exchange including Tsingtao Brewery Company Limited.

Mr. WANG Guang Yu, aged 42, has been serving as an Executive Director of the Company since August 2004. He holds a Master's Degree in Chemical Analysis and has a qualification of senior engineer. Mr. Wang is currently the General Manager of a wholly foreign-owned enterprise in the PRC engaging in the research and development of flavour and fragrance products and also a General Manager of a sino-foreign equity joint venture engaging in the manufacture of flavour and fragrance. Mr. Wang is also a vice chairman of the fifth executive committee of China Association of Fragrance Flavor and Cosmetic Industry (中國香料香精化妝品工業協會). Mr. Wang has over 10 years' extensive experiences in corporate management.

Independent Non-executive Directors

Mr. LEE Luk Shiu, aged 48, joined the Group on 1 May 2006 as an Independent Non-executive Director of the Company. Mr. Lee has about 25 years ample experience in commercial accounting and corporate finance. Mr. Lee has principally engaged in corporate finance and regulatory aspects in the Stock Exchange. Mr. Lee was an Assistant Vice President of the Listing Division of the Stock Exchange, and his duties included regulating and monitoring the Hong Kong listed companies in relation to their compliance with the Listing Rules and processing new listing applications. He is a fellow member of the Association of Chartered Certified Accountants ("ACCA") and an associate member of Hong Kong Institute of Certified Public Accountants ("HKICPA").

Ms. MA Yun Yan, aged 45, has been serving as an Independent Non-executive Director of the Company since September 2004. She graduated from the Law School of Peking University in 1984 and has been qualified as a lawyer in the PRC in 1986. Ms. Ma has been dedicated to teaching and doing research in the Law School in relation to international commerce and investment aspects for 10 years. She is now the Managing Partner of Shu Jin Law Firm as well as the Head of the Capital Market Department of the same firm. Ms. Ma has extensive experience in the legal field in relation to the capital markets, including investments, acquisition and mergers, issuance of securities etc, and has lead-managed the issuance of shares and convertible bonds and major restructuring of numerous listed companies such as China Vanke Co., Ltd., China Petroleum Jilin Chemical Engineering Construction Co. Ltd., China Merchants Property Development Co., Ltd., which shares are listed in the Mainland, and also AAC Acoustic Technologies Holdings Inc., Vital BioTech Holdings Limited and Shenzhen High-Tech Holdings Limited, which shares are listed in Hong Kong. Ms. Ma is now an Independent Non-executive Director of Shenzhen Laibao High Technology Co. Ltd.

Mr. MAK Kin Kwong, Peter, aged 44, has served as a member of the board of directors of the Company since March 2004. Mr. Mak is the Managing Director of Venfund Investment, a boutique investment bank, which he co-founded in late 2001. Prior to that, he was a Managing Partner of Arthur Andersen. Mr. Mak also serves as a Director of China Grentech Corporation Limited and Dragon Pharmaceutical Inc., both listed in NASDAQ, Shenzhen Victor Onward Textile Industrial Co. Ltd. and Gemdale Industries Inc., both listed in the PRC, and Bright World Precision Machinery Limited, listed in Singapore. Mr. Mak is a graduate of the Hong Kong Polytechnic University and a fellow member of ACCA, UK, and HKICPA.

(iv) The branch share registrar and the transfer office of the Company in Hong Kong is Tengis Limited at 26/F., Tesbury Centre, 28 Queen's Road East, Hong Kong.

(v) The English text of this circular and the accompanying proxy form shall prevail over its Chinese text in the event of inconsistency.

11. DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents will be available for inspection at the office of Herbert Smith, 23/F., Gloucester Tower, 11 Pedder Street, Central, Hong Kong during normal business hours from the date of this circular up to and including 14 July 2006:

(i) the memorandum of association and bye-laws of the Company;

(ii) the annual reports of the Company for each of the years ended 31 March 2004, 31 March 2005 and 31 March 2006;

(iii) the accountants' report set out in Appendix IV to this circular;

(iv) the letter from the Independent Board Committee set out on page 38 of this circular; the letter from Tai Fook set out on pages 39 to 57 of this circular;

(v) the property valuation report as set out in Appendix VI to this circular;

(vi) the material contract referred to in the paragraph headed "Material contracts" of this appendix;

(vii) the Framework Agreement; and

(viii) the written consents referred to in the paragraph headed "Experts and consents" of this appendix.

