MANAGEMENT DISCUSSION AND ANALYSIS

OPERATIONAL AND FINANCIAL REVIEW

The Group is principally engaged in the research and development, manufacture and sale of flavours and fragrances, which are provided to the Group's customers for making addition or improvement of flavours or fragrances in the customers' manufactured tobacco, food and daily consumer goods.

Turnover

For the financial year ended 31 December 2005, the Group recorded a turnover of approximately RMB221.7 million (2004: RMB158.5 million), representing an increase of approximately 40% in comparison to the previous financial year. The increase in turnover was attributable to (i) the increasing demand by the customers of flavour enhancer as a result of the continuous merging tobacco manufacturers in 2005; (ii) the introduction of new flavour enhancer products by the Group; (iii) the improvement of the existing flavour enhancer products by the Group; and (iv) the increase in sales of food flavouring and fine fragrances as a result of successful marketing strategy and increasing exhibition activities of the Group.

Gross Profit

The gross profit of the Group increased by 36% from approximately RMB103.7 million in the previous year to approximately RMB141.3 million in the current year. The gross profit margin was decreased from approximately 65% for the year ended 31 December 2004 to 64% for the year ended 31 December 2005. The slight reduction in gross profit margin was due to the Company's sales expansion to the fine fragrances in which economies of scale of production has not yet achieved.

Net Profit

The Group's net profit attributable to shareholders for the financial year ended 31 December 2005 was approximately RMB59.8 million (2004: RMB42.5 million), approximately 41% more than the previous year. Net profit margin for the year ended 31 December 2005 remained quite stable at approximately 27% (2004: 27%).

Expenses

Selling and marketing expenses amounted to approximately RMB35.7 million (2004: RMB28.5 million), representing approximately 16% (2004: 18%) of turnover for the year ended 31 December 2005. Selling and marketing expenses increased by 25% in comparison with that of 2004. It was mainly attributable to the Group's increasing effort on the marketing of its products.

Administrative expenses amounted to approximately RMB33.6 million (2004: RMB25.4 million), representing approximately 15% (2004: 16%) of turnover for the year ended 31 December 2005. Administrative expenses increased by approximately 33% when compared with that of 2004. It was mainly due to the increase in R&D expenses of approximately 11% and the increase in depreciation expenses of approximately 84% as a result of purchasing the properties in Union Square in Shenzhen by the Group for office use in October 2004.

MANAGEMENT DISCUSSION AND ANALYSIS

Finance costs of approximately RMB3.2 million (2004: RMB3.6 million). Decrease in amount was due to the relatively lower interest rate for bank borrowings in the earlier part of the year.

Dividend

The Directors do not recommend the payment of final dividend for the year ended 31 December 2005.

FUTURE PLANS AND PROSPECTS

The demand for consumer products utilising flavours and fragrances has been stimulated and broadened by changing social habits resulting from various factors such as increases in personal income, employment of women, teenage population, leisure time, health concerns and urbanisation and by the continued growth in the PRC's population. In the fragrance field, these developments have expanded the market for hair care products, candles, air-care products, deodorant and personal wash products with finer fragrance quality, as well as the market for colognes, toilet waters, men's toiletries and other products beyond traditional luxury items such as perfumes. In the flavouring field, similar market characteristics have stimulated the demand for products such as convenience food, soft drinks and low cholesterol and low-fat food products that must conform to expected tastes.

In order to cope with the increasing demand of food flavouring and fine fragrances as a result of the improvement in the PRC's living standard, the Group will, at its best efforts, capture such business opportunities by expanding its sales network in some of the provinces in the PRC, including but not limited to Hebei, Qingdao and Shanghai.

The growth of the PRC economy has resulted in an improvement in the living standard of the people in the PRC. As a result, the Group is of the view that people in the PRC will have higher demands for consumer products of better quality. In the contemplation of the increase in demand for consumer products of better quality and the full utilisation of the current production capacity, the Group plans to invest approximately HK$30 million to expand its production facilities, especially for the design and development of fine fragrances.

The Group is well aware that better quality products must be supported by research and development. The Group will continue to expand its research and development by recruiting more experienced flavourists and perfumers.

