**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 you should take, you should consult your licensed securities dealer or other registered institution in securities, bank manager, solicitor, professional accountant or other professional adviser.

**If you have sold or transferred** all your shares in China Flavors and Fragrances Company Limited 中國香精香料有限公司, you should at once hand this circular 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.



**China Flavors and Fragrances Company Limited**
**中國香精香料有限公司**

*(Incorporated in the Cayman Islands with limited liability)*

**(Stock Code: 3318)**

# MAJOR TRANSACTION
# ACQUISITION OF THE ENTIRE ISSUED SHARE CAPITAL IN KIMREE, INC.

All capitalised terms used in this circular have the meaning set out in the section headed "Definitions" of this circular. A letter from the Board containing details of the Acquisition is set out on pages 5 to 21 of the circular.

The Company has obtained written Shareholders' approval for the Acquisition pursuant to Rule 14.44 of the Listing Rules from the Relevant Shareholders who form a closely allied group of Shareholders and together hold more than 50% of the issued Shares giving the right to attend and vote at a general meeting. Accordingly, no Shareholders' meeting will be held to approve the Acquisition pursuant to Rule 14.44 of the Listing Rules. This circular is being despatched to the Shareholders for information only.

18 April 2016

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

| | |
|---|---|
| "Acquisition" | the acquisition of the entire issued share capital of the Target Company by the Company from the Vendors |
| "Acquisition Agreement" | the Acquisition Agreement dated 25 January 2016 entered into by the Vendors and the Company in relation to the Acquisition |
| "Associates" | has the meaning ascribed to it under the Listing Rules |
| "Audited Consolidated Net Profit" | the audited consolidated net profit after tax of the Target Company for each of the financial year end of 2016, 2017 and 2018 (as the case may be) ascertained after the relevant audit has been completed by the Auditor within 2 months after the relevant financial year end |
| "Auditor" | the auditor appointed by the Company to complete the audit of the Target Company for the financial year end of 2016, 2017 and 2018 (as the case may be) |
| "Board" | the board of Directors of the Company |
| "Business Day" | means any day (excluding Saturday, Sunday and public holiday) on which licensed banks in Hong Kong are open to the general public for business |
| "BVI" | the British Virgin Islands |
| "Company" | China Flavors and Fragrances Company Limited (中國香精香料有限公司), a company incorporated in the Cayman Islands with limited liability, the issued shares of which are listed on the Main Board of the Stock Exchange |
| "Completion" | the completion of the Acquisition in accordance with the terms and conditions of the Acquisition Agreement |
| "Completion Accounts" | the unaudited balance sheets (as of a date within 30 days before the Completion Date) and the unaudited income statements (for the period from 1 January 2015 to a date within 30 days before the Completion Date) of each of the companies in the Target Group provided by the Vendors, together with the consolidated accounts of the Target Group as of the date of the 7th day before the Completion Date |

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| "Completion Date" | the 3rd Business Day after the fulfillment or wavier (as the case may be) of all the conditions precedent stipulated in the Acquisition Agreement (or such other date as agreed between the Company and the Vendors) |
| "Connected person(s)" | has the meaning ascribed to it under the Listing Rules |
| "Consideration" | the total consideration of RMB750,000,000 (equivalent to approximately HK$900,000,000) for the Acquisition pursuant to the Acquisition Agreement |
| "Director(s)" | director(s) of the Company |
| "Enlarged Group" | the Group as enlarged by the Acquisition |
| "Group" | the Company and its subsidiaries |
| "HK$" | Hong Kong dollars, the lawful currency of Hong Kong |
| "Hong Kong" | Hong Kong Special Administrative Region of the People's Republic of China |
| "Independent Third Parties" | any person(s) or company(ies) and their respective ultimate beneficial owner(s), to the best of the Directors' knowledge, information and belief having made all reasonable enquiries, are not connected persons of the Company and are third parties independent of the Company and its connected persons in accordance with the Listing Rules |
| "Latest Practicable Date" | 13 April 2016, being the latest practicable date prior to the publication of this circular for the purpose of ascertaining certain information contained in this circular |
| "Listing Rules" | the Rules Governing the Listing of Securities on the Stock Exchange |
| "Mr. Wang" | Mr. Wang Ming Fan, the executive director, chairman of the Board and chief executive officer of the Company |
| "PRC" | the People's Republic of China, and for the purposes of this announcement, excluding Hong Kong, Macau and Taiwan |
| "RMB" | Renminbi, the lawful currency of the PRC |
| "Relevant Shareholders" | Mr. Wang, Creative China Limited and Full Ashley Enterprises Limited |

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|---|---|
| "Sale Shares" | 100,000,000 ordinary shares of US$0.00001 each in the share capital of the Target Company, representing the entire issued share capital in the Target Company immediately before Completion |
| "SFO" | the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) |
| "Share(s)" | ordinary share(s) of HK$0.10 each in the share capital of the Company |
| "Shareholder(s)" | holder(s) of Shares |
| "Stock Exchange" | the Stock Exchange of Hong Kong Limited |
| "Target Company" | Kimree, Inc., a company incorporated in the Cayman Islands with limited liability |
| "Target Group" | the Target Company and its subsidiaries |
| "US$" | United States dollars, the lawful currency of the United States |
| "Vendors" | the six vendors who are the shareholders of the Target Company, namely (1) Ree Jia Limited, (2) Ree Jie Limited, (3) Ree Min Limited, (4) Ree Lin Limited, (5) Ree Zhi Limited and (6) Ree Fen Limited |
| "Warrantors" | the six warrantors who are the respective ultimate beneficial owners of the vendors, namely Zhang Jian, Ai Jianjie, Liu Qiuming, Jiang Lingfan, Xiang Zhiyong, and Yu Daifeng |
| "%" | per cent |

*For the purpose of illustration only and unless otherwise stated, conversion of RMB into Hong Kong dollars in this circular is based on the exchange rate of RMB1 to HK$1.2. Such conversion should not be construed as a representation that any amount has been, could have been, or may be, exchanged at this or any other rate.*

*Certain figures set out in this circular have been subject to rounding adjustments. Accordingly, figures shown as the currency conversion or percentage equivalents may not be an arithmetic sum of such figures. Any discrepancy in any table between totals and sums of amounts listed in this circular is due to rounding.*

*The English names of the PRC nationals, companies, entities, departments, facilities, certificates, titles and the like are translation of their Chinese names and are included in this circular for identification purpose only and should not be regarded as their official English translation. In the event of any inconsistency, the Chinese names prevail.*

**China Flavors and Fragrances Company Limited**
**中國香精香料有限公司**

*(Incorporated in the Cayman Islands with limited liability)*

**(Stock Code: 3318)**

*Executive Directors:*
Mr. Wang Ming Fan *(Chairman & Chief Executive Officer)*
Mr. Li Qing Long
Mr. Qian Wu

*Non-executive Director:*
Ms. Sy Wai Shuen

*Independent non-executive Directors:*
Mr. Leung Wai Man, Roger
Mr. Ng Kwun Wan
Mr. Zhou Xiao Xiong

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71 Des Voeux Road Central
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Hong Kong

18 April 2016

*To the Shareholders*

Dear Sir or Madam

# MAJOR TRANSACTION ACQUISITION OF THE ENTIRE ISSUED SHARE CAPITAL IN KIMREE, INC.

## INTRODUCTION

Reference is made to the announcements of the Company dated 11 November 2015, 17 December 2015, 25 January 2016 and 19 February 2016 in relation to, *inter alia*, the memorandum of understanding dated 11 November 2015 and the Acquisition Agreement in respect of the Acquisition. Pursuant to the Acquisition Agreement, the Vendors have conditionally agreed to sell the Sale Shares and the Company has conditionally agreed to purchase the Sale Shares, representing the entire issued share capital of the Target Company, for a total consideration of RMB750,000,000 (equivalent to approximately HK$900,000,000) in cash. Subject to and in accordance with the terms and conditions of the Acquisition Agreement, the Target Company shall become a wholly-owned subsidiary of the Company upon Completion.

The purpose of this circular is to provide you with, among others, (i) further details of the Acquisition Agreement and the transactions contemplated thereunder; (ii) financial information of the Group; (iii) financial information of the Target Group; (iv) the unaudited pro forma financial information of the Enlarged Group; (v) management discussion and analysis of the Target Group; (vi) the valuation report on the Target Group; and (vii) letter from PricewaterhouseCoopers on the discounted cash flows in relation to the valuation of the Target Group and letter from I-Access Investors Limited in relation to the valuation of the Target Group.

## ACQUISITION AGREEMENT

### Date

25 January 2016

### Parties

***Vendors:***

(1) Ree Jia Limited, holding 17.5% of the entire issued share capital in the Target Company;

(2) Ree Jie Limited, holding 16.5% of the entire issued share capital in the Target Company;

(3) Ree Min Limited, holding 16.5% of the entire issued share capital in the Target Company;

(4) Ree Lin Limited, holding 16.5% of the entire issued share capital in the Target Company;

(5) Ree Zhi Limited, holding 16.5% of the entire issued share capital in the Target Company; and

(6) Ree Fen Limited, holding 16.5% of the entire issued share capital in the Target Company

***Warrantors:***

(1) Zhang Jian, the legal and beneficial owner of Ree Jia Limited;

(2) Ai Jianjie, the legal and beneficial owner of Ree Jie Limited;

(3) Liu Qiuming, the legal and beneficial owner of Ree Min Limited;

(4) Jiang Lingfan, the legal and beneficial owner of Ree Lin Limited;

(5) Xiang Zhiyong, the legal and beneficial owner of Ree Zhi Limited; and

(6) Yu Dafeng, the legal and beneficial owner of Ree Fen Limited

***Purchaser:*** The Company

To the best of the Directors' knowledge, information and belief having made all reasonable enquiries, each of the Vendors and the Warrantors (being the legal and ultimate beneficial owners of the Vendors) are Independent Third Parties.

**Interests to be acquired**

The Company has agreed to acquire from the Vendors the Sale Shares, representing the entire issued share capital of the Target Company as at Completion, free from all encumbrances and together with all rights attaching and accruing thereto from the date of the Acquisition Agreement.

**Consideration**

The Consideration for the Sale Shares is RMB750,000,000 (equivalent to approximately HK$900,000,000). As at the date of this circular, an aggregate amount of RMB237,500,000 (equivalent to approximately HK$285,000,000) has been paid by the Company, which shall be applied as partial settlement of the Consideration. The balance of the Consideration shall be satisfied by the Company in the following manner:

(a) RMB362,500,000 (equivalent to approximately HK$435,000,000) cash shall be paid by the Company to the Vendors within 20 business days after the Completion Date subject to the fulfillment of all the conditions precedent;

(b) RMB41,208,800 (equivalent to approximately HK$49,450,560) cash shall be paid by the Company to the Vendors (or the nominee(s) of the Vendors) if the Audited Consolidated Net Profit of the Target Company for the financial year of 2016 is not less than RMB60,000,000 (equivalent to approximately HK$72,000,000). The Company shall pay within 10 business days from the date the relevant audit was completed by the Auditor, which shall take place within 2 months from the financial year end of 2016;

(c) RMB49,450,500 (equivalent to approximately HK$59,340,600) cash shall be paid by the Company to the Vendors (or the nominee(s) of the Vendors) if the Audited Consolidated Net Profit of the Target Company for the financial year of 2017 is not less than RMB72,000,000 (equivalent to approximately HK$86,400,000). The Company shall pay within 10 business days from the date the relevant audit was completed by the Auditor, which shall take place within 2 months from the financial year end of 2017;

(d) RMB59,340,700 (equivalent to approximately HK$71,208,840) cash shall be paid by the Company to the Vendors (or the nominee(s) of the Vendors) if the Audited Consolidated Net Profit of the Target Company for the financial year of 2018 is not less than

RMB86,400,000 (equivalent to approximately HK$103,680,000). The Company shall pay within 10 business days from the date the relevant audit was completed by the Auditor, which shall take place within 2 months from the financial year end of 2018.

