NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2006
(All amounts in Renminbi thousands unless otherwise stated)

1. GENERAL INFORMATION

China Flavors and Fragrances Company Limited (the "Company") and its subsidiaries (together the "Group") manufacture and sell flavours and fragrances in the People's Republic of China (the "PRC"). The Company was incorporated in the Cayman Islands on 9 March 2005 as an exempted company with limited liability under the Companies Law, Cap. 22, (Law 3 of 1961 as consolidated and revised) of the Cayman Islands. The address of its registered office is: Century Yard, Cricket Square, Hutchins Drive, P.O, Box 2681 GT, George Tower, Grand Cayman, Cayman Islands, British West Indies.

Pursuant to a group reorganisation (the "Reorganisation"), on 29 October 2004, CFF Holdings Limited ("CFF Holdings"), acquired the entire capital of Shenzhen Guanlida Boton Spice Co., Ltd. (renamed as Shenzhen Boton Spice Co., Ltd. on 7 June 2006, "Shenzhen Boton") for a cash consideration from its owners. Subsequently, on 25 November 2005, the Company acquired the entire issued share capital of CFF Holdings, through a share exchange with Creative China Limited ("Creative China"), the owner of CFF Holdings and the holding company of the Company. As a result, the Company became the holding company of the Group and CFF Holdings acts as an intermediate company of another company, Shenzhen Boton.

The Reorganisation has been accounted for on the basis of merger accounting, under which the consolidated financial statements have been prepared as if the Company had been the holding company of the other companies comprising the Group throughout the years presented.

On 9 December 2005, shares of the Company were listed on The Stock Exchange of Hong Kong Limited.

These consolidated financial statements are presented in Renminbi (RMB) thousands, unless otherwise stated.

These consolidated financial statements have been approved for issue by the Board of Directors on 29 March 2007.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2006
(All amounts in Renminbi thousands unless otherwise stated)

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

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 Group'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.

(a) *Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Group*

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 May 2006 or later periods but which the Group has not early adopted, as follows:

- HK(IFRIC)-Interpretation 8, Scope of HKFRS 2 (effective for annual periods beginning on or after 1 May 2006). HK(IFRIC)-Interpretation 8 requires consideration of transactions involving the issuance of equity instruments – where the identifiable consideration received is less than the fair value of the equity instruments issued – to establish whether or not they fall within the scope of HKFRS 2. The Group will apply HK(IFRIC)-Interpretation 8 from 1 January 2007, but it is not expected to have any impact on the Group's consolidated financial statements;

- HK(IFRIC)-Interpretation 10, Interim Financial Reporting and Impairment (effective for annual periods beginning on or after 1 November 2006). HK(IFRIC)-Interpretation 10 prohibits the impairment losses recognised in an interim period on goodwill, investments in equity instruments and investments in financial assets carried at cost to be reversed at a subsequent balance sheet date. The Group will apply HK(IFRIC)-Interpretation 10 from 1 January 2007, but it is not expected to have any impact on the Group's consolidated financial statements;

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.1 Basis of preparation *(continued)*

(a) *Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Group (continued)*

- HKFRS 7, Financial instruments: Disclosures (effective for annual periods beginning on or after 1 January 2007). HKFRS 7 introduces new disclosures relating to financial instruments. The Group will apply HKFRS 7 from 1 January 2007; and

- HKAS 1 Amendment – Capital Disclosures (effective for annual periods beginning on or after 1 January 2007). This HKAS 1 Amendment will affect the disclosures about qualitative information about the Group's objective, policies and processes for managing capital; quantitative data about what the Company regards as capital; and compliance with any capital requirements and the consequences of any non-compliance. The Group will apply HKAS 1 Amendment from 1 January 2007.

(b) *Standards, amendments and interpretations effective in 2006 but not relevant for the Group's operations*

The following standards, amendments and interpretations are mandatory for accounting periods beginning on or after 1 January 2006 but are not relevant to the Group's operations:

- HKAS 19 (Amendment), Employee Benefits;

- HKAS 21 Amendment – New Investment in a Foreign Operation;

- HKAS 39 Amendment – Cash Flow Hedge Accounting of Forecast Intragroup Transactions;

- HKAS 39 Amendment – The Fair Value Option;

- HKAS 39 and IFRS 4 Amendment – Financial Guarantee Contracts;

- HKFRS 6, Exploration for and Evaluation of Mineral Resources;

- HKFRS 1 Amendment – First-time Adoption of International Financial Reporting Standards and HKFRS 6 (Amendment), Exploration for and Evaluation of Mineral Resources;

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2006
(All amounts in Renminbi thousands unless otherwise stated)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.1 Basis of preparation *(continued)*

(b) *Standards, amendments and interpretations effective in 2006 but not relevant for the Group's operations (continued)*

- HK (IFRIC)-Interpretation 4, Determining whether an Arrangement contains a Lease;
- HK (IFRIC)-Interpretation 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds; and
- HK (IFRIC)-Interpretation 6, Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment.

