# MANAGEMENT DISCUSSION AND ANALYSIS

## OPERATIONAL AND FINANCIAL REVIEW

### Turnover

The Group recorded an encouraging turnover of approximately RMB292.6 million (2005: RMB221.7 million) for the financial year ended 31 December 2006, an increase of about 32% from that of last year.

The Group's turnover for the year was mainly derived from operations in the mainland of PRC.

### Gross Profit

The overall gross profit margin for the year was stable at about 62.4%.

### Net Profit

The Group's net profit attributable to shareholders for the financial year ended 31 December 2006 was approximately RMB75.4 million (2005: RMB59.8 million), approximately 26% more than in previous year. Net profit margin for the year ended 31 December 2006 was approximately 26% (2005: 27%).



### Expenses

Selling and distribution expenses amounted to approximately RMB39.1 million (2005: RMB35.7 million), representing approximately 13% (2005: 16%) of turnover for the year ended 31 December 2006. The slight decrease in percentage of turnover was due to the success of the control of selling and distribution expenses.

Administrative expenses amounted to approximately RMB52.5 million (2005: RMB33.6 million), representing approximately 18% (2005: 15%) of turnover for the year ended 31 December 2006. Administrative expenses increased by approximately 56% when compared with that of 2005. It was mainly due to the increase of the salary of the directors of the Company, the administrative cost of the Company and the increase of employees of 56.

### Loss from revaluation of foreign currency positions

The Group reported a net exchange loss of RMB4.2 million which was attributable to its revaluation of its net foreign exchange positions in 2006. The foreign currency proceeds from the IPO and the placement were HK$115.60 million and HK$108 million respectively, which increased the Group's foreign currency position. In view of the above, the Group will actively manage its net foreign currency position in 2007 by formulating foreign currency control policy and strategy in order to reduce its foreign currency risk in 2007.

# MANAGEMENT DISCUSSION AND ANALYSIS

### Ageing Analysis of account receivable

The ageing of the account receivable of food flavor and fine fragrances in 2006 is from 90 to 180 days, which the management of the Group allows the flexibility of the credit policy for the customers of food flavor and fine fragrances in view of the integration into the PRC market of food flavor and fine fragrances. As the customers of food flavor and fine fragrances are the current market participants, the management of the Group is able to obtain the information of the customers gathered from the market, including but not limited to the financial position, potential growth and the credibility of the customers prior to the decision of allowing a longer credit period to them.

The management of the Group is well aware of the credit risk from the market of food flavor and fine fragrances and will closely monitor the credibility of the customers from both segments by way of regular visit of their factories and effective communication with them.

Although the Group has formulated its strategy in the development of the segments of food flavor and fine fragrances, they are well aware that it is necessary to strike the balance between the growth of business and the credit policy of the customers. They are of the view that both segments will have significant growth in 2007 and credit policy of the customers from both segments will be gradually well developed by the Group.



### Dividend

The Board recommends the payment of a final dividend of RMB0.068 and a special dividend of RMB0.007 per ordinary share in respect of the year, to shareholders whose names appear on the register of members on 23 April 2007 at 4:00 p.m. if approved at the forthcoming annual general meeting.

## FUTURE PLANS AND PROSPECTS

As a result of constant improvement of quality of life in the PRC, the demand for quality flavor enhancer, food flavors and fine fragrances increases. In view of the strong demand in the market, the Group is at the final stage of negotiation for the use right of the Land. On the completion of the premises by 2008, the production capacity of the Group will be increased by 139% which will further strengthen the Group's leading position in the PRC market.

## LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December 2006, the Group had net current assets and total assets less current liabilities of approximately RMB352.3 million (2005: RMB191.3 million) and RMB447.1 million (2005: RMB244.3 million), respectively. The Group maintains a strong financial position by financing its operation with internally generated resources and placement at 3 July 2006. As at 31 December 2006, the Group had cash and bank deposits of approximately RMB268.6 million (2005: RMB152.8 million). The current ratio of the Group was approximately 5.7 (2005: 3.2).