In the event that the Audited Consolidated Net Profit of the Target Company in respect of any financial year of 2016, 2017 or 2018 is less than the RMB60,000,000, RMB72,000,000 and RMB86,400,000 respectively (equivalent to approximately HK$72,000,000, HK$86,400,000 and HK$103,680,000 respectively), the amount payable under items (b), (c) and (d) above shall be reduced accordingly by the amount of shortfall (the "**Profit Shortfall**"). If the relevant amount payable under items (b), (c) and (d) above is not sufficient to offset the amount of Profit Shortfall, the Vendors and the Warrantors shall compensate the amount of difference after the aforesaid offset on a dollar-to-dollar basis subject to a cap of

(i) RMB18,791,200 *(being the difference between the Audited Consolidated Net Profit of RMB60,000,000 and the relevant amount payable under item (b))* for the financial year of 2016;

(ii) RMB22,549,500 *(being the difference between the Audited Consolidated Net Profit of RMB72,000,000 and the relevant amount payable under item (c))* for the financial year of 2017; and

(iii) RMB27,059,300 *(being the difference between the Audited Consolidated Net Profit of RMB86,400,000 and the relevant amount payable under item (d))* for the financial year of 2018.

In the event that the Target Company incurs net loss in each of the financial year of 2016, 2017 and 2018, the compensation from the Vendors and Warrantors shall be subject to the same cap as mentioned above.

The Consideration was arrived at after arm's length negotiations between the Vendors and the Company on normal commercial terms with reference to (a) the audited consolidated net profits after taxation of the Target Group for the year ended 31 December 2015 of approximately RMB42.5 million as extracted from the accountant's report of the Target Group for the year ended 31 December 2015; (b) fair value of the Sale Shares in the amount of approximately RMB756 million as at 31 December 2015 as set out in Appendix V to this circular, as appraised by BMI Appraisals Limited, an independent valuer engaged by the Company, using the income approach with discounted cash flow method (which constitutes a profit forecast under Rule 14.61 of the Listing Rules ("**Profit Forecast**"); (c) historical and current financial position and the profitability of the Target Group; and (d) the profit guarantee of the Vendors as set out in the Acquisition Agreement.

Based on the aforesaid, the Directors consider that the terms and conditions of the Acquisition, including the Consideration, are fair and reasonable and are in the interests of the Company and the Shareholders as a whole.

The Consideration will be financed by the Company primarily through the new bank borrowings and internal cash resources for the remaining balance and if required, debt and equity fund raising and/or other means.

**Conditions precedent**

Completion is conditional upon the fulfillment of, *inter alia*, the following conditions:

(a) the Company having obtained the approval from the Stock Exchange in respect of the announcement on the Acquisition;

(b) the Acquisition Agreement and the transactions contemplated thereunder having been approved by the Shareholders in accordance with the Listing Rules and all applicable laws and regulations;

(c) the Target Company having repaid all shareholders' loans (if any);

(d) the audited consolidated net profit of the Target Company shall not be less than RMB39,000,000 (equivalent to approximately HK$46,800,000) and the consolidated revenue of the Target Company shall not be less than RMB220,000,000 (equivalent to approximately HK$264,000,000) as at the date of the Completion Accounts;

(e) the Completion Accounts showing that as of the date of the Completion Accounts, the working capital available to the Target Group shall be sufficient for the Target Group's ordinary business for at least 12 months from the date of the Completion Accounts and the total liabilities shall not exceed RMB30,000,000 (equivalent to approximately HK$36,000,000);

(f) the shareholders, the connected persons and other relevant persons of the Target Group (the "**IP Rights Holders**") holding the intellectual property rights in use by the Target Group, which consist of mainly electronic cigarettes related patents, technologies and registered design in key jurisdiction such as the European Union and the United States (the "**IP Rights**") having entered into assignment or licensing agreements or other agreements (the form and content of which to the satisfaction of the Company at its absolute discretion) to assign the ownership of the IP Rights to the Target Group at nil consideration and if the same is not permissible by law, the IP Rights Holders shall have entered into agreements or arrangements to allow the use of the IP Rights by the Target Group at nil consideration for an indefinite period of time;

(g) the Vendors having provided a legal opinion issued by the lawyers approved of by the Company as of the Completion Date (the form and content of which to the satisfaction of the Company at its absolute discretion) in respect of the Target Group's current business activities and the Vendors having provided to the Company the relevant resolutions, consents, approvals, authorizations and permits in relation to the Acquisition Agreement and the transactions contemplated thereunder; and

(h) the warranties, guarantees and undertakings given by the Vendors are true and accurate as at the Completion Date and the Vendors have performed or complied with such warranties, guarantees and undertakings on or before the Completion Date.

Save and except conditions (a) and (b), all conditions stated above can be waived by the Company. As at the Latest Practicable Date, conditions (a) and (b) have been fulfilled. If the other conditions precedent are not fulfilled or waived on or before 31 December 2016 (or such other date as the parties agree in writing), the Acquisition Agreement shall be of no effect, subject to the liability of any party to the other in respect of the antecedent breaches of the terms pursuant to the Acquisition Agreement. In that case, the Vendors shall refund any sums received from the Company. As at the Latest Practicable Date, the Company has no intention to waive any of the conditions.

**Completion**

Completion of the Acquisition Agreement shall take place on the 3rd Business Day after all conditions precedent are fulfilled or waived by the Company (or such other date as agreed between the Company and the Vendors).

**Profit Guarantee of the Vendors**

The Vendors jointly and severally warrant that in respect of each of the financial period from 2016 to 2018 of the Target Company:

(a) the Audited Consolidated Net Profit for the financial year of 2016 of the Target Company shall not be less than RMB60,000,000 (equivalent to approximately HK$72,000,000);

(b) the Audited Consolidated Net Profit for the financial year of 2017 of the Target Company shall not be less than RMB72,000,000 (equivalent to approximately HK$86,400,000); and

(c) the Audited Consolidated Net Profit for the financial year of 2018 of the Target Company shall not be less than RMB86,400,000 (equivalent to approximately HK$103,680,000).

If the Audited Consolidated Net Profit is not achieved in a relevant financial year, the Consideration shall be adjusted downwards by deducting the shortfall and without prejudice to any other rights and remedies of the Company, the Company may sue for relevant amount resulting from the breach of the profit guarantee of the Vendors.

The Warrantors guarantee the performance of the above warranties by the Vendors.

## INFORMATION OF THE VENDORS AND THE WARRANTORS

To the best of the Directors' knowledge, information and belief, the Vendors are investment holding companies and their respective sole investment is the shareholding interests in the Target Company. The respective Warrantors beneficially own the Vendors. The Warrantors are the founders and directors of the Target Company and have been engaged in the electronic cigarette business for over ten years.

To the best of the Directors' knowledge, information and belief, the roles of each of the Warrantors in the Target Company and their principal business activities are as follows:

(1) Mr. Zhang Jian is a passive investor of the Target Company. Although Mr. Zhang Jian is a director of the Target Company, he is not involved in daily management of the Target Company. Prior to founding the Target Company, Mr. Zhang Jian was engaged in manufacturing business of home audio and vehicle audio products.

(2) Mr. Ai Jianjie is a director of the Target Company who is responsible for the financial management of the Target Company. Prior to founding the Target Company, Mr. Ai Jianjie held various managerial positions at different subsidiaries of a respectable electronics corporation.

(3) Mr. Liu Qiuming is the executive chairman of board of directors of the Target Company. Further information about his personal particulars is set out under the section "INFORMATION OF THE ENLARGED GROUP".

(4) Mr. Jiang Lingfan is a director of the Target Company who is responsible for the management of the purchasing arm of the Target Group. Prior to founding the Target Company, Mr. Jiang Lingfan served as the deputy general manager at an electronics corporation.

(5) Mr. Xiang Zhiyong is a director of the Target Company who is responsible for the management of the production arm of the Target Group. Further information about his personal particulars is set out under the section "INFORMATION OF THE ENLARGED GROUP".

(6) Ms. Yu Dafeng is a passive investor of the Target Company. Although Ms. Yu Dafeng is a director of the Target Company, she is not involved in daily management of the Target Company. Prior to founding the Target Company, Ms. Yu Dafeng served as the sales manager of an industrial corporation.

Mr. Wang has known Mr. Liu Qiuming for about three years. Mr. Liu Qiuming has had over ten years of experience in the electronic cigarette business and has established contacts with the customers and suppliers of electronic cigarette and also suppliers of the raw materials thereof. In or around 2013, Mr. Liu Qiuming contacted Mr. Wang to explore business dealings with the Group and since then the Company has become a supplier of flavours for the electronic cigarettes manufactured by the Target Group.

In or about 2015, the Company started to explore with the Vendors and the Warrantors the possibility to acquire the Target Company and the future development of the Target Group. Thereafter, the Company entered into a memorandum of understanding in relation to the Acquisition with the Vendors on 11 November 2015.

## REASONS FOR AND BENEFITS OF THE ACQUISITION

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

### Business model of the Target Group

The Target Group is a technology-driven company with an extensive global patent portfolio relating to core electronic cigarette technologies. The Target Group leverages strong research and development capabilities to design and develop innovative electronic cigarette products that cater to varying customer demands.

The Target Group manufactures its electronic cigarette products in Guangdong Province, the PRC and has received major international certifications for their products and production processes. The Target Group adopts its comprehensive quality assurance procedures to manufacture electronic cigarette products that adhere to the manufacturing requirements which are usually applied to food and drug manufacturers rather than the more relaxed requirements applied to electronic product manufacturers. The Target Group is also capable of customizing production lines based on customer requirements for design, quality and quantity.

The Target Group currently operates its business under both the original design manufacturing and original brand manufacturing business models. The products manufactured are mainly exported to overseas customers located in the United States and the European Union. The Target Company also promotes its brand and products through e-commerce, including through its own website and other established online stores in China.

### Regulatory requirements for the electronic cigarette industry

The Target Group manufactures its electronic cigarette products in the PRC. The electronic cigarette products manufacturing business in the PRC is not listed in the Guidance Catalogue of Industries for Foreign Investment (the "**Catalogue**"), which was promulgated and is amended from time to time by the Ministry of Commerce and the National Development and Reform Commission and falls under the category of permitted industries, and therefore falls under the category of permitted industries.

Currently, electronic cigarette manufacturers are also not required to obtain any industry specific permits or approvals from regulatory authorities in the PRC but is generally subject to the laws and regulations relating to product quality and consumer protection, import or export of products, production safety, labour laws, environmental protection, intellectual property rights and foreign currency exchange in the PRC.

The Target Group sells a majority of its products to customers located in the United States and the European Union and therefore has to comply with the laws and regulations in the relevant jurisdictions. In recent years, certain state, local and municipal governments, agencies and private businesses in the United States have adopted legislation, regulations or policies which prohibit or restrict the sales and marketing of cigarettes, and smoking in public buildings and facilities, stores, restaurants, bars, on airline flights and in workplaces. Smoking in virtually all enclosed public places and workplaces is now prohibited by law throughout the United Kingdom. Several local governments have considered and, in some cases imposed, similar restrictions on the use of electronic cigarettes.

The United States Food and Drug Administration ("**FDA**") has proposed extending its authority to cover regulation on electronic cigarettes under the proposed rule: Tobacco Products Deemed to be Subject to Food, Drug & Cosmetic Act (Deeming). Once the proposed rule becomes final, FDA will be able to use powerful regulatory tools, such as age restrictions and rigorous scientific review of new tobacco products and claims to reduce tobacco related disease and death.

In the European Union, the revised Tobacco Products Directive which has entered into force in May 2014 regulates the content, manufacture, marketing and labelling of tobacco products and electronic cigarette products. Furthermore, the European Union member states may regulate electronic cigarette as medicinal products at a national level at any time.