2.2 Consolidation

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

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 deconsolidated 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 recognised directly in the income statement.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.2 Consolidation *(continued)*

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence 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 for by the Company on the basis of dividends 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"). These financial statements are presented in Renminbi, 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 exchanges rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2006
(All amounts in Renminbi thousands unless otherwise stated)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.4 Foreign currency translation *(continued)*

(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 transaction); and

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

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

2.5 Property, plant and equipment

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

Construction in progress are property, plant and equipment on which construction work has not been completed and stated at cost. Cost includes acquisition and construction expenditure incurred, interest and other direct costs attributable to the development. Depreciation is not provided on construction in progress until the related asset is completed for intended use and transferred to property, plant and equipment.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.5 Property, plant and equipment *(continued)*

Subsequent costs are included in the asset's carrying amount or recognised 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. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged 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 over their estimated useful lives as follows:

Buildings	20 years
Plant and machinery	10 years
Motor vehicles	5 years
Furniture, fixtures and equipment	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.

2.6 Intangible assets

Purchased technology is capitalized as intangible assets at fair value on acquisition and amortised on a straight-line basis over its useful life of 5 years.

2.7 Impairment of assets

Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised 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).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2006
(All amounts in Renminbi thousands unless otherwise stated)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.8 Inventories

Inventories are stated at the lower of cost and net realisable 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 realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

2.9 Trade and other receivables

Trade and other receivables are recognised initially at fair value and subsequently measured at amortised 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 recognised in the income statement.

2.10 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.

2.11 Share capital

Shares issued 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.

2.12 Trade payables

Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.13 Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised costs; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

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

2.14 Government grants

A government grant is recognised, when there is a reasonable assurance that the Group will comply with the conditions attaching with it and that the grant will be received.

Grants relating to income are deferred and recognised in the income statement 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 credited to the income statement on a straight-line basis over the expected lives of the related assets.

2.15 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 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 realised or the deferred income tax liability is settled.

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

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2006
(All amounts in Renminbi thousands unless otherwise stated)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.16 Employee benefits

(a) *Pension obligations*

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

(b) *Share-based compensation*

The Group operates an equity-settled, share-based employee share option scheme. The fair value of the employee services received in exchange for the grant of the options is recognised as an expense. The total amount to be expensed is determined by reference to the fair value of the options granted.

The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

2.17 Revenue recognition

Revenue comprises the fair value for the sale of goods, net of value-added tax, rebates and discounts and after eliminating sales within the Group.

Sales of goods are recognised 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.

Interest income is recognised on a time-proportion basis using the effective interest method.

2.18 Borrowing costs

Borrowing costs that are directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalised as part of the cost of that asset.

All other borrowing costs are charged to the income statement in the year in which they are incurred.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.19 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 statement on a straight-line basis over the period of the lease.

2.20 Dividend distribution

Dividend distribution to the Company's shareholders is recognised as a liability in the Group's financial statements in the period in which the dividend is approved by the Company's shareholders.

3. FINANCIAL RISK MANAGEMENT

3.1 Financial risk factors

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.

(a) Market risk

(i) Foreign exchange risk

The Group mainly operates in the PRC with most of the transactions settled in RMB. Except for certain cash and bank balances, the Group's receivables, payables and borrowings were mainly denominated in RMB. However, as cash and bank balances kept by the Group are mainly denominated in RMB and HK dollars ("HK$"), the Group is exposed to foreign exchange risk in respect of exchange fluctuation of HK$ against RMB. The Group has not hedged foreign exchange risk. Moreover, 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

The Group is not exposed to commodity price risk.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2006
(All amounts in Renminbi thousands unless otherwise stated)

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Financial risk factors *(continued)*

(a) Market risk (continued)

(iii) Cash flow and fair value interest rate risk

The Group's interest rate risk arises from borrowings and bank balances. Borrowings issued at fixed rates and bank balances with fixed interest income rate expose the Group to fair value interest rate risk. Borrowings issued at variable rates expose the Group to cash flow interest rate risk. The Group has not used any interest rate swaps to hedge its exposure to interest rate risk.

(b) Credit risk

The Group has no significant concentration of credit risk and 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, the availability of funding through an adequate amount of committed credit facilities. Due to the dynamic nature of the underlying businesses, the Group aims to maintain flexibility in funding by arranging banking facilities and other external financing.