HUABAO INTERNATIONAL HOLDINGS LIMITED
華寶國際控股有限公司 *

(Incorporated in Bermuda with limited liability)
(Stock Code: 336)

NOTICE IS HEREBY GIVEN that a special general meeting of Huabao International Holdings Limited (the "Company") will be held at Tianshan Room, Level 5, Island Shangri-La Hotel, Pacific Place II, Supreme Court Road, Central, Hong Kong on Wednesday, 26 July 2006 at 3:15 p.m. for the purpose of considering and, if thought fit, passing the following resolutions:

ORDINARY RESOLUTIONS

(1) Resolution regarding increase of authorised share capital

"**THAT** the authorised share capital of the Company be and is hereby increased from HK$337,690,000 to HK$887,690,000 by the creation of an additional 3,000,000,000 ordinary shares of par value HK$0.10 per share of the Company ("Shares") ranking pari passu in all respects with the existing issued and unissued ordinary shares of the Company, and 2,500,000,000 new convertible preference shares of par value HK$0.10 per share ("New Convertible Preference Shares"), having the rights and restrictions as set out in the amendments to the bye-laws of the Company ("Bye-Laws") under Special Resolution No. (5) ("Capital Increase")."

(2) Resolution regarding acquisition of 100% interests in Chemactive Investments Limited

"**THAT**:

(a) (i) the Acquisition Agreement dated 7 June 2006 (as defined in the Company's circular to Shareholders dated 28 June 2006 (the "Circular") of which this notice of Special General Meeting forms a part) (a copy of which has been produced to this meeting marked "A" and initialled by the chairman of this meeting for the purpose of identification) entered into between the Company and Ms. Chu Lam Yiu, and the transactions contemplated thereunder be and are hereby approved, confirmed and ratified; and that any one director of the Company (other than Ms. Chu) be and is hereby authorized with full power, to do all things and sign or execute all documents on behalf of the Company which may in his opinion be necessary or desirable for the purpose of giving effect to the Acquisition Agreement or any matters relation thereto; and

* *for identification purposes only*

(ii) the allotment and issue of 2,219,731,526 New Convertible Preference Shares (as defined in the Circular) at an issue price of HK$1.80 per New Convertible Preference Share upon and subject to the terms and conditions contained in the Bye-Laws (as amended by Special Resolution No. (5)) be and are hereby approved and that any two directors of the Company or any one director and the secretary of the Company be and hereby authorized to execute a share certificate (or certificates) representing the New Convertible Preference Shares and affix the common seal of the Company thereto for and on behalf of the Company, and any one director of the Company (in any case where the common seal of the Company is required to be affixed, then any two directors or any one director and the secretary, of the Company) be authorized, with full power, to do all things and sign or execute all documents on behalf of the Company which may in his/her (or their) opinion be necessary or desirable in connection with the issue of the New Convertible Preference Shares, the share certificates or any matters in relation thereto and the directors of the Company be and are authorized to allot, issue and deal with additional shares in the capital of the Company which may fall to be allotted and issued upon conversion rights attached to the New Convertible Preference Shares."

(3) Resolution regarding the Framework Agreement

"**THAT**:

(a) the framework agreement dated 1 June 2006 (the "Framework Agreement") (a copy of which marked "B" has been produced to the meeting and initialled by the Chairman for the purpose of identification) made between Chemactive Investments Limited and Hongta Tobacco (Group) Limited Liability Company in relation to the sale of tobacco flavours products to Hongta Tobacco (Group) Limited Liability Company and its associates by Chemactive Investments Limited (and its associates) after completion of the acquisition of Chemactive Investments Limited by the Company (details of which are set out in the Circular) and all transactions contemplated thereunder be and are hereby approved, ratified and confirmed;

(b) any one of the directors of the Company ("Directors") (or a duly authorized committee thereof) be hereby authorized to do all such acts and things, to sign and execute all such further documents and to take such steps as the Directors may in their absolute discretion consider necessary, appropriate, desirable or expedient to give effect to or in connection with the Framework Agreement or any of the transactions contemplated thereunder and matters contemplated in paragraph (a) of this Resolution No. (3) above and all other matters incidental thereto."