The Target Group confirmed that as at the Latest Practicable Date, the Target Group has complied with the relevant laws, rules and regulations in the PRC, the United States and the European Union in all material respects.

## RISK FACTORS

### Business risk of the Acquisition

***Increases in labour costs in the PRC may adversely affect business and profitability***

The economy of China has been experiencing increases in inflation and labour costs in recent years. The average compensation level for the employees has increased in recent years. In addition, the Target Group is required by PRC laws and regulations to pay various statutory employee benefits, including pensions, housing funds, medical insurance, work-related injury insurance, unemployment insurance and childbearing insurance to designated government agencies for the benefit of its employees. The labour costs, including wages and employee benefits, are expected to continue to increase. Unless the Target Group is able to pass on these increased labour costs to its customers by increasing prices of the products or improving the utilization of the manufacturing facilities, the profitability and results of operations may be materially adversely affected.

***The operations are subject to natural disasters, adverse weather conditions, operating hazards, environmental incidents and labour disputes***

The Target Group may experience earthquakes, floods, typhoons, power outages, labour disputes or similar events beyond its control that would affect its operations. The occurrences of such events could result in production curtailments, shutdowns or periods of reduced production, which could significantly disrupt its business operations, cause it to incur additional costs and affect its ability to deliver its products to its customers as scheduled, which may adversely affect its business, financial condition and results of operations. Moreover, such events could result in severe damage to property, personal injuries, fatalities, regulatory enforcement proceedings or in its being named as a defendant in lawsuits asserting claims for large amounts of damages, which in turn could lead to significant liabilities.

**Specific risk of the Acquisition**

***Intense competition and may not be able to compete successfully against existing and new competitors***

The electronic cigarette market is intensely competitive. Some of its current and potential competitors may have greater financial, marketing and other resources than the Target Group does. The Target Group may also face competitive pressure from new competitors, including Target Group's customers with in-house manufacturing capabilities.

***Rapidly evolving industry could render products uncompetitive or obsolete, and reduce sales and market share***

The electronic cigarette industry is rapidly evolving. The Target Group's future success and competitiveness depend largely on the ability to further improve the technology and develop and introduce new products to meet evolving customer demands and industry standards, which require significant financial resources in research and development. The research and development efforts may or may not be commercially or otherwise successful.

***Product defects could increase expenses, damage reputation or expose to liability***

Product defects in electronic cigarettes may harm the health or safety of the end-consumers. Any actual or perceived defects in its products could result in unsold inventory, product recalls, repairs or replacements, damage to its reputation, increased customer service costs and other expenses, as well as divert management attention and expose us to liabilities. Furthermore, a product liability claim brought against the Target Group by its customers or end-consumers could be time-consuming and costly to defend and, if successful, could require the Target Group to make significant payments.

***The increasingly stringent regulations on the sale and use of electronic cigarette could adversely affect sales volume, revenues and profitability***

As mentioned under the paragraph "Regulatory requirements for the electronic cigarette industry" above, it is expected that there will be increasing stringent regulations on the sale and use of electronic cigarette in the European Union and the United States. If any of these countries promulgates more stringent regulations, some of the customers of the Target Group may be unable to continue to sell their products there, causing them to reduce their orders with the Target Group or cease placing such orders completely, which in turn may materially adversely affect its business and operating results.

The Board believes that the Acquisition represents a valuable business opportunity for both the Company and the Target Company in the following ways:

1. The Target Group is currently an original design manufacturer of electronic cigarette. With our capabilities and support on the research and development of e-liquid (which is the flavor supplied by the Group to the Target Group for manufacturing electronic cigarettes), the Target Group will become an integrated manufacturer of electronic cigarette. The Board believes such development of the Target Group will enhance its market share and leadership in the electronic cigarette market which will as a result be beneficial to the Group as the Target Group will become a wholly owned subsidiary of the Group after completion of the Acquisition.

2. The sales of the Target Group is mainly in overseas. The Group has established sales network in the PRC to state-owned enterprises. After the Acquisition, the electronic cigarettes can be distributed in the Group's existing established network in the PRC which can enhance the sales of the electronic cigarettes of the Target Group. As people are becoming more health conscious, consumption of electronic cigarettes will increase as an alternative or substitute for tobacco cigarettes. As such, the Board believes that the Group's revenue base will be broadened with the sale of electronic cigarettes and the Group's product portfolio will be diversified.

3. An electronic cigarette composes of a device which transforms e-liquid into inhalable form. Such device is also used with pharmaceutical and health supplement products for children and elderly which transforms such health supplement products from liquid form to inhalable form for more convenient intake and less irritation. The Board believes that with the source of such device and the knowledge and expertise in such technology of applying the same, the Group may have synergy with and tap into the health care industry by cooperating with health chain store as a solution provider in respect thereof. The development of health care related business will be a new segment to the Group and the Board is optimistic towards the prospects of the health care industry in the PRC with the increase of living standard and health awareness of the people in the PRC.

The Board considers that the Acquisition Agreement was entered into after arm's length negotiation between the Company and the Vendors on normal commercial terms and the Acquisition is fair and reasonable and in the interests of the Company and the Shareholders as a whole.

## FINANCIAL EFFECTS OF THE ACQUISITION ON THE GROUP

Following the Completion, members of the Target Group will become wholly owned subsidiaries of the Company.

### Assets and liabilities

The audited consolidated total assets and total liabilities of the Group as at 31 December 2015, as extracted from the annual report for the year ended 31 December 2015 of the Company, were approximately RMB1,798.2 million and RMB369.2 million respectively. As set out in Appendix III to this circular, assuming Completion had taken place on 31 December 2015, the pro forma total assets and total liabilities of the Enlarged Group would have been increased to approximately RMB2,679.4 million and RMB1,255.3 million respectively.

### Earnings

The audited net profit of the Group for the financial year ended 31 December 2015 as extracted from the annual report for the year ended 31 December 2015 of the Company was approximately RMB89.0 million.

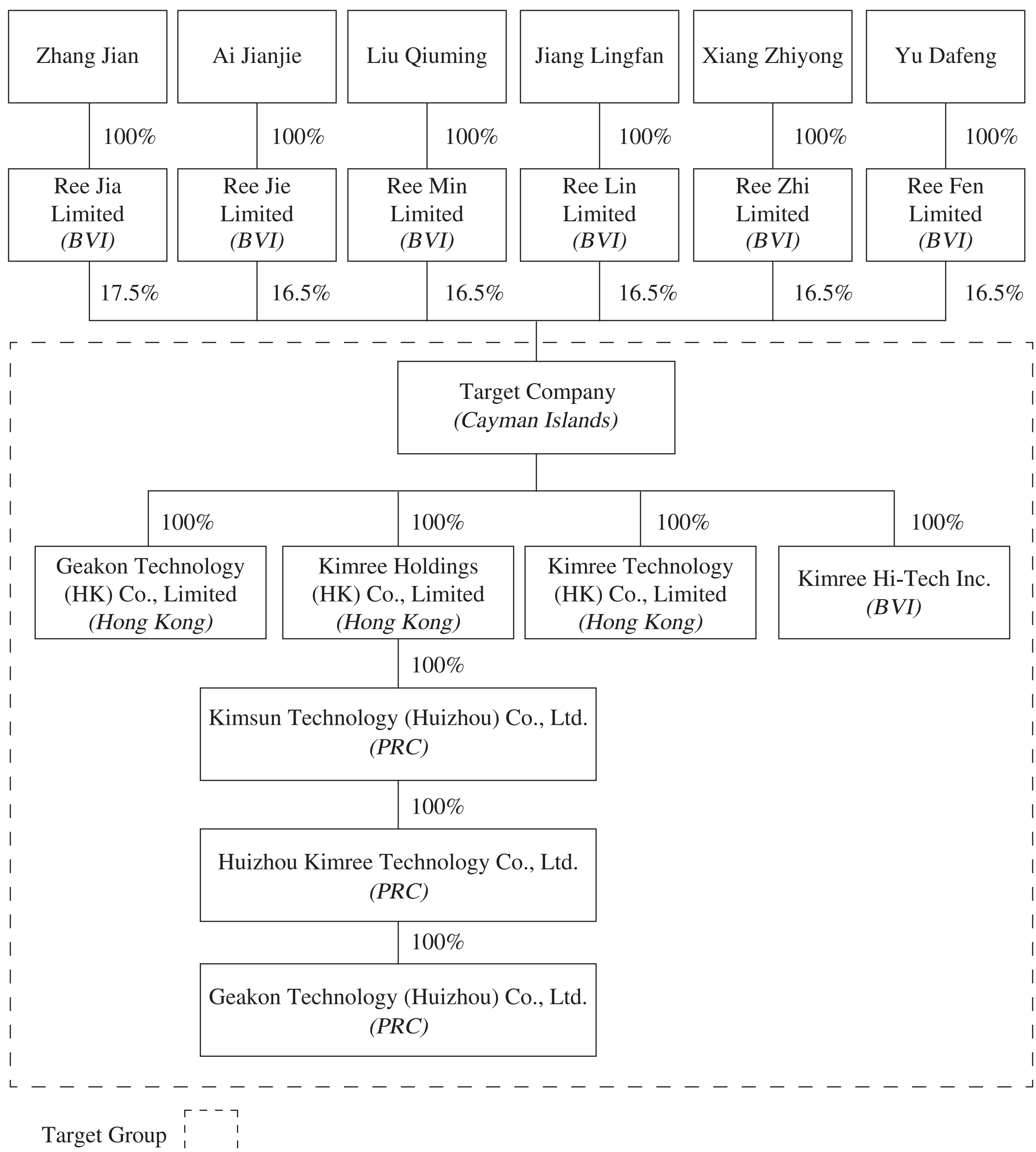
As set out in Appendix II to this circular, the Target Group recorded an audited net profit of approximately RMB42.5 million for the financial year ended 31 December 2015.

Following the Completion, members of the Target Group will become subsidiaries of the Company and the financial results, including but not limited to the revenue, costs and profit attributable to owner of the Target Company will be consolidated into the consolidated financial statements of the Group after Completion. With reference to the historical financial performance of the Target Group, the Directors are of the view that the Acquisition would have a positive impact on the future earnings of the Enlarged Group.

## INFORMATION ON THE TARGET GROUP

### Shareholding structure of the Target Group

The shareholding structure of the Target Group as at the date of this circular and before Completion is shown below:



The Target Company was incorporated in the Cayman Islands on 7 May 2014. The Target Group is a world-leading electronic cigarette company group which has been established for over ten years and is principally engaged in the research and development, manufacture and sale of electronic cigarettes and related accessories in the PRC, Europe and the United States. The Target Group has a strong customer base in over twenty countries which includes a majority of the five largest global tobacco companies as well as top independent electronic cigarette brands. The Group is a supplier of flavors to the Target Group for use in its production of electronic cigarettes.

**Financial information of the Target Group**

Set out below is the audited financial information of the Target Group:

| | For the year ended 31 December | | |
|---|---|---|---|
| | **2013** | **2014** | **2015** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Revenue | 492,205 | 659,975 | 236,198 |
| Net Profits (before taxation and extraordinary items) | 129,369 | 172,889 | 53,951 |
| Net Profits (after taxation and extraordinary items) | 96,890 | 140,654 | 42,532 |

| | As at 31 December | | |
|---|---|---|---|
| | **2013** | **2014** | **2015** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Total assets | 261,544 | 314,893 | 285,452 |
| Total liabilities | 183,189 | 181,969 | 129,491 |
| Net assets | 78,335 | 132,924 | 155,961 |

The Directors confirm that the financial information of the Target Group as contained in the accountant's report in Appendix II is prepared by using accounting policies which are materially consistent with those of the Group.