3.2 Fair value estimation

The nominal values less any estimated credit adjustments for financial assets and liabilities with a maturity of less than one year, if any, are assumed to approximate their fair value. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate available to the Group for similar financial instruments.

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

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 amount of assets and liabilities within the next financial year are discussed below.

(a) Useful lives of property, plant and equipment

The Group's management determines the estimated useful lives and consequently related depreciation charges. This estimate is based on the historical experience of the actual useful lives of property, plant and equipment of similar nature and functions. It could change significantly as a result of technical innovations and competitor actions in response to severe industry cycles. Management will increase the depreciation charge where useful lives are less than previously estimated lives, or it will write-off or write-down technically obsolete or non-strategic assets that have been abandoned or sold.

(b) Estimated impairment of receivables

The Group records impairment of receivables based on an assessment of the recoverability of accounts and bills receivable and other receivables. Provisions are applied to accounts and bills receivable and other receivables where events or changes in circumstances indicate that the balances may not be collectible. The identification of doubtful debts requires the use of judgement and estimates. Where the expectation is different from the original estimate, such difference will impact carrying value of accounts and bills receivable and other receivables and doubtful debt expenses in the period in which such estimate has been changed.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2006
(All amounts in Renminbi thousands unless otherwise stated)

5. PROPERTY, PLANT AND EQUIPMENT

	Group						Company
	Buildings	Plant and machinery	Motor vehicles	Furniture, fixtures and equipment	Construction in progress	Total	Furniture, fixtures and equipment
At 1 January 2005							
Cost	34,910	5,577	7,404	21,742	37	69,670	–
Accumulated depreciation	(6,110)	(3,425)	(5,253)	(5,548)	–	(20,336)	–
Net book amount	28,800	2,152	2,151	16,194	37	49,334	–
Year ended 31 December 2005							
Opening net book amount	28,800	2,152	2,151	16,194	37	49,334	–
Additions	3	2,714	484	4,121	575	7,897	183
Transfers	–	–	–	47	(47)	–	–
Depreciation (Note 18)	(1,568)	(291)	(665)	(3,725)	–	(6,249)	(6)
Closing net book amount	27,235	4,575	1,970	16,637	565	50,982	177
At 31 December 2005							
Cost	34,913	8,291	7,888	25,910	565	77,567	183
Accumulated depreciation	(7,678)	(3,716)	(5,918)	(9,273)	–	(26,585)	(6)
Net book amount	27,235	4,575	1,970	16,637	565	50,982	177
Year ended 31 December 2006							
Opening net book amount	**27,235**	**4,575**	**1,970**	**16,637**	**565**	**50,982**	**177**
Additions	**–**	**3,794**	**5,667**	**1,463**	**13,857**	**24,781**	**91**
Disposals	**–**	**–**	**(13)**	**–**	**–**	**(13)**	**–**
Transfers	**–**	**309**	**–**	**–**	**(309)**	**–**	**–**
Depreciation (Note 18)	**(1,567)**	**(795)**	**(811)**	**(4,091)**	**–**	**(7,264)**	**(50)**
Closing net book amount	**25,668**	**7,883**	**6,813**	**14,009**	**14,113**	**68,486**	**218**
At 31 December 2006							
Cost	**34,913**	**12,394**	**13,542**	**27,373**	**14,113**	**102,335**	**274**
Accumulated depreciation	**(9,245)**	**(4,511)**	**(6,729)**	**(13,364)**	**–**	**(33,849)**	**(56)**
Net book amount	**25,668**	**7,883**	**6,813**	**14,009**	**14,113**	**68,486**	**218**

5. PROPERTY, PLANT AND EQUIPMENT *(continued)*

Depreciation expense of RMB1,510,000 (2005: RMB971,000) has been expensed in cost of goods sold, RMB5,754,000 (2005: RMB5,278,000) in administrative expenses.

Lease rentals amounting to RMB1,200,000 (2005: RMB1,374,000) and RMB1,134,000 (2005: RMB1,622,000) for the lease of buildings and motor vehicles, respectively, are included in the consolidated income statement (Note 18).

The buildings are pledged for bank borrowings (Note 16).