SPECIAL RESOLUTIONS

(4) Resolution regarding cancellation of share premium

"**THAT**, subject to the completion of the acquisition of 100% interests in Chemactive Investments Limited (the "Completion"):

with effect on the 20th business day (not being a Saturday) following the Completion:

(a) the entire amount standing to the credit of the share premium account of the Company as at the day of Completion be cancelled (the "Share Premium Cancellation"); and

(b) the credit amount (the "Credit Amount") arising from the Share Premium Cancellation be applied to eliminate the audited accumulated losses of the Company as at 31 March 2006 and any of the remaining balance of the Credit Amount be credited to the contributed surplus account of the Company where it may be applied in accordance with the Bye-Laws and the laws of Bermuda (the "Application of Credit");

and any one of the directors of the Company be and is hereby authorised to do all such acts, deeds and things (including, without limitation to the generality of the foregoing, the execution of any additional document, instrument or agreement) as he/she may, in his/her absolute discretion, consider necessary, desirable or expedient to implement and/or to give effect to the Share Premium Cancellation and the Application of Credit."

(5) Resolution regarding amendments to the Company's bye-laws

"**THAT** the Bye-Laws be altered in the following manners:

(a) by inserting under Bye-law 1 interpretation of "New Preference Shares" as follows:

"New Preference Shares" means the new convertible preference shares of HK$0.10 per share to be issued by the Company upon completion of the sale and purchase of the entire issued share capital of Chemactive Investments Limited pursuant to a sale and purchase agreement entered into between the Company and Ms. Chu Lam Yiu on 7th June 2006."

(b) by inserting the terms of New Preference Shares as Bye-law 9A of the Bye-Laws as follows:

"9A. The New Preference Shares shall have the following rights and restrictions and subject to the following conditions:

for the purpose of this new Bye-law 9A:

(1) **Definitions**

"**Business Day**"	means a day (not being a Saturday) on which banks are open for general banking business in Hong Kong;
"**Conversion Period**"	means in relation to any New Preference Shares, the period commencing on the New PS Issue Date and ending on the date the Company passes a voluntary winding up resolution or is otherwise placed into liquidation;
"**Conversion Right**"	means the right of New Preference Shareholders to convert their New Preference Shares into Ordinary Shares;
"**New PS Issue Date**"	means the date of allotment and issue of the New Preference Shares;
"**New Preference Shareholder**"	means a person registered from time to time in the register of members of the Company as a holder of any New Preference Share(s).

(2) **No entitlement to Dividend**

The New Preference Shares shall not have any right as to dividends.

(3) **Return of Capital**

On a return of capital on liquidation or otherwise (but not on conversion of New Preference Shares or any repurchase by the Company of New Preference Shares or Ordinary Shares) the assets of the Company available for distribution among the members of the Company shall be applied as follows:

(i) firstly, towards repayment of an amount equal to the aggregate of the paid up (or credited as paid up) amounts of all of the New Preference Shares; and

(ii) secondly, the balance of such assets shall belong to and be distributed among the holders of the Ordinary Shares and other classes of shares of the Company currently or to be created in future in the capital of the Company. The New Preference Shareholders shall not have the right to participate in such remaining assets.

(4) **Voting**

(i) The New Preference Shareholders shall not be entitled to vote at general meetings of the Company unless a resolution is to be proposed at a general meeting for winding-up the Company or a resolution is to be proposed at a general meeting which if passed would (subject to any consents required for such purpose being obtained) vary or abrogate the rights or privileges of the New Preference Shareholders, in which event the New Preference Shares shall confer on the holders thereof the right to receive notice of, and to attend, participate and vote, such that one New Preference Share shall confer one vote either in person or by proxy at that general meeting, save that such holders may not vote upon any business dealt with at such general meeting except the election of a Chairman, any motion for adjournment and the particular resolution for winding-up of the Company or any resolution which if passed would (subject to any consents required for such purpose being obtained) vary or abrogate the rights and privileges of the New Preference Shareholders.

(ii) Notwithstanding paragraph 4(i) in this new Bye-law 9A, each New Preference Shareholder shall be entitled to receive copies of all notices of any general meeting of the Company and shall be entitled to attend the same, whether or not it has a right to vote thereat.