## INFORMATION OF THE ENLARGED GROUP

**Trading and financial prospects of the Enlarged Group**

As mentioned under the paragraph headed "Reasons and Benefits for the Acquisition" in this circular, the Directors believe that the Acquisition will allow the Group to distribute electronic cigarettes of the Target Group in the Group's established network in the PRC and that the Group's revenue base will be broadened with the sales of electronic cigarettes.

The Target Group is generating positive cash flow from operating activities and has been profitable. As stated in Appendix I "Financial Information of the Group" in this circular, the Directors confirms that the Enlarged Group has sufficient working capital for the Enlarged Group's requirements for at least the next twelve months from the date of this circular, taking into account available banking facilities, other financial resources available and cash flows from its operations and completion of the Acquisition.

Upon Completion, the key management of the Target Company will be as follows:

Mr. Liu Qiuming, aged 40, is the founder and executive chairman of board of directors of the Target Company. Upon Completion, Mr. Liu Qiuming will continue to be the executive chairman of board of directors of the Target Company and be responsible for overseeing the research and development, operations and overall strategy of the Target Group. Prior to founding the Target Group, Mr. Liu Qiuming served as a technical engineer, and held several managerial positions in research and development, purchase, quality control, production material control and resource development at Guangdong BBK Industrial Electronics Co., Ltd. from 2000 to 2009. He was an engineer at Jiangnan Mold & Plastic Group from 1999 to 2000. Mr. Liu Qiuming received a bachelor's degree in molding technique and equipment from Huabei College of Technology, China (currently known as North University of China) in 1999.

Mr. Xiang Zhiyong, aged 40, is the founder and a director of the Target Company. Upon Completion, Mr. Xiang Zhiyong will continue to be a director of the Target Company who is responsible for the management of the production arm of the Target Group. Prior to founding the Target Company, Mr. Xiang served as the general manager of Wye Industrial Co., Ltd. from 2007 to 2009, a software engineer at Shenzhen Zhaochi Co., Ltd. from 2006 to 2007, a software engineer at Shenzhen Youyuan Keda Microelectronics Co., Ltd. from 2002 to 2004 and research and development engineer at Guangdong BBK Industrial Electronics Co., Ltd. from 2000 to 2001. Mr. Xiang received a bachelor's degree in applied electrical technology from Huabei College of Technology, China in 2000.

Mr. Niu Jianhua, aged 36, is the vice supervisor of the research and development department of the Target Company. Mr. Niu Jianhua obtained a bachelor degree of industrial design at Hubei University of Technology (湖北工業大學). Mr. Niu Jianhua has joined the Target Group since 2012. Prior to joining the Target Group, he has worked as an industrial designer at Guangdong Bubu Gao Electronics Corporation* (廣東步步高電子有限公司) and the manager at research and development department at Shenzhen Gang Litong Technology Limited* (深圳港利通科技有限公司).

Mr. Li Xiaoping, aged 40, is the chief financial officer of the Target Company. Mr. Li Xiaoping has been appointed the chief financial officer of the Target Company since 2012. Mr. Li Xiaoping was graduated from Wuhan University of Technology (武漢理工大學) majoring in professional accountancy. Mr. Li Xiaoping has worked as financial manager at various firms before joining the Target Group.

Mr. Pang Yi, aged 41, is the financial manager of the Target Company. Mr. Pang Yi obtained a bachelor degree in professional accountancy from Shanxi University of Finance and Economics (山西財經大學). Mr. Pang Yi has taken up accounting or financial managerial roles at various firms prior to joining the Target Group.

The Directors consider that as the founders of the Target Group and the key management in operation, research and development and accounting and finance, will remain unchanged upon Completion, the Group will have sufficient management expertise and qualified personnel at operational level to operate the business of the Target Group, and the Group will also be benefited from the cost and operation efficiency and other synergy effect arising from the sharing of the management expertise and financial resources between the Group and the Target Group.

In light of the above, the Directors are of the view that the Acquisition will enhance the performance of the Enlarged Group and the return to the Shareholders as a whole.

## LISTING RULES IMPLICATIONS

Since the applicable percentage ratios under Rule 14.07 of the Listing Rules exceed 25% but are less than 100%, Acquisition constitutes a major transaction of the Company and is subject to the reporting, announcement and Shareholders' approval requirements under the Listing Rules.

To the best of the knowledge, information and belief of the Directors, after having made all reasonable enquiries, no Shareholders or any of their respective associates have any material interest in the Acquisition. As such, no Shareholders would be required to abstain from voting in favour of the resolution approving the Acquisition.

Written approval of the Acquisition has been obtained from the Relevant Shareholders who form a closely allied group of Shareholders and together hold more than 50% of the issued Shares giving the right to attend and vote at a general meeting:

| Name | Number of Shares held | Approximate percentage of shareholding *(Note 1)* |
|---|---|---|
| Mr. Wang | 67,846,938 | 10.14% |
| Creative China Limited *(Note 2)* | 330,562,056 | 49.38% |
| Full Ashley Enterprises Limited *(Note 2)* | 18,333,333 | 2.74% |
| Total | 416,742,327 | 62.26% |

*Notes:*

1. The percentage was calculated based on 669,402,897 issued Shares as at the Latest Practicable Date.

2. Creative China Limited is beneficially owned as to 41.19% by Mr. Wang, 28.11% by Mr. Wong Ming Bun (a former director of the Company), 19.87% by Mr. Wang Ming You (a former director of the Company), 6.89% by Mr. Qian Wu and 3.94% by Mr. Li Qing Long. To the best of the Company's knowledge, information and belief, Mr. Wang has control of Creative China Limited as Mr. Wang owns more than 30% shareholding interest in Creative China Limited.

3. Full Ashley Enterprises Limited is 100% beneficially owned by Mr. Wang.

Accordingly, no Shareholders' meeting will be held to approve the Acquisitions pursuant to Rule 14.44 of the Listing Rules.

## ADDITIONAL INFORMATION

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

As Completion is subject to the fulfillment of conditions precedent which are detailed in this circular under the paragraph headed "Conditions Precedent", the Acquisition may or may not be completed. Shareholders and potential investors of the Company should exercise caution when dealing in the Shares or any other securities of the Company.

By Order of the Board
**China Flavors and Fragrances Company Limited**
**Wang Ming Fan**
*Chairman*

## 1. FINANCIAL INFORMATION OF THE GROUP

The financial information of the Group (i) for the year ended 31 December 2015 is disclosed in the 2015 annual report of the Company published on 5 April 2016 from pages 43 to 107; (ii) for the year ended 31 December 2014 is disclosed in the 2014 annual report of the Company published on 1 April 2015 from pages 40 to 97 and (iii) for the year ended 31 December 2013 is disclosed in the 2013 annual report of the Company published on 2 April 2014 from pages 37 to 99, all of which have been published on the website of The Hong Kong Exchanges and Clearing Limited (www.hkexnews.hk) and the website of the Company (www.chinaffl.com).

## 2. STATEMENT OF INDEBTEDNESS

At close of business on 29 February 2016, being the latest practicable date for the purpose of this statement of indebtedness prior to the publication of this circular, the Enlarged Group had outstanding bank borrowings as follows:

| | **As at 29 February 2016** |
|---|---|
| | *RMB'000* |
| **Unsecured:** | |
| Short-term bank loans | 148,500 |
| **Unsecured:** | |
| Long-term bank loans | 35,496 |
| **Total borrowing** | 183,996 |

At close of business day on 29 February 2016, the Enlarged Group has guaranteed Shenzhen Gas Corporation Limited with amount of RMB442,000 for the pipeline installation project.

Save and except for the above and apart from intra-group liabilities, as at the close of business on 29 February 2016, the Enlarged Group did not have any debt securities issued and outstanding, or authorized or otherwise created but unissued, or term loans, or other borrowings or indebtedness in the name of borrowing including bank overdrafts and liabilities under acceptances (other than normal trade bills) or acceptance credits or hire purchase commitments, or mortgages and charges, and there were no other contingent liabilities nor guarantees.

## 3. WORKING CAPITAL STATEMENT

Taking into account of the cash flow impact upon the completion of the Acquisition and the financial resources available to the Enlarged Group, including the internally generated funds and the available banking facilities, the Directors are of the opinion that the Enlarged Group has sufficient working capital for its present requirements, that is for at least the next twelve months from the date of this circular.

## 4. FINANCIAL AND TRADING PROSPECT OF THE GROUP

As mentioned under the paragraph headed "Reasons for and benefits of the Acquisition" in the Letter from the Board in this circular, the Company targets to expand its market share and sales in the electronic cigarette market and to become a one-stop supplier of electronic cigarettes from upstream research and development as original designer and manufacturer of electronic cigarette to downstream provision of the Group's established sales network in the PRC to state-owned enterprises for the sale of electronic cigarettes. By further promoting electronic cigarette products, a replacement to mimic traditional cigarette, the Company strives to expand both the demand in electronic cigarette market and the corresponding market shares of the Enlarged Group.

Besides focusing on the growth prospects of the electronic cigarette market in the PRC, the Company intends to tap into the health care related business by applying the knowledge and experience in the technology of electronic cigarette of transforming e-liquid into inhalable form through devices for research and development of the technology of transforming pharmaceutical and health supplement products which are in liquid form to inhalable form for more convenient intake and less irritation for children, elderly or people with special needs. This shall offer new business opportunity for the Company to be a solution provider for pharmaceutical companies and health chain stores for application of such technology on those pharmaceutical and health supplement products. The Group will be aiming initially the market of medical nebulizer, in particular, for bronchitis. The Group will first conduct feasibility studies before entering into the corresponding health care related business. Further formulation and implementation of the business plan, including but not limited to identifying collaboration partner, development of innovative products and establishment of sales and distribution channel are subjected to the results of the relevant studies. As at the Latest Practicable Date, the Company does not have a concluded and concrete schedule on such business development. The Company is of the view that the success in engaging into the health care related business shall initiate a new business segment for the Company and broaden the Company's business horizon and product portfolio.

Going forward, the Company will continue to pursue leading-edge initiatives in other areas of consumer products of flavors and fragrances, either through organic growth or by merger and acquisition, for the long-term sustainable growth of the Group and the maximization of shareholder's value.

## 5. MATERIAL ADVERSE CHANGE

As at the Latest Practicable Date, the Directors were not aware of any material adverse change in the financial or trading position of the Group since 31 December 2015, being the date of which the latest published audited consolidated financial statements of the Group were made up.

*The following is the text of a report received from the Company's reporting accountant, PricewaterhouseCoopers, Certified Public Accountants, Hong Kong, for the purpose of incorporation in this circular.*

pwc 羅兵咸永道

18 April 2016

The Directors
China Flavors and Fragrances Company Limited

Dear Sirs,

We report on the financial information of Kimree, Inc. (the "Target") and its subsidiaries (together, the "Target Group"), which comprises the consolidated balance sheets of the Target as at 31 December 2013, 2014 and 2015, the balance sheets of the Target as at 31 December 2014 and 2015, and the consolidated income statements, the consolidated statements of comprehensive income, the consolidated statements of changes in equity and the consolidated statements of cash flows of the Target for each of the years ended 31 December 2013, 2014 and 2015 (the "Relevant Periods") and a summary of significant accounting policies and other explanatory information. This financial information has been prepared by the directors of China Flavors and Fragrances Company Limited (the "Company") and is set out in Sections I to III below for inclusion in Appendix II to the circular of the Company dated 18 April 2016 (the "Circular") in connection with the proposed acquisition of the Target by the Company.

The Target was incorporated in the Cayman Islands on 7 May 2014 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. Pursuant to a group reorganisation as described in Note 1.2 of Section II headed "Reorganisation and changes in group structure" below, which was completed on 22 August 2014, the Target become the holding company of the subsidiaries now comprising the Target Group (the "Reorganisation").