6. LAND USE RIGHT – GROUP

The Group's interests in land use right represent prepaid operating lease payments for land occupied by the Group in the PRC and its net book amount is analysed as follows:

	2006	2005
Opening net book amount	**2,048**	2,092
Amortisation charge (Note 18)	**(47)**	(44)
Closing net book amount	**2,001**	2,048

	2006	2005
Cost	**2,327**	2,327
Accumulated amortisation	**(326)**	(279)
Net book amount	**2,001**	2,048

The remaining lease period of land use right is 43 years.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2006
(All amounts in Renminbi thousands unless otherwise stated)

7. INTANGIBLE ASSETS – GROUP

	Purchased technologies	
	2006	2005
Opening net book amount	**–**	–
Additions	**25,000**	–
Amortisation charge (Note 18)	**(687)**	–
Closing net book amount	**24,313**	–
Cost	**25,000**	–
Accumulated amortisation	**(687)**	–
Net book amount	**24,313**	–

8. INVESTMENT IN SUBSIDIARIES – COMPANY

	2006	2005
Unlisted shares at cost	**100,598**	100,598
Investments arising from share-based compensation (Note i)	**3,237**	–
Amount due from a subsidiary (Note ii)	**49,701**	–
	153,536	100,598

(i) The amount represents injection of capital by way of granting of share options of the Company to employees of subsidiaries in exchange for their services rendered to the subsidiaries.

(ii) The amount due from a subsidiary is unsecured, non-interest bearing and provided as part of owner's equity.

8. INVESTMENT IN SUBSIDIARIES – COMPANY *(continued)*

The following is a list of the major subsidiaries at 31 December 2006:

Name	Place of incorporation and kind of legal entity	Authorised/ Registered capital	Paid up capital	Interest held	Principal activities and place of operation
Directly held:					
CFF Holdings	British Virgin Islands, limited liability company	HK$389,500 divided into 38,950,000 shares of HK$0.01 each	HK$300 divided into 30,000 shares of HK$0.01 each	100%	Investment holding, British Virgin Islands
Boton Investments Limited	British Virgin Islands, limited liability company	US$50,000 divided into 50,000 shares of US$1 each	US$1	100%	Investment holding British Virgin Islands
Indirectly held:					
Shenzhen Boton	The PRC, limited liability company	RMB75,000,000	RMB75,000,000	100%	Manufacturing and sale of flavours and fragrance products, the PRC
Boton Flavors and Fragrances (Hong Kong) Limited	Hong Kong, limited liability company	HK$10,000 divided into 10,000 shares of HK$1 each	HK$1	100%	Trading, Hong Kong

9. INVENTORIES – GROUP

	2006	2005
Raw materials	**19,113**	19,798
Work in progress	**391**	922
Finished goods	**11,142**	5,951
	30,646	26,671

The cost of inventories recognised as expense and included in cost of goods sold for the year amounted to RMB109,890,000 (2005: RMB80,348,000).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2006
(All amounts in Renminbi thousands unless otherwise stated)

10. TRADE AND OTHER RECEIVABLES

		Group		Company	
	Note	**2006**	2005	**2006**	2005
Trade receivables	(b)	**86,560**	71,560	**–**	–
Less: provision for impairment		**(2,265)**	(2,152)	**–**	–
Trade receivables – net		**84,295**	69,408	**–**	–
Bills receivable	(c)	**21,539**	4,071	**–**	–
Prepayments		**500**	7,177	**–**	–
Advances to staff		**8,288**	7,581	**–**	–
Staff benefit payments		**5,864**	4,854	**–**	–
Due from subsidiaries	(d)	**–**	–	**104,122**	312
Other receivables		**7,973**	5,681	**213**	267
		128,459	98,772	**104,335**	579

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

(b) The credit period generally granted to customers is 90 days. The ageing analysis of the trade receivables from the date of sales is as follows:

	2006	2005
0 – 30 days	**36,143**	31,804
31 – 60 days	**16,012**	13,152
61 – 90 days	**8,632**	9,177
91 – 180 days	**11,528**	12,257
181 – 360 days	**10,243**	3,631
Over 360 days	**4,002**	1,539
	86,560	71,560

(c) Bills receivable are with maturity between 30 and 180 days.

(d) Amounts due from subsidiaries are unsecured, interest-free and repayable on demand.

11. CASH AND CASH EQUIVALENTS

	Group		Company	
	2006	2005	**2006**	2005
Cash at bank and in hand	**86,735**	59,155	**5,511**	17,316
Short-term bank deposits	**181,899**	93,645	**60,318**	93,645
	268,634	152,800	**65,829**	110,961

The effective interest rate on short-term bank deposits was 4% (2005: 4%). These deposits have an average maturity of 60 days.