FUNDING AND TREASURY POLICIES

The Board confirm that the Group's funding and treasury policies are mainly based on its cash flow forecast and budgetary system to monitor and control the sources and applications of funds.

The objectives of the Group's funding and treasury policies are to prevent the unreasonable utilisation of funding, enhance the effectiveness on the utilisation of working capital, ensure the punctual repayment of the Group's liabilities upon the relevant maturity date and ensure liquidity of the working capital, so as to optimise the Group's net cash flow position.

LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December 2005, the Group had net current assets and total assets less current liabilities of approximately RMB191.3 million (2004: RMB26.5 million) and RMB244.3 million (2004: RMB77.9 million), respectively. The Group maintains a strong position by financing its operations with internally generated resources. The Group has cash and cash equivalents of approximately RMB152.8 million (2004: RMB21.3 million). The current ratio of the Group was approximately 3.2 (2004: 1.3).

Shareholders' fund of the Group as at 30 December 2005 was approximately RMB242.7 million (2004: RMB75.8 million). The total bank borrowings of the Group for the year ended 31 December 2005, repayable within 12 months from the balance sheet, were donominated in RMB, and amounted to RMB45.4 million (2004: RMB58.6 million), together giving a gross debt gearing of approximately 37% (2004: 123%).

The financial health of the Group was sound in 2005 as indicated by the above figures.

FINANCING

As at 31 December 2005, the total banking and loan facilities of the Group amounted to about RMB60 million (2004: RMB58.6 million), of which, RMB45.4 million (2004: RMB58.6 million) has been utilised. The loan amount has been decreased by 22.5%. The Board believes that the existing financial resources will be sufficient to meet future expansion plans and, if necessary, the Group will be able to obtain additional financing with favourable term.

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 expenses, amounted to approximately HK$115.6 million. These proceeds were to be substantially applied in the following manner and in accordance with the proposed applications set out in the Company's prospectus dated 30 November 2005 (the "Prospectus"):

– approximately HK$30 million for the expansion in the Group's sales and distribution network;

– approximately HK$30 million for the expansion in the Group's current production facilities;

– approximately HK$25 million for the expansion of the Group's product development to cope with the ever-changing market demand;

– approximately HK$10 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; and

– the balance of approximately HK$20.6 million to be used as general working capital of the Group.

MANAGEMENT DISCUSSION AND ANALYSIS

The net proceeds as at 31 December 2005 were placed with banks in the PRC and Hong Kong 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

For the year ended 31 December 2005, the share capital of the Company comprises ordinary shares.

For the year ended 31 December 2005, the Group had gearing ratio (which is defined as total debts net of payables under ordinary course of business over total assets) of approximately 16% (2004: approximately 38%), while the net debt to total equity ratio during the period was approximately negative 41% (2004: 56%). Net debt is defined to include total debts net of payables under ordinary course of business and cash and cash equivalents.

The Directors have confirmed that the Group has financed its operations principally from cash generated from its business operations and has not experienced any liquidity problem for the year ended 31 December 2005.

FOREIGN EXCHANGE RISK AND INTEREST RATE RISK

For the year ended 31 December 2005, the Group was not subject to any significant exposure to foreign exchange risk as the majority of the transactions of the Group were denominated in Renminbi. Hence, no financial instrument for hedging was employed.

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

CHARGE ON GROUP'S ASSET

As at 31 December 2005, the building of RMB27.2 million and the land use right of RMB2 million were pledged for bank borrowing of RMB30 million.

CAPITAL EXPENDITURE

During the year, the Group invested approximately RMB6.9 million (2004: RMB9.2 million) in fixed assets, of which RMB2.7 million (2004: RMB0.5 million) was used for purchase of plant and machinery.

For the year ended 31 December 2005, the Group had capital commitments of approximately RMB2.9 million (2004: RMB5.9 million) in respect of fixed assets, which are to be funded by internal resources.

STAFF POLICY

The Group had 371 employees in the PRC and 2 employees in Hong Kong as at 31 December 2005. 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 2005, the Group had no material investment. Details of future plans for material investments or capital assets have been disclosed in the prospectus of the Company dated 30 November 2005.

CONTINGENT LIABILITIES

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