As at the date of this report, the Target has direct and indirect interests in the subsidiaries as set out in Note 1.2 of Section II below.

No statutory audited financial statements have been prepared by the Target as it has not involved in any significant business transactions since its date of incorporation. The statutory audited financial statements of the other companies now comprising the Target Group as at the date of this report for which there are statutory audit requirements have been prepared in accordance with the relevant accounting principles generally accepted in their place of incorporation. The details of the statutory auditors of these companies are set out in Note 1.2 of Section II.

*PricewaterhouseCoopers, 22/F Prince's Building, Central, Hong Kong*
*T: +852 2289 8888, F: +852 2810 9888,* www.pwchk.com

The directors of the Target are responsible for the preparation of the consolidated financial statements of the Target for the Relevant Periods that give a true and fair view in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA") (the "Underlying Financial Statements"), and for such internal control as the directors of the Target determine is necessary to enable the preparation of the Underlying Financial Statements that are free from material misstatement, whether due to fraud or error. We have audited the Underlying Financial Statements in accordance with Hong Kong Standards on Auditing issued by the HKICPA pursuant to separate terms of engagement.

The financial information has been prepared based on the Underlying Financial Statements, with no adjustment made thereon.

**Directors' Responsibility for the Financial Information**

The directors of the Company are responsible for the preparation of the financial information that gives a true and fair view in accordance with HKFRSs and accounting policies adopted by the Company and its subsidiaries (together, the "Group") as set out in the annual report of the Company for the year ended 31 December 2015.

**Reporting Accountant's Responsibility**

Our responsibility is to express an opinion on the financial information and to report our opinion to you. We carried out our procedures in accordance with Auditing Guideline 3.340 "Prospectuses and the Reporting Accountant" issued by the HKICPA.

**Opinion**

In our opinion, the financial information gives, for the purpose of this report, a true and fair view of the financial position of the Target as at 31 December 2014 and 2015 and of the financial position of the Target Group as at 31 December 2013, 2014 and 2015, and of the Target Group's financial performance and cash flows for the Relevant Periods.

## I FINANCIAL INFORMATION OF THE TARGET GROUP

The following is the financial information of the Target Group prepared by the directors of the Company as at 31 December 2013, 2014 and 2015 and for each of the years ended for 31 December 2013, 2014 and 2015 (the "Financial Information"):

### (A) Consolidated Income Statements

| | | Year ended 31 December | | |
|---|---|---|---|---|
| | | **2013** | **2014** | **2015** |
| | *Note* | *RMB'000* | *RMB'000* | *RMB'000* |
| Revenue | *5* | 492,205 | 659,975 | 236,198 |
| Cost of sales | *7* | (319,068) | (394,853) | (141,150) |
| **Gross profit** | | 173,137 | 265,122 | 95,048 |
| Other income | *6* | 23 | 668 | 1,914 |
| Other (losses)/gains — net | *6* | (1,898) | (1,228) | 5,510 |
| Selling and marketing expenses | *7* | (9,561) | (11,753) | (12,610) |
| Administrative expenses | *7* | (33,047) | (80,303) | (36,412) |
| **Operating profit** | | 128,654 | 172,506 | 53,450 |
| Finance income | *10* | 108 | 383 | 501 |
| Share of profit of associates accounted for using equity method | | 607 | — | — |
| **Profit before income tax** | | 129,369 | 172,889 | 53,951 |
| Income tax expense | *11* | (32,479) | (32,235) | (11,419) |
| **Profit for the year attributable to owners of the Company** | | 96,890 | 140,654 | 42,532 |
| **Earnings per share for profit attributable to owners of the Company during the year** — basic and diluted (RMB) | *12* | 0.97 | 1.41 | 0.43 |

## (B) Consolidated Statements of Comprehensive Income

| | | Year ended 31 December | | |
|---|---|---|---|---|
| | | **2013** | **2014** | **2015** |
| | *Note* | *RMB'000* | *RMB'000* | *RMB'000* |
| **Profit for the year** | | 96,890 | 140,654 | 42,532 |
| **Items that may be reclassified subsequently to profit and loss** | | | | |
| Currency translation differences | | (788) | 465 | 177 |
| **Total comprehensive income for the year attributable to owners of the Company** | | 96,102 | 141,119 | 42,709 |

## (C) Consolidated Balance Sheets

| | | As at 31 December | | |
|---|---|---|---|---|
| | | 2013 | 2014 | 2015 |
| | *Note* | *RMB'000* | *RMB'000* | *RMB'000* |
| **ASSETS** | | | | |
| **Non-current assets** | | | | |
| Property, plant and equipment | *13* | 62,479 | 95,475 | 78,289 |
| Intangible assets | *14* | 8,311 | 13,283 | 17,428 |
| Deferred income tax assets | *20* | 2,907 | 5,807 | 2,618 |
| Prepayments for property, plant and equipment | | 2,186 | 2,673 | 616 |
| | | 75,883 | 117,238 | 98,951 |
| **Current assets** | | | | |
| Inventories | *17* | 26,773 | 24,314 | 29,285 |
| Trade and other receivables | *16* | 22,538 | 44,350 | 35,891 |
| Amounts due from related parties | *29(c)* | 2,048 | — | 1,983 |
| Derivative financial instruments | *24* | 1,529 | — | — |
| Cash and cash equivalents | *18* | 128,372 | 127,077 | 119,342 |
| Restricted bank deposits | *19* | 4,401 | 1,914 | — |
| | | 185,661 | 197,655 | 186,501 |
| **Total assets** | | 261,544 | 314,893 | 285,452 |
| **Equity and liabilities** | | | | |
| **EQUITY** | | | | |
| **Capital and reserves attributable to owners of the Company** | | | | |
| Share capital | *25* | — | 6 | 6 |
| Capital reserves | *25* | 10,016 | — | — |
| Other reserves | *26* | 1,072 | 1,836 | 2,146 |
| Retained earnings | | 67,267 | 131,082 | 153,809 |
| **Total equity** | | 78,355 | 132,924 | 155,961 |

| | | As at 31 December | | |
|---|---|---|---|---|
| | | **2013** | **2014** | **2015** |
| | *Note* | *RMB'000* | *RMB'000* | *RMB'000* |
| **LIABILITIES** | | | | |
| **Current liabilities** | | | | |
| Advance from customers | | 82,693 | 27,138 | 7,698 |
| Trade and other payables | *22* | 67,091 | 87,115 | 61,815 |
| Amounts due to related parties | *29(d)* | 1,818 | 15,812 | 109 |
| Income tax liabilities | | 31,587 | 51,538 | 59,869 |
| Derivative financial instruments | *24* | — | 366 | — |
| | | 183,189 | 181,969 | 129,491 |
| **Total liabilities** | | 183,189 | 181,969 | 129,491 |
| **Total equity and liabilities** | | 261,544 | 314,893 | 285,452 |

## (D) Balance Sheets — Target

| | | As at 31 December | |
|---|---|---|---|
| | | 2014 | 2015 |
| | *Note* | *RMB'000* | *RMB'000* |
| **ASSETS** | | | |
| **Non-current assets** | | | |
| Investments in subsidiaries | *30(a)* | 86,033 | 86,033 |
| **Current assets** | | | |
| Cash and cash equivalents | | 6 | 6 |
| **Total assets** | | 86,039 | 86,039 |
| **EQUITY** | | | |
| **Capital and reserves attributable to owners of the Company** | | | |
| Share capital | *25* | 6 | 6 |
| Capital reserve | | 86,017 | 86,017 |
| Total equity | | 86,023 | 86,023 |
| **LIABILITIES** | | | |
| **Current liabilities** | | | |
| Amounts due to the Founder Shareholders | *30(b)* | 16 | 16 |
| **Total liabilities** | | 16 | 16 |
| **Total equity and liabilities** | | 86,039 | 86,039 |

## (E) Consolidated Statements of Changes in Equity

| | | | Other reserves | | | | |
|---|---|---|---|---|---|---|---|
| | **Share capital** | **Capital reserves** | **Statutory reserves** | **Exchange reserves** | **Total** | **Retained earnings** | **Total equity** |
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* |
| Balance at 1 January 2013 | — | 3,008 | 441 | (2) | 439 | 5,930 | 9,377 |
| **Comprehensive income** | | | | | | | |
| Profit for the year | — | — | — | — | — | 96,890 | 96,890 |
| **Other comprehensive income** | | | | | | | |
| Currency translation differences | — | — | — | (788) | (788) | — | (788) |
| **Total comprehensive income** | — | — | — | (788) | (788) | 96,890 | 96,102 |
| **Transaction with owners** | | | | | | | |
| Dividends | — | — | — | — | — | (34,132) | (34,132) |
| Deemed contribution *(Note 29 (b)(v)(i))* | — | 7,008 | — | — | — | — | 7,008 |
| Appropriation to statutory reserves | — | — | 1,421 | — | 1,421 | (1,421) | — |
| **Transaction with owners, recognised directly in equity** | — | 7,008 | 1,421 | — | 1,421 | (35,553) | (27,124) |
| **Balance at 31 December 2013** | — | 10,016 | 1,862 | (790) | 1,072 | 67,267 | 78,355 |
| Balance at 1 January 2014 | — | 10,016 | 1,862 | (790) | 1,072 | 67,267 | 78,355 |
| **Comprehensive income** | | | | | | | |
| Profit for the year | — | — | — | — | — | 140,654 | 140,654 |
| **Other comprehensive income** | | | | | | | |
| Currency translation differences | — | — | — | 465 | 465 | — | 465 |
| **Total comprehensive income** | — | — | — | 465 | 465 | 140,654 | 141,119 |
| **Transaction with owners** | | | | | | | |
| Share issuance *(Note 25)* | 6 | — | — | — | — | — | 6 |
| Dividends | — | — | — | — | — | (66,540) | (66,540) |
| Deemed distribution *(Note 29 (b)(v)(ii))* | — | (10,016) | — | — | — | (10,000) | (20,016) |
| Appropriation to statutory reserves | — | — | 299 | — | 299 | (299) | — |
| **Transaction with owners, recognised directly in equity** | 6 | (10,016) | 299 | — | 299 | (76,839) | (86,550) |
| **Balance at 31 December 2014** | 6 | — | 2,161 | (325) | 1,836 | 131,082 | 132,924 |

| | | | Other reserves | | | | |
|---|---|---|---|---|---|---|---|
| | Share capital | Capital reserves | Statutory reserves | Exchange reserves | Total | Retained earnings | Total equity |
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* |
| Balance at 1 January 2015 | 6 | — | 2,161 | (325) | 1,836 | 131,082 | 132,924 |
| **Comprehensive income** | | | | | | | |
| Profit for the year | — | — | — | — | — | 42,532 | 42,532 |
| **Other comprehensive income** | | | | | | | |
| Currency translation differences | — | — | — | 177 | 177 | — | 177 |
| **Total comprehensive income** | — | — | — | 177 | 177 | 42,532 | 42,709 |
| **Transaction with owners** | | | | | | | |
| Dividends | — | — | — | — | — | (19,672) | (19,672) |
| Appropriation to statutory reserves | — | — | 133 | — | 133 | (133) | — |
| **Transaction with owners, recognised directly in equity** | — | — | 133 | — | 133 | (19,805) | (19,672) |
| **Balance at 31 December 2015** | 6 | — | 2,294 | (148) | 2,146 | 153,809 | 155,961 |