12. SHARE CAPITAL

Movements of the share capital of the Company are as follows:

	Note	Authorised Number of shares (of HK$0.1 each)	RMB'000
Upon incorporation of the Company on 9 March 2005	(a)	3,800,000	395
Increase	(b)	796,200,000	82,805
At 31 December 2005		800,000,000	83,200
At 31 December 2006		800,000,000	83,200

	Note	Issued and fully paid Number of shares (of HK$0.1 each)	RMB'000
Upon incorporation of the Company on 9 March 2005	(a)	1	–
Shares allotted to Creative China in consideration for entire issued share capital of CFF Holdings	(c)	19,999,999	2,080
Shares capitalised from share premium account	(d)	280,000,000	29,120
Issue of shares	(e)	100,000,000	10,400
At 31 December 2005		400,000,000	41,600
Issue of shares	(f),(g)	44,455,000	4,587
Share options exercised	(i)	430,000	43
At 31 December 2006		444,885,000	46,230

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2006
(All amounts in Renminbi thousands unless otherwise stated)

12. SHARE CAPITAL *(continued)*

Notes:

(a) Upon incorporation, the Company had an authorised share capital of HK$380,000 (approximately RMB395,000) divided into 3,800,000 shares of HK$0.1 each. On 4 April 2006, one share of the Company was allotted and issued to the initial subscriber for cash at par and was transferred to Mr. Wong Ming Bun, the ultimate controlling shareholder of the Company. On 25 November 2006, Mr. Wong Ming Bun transferred the one share to Creative China, a company directly controlled by him for cash at par.

(b) On 25 November 2005, the authorised share capital of the Company was increased from HK$380,000 to HK$80,000,000 (approximately RMB83,200,000) by the creation of additional 796,200,000 shares of HK$0.1 each.

(c) On 25 November 2005, the Company acquired from Creative China the entire issued share capital of CFF Holdings for a consideration of RMB100,598,000 satisfied by the allotment and issue of, credited as fully paid, 19,999,999 shares to Creative China. The difference between the consideration and nominal value of the shares allotted, amounting to RMB98,518,000, was credited to the share premium account of the Company.

(d) On 25 November 2005, the sole shareholder passed written resolutions, pursuant to which the directors were authorised to capitalise the amount of HK$28,000,000 (approximately RMB29,120,000) as 280,000,000 shares issued at HK$0.1 each from the amount standing to the credit of the share premium account of the Company.

(e) On 8 December 2005, 100,000,000 shares of HK$0.1 per share were issued at HK$1.18 per share through a placing and public offer (the "New Issue"), resulting in net proceeds of approximately RMB122,720,000. After the New Issue, the issued and fully-paid share capital of the Company increased by HK$10,000,000 (approximately RMB10,400,000), divided into 100,000,000 shares of HK$0.1 each. The difference between the New Issue proceeds and the increased issued and fully-paid share capital, amounting to RMB112,320,000, was credited to the share premium account.

(f) In connection with the New Issue, the Company granted to the placing underwriters the over-allotment option of no more than an aggregate of 15,000,000 additional new shares. The over-allotment option was partially exercised on 4 January 2006 and 7,892,000 shares were issued and allotted by the Company at HK$1.18 per share. The difference between the proceeds from over-allotment option and the increased issued and fully-paid share capital, amounting to RMB8,864,000, was credited to the share premium account.

(g) On 3 July 2006, 36,563,000 shares of HK$0.1 per share were issued at HK$3.15 per share to Creative China pursuant to the Placing and Subscription Agreement. The difference between the proceeds from share subscription and the increased issued and fully-paid share capital, amounting to approximately RMB114,863,000, was credited to the share premium account.

(h) All shares issued have the same rights as the other shares in issue.

12. SHARE CAPITAL *(continued)*

(i) Share options

The Company has a share option scheme adopted on 25 November 2005 (the "Share Option Scheme"). On 28 April 2006 and 7 September 2006, the Group respectively granted 4,560,000 and 6,200,000 share options with an exercise price of HK$2.95 and HK$3.20 each to existing employees. 430,000 shares of theses options were exercised during the year. The difference between the proceeds from share subscription and the increased issued and fully-paid share capital, amounting to approximately RMB1,226,000, was credited to the share premium account.