Shareholders' fund of the Group as at 31 December 2006 was approximately RMB446.2 million (2005: RMB242.7 million). As at 31 December 2006, the total bank borrowings of the Group, repayable within 12 months from the balance sheet date, were denominated in RMB, and amounted to RMB27 million (2005: RMB45.4 million) together giving a gross debt gearing of approximately 17% (2005: 37%).

The financial health of the Group has been strong throughout the year as indicated by the above figures.

## FINANCING

As at 31 December 2006, the total banking and loan facilities of the Group amounted to about RMB40 million (2005: RMB60 million), of which RMB27 million (2005: RMB45.4 million) was utilized.

The Board believes that the existing financial resources will be sufficient to meet future expansion plans and, if additional financing is required, the Group is confident to obtain such financing with favourable terms.

## USE OF PROCEEDS FROM THE COMPANY'S INITIAL PUBLIC OFFERING

The net proceeds from the Company's issue of new shares at the time of its listing on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") in December 2005, after deduction of related expanses, amounted to approximately HK$115.6 million. These proceeds were applied up to 31 December 2006 in the following manner and in accordance with the proposed applications set out in the Company's prospectus dated 30 November 2005:

- as to approximately HK$25 million for the expansion in the Group's sales and distribution network;
- as to approximately HK$8 million for the expansion in the Group's current production facilities;
- as to approximately HK$21 million for the expansion of the Group's product development to cope with market demand; and
- as to approximately HK$4 million for strengthening R&D capabilities by expanding the Group's R&D department and cooperating with SAAT and CAU in R&D on new products and new technology.

The remaining net proceeds as at 31 December 2006 were placed with banks in PRC as deposits. The Board is of the opinion that the remaining proceeds will be applied in the future for their intended uses as set out in the Prospectus.

## CAPITAL STRUCTURE

The share capital of the Company comprises ordinary shares for the year ended 31 December 2006.

# MANAGEMENT DISCUSSION AND ANALYSIS

## FOREIGN EXCHANGE RISK AND INTEREST RATE RISK

The Group has net exchange loss of RMB4.2 million in 2006. Please refer to note 3.1(a) to the consolidated financial statements for the analysis of foreign exchange risk. Hence, no financial instrument for hedging was employed.

All bank borrowings of the Group were denominated in Renminbi and at fixed rate basis. The Board is of the opinion that the Group is not subject to any significant interest rate risk.

## CHARGE ON GROUP'S ASSETS

As at 31 December 2006, the buildings of RMB25.7 million were pledged to banks to secure bank facilities granted to the Group.

## CAPITAL EXPENDITURE

During the year, the Group invested approximately RMB24.8 million (2005: RMB7.9 million) in fixed assets, of which RMB17.7 million (2005: RMB3.3 million) was used for the purchase of plant and machinery including construction in progress.



For the year ended 31 December 2006, the Group had capital commitments of approximately RMB4.1 million (2005: RMB2.9 million) in respect of fixed assets, which are to be funded by internal resources.

## STAFF POLICY

The Group had 427 employees in the PRC and 4 employees in Hong Kong as at 31 December 2006. The Group offers a comprehensive and competitive remuneration, retirement scheme and benefit package to its employees. Discretionary bonus is offered to the Group's staff depending on their performance. The Group is required to make contribution to a social insurance scheme in the PRC. The Group and its employees in the PRC are each required to make contribution to fund the endowment insurance and unemployment insurance at the rates specified in the relevant PRC laws and regulations. The Group has adopted a provident fund scheme, as required under the Mandatory Provident Fund Schemes Ordinance, for its employees in Hong Kong.

## MATERIAL INVESTMENT

For the year ended 31 December 2006, the Group had no material investments in the land and building.

## CONTINGENT LIABILITIES

At the balance sheet date, the Group did not have any significant contingent liabilities.