## (F) Consolidated Statements of Cash Flows

| | Note | Year ended 31 December 2013 RMB'000 | 2014 RMB'000 | 2015 RMB'000 |
|---|---|---|---|---|
| **Cash flows from operating activities** | | | | |
| Cash generated from operations | *21(a)* | 227,732 | 123,318 | 34,340 |
| Income tax paid | | (5,559) | (15,184) | (1,644) |
| Net cash generated from operating activities | | 222,173 | 108,134 | 32,696 |
| **Cash flows from investing activities** | | | | |
| Purchase of property, plant and equipment | | (61,910) | (51,496) | (7,429) |
| Purchase of intangible assets | | (6,880) | (5,467) | (5,752) |
| Payment for investment in associates | | (1,473) | — | — |
| Proceeds from disposal of investment in associates | *29(b)(iii)* | 7,473 | — | — |
| Proceeds from disposals of property, plant and equipment | *21(b)* | 28 | 2,183 | 552 |
| Repayments from related companies | | 8,926 | 17,877 | — |
| (Increase)/decrease in restricted bank deposits | | (4,401) | 2,487 | 1,914 |
| Net cash used in investing activities | | (58,237) | (34,416) | (10,715) |
| **Cash flows from financing activities** | | | | |
| Proceeds from issuance of shares | | — | 6 | — |
| Dividends paid to the Founder Shareholders | *23* | (34,132) | (55,445) | (19,672) |
| Deemed contribution from the Founder Shareholders | *29(b)(v)* | 7,008 | — | — |
| Deemed distribution to the Founder Shareholders | | — | (20,000) | — |
| Repayments to related companies | | (24,852) | — | (17,308) |
| Net cash used in financing activities | | (51,976) | (75,439) | (36,980) |
| **Net increase/(decrease) in cash and cash equivalents** | | 111,960 | (1,721) | (14,999) |
| Cash and cash equivalents at beginning of the year | | 16,717 | 128,372 | 127,077 |
| Exchange (losses)/gains on cash and cash equivalents | | (305) | 426 | 7,264 |
| **Cash and cash equivalents at end of the year** | | 128,372 | 127,077 | 119,342 |

## II NOTES TO THE FINANCIAL INFORMATION OF THE TARGET GROUP

### 1. GENERAL INFORMATION AND GROUP REORGANISATION

#### 1.1 General information

Kimree, Inc. (the "Target") was incorporated as an exempted company with limited liability in the Cayman Islands on 7 May 2014 by six founding shareholders through their respective wholly-owned entity incorporated in the British Virgin Islands ("BVI"). The Target is considered a foreign entity under the laws of the People's Republic of China (the "PRC"). The address of the Target's registered office is P.O. Box 2547, Cassie Court, Camana Bay, Grand Cayman, Cayman Islands. The ultimate holding companies of the Company are Ree Jia Limited, Ree Jie Limited, Ree Min Limited, Ree Lin Limited, Ree Zhi Limited and Ree Fen Limited (the "Founder Companies"). The ultimate controlling parties of the Target Group are Zhang Jian, Ai Jianjie, Liu Qiuming, Jiang Lingfan, Xiang Zhiyong and Yu Daifeng (the "Founder Shareholders").

The Target and its subsidiaries (collectively, the "Target Group") are principally engaged in the design, development, manufacture and sales of electronic cigarettes ("e-cigarettes"), e-cigarette kit and e-cigarette accessories (the "Target Business"). As more fully described below, the Target, through a series of transactions which are accounted for as a reorganisation of entities under identical common ownership (the "Reorganisation"), became the ultimate parent entity of its subsidiaries on 22 August 2014. Accordingly, these consolidated financial statements reflect the historical operations of the Target Group as if the current organization structure had been in existence throughout the periods presented.

The financial information is presented in Renminbi ("RMB"), unless otherwise stated.

#### 1.2 Reorganisation and changes in group structure

The financial information covers each of the years ended 31 December 2013, 2014 and 2015 (the "Relevant Periods") and the Target Business was controlled by the Founder Shareholders throughout and at the end of each of the Relevant Periods. The following transactions were undertaken to reorganise the legal structure of the Target Group:

(i) On 7 May 2014, the Target was incorporated in the Cayman Islands with an authorised share capital of US$1,000 divided into 100,000,000 shares at a par value of US$ 0.00001 each. All shares were allotted and issued by the Target to the Founder Companies, incorporated in the British Virgin Islands ("BVI"), each of which is owned by the respective Founder Shareholders.

(ii) On 12 May 2014, the Target incorporated Kimree Holdings (HK) Co., Limited ("Kimree Holdings"), which became its wholly-owned subsidiary in Hong Kong with an authorised and paid up capital of HK$1 divided into 1 share at a par value of HK$1 each.

(iii) On 26 June 2014, the Target acquired 100% of the equity interests in Kimree Technology (HK) Company Limited ("Kimree HK") and Geakon Technology (HK) Company Limited ("Geakon HK") from the Founder Shareholders at a consideration of Hong Kong Dollars ("HK$") 10,000 each. The authorised and paid up capital of Kimree HK and Geakon HK are HK$10,000 and HK$10,000, respectively, divided into 10,000 shares and 10,000 shares, respectively, at a par value of HK$1 each.

(iv) On 2 July 2014, Kimree Holdings incorporated Kimsun Technology (Huizhou) Co., Ltd. ("Kimsun Huizhou"), which became its wholly owned subsidiary in the PRC. The registered and paid up capital of Kimsun Huizhou is RMB20,000,000.

(v) On 4 July 2014, the Target incorporated Kimree Hi-Tech Inc. ("Kimree Hi-Tech"), which became its wholly owned subsidiary in the BVI. The authorised and paid up capital of Kimree Hi-Tech are US$50,000 and US$1, respectively, divided into 50,000 shares and 1 shares, respectively, at a par value of US$1 each.

(vi) On 18 August 2014, Kimsun Huizhou acquired 100% equity interest in Huizhou Kimree Technology Co., Ltd. ("Kimree Huizhou") from the Founder Shareholders at a consideration of RMB20,000,000. The registered and paid up capital of Kimree Huizhou is RMB10,000,000.

(vii) On 22 August 2014, Kimree Huizhou acquired 100% equity interest in Geakon Technology (Huizhou) Co., Ltd. ("Geakon Huizhou") from Geakon HK at a consideration of RMB60,000,000.

Upon completion of the Reorganisation and as of the date of this report, the Target had direct or indirect interests in the following subsidiaries:

| Company name | Place and date of incorporation/ establishment | Registered/Issued and paid-up capital | Equity interest held As at 31 December 2013 | 2014 | 2015 | Principal activities/place of operation | Statutory auditors |
|---|---|---|---|---|---|---|---|
| **Directly owned:** | | | | | | | |
| Kimree Holdings | HK/12 May 2014 | HK$1/HK$1 | N/A | 100% | 100% | Investment holding/HK | *Note ii* |
| Geakon HK | HK/22 July 2013 | HK$10,000/ HK$10,000 | 100% | 100% | 100% | Sales of e-cigarettes/HK | *Note ii* |
| Kimree HK | HK/15 August 2012 | HK$10,000/ HK$10,000 | 100% | 100% | 100% | Sales of e-cigarettes/HK | *Note ii* |
| Kimree Hi-Tech | BVI/4 July 2014 | US$50,000/ US$1 | N/A | 100% | 100% | Investment holding/BVI | *Note i* |
| **Indirectly owned:** | | | | | | | |
| Kimree Huizhou | The PRC/ 25 January 2010 | RMB10,000,000/ RMB10,000,000 | 100% | 100% | 100% | Manufacture of e-cigarettes/ The PRC | *Note iii* |
| Geakon Huizhou | The PRC/ 10 September 2013 | RMB60,000,000/ RMB60,000,000 | 100% | 100% | 100% | Manufacture of e-cigarettes/ The PRC | *Note iii* |
| Kimsun Huizhou | The PRC/ 2 July 2014 | RMB20,000,000/ RMB20,000,000 | N/A | 100% | 100% | Manufacture of e-cigarettes/ The PRC | *Note iii* |

*Note:*

i. No statutory audited financial statements have been prepared for this company as there is no statutory requirement under its place of incorporation.

ii. The statutory financial statements of these companies for the years ended 31 December 2013 were audited by Kenny Chan & Co. in HK. Lam, Lee & So C.P.A. Co. Limited and KL CPA Limited were their statutory auditors in HK for the years ended 31 December 2014 and 2015, respectively.

iii. The statutory financial statements of these companies for the years ended 31 December 2013, 2014 and 2015 were audited by Guangdong Yuexin Accounting Firm in the PRC.

**1.3 Basis of presentation**

Immediately prior to and after the Reorganisation, the Target Business is held by the Founder Shareholders. The Target Business is mainly conducted through Kimree Holdings, Kimree HK, Geakon HK, Kimsun Huizhou, Kimree Huizhou, Kimree Hi-Tech and Geakon Huizhou, which are all wholly-owned subsidiaries of the Target. Pursuant to the Reorganisation, the Target Business was transferred to the Target. The Target is an investment holding company. The Target has not been involved in any other activities prior to the Reorganisation and do not meet the definition of a business. The Reorganisation is merely a reorganisation of the Target Business with no change in management of such business and the ultimate owners of the Target Business remain the same. Accordingly, the consolidated financial information of the companies now comprising the Target Group is presented using the carrying values of the Target Business for all periods presented. For the purpose of this report, the financial information of the Target Group has been prepared on a basis in accordance with the principles of the Auditing Guideline 3.340 "Prospectus and the Reporting Accountant" issued by the HKICPA.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### (a) Basis of preparation

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

The consolidated financial information has been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRSs"). The consolidated financial information has been prepared under the historical cost convention, as modified by the revaluation of derivative financial instruments which are carried at fair value.

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

The following new standards and amendments to standards have been issued but are not effective for the period and have not been early adopted by the Target:

| | | **Effective for annual periods beginning on or after** |
|---|---|---|
| HKAS 1 (amendment) | Disclosure initiative | 1 January 2016 |
| HKAS 16 and HKAS 38 (amendment) | Clarification of acceptable methods of depreciation and amortisation | 1 January 2016 |
| HKAS 16 and HKAS 41 (amendment) | Agriculture: bearer plants | 1 January 2016 |
| HKAS 27 (amendment) | Equity method in separate financial statements | 1 January 2016 |
| HKFRS 9 (2014) | Financial instruments | 1 January 2018 |
| HKFRS 10 and HKAS 28 (amendment) | Sale or contribution of assets between an investor and its associate or joint venture | 1 January 2016 |
| HKFRS 10, HKFRS 12 and HKAS 28 (amendment) | Investment entities: applying the consolidation exception | 1 January 2016 |
| HKFRS 11 (amendment) | Accounting for acquisitions of interests in joint operations | 1 January 2016 |
| HKFRS 14 | Regulatory deferral accounts | 1 January 2016 |
| HKFRS 15 | Revenue from contracts with customers | 1 January 2018 |
| HKFRS 16 | Leases | 1 January 2019 |
| HKFRSs/HKASs (amendment) | Annual improvements 2012–2014 cycle | 1 January 2016 |

The Target Group did not early adopt any of these new HKASs and HKFRSs and amendments to existing HKAS and HKFRSs. Management is currently assessing the financial impact of these revisions to the Target Group's financial position and performance.

**(b) Consolidation**

***Subsidiaries***

A subsidiary is an entity (including a structured entity) over which the Target Group has control. The Target Group controls an entity when the Target Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are consolidated from the date on which control is transferred to the Target 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 Target 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 cost directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measure initially at their fair values at the acquisition date, irrespective of the extent of any non-controlling interest. The excess of the cost of acquisition over the fair value of the Target 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 consolidated statements of comprehensive income.

Inter-company transactions, balances and unrealised gains on transactions between Target Group and companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the transferred assets. When necessary amount reported by subsidiaries have been adjusted to confirm with the Target Group's accounting policies.

Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Target Group.

**(c) Separate financial statements**

Investments in subsidiaries are accounted for at cost less impairment. Cost also includes direct attributable costs of investment. The results of subsidiaries are accounted for by the Target on the basis of dividend received and receivable.

Impairment testing of the investments in subsidiaries is required upon receiving dividends from these investments if the dividend exceeds the total comprehensive income of the subsidiary in the period the dividend is declared or if the carrying amount of the investment in the separate financial statements exceeds the carrying amount in the consolidated financial statements of the investee's net assets including goodwill.