Movements in the number of share options outstanding and their related weighted average exercise price are as follows:

	Average exercise price in HK$ per share	Number of Options ('000)
At 1 January 2005 and 2006	–	–
Granted	3.09	10,760
Exercised	2.95	(430)
Lapsed	2.95	(4,130)
At 31 December 2006	3.20	6,200

Share options outstanding as at the 31 December 2006 were currently exercisable and have the following terms:

Grantee	**Exercise price in HK$ per share**	**Number of options ('000)**	**Expiry date**
Employees	3.20	4,200	6 March 2007
Employees	3.20	2,000	6 September 2008
At 31 December 2006		6,200	

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2006
(All amounts in Renminbi thousands unless otherwise stated)

12. SHARE CAPITAL *(continued)*

The fair values of the options granted to the employees during the year, determined using the Black-Scholes Model, are as follows:

Date of grant	Fair value of options	Number of options granted ('000)	Exercise price in HK$ per share	Closing share price at date of grant	Risk free rate	Dividend yield	Expected volatility	Expected option life
28 April 2006	807	4,560	2.95	2.80	3.87%	8%	33.90%	6 months
7 September 2006	1,458	4,200	3.20	3.20	3.67%	–%	45.23%	4 months
7 September 2006	973	2,000	3.20	3.20	3.64%	–%	51.96%	6 months
	3,238	10,760						

13. OTHER RESERVES

The Group

	Reserve fund Note (a)	Discretionary surplus reserve Note (a)	Enterprise expansion fund Note (a)	Merger reserve Note (b)	Share premium	Total
At 1 January 2005	13,934	6,034	6,966	22,920	(1,886)	47,968
Capitalisation (Note 12(d))	–	–	–	–	(29,120)	(29,120)
Issue of shares (Note 12(e))	–	–	–	–	112,320	112,320
Share issuance costs	–	–	–	–	(15,622)	(15,622)
At 31 December 2005	13,934	6,034	6,966	22,920	65,692	115,546
Employee share option scheme:						
– value of employee services	–	–	–	–	3,238	3,238
– proceeds from shares issued (Note 12(i))	–	–	–	–	1,226	1,226
Issue of shares (Note 12(f), (g))	–	–	–	–	123,727	123,727
Share issuance costs	–	–	–	–	(4,647)	(4,647)
Profit appropriations	8,807	–	–	–	–	8,807
At 31 December 2006	22,741	6,034	6,966	22,920	189,236	247,897

13. OTHER RESERVES *(continued)*

Notes:

(a) In accordance with relevant laws and regulations of the PRC, Shenzhen Boton should make the appropriations from the net profit to the reserve fund, discretionary surplus reserve 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. The percentages to be appropriated to the discretionary surplus reserve and the enterprise expansion fund are determined by the Board of Directors of Shenzhen Boton.

Upon approval from the Board of Directors, 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.

(b) Merger reserve of the Group represents the difference between the nominal value of the share capital issued by the Company and share capital and share premium of a subsidiary acquired through an exchange of shares.

The Company

	Share premium
Issue of shares for the acquisition of a subsidiary (Note 12(c))	98,518
Capitalisation (Note 12(d))	(29,120)
Issue of shares (Note 12(e))	112,320
Share issuance costs	(17,508)
At 31 December 2005	164,210
Employee share option scheme:	
– value of employee services (Note 12(i))	3,238
– proceeds from shares issued (Note 12(i))	1,226
Issue of shares (Note 12(f), (g))	123,727
Share issuance costs	(4,647)
At 31 December 2006	287,754

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2006
(All amounts in Renminbi thousands unless otherwise stated)

14. DEFERRED GRANTS — GROUP

Amounts represent grants received from Shenzhen Technology and Information Bureau pursuant to the document Shen Ke Xin [2003] No. 097 and Shen Ke Xin [2006] No. 443 for subsidising the research and development projects conducted by the Group. The movements are as follows:

	2006	2005
At 1 January	**1,630**	2,037
Receipt of grants	**1,689**	2,421
Recognised in consolidated income statement (Note 17)	**(2,465)**	(2,828)
At 31 December	**854**	1,630

15. TRADE AND OTHER PAYABLES

		Group		**Company**	
	Note	**2006**	2005	**2006**	2005
Trade payables	(a)	**30,560**	19,293	**–**	–
Other tax payables		**2,838**	4,184	**–**	–
Accrued expenses		**1,970**	3,722	**–**	–
Due to a subsidiary	(b)	**–**	–	**4,293**	2,116
Other payables		**7,302**	8,709	**1,554**	4,984
		42,670	35,908	**5,847**	7,100

(a) The ageing analysis of the trade payables is as follows:

	2006	2005
0 – 30 days	**19,569**	5,307
31 – 60 days	**6,137**	7,776
61 – 180 days	**3,704**	4,541
181 – 360 days	**70**	411
Over 360 days	**1,080**	1,258
	30,560	19,293

(b) Amount due to a subsidiary is unsecured, interest free and repayable on demand.

16. BORROWINGS

	2006	2005
Short-term bank loans	**27,000**	45,364

The loans are secured by buildings of the Group (Note 5).