(5) **Conversion**

(i) At any time during the Conversion Period, a New Preference Shareholder may serve a notice in writing on the Company to convert all or such number of the New Preference Shares in multiples of 1,000,000 New Preference Shares held by it and the balance thereof into Ordinary Shares whereupon the Company shall cause to be allotted and issued to such New Preference Shareholder such number of Ordinary Shares as shall be equal to the number of New Preference Shares, subject to adjustment as set out in paragraph 8 below.

(ii) Conversion of the New Preference Shares as aforesaid during the Conversion Period shall be effected in such manner as the directors of the Company shall, subject to the Bye-laws of the Company and the Act, from time to time determine.

(iii) Upon conversion of any New Preference Shares into Ordinary Shares, the Company shall cause the share certificates in respect of the relevant Ordinary Shares to be delivered to the relevant New Preference Shareholder or credit the number of such Ordinary Shares into the relevant New Preference Shareholder's brokers' account and the relevant New Preference Shareholder shall surrender the certificates in respect of the relevant New Preference Shares held by it for cancellation, in each case, as soon as reasonably practicable and in any event within five Business Days from the date of the service of the notice of conversion given by such New Preference Shareholder.

(iv) In the event of any fraction of a whole number of Ordinary Shares in the case of a conversion, such fraction shall be rounded down to the nearest whole number of the Ordinary Share.

(v) Holders of the New Preference Shares shall not exercise the conversion rights as to such number of New Preference Shares if upon the conversion thereof, the percentage of the Ordinary Shares held by the public would fall below the minimum public float requirements under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited applicable to the Company from time to time.

(vi) All notices served pursuant to paragraph 5(i) in this new Bye-law 9A shall be in writing and shall be deemed to have been served on after two Business Days of posting if sent by registered post, in the case of notice to the Company to the principal place of business of the Company in Hong Kong and in the case of notice to any New Preference Shareholder, to the address recorded in the register of holders of the New Preference Shares kept by the Company.

(6) **Non-Redemption**

All New Preference Shares are non-redeemable by the Company and the holders of the New Preference Shares shall have no right to request the Company to redeem the New Preference Shares.

(7) **Transfer**

The New Preference Shares shall be transferable by an instrument of transfer in any usual or common form or such other form as may be approved by the board of directors of the Company. For this purpose, the Company shall maintain a register of New Preference Shareholders in Bermuda and a branch register of New Preference Shareholders in Hong Kong.

(8) **Adjustment**

(i) If, while any of the New Preference Shares remain outstanding, the Company shall sub-divide or consolidate the Ordinary Shares, the number of Ordinary Shares into which the New Preference Shares may be converted on any subsequent conversion shall in the case of a sub-division be increased or in the case of a consolidation be reduced proportionately.

(ii) If, while any of the New Preference Shares remain outstanding, the Company shall make any bonus issue by way of capitalization of profits or reserves (including any share premium account) to members of the Company, such issue shall be made only to the holders of the Ordinary Shares and shall be in the form of fully paid Ordinary Shares.

(iii) A certificate by the Company as to any appropriate adjustment to be made as a result of the provisions of this paragraph 8 in this new Bye-law 9A, shall be sent within 28 days of the event resulting in such adjustment to the holders of the New Preference Shareholders and shall be conclusive and binding."

By Order of the Board
POON Chiu Kwok
Executive Director

Hong Kong, 28 June 2006

Notes:

1. A shareholder of the Company entitled to attend and vote at the special general meeting (or at any adjournment thereof) is entitled to appoint another person as his/her/its proxy to attend and vote in his/her/its stead in accordance with the bye-laws of the Company. A proxy need not be a shareholder of the Company.

2. A form of proxy for use at the special general meeting is enclosed.

3. To be valid, the form of proxy, together with the power of attorney or other authority, if any, under which it is signed or a certified true copy of that power of attorney or authority must be deposited at the Company's branch share registrar in Hong Kong, Tengis Limited, at 26/F., Tesbury Centre, 28 Queen's Road East, Hong Kong not less than 48 hours before the time appointed for holding the meeting (or any adjourned meeting thereof) and in default the form of proxy shall not be treated as valid. Completion and return of the form of proxy will not preclude shareholders of the Company from attending and voting in person at the meeting (or any adjourned meeting thereof) should they so wish.

4. In the case of joint holders, the vote of the senior who tenders a vote, whether in person or by proxy, will be accepted to the exclusion of the vote(s) of other joint holder(s), and for this purpose seniority will be determined by the order in which the names stand in the register of members of the Company in respect of such shares.