**(d) Associates**

An associate is an entity over which the Target 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. Under the equity method, the investment is initially recognised at cost, and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition.

If the ownership interest in an associate is reduced but significant influence is retained, only a proportionate share of the amounts previously recognised in other comprehensive income is reclassified to profit or loss where appropriate.

The Target Group's share of post-acquisition profit or loss is recognised in the income statement, and its share of post-acquisition movements in other comprehensive income is recognised in other comprehensive income with a corresponding adjustment to the carrying amount of the investment. When the Target Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Target Group does not recognise further losses, unless it has incurred legal or constructive obligations or made payments on behalf of the associate.

The Target Group determines at each reporting date whether there is any objective evidence that the investment in the associate is impaired. If this is the case, the Target Group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value and recognises the amount adjacent to "share of profit of associates accounted for using equity method" in the consolidated income statement.

Profits and losses resulting from upstream and downstream transactions between the Target Group and its associate are recognised in the Target Group's financial statements only to the extent of unrelated investor's interests in the associates. Unrealised losses are 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 the Target Group.

Gain or losses on dilution of equity interest in associates are recognised in the consolidated income statement.

**(e) Segment reporting**

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources, assessing performance of the operating segments, has been identified as the executive directors that makes strategic decisions.

**(f) Impairment of non-financial assets**

Intangible assets that have an indefinite useful life or intangible assets not ready to use are not subject to amortisation and are tested annually for impairment. 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). Non-financial assets other than goodwill that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

**(g) Financial assets**

**(i) *Classification***

The Target Group classifies its financial assets in the following categories: at fair value through profit or loss and loans and receivables. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

(a) *Financial assets at fair value through profit or loss*

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Derivatives are also categorised as held for trading unless they are designated as hedges. Assets in this category are classified as current assets if expected to be settled within 12 months; otherwise, they are classified as non-current.

(b) *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for the amounts that are settled or expected to be settled more than 12 months after the end of the reporting periods. These are classified as non-current assets. The Target Group's loans and receivables comprise 'trade and other receivables' and 'cash and cash equivalents' in the balance sheet (Notes 16 and 18).

**(ii) *Recognition and measurement***

Regular way purchases and sales of financial assets are recognised on the trade-date — the date on which the Target Group commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Target Group has transferred substantially all risks and rewards of ownership. Loans and receivables are subsequently carried at amortised cost using the effective interest method.

**(iii) *Offsetting financial instruments***

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously. The legally enforceable right must not be contingent on future events and must be enforceable in the normal course of business and in the event of default, insolvency or bankruptcy of the company or the counterparty.

**(iv) *Impairment of financial assets***

The Target Group assesses at the end of each reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a "loss event") and that loss event or events has an impact on the estimated future cash flows of the financial asset or Target Group of financial assets that can be reliably estimated.

Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation, and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

For loans and receivables category, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced and the amount of the loss is recognised in the consolidated income statement. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Target Group may measure impairment on the basis of an instrument's fair value using an observable market price.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised such as an improvement in the debtor's credit rating, the reversal of the previously recognised impairment loss is recognised in the consolidated income statement.

**(h) Trade and other receivables**

Trade receivables are amounts due from customers for merchandise sold in the ordinary course of business. If collection of trade and other receivables is expected in one year or less (or in the normal operating cycle of the business if longer), they are classified as current assets. If not, they are presented as non-current assets.

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.

**(i) Cash and cash equivalents**

In the consolidated statements of cash flows, cash and cash equivalents comprise deposits held at call with banks, with original maturities of three months or less.

**(j) Trade payables**

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Trade payables are classified as current liabilities if payment is due within one year or less (or in the normal operating cycle of the business if longer). If not, they are presented as non-current liabilities.

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

**(k) Other payables and accruals**

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

Payables are classified as current liabilities if payment is due within one year or less (or in the normal operating cycle of business if longer). If not, they are presented as non-current liabilities.

**(l) Government grants**

Grants from the government are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Target Group will comply with all attached conditions.

Government grants relating to costs are deferred and recognised in the consolidated income statement over the period necessary to match them with the costs that they are intended to compensate.

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

**(m) Current and deferred income tax**

The income tax expense for the period comprises current and deferred tax. Tax is recognised in the consolidated income statements, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case the tax is also recognised in other comprehensive income or directly in equity, respectively.

**(i) *Current income tax***

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the end of the reporting periods in the country where the Target Group operates and generates taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

**(ii) *Deferred income tax***

*Inside basis differences*

Deferred income tax is recognised 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, 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 substantively enacted by the end of the reporting periods and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

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

*Outside basis differences*

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

Deferred income tax assets are recognised on deductible temporary differences arising from investments in subsidiaries and associates only to the extent that it is probable the temporary difference will reverse in the future and there is sufficient taxable profit available against which the temporary difference can be utilised.

**(iii) *Offsetting***

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income tax assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

**(n) Employee's benefits**

***Pension obligations***

The Target Group contributes on a monthly basis to various defined contribution plans organised by the relevant governmental authorities. The Target 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.

***Housing funds, medical insurance and other social insurances***

Full-time employees of the Target Group's subsidiaries in the PRC participate in a government mandated multi-employer defined contribution plan pursuant to which certain pension insurance, medical insurance, unemployment insurance, maternity insurance, occupational injury insurance, employee housing fund and other welfare benefits are provided to employees. Chinese labour regulations require that the subsidiaries of the Target Group make contributions to the government for these benefits based on certain percentages of the employees' salaries. The Target Group has no legal obligation for the benefits beyond the contributions made.

**(o) Provisions**

Provisions are recognised when the Target Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Target Group. It can also be a present obligation arising from past events that is not recognised because it is not probable that an outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognised but is disclosed in the notes to the financial information. When a change in the probability of an outflow occurs so that the outflow is probable, it will then be recognised as a provision.

**(p) 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 excluded borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

**(q) Restricted bank deposits**

Restricted bank deposits represent deposits held by the bank in a segregated account as security for the foreign exchange contracts with the bank. Such restricted bank deposits will be released when the Target Group settles the related foreign exchange contracts.

**(r) Revenue recognition**

Revenue comprises the fair value of the consideration received or receivable for the sale of goods and services in the ordinary course of the Target Group's activities. Revenue is shown net of value-added tax, returns, and rebates.

The Target Group recognises revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and specific criteria have been met for each of the Target Group's activities as described below. The amount of revenue is not considered to be reliably measurable until all contingencies relating to sale have been resolved. The Target Group bases its estimates on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

**(a)** ***Sales of goods***

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

Delivery does not occur until the products have been delivered to the specified location, the risks of obsolescence and loss have been transferred to the customer, and either the customer has accepted the products in accordance with the sales contract, the acceptance provisions have lapsed, or the Target Group has objective evidence that all criteria for acceptance have been satisfied.

**(b)** ***Interest income***

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

**(s) 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 to the consolidated income statement on a straight-line basis over the period of the lease.

**(t) Dividend distribution**

Dividend distribution to the Target's shareholders is recognised as a liability in the Target Group's and the Target's consolidated financial statements in the period in which the dividends are approved by the Target's shareholders or directors, where appropriate.

**(u) Foreign currency translation**

**(i)** ***Functional and presentation currency***

Items included in the financial information of each of the Target 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 RMB, which is the Target's functional and the Target Group's presentation currency.

**(ii)** ***Transactions and balances***

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. 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 recognised in the consolidated income statement within 'Other (losses)/gains — net'.

**(iii)** ***Group companies***

The results and financial position of the Target Group entities (none of which has the currency of hyper-inflationary 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 statements of financial position;

(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 recognised as a separate component of other comprehensive income.

**(iv) *Disposal of foreign operation and partial disposal***

On the disposal of a foreign operation (that is, a disposal of the Target Group's entire interest in a foreign operation, or a disposal involving loss of control over a subsidiary that includes a foreign operation, a disposal involving loss of joint control over a joint venture that includes a foreign operation, or a disposal involving loss of significant influence over an associate that includes a foreign operation), all of the currency translation differences accumulated in equity in respect of that operation attributable to the owners of the Target are reclassified to profit or loss.

In the case of a partial disposal that does not result in the group losing control over a subsidiary that includes a foreign operation, the proportionate share of accumulated currency translation differences are re-attributed to non-controlling interests and are not recognised in profit or loss. For all other partial disposals (that is, reductions in the group's ownership interest in associates or joint ventures that do not result in the Target Group losing significant influence or joint control), the proportionate share of the accumulated exchange difference is reclassified to profit or loss.

**(v) *Property, plant and equipment***

All property, plant and equipment is stated at historical cost less depreciation. 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 recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Target 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 to the income statement during the financial period in which they are incurred.

Depreciation is calculated using the straight-line method to allocate their cost to their residual values, where appropriate, over their estimated useful lives as follows:

| | |
|---|---|
| Plant and machinery | 10 years |
| Furniture, fixtures and equipment | 3–5 years |
| Motor vehicles | 5 years |
| Leasehold improvement | Shorter of remaining term of the lease and estimated useful lives of assets |

Construction in progress represents plant under construction which is carried at cost less any accumulated impairment losses. Construction in progress includes construction expenditure incurred and other direct costs attributable to the construction. On completion, the construction in progress is transferred to appropriate categories of property, plant and equipment. Depreciation is not provided on construction in progress until the related asset is completed for intended use.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

An asset's carrying amount is written down immediately to its recoverable amount if the assets carrying amount is greater than its estimated recoverable amount (Note 2(f)).

Gains or losses on disposals are determined by comparing the proceeds with the carrying amount and are recognised within 'Other (losses)/gains — net' in the consolidated income statement.

**(w) Intangible assets**

Intangible assets mainly include patents and computer software at historical costs.

Patents are amortised on a straight-line basis over useful lives of 2.5 to 20 years.

Acquired computer software programmes are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised over the estimated useful lives of 3 to 10 years on a straight-line basis.

**(x) Research and development expenditure**

Research expenditures is recognised as an expense as incurred. Costs incurred on development projects (relating to the design and testing of new and improved products) are recognised as intangible assets when the following criteria are met:

- it is technically feasible to complete the intangible asset so that it will be available for use;
- management intends to complete the intangible asset and use or sell it;
- there is an ability to use or sell the intangible asset;
- it can be demonstrated how the intangible asset will generate probable future economic benefits;
- adequate technical, financial and other resources to complete the development and to use or sell the intangible asset are available; and
- the expenditure attributable to the intangible asset during its development can be reliably measured.

Other development expenditures that do not meet these criteria are recognised as an expense as incurred. Development cost previously recognised as an expense is not recognised as an asset in a subsequent period. Capitalised development costs are recorded as intangible assets and amortised from the point at which the asset is ready for use on a straight-line basis over their estimated useful lives.

**(y) Share capital**

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

**(z) Derivative financial instruments**

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if not, the gain or loss from fair value change is recognised immediately in the consolidated income statement within 'Other (losses)/gains — net'.

**3. FINANCIAL RISK MANAGEMENT**

**(a) Financial risk factors**

The Target Group's activities expose it to a variety of financial risks: market risk (including foreign exchange risk and cash flow and fair value interest rate risk), price risk, credit risk and liquidity risk. The Target Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Target Group's financial performance. Risk management is carried out by senior management of the Target Group approved by the board of directors.

**(i) *Market risk***

(i) *Foreign exchange risk*

Foreign exchange risk arises from future commercial transactions and recognised assets and liabilities. Foreign exchange risk arises when future commercial transactions or recognised assets or liabilities are denominated in a currency that is not the entity's functional currency.

The Target Group operates mainly in the PRC, and is exposed to foreign currency risks arising from various currency exposures, mainly with respect to HK$ and US dollar ("USD"). Exchange rate fluctuations and market trends have always been a concern of the Target Group. Foreign exchange risk of the Target Group has been managed by the Target Group's financial controller.