The carrying amounts of the borrowings are denominated in the following currencies:

	2006	2005
HK$	**–**	8,364
RMB	**27,000**	37,000
	27,000	45,364

The effective annual interest rates at the balance sheet dates were as follows:

	2006		2005	
	HK$	**RMB**	HK$	RMB
Bank borrowings	**–**	**6.14%**	6.26%	6.14%

The carrying amounts of short-term bank loans approximate their fair value, as the impact of discounting is not significant. The fair values are based on cash flows discounted using rates based on the average borrowing rates of 6.16% and 6.14% per annum as at 31 December 2005 and 2006 respectively.

The exposure of the Group's borrowings to interest-rate changes and the contractual repricing dates are as followings:

	2006	2005
6 months or less	**27,000**	45,364

The Group has the following undrawn borrowing facilities:

	2006	2005
Fixed rate		
– Expired within one year	**13,000**	14,636

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2006
(All amounts in Renminbi thousands unless otherwise stated)

17. TURNOVER AND OTHER GAINS

The Group is principally engaged in manufacturing and sale of flavours and fragrances. Turnover and other gains recognised during the year are as follows:

	2006	2005
Turnover		
Sales of goods	**292,580**	221,667
Other gains		
Government grants (Note 14)	**2,465**	2,828
Sales of raw materials	**346**	228
	2,811	3,056

The Group's turnover and profit are generated from manufacturing and sale of flavors and fragrances in the PRC, no segment information is therefore presented.

18. EXPENSES BY NATURE

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

	2006	2005
Depreciation and amortisation (Notes 5, 6 and 7)	**7,998**	6,293
Employee benefit expenses, excluding amount included in research and development costs (Note 19)	**32,031**	22,318
Changes in inventories of finished goods and work in progress	**(4,660)**	541
Raw materials used	**100,834**	70,064
Impairment charge for bad and doubtful debts	**230**	753
Lease expenses (Note 5)	**2,334**	2,996
Transportation and travelling	**15,281**	10,855
Advertising costs	**3,051**	2,993
Auditors' remuneration	**1,400**	832
Research and development costs		
– Employee benefit expenses (Note 19)	**4,248**	4,784
– Others	**1,009**	1,090
Entertainment	**16,196**	11,042
Office expenses	**9,012**	5,005
Other expenses	**12,463**	10,096
Total	**201,427**	149,662

19. EMPLOYEE BENEFIT EXPENSES

	2006	2005
Wages, allowance and bonus	**31,169**	24,607
Retirement scheme contribution (Note (a))	**1,573**	1,035
Share options granted to directors and employees	**3,238**	–
Others	**299**	1,460
	36,279	27,102

(a) Retirement scheme contribution

Shenzhen Boton makes defined contribution to retirement scheme managed by local government in the PRC based on 15.7% of the basic salary of eligible staff. It is the local government's responsibility to pay the retirement pension to those staff who retired.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2006
(All amounts in Renminbi thousands unless otherwise stated)

19. EMPLOYEE BENEFIT EXPENSES *(continued)*

(b) Directors' and senior management's emoluments

The remuneration of every director is set out below:

	2006	2005
Mr. Wong Ming Bun		
Fees	**–**	–
Salary	**1,800**	111
Other benefits and allowance	**–**	–
Pension scheme contribution	**–**	–
Total	**1,800**	111
Mr. Wang Ming Fan		
Fees	**–**	–
Salary	**1,499**	531
Other benefits and allowance	**120**	120
Pension scheme contribution	**6**	6
Total	**1,625**	657
Mr. Li Qing Long		
Fees	**–**	–
Salary	**1,197**	192
Share options granted	**301**	–
Other benefits and allowance	**30**	30
Pension scheme contribution	**7**	7
Total	**1,535**	229
Mr. Goh Gen Cheung		
Fees	**150**	9
Mr. Leung Wai Man, Roger		
Fees	**150**	9
Mr. Zhou Xiao Xiong		
Fees	**150**	9

19. EMPLOYEE BENEFIT EXPENSES *(continued)*

(c) Five highest paid individuals

The five individuals whose emoluments were the highest in the Group for the year ended 31 December 2006 include three directors (2005: two directors) whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining two individuals (2005: three individuals) during the year are as follows:

	2006	2005
Basic salaries, housing allowance, other allowance and benefits in kind	**914**	528
Pension scheme contribution	**26**	26
	940	554

The emoluments to the above two highest paid individuals (2005: three individuals) during the years presented were all less than RMB1,000,000 (HK$1,000,000) per person.

During the year, there was no arrangement under which a director waived or agreed to waive any emoluments and no emoluments were paid by the Group to the directors as an inducement to join, or upon joining the Group, or as compensation for loss of office.