The conversion of RMB into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC government.

The carrying amount of the Target Group's foreign currency denominated monetary assets and monetary liabilities at the respective balance sheet dates are as follows:

| | As at 31 December | | |
|---|---|---|---|
| | **2013** | **2014** | **2015** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| **Assets** | | | |
| HK$ | 314 | 215 | 131 |
| USD | 93,198 | 108,140 | 118,875 |
| Total | 93,512 | 108,355 | 119,006 |
| **Liabilities** | | | |
| USD | 86,457 | 32,767 | 11,717 |

If RMB had strengthened/weakened by 5% against the relevant foreign currencies, with all other variable held constant, the profit before income tax would increase/decrease as follows:

| | Year ended 31 December | | | | | |
|---|---|---|---|---|---|---|
| | **2013** Increase/(decrease) in profit after income tax if exchanges rates change by | | **2014** Increase/(decrease) in profit after income tax if exchanges rates change by | | **2015** Increase/(decrease) in profit after income tax if exchanges rates change by | |
| | **+5%** | **–5%** | **+5%** | **–5%** | **+5%** | **–5%** |
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* |
| USD | (253) | 253 | (2,826) | 2,826 | (4,018) | 4,018 |

(ii) *Cash flow and fair value interest rate risk*

The Target Group has no significant interest-bearing assets (other than bank deposits) and interest income from bank deposits is not significant. As such, the Target's income and operating cash flows are substantially independent of changes in market interest rates.

**(ii) *Price risk***

The Target Group is not exposed to equity securities price risk as it has no investment in equity securities. Also, the Target Group has entered into currency forward contracts to mitigate the effect of foreign exchange price fluctuations.

**(iii) *Credit risk***

The Target Group is exposed to credit risk in relation to its cash and cash equivalents, restricted bank deposits, trade and other receivables, amounts due from related parties and derivative financial instruments.

For cash and cash equivalents and restricted bank deposits, the management manages the credit risk by placing all the bank deposits in state-owned financial institutions or reputable banks which are all high-credit-quality financial institutions.

To manage the credit risk in respect of trade and other receivables and amounts due from related parties, the Target Group performs ongoing credit evaluations of its debtors' financial condition and does not require collateral from the debtors on the outstanding balances. Based on the expected recoverability and timing for collection of the outstanding balances, the Target Group maintains an allowance for doubtful accounts and actual losses incurred have been within management's expectations.

As at 31 December 2013, 2014 and 2015, the Target Group's credit risk was concentrated to the extent that its largest customers accounted for 100%, 76.7% and 99.7%, respectively, of the total trade receivables as disclosed below. The trade receivables which are past due are analysed in Note 16.

| | **As at 31 December** | | |
|---|---|---|---|
| | **2013** | **2014** | **2015** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Customer A | 2,082 | — | 14,569 |
| Customer B | — | 11,263 | 6,395 |
| Customer C | — | — | 674 |
| Customer D | — | — | 36 |
| Customer E | — | 560 | — |
| Customer F | 384 | — | — |
| | 2,466 | 11,823 | 21,674 |

**(iv) *Liquidity risk***

The Target Group maintains prudent liquidity risk management by maintaining sufficient cash and bank balances. The Target Group's liquidity risk is further mitigated through the availability of financing through its own cash resources and the availability of banking facilities to meet its financial commitments. In the opinion of the directors, the Target Group does not have any significant liquidity risk.

The table below analyses the financial liabilities of the Target Group into relevant maturity groupings based on the remaining period at the end of the reporting periods to the contractual maturity date. The amounts disclosed in the table were the contractual undiscounted cash flows of financial liabilities based on earliest date on which the Target Group can be required to pay. Balances due within twelve months approximate their carrying balances, as the impact of discounting was not significant. Derivative financial liabilities are included in the analysis if their contractual maturities are essential for an understanding of the timing of the cash flows. The amounts disclosed in the table are the contractual undiscounted cash flows.

| | **On demand** | **3 months or less** | **Total** |
|---|---|---|---|
| | *RMB'000* | *RMB'000* | *RMB'000* |
| At 31 December 2013 | | | |
| Trade and other payables (excluding non-financial liabilities) | — | 45,932 | 45,932 |
| Amounts due to related parties | 1,818 | — | 1,818 |
| Total | 1,818 | 45,932 | 47,750 |

| | **On demand** | **3 months or less** | **Total** |
|---|---|---|---|
| | *RMB'000* | *RMB'000* | *RMB'000* |
| At 31 December 2014 | | | |
| Trade and other payables (excluding non-financial liabilities) | — | 47,676 | 47,676 |
| Amounts due to related parties | 15,812 | — | 15,812 |
| Derivative financial instruments | — | 366 | 366 |
| Total | 15,812 | 48,042 | 63,854 |

| | **On demand** | **3 months or less** | **Total** |
|---|---|---|---|
| | *RMB'000* | *RMB'000* | *RMB'000* |
| At 31 December 2015 | | | |
| Trade and other payables (excluding non-financial liabilities) | — | 32,919 | 32,919 |
| Amounts due to related parties | 109 | — | 109 |
| Total | 109 | 32,919 | 33,028 |

**(b) Capital risk management**

The Target Group's objectives when managing capital are to safeguard its ability to continue as a going concern in order to provide returns for its shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital.

In order to maintain or adjust the capital structure, the Target Group may adjust the amount of dividends paid to shareholders, return capital to its shareholders, issue new shares or sell assets to reduce debt.

Consistent with others in the industry, the Target Group monitors capital on the basis of the gearing ratio. This ratio is calculated as net debt divided by total capital. The Target Group had no bank borrowings during the year ended 31 December 2013, 2014 and 2015.

**(c) Fair value estimation**

The table below analyses financial instruments carried at fair value, by the levels of inputs to valuation techniques. The inputs to valuation techniques are categorised into three levels within a fair value hierarchy, as follows:

Level 1 — Quoted prices unadjusted in active markets for identical assets or liabilities.

Level 2 — Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly that is, as prices or indirectly that is, derived from prices.

Level 3 — Inputs for the asset or liability that are not based on observable market data that is, unobservable inputs.

The following table presents the Target Group's assets and liabilities that are measured at fair value as at 31 December 2013 and 2014:

| | As at 31 December 2013 | | | |
|---|---|---|---|---|
| | **Level 1** | **Level 2** | **Level 3** | **Total** |
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* |
| Recurring fair value measurements | | | | |
| Assets | | | | |
| Derivative financial instruments | — | 1,529 | — | 1,529 |

| | As at 31 December 2014 | | | |
|---|---|---|---|---|
| | **Level 1** | **Level 2** | **Level 3** | **Total** |
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* |
| Recurring fair value measurements | | | | |
| Liabilities | | | | |
| Derivative financial instruments | — | 366 | — | 366 |

**(a)** ***Financial instruments in level 1***

The fair value of financial instruments traded in active markets is based on quoted market prices at the end of the reporting period. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets held by the Target Group is the current bid price. These instruments are included in level 1.

**(b)** ***Financial instruments in level 2***

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2.

If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3.

Specific valuation techniques used to value financial instruments include:

- Quoted market prices or dealer quotes for similar instruments.
- The fair value of interest rate swaps calculated as the present value of the estimated future cash flows based on observable yield curves.
- The fair value of forward foreign exchange contracts determined using forward exchange rates at the balance sheet date, with the resulting value discounted back to present value.

**(c) *Financial instruments in level 3***

There were no transfers of financial assets between level 2 and level 3 fair value hierarchy classifications during the Relevant Periods.

## 4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

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.

### (a) Critical accounting estimates and assumptions

The Target 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 having a significant effect on the carrying amounts of assets and liabilities are discussed below:

**(i) *Provision for impairment of receivables***

The management determines the provision for impairment of receivables (including trade and other receivables) based on an assessment of the recoverability of the receivables. The assessment is based on the credit history of its customers and other debtors and the current market condition and requires the use of judgments and estimates. The management reassesses the provision at the end of each reporting period.

**(ii) *Income taxes and deferred taxation***

The Target Group is subject to income taxes in the PRC and HK. Significant judgement is required in determining the provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current and deferred income tax assets and liabilities in the period in which such determination is made.

Deferred tax assets relating to certain temporary differences and tax losses are recognised when management considers to be probable that future taxable profit will be available against which the temporary differences or tax losses can be recognised. The outcome of their actual recognition may be different.

**(iii) *Uncertain tax positions***

The Target Group is subject to taxation in numerous jurisdictions and is routinely under audit by many different taxing authorities in the ordinary course of business. There are many transactions and calculations during the course of business for which the ultimate tax determination is uncertain, as taxing authorities may challenge some of the Target Group's positions and propose adjustments or changes to its tax filings. As a result, the Target Group maintains provisions for uncertain tax positions and propose appropriately reflect its risk. These provisions are made using the Target Group's best estimates of the amount expected to be paid based on a qualitative assessment of all relevant factors. The Target Group reviews the adequacy of these provisions at the end of each reporting period and adjusts them based on changing facts and circumstances. Due to the uncertainty associated with tax audits, it is possible that at some future date, liabilities resulting from such audits or related litigation could vary significantly from the Target Group's provisions. Where the final outcome of these tax-related matters is different from the amounts that were initially recorded, such differences will affect the tax provisions in the period in which such determination is made.

**(iv) *Useful lives of property, plant and equipment***

The management determines the estimated useful lives and related depreciation charges for its property, plant and equipment. This estimate is based on the historical experience of the actual useful lives of property, plant and equipment with similar nature and function. It could change significantly as a result of changes in the Target Group's operations including any future renovation of the Target Group's facilities. The management will increase the depreciation charge where useful lives are less than previously estimated, or it will write off or write down assets that have been abandoned or sold. Actual economic lives may differ from estimated useful lives. Periodic review could result in a change in depreciable lives and therefore depreciation expense in future periods.

**(v) *Allowance for inventories***

In determining the amount of allowance required for obsolete and slow-moving inventories, the Target Group would evaluate ageing analysis of inventories and compare the carrying amount of inventories to their respective net realisable value. A considerable amount of judgment is required in determining such allowances. If conditions which have impact on the net realisable value of inventories deteriorate, additional allowances may be required.

## 5. SEGMENT INFORMATION

The chief operating decision-maker has been identified as the executive directors of the Target Group. The executive directors review the Target Group's internal reporting in order to assess performance and allocate resources and have determined the operating segments based on the internal reports that are used to make strategic decisions. The executive directors considered the nature of the Target Group's business and determined that the Target Group has three reportable segments as follows: (i) disposable e-cigarettes, (ii) rechargeable e-cigarettes, and (iii) E-cigarettes accessories.

(a) The following tables present information on revenue of the Target Group by geographical segment for the Relevant Periods.

**Revenue from external customers**

| | Year ended 31 December | | |
|---|---|---|---|
| | **2013** | **2014** | **2015** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| United States | 326,202 | 597,450 | 164,260 |
| European Union | 86,590 | 54,870 | 53,955 |
| Asia and others | 79,413 | 7,655 | 17,983 |
| | 492,205 | 659,975 | 236,198 |

The revenue information above is based on customers' delivery address.

(b) The segment information for the reportable segments is set out as below:

| | Year ended 31 December 2013 | | | |
|---|---|---|---|---|
| | **Disposable e-cigarettes** | **Rechargeable e-cigarettes** | **E-cigarettes accessories** | **Total** |
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* |
| **Revenue** | | | | |
| Revenue from external customers | 199,933 | 155,260 | 137,012 | 492,205 |
| Segment gross profits* | 75,151 | 56,246 | 41,740 | 173,137 |
| Other income | | | | 23 |
| Other losses — net | | | | (1,898) |
| Selling and marketing expenses