(d) The directors and senior managements' emoluments above included the compensation to key management.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2006
(All amounts in Renminbi thousands unless otherwise stated)

20. FINANCE INCOME AND COSTS

	2006	2005
Interest expense:		
– Bank loans	**(1,941)**	(3,116)
– Others	**(116)**	(126)
Exchange loss	**(4,181)**	–
	(6,238)	(3,242)
Interest income	**4,040**	922
Finance costs - net	**(2,198)**	(2,320)

21. INCOME TAX EXPENSE

The amount of taxation charged to the consolidated income statement represents:

	2006	2005
Current taxation:		
– PRC income tax	**16,382**	12,978

(a) Shenzhen Boton was established in the Shenzhen Special Economic Zone and is subject to PRC income tax rate of 15%. The major operation of the Group is conducted by Shenzhen Boton.

(b) No provision for income tax in other jurisdictions has been made as the Group has no income assessable for income tax for the year in those jurisdictions.

(c) As of 31 December 2005 and 2006, there was no material unprovided deferred taxation.

(d) The taxation on the Group's profit before taxation differs from the theoretical amount that would arise using the PRC taxation rate of Shenzhen Boton as follows:

	2006	2005
Profit before taxation	**91,766**	72,741
Calculated at a taxation rate of 15% (2005: 15%)	**13,765**	10,911
Expenses not deductible for taxation purposes	**2,617**	2,067
Taxation charge	**16,382**	12,978

22. PROFIT ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY

The profit attributable to equity holders of the Company is dealt with in the financial statements of the Company to the extent of a loss of RMB15,318,000 (2005: RMB595,000)

23. EARNINGS PER SHARE

(a) Basic

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year.

	2006	2005
Profit attributable to equity holders of the Company	**75,384**	59,763
Weighted average number of ordinary shares in issue* (thousand shares)	**426,042**	306,027
Basic earnings per share (RMB per share)	**0.18**	0.20

* In determining the number of shares in issue, 300,000,000 shares issued on the incorporation of the Company and the Reorganisation of the Group were deemed to have been in issue since 1 January 2005.

(b) Diluted

Share options outstanding as at 31 December 2006 (Note 12) have no dilutive effect as the average market price of the Company's ordinary shares during the period from the date when options were granted to 31 December 2006 is below the exercise price of the options. As there were no dilutive potential ordinary shares, the Group's basic and diluted earnings per share are the same during the year.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2006
(All amounts in Renminbi thousands unless otherwise stated)

24. DIVIDEND

No dividend has been paid by the Company in the years ended 31 December 2005 and 2006.

At a meeting held on 29 March 2007, the directors proposed a final dividend of HK$0.068 (equivalent to RM0.068) per ordinary share and a special dividend of HK$0.007 (equivalent to RMB0.007) per ordinary share, totalling HK$0.075 (equivalent to RMB0.075) per ordinary share. Such dividends represented an aggregate amount of approximately HK$33,366,000 (equivalent to RMB33,366,000) for the 444,885,000 shares issued and outstanding as at 31 December 2006. These proposed dividends are not reflected as dividend payable in these financial statements.

25. CASH GENERATED FROM OPERATIONS

	2006	2005
Profit for the year	**75,384**	59,763
Adjustments for:		
– Income tax expense (Note 21)	**16,382**	12,978
– Depreciation and amortisation (Notes 5, 6 and 7)	**7,998**	6,293
– Loss on disposal of property, plant and equipment	**13**	–
– Interest income (Note 20)	**(4,040)**	(922)
– Interest expense (Note 20)	**2,057**	3,242
– Share options granted to directors and employees (Note 19)	**3,238**	–
Changes in working capital:		
– Inventories	**(3,975)**	(1,525)
– Trade and other receivables	**(29,687)**	(27,354)
– Trade and other payables and deferred grants	**4,086**	8,338
Cash generated from operations	**71,456**	60,813

26. COMMITMENTS – GROUP

(a) Capital commitments

Capital expenditure of the Group at the balance sheet date but not yet incurred is as follows:

	2006	2005
Property, plant and equipment contracted but not provided for	**4,099**	2,860

(b) Operating lease commitments

The Group leases various plant, offices and vehicles under non-cancellable operating lease agreements. The future aggregate minimum lease payments under non-cancellable operating leases are as follows:

	2006	2005
Not later than one year	**1,728**	1,692
Later than 1 year and not later than 5 years	**1,110**	2,373
	2,838	4,065

27. ULTIMATE HOLDING COMPANY

The directors regard Creative China Limited, a company incorporated in the British Virgin Islands, as the immediate and ultimate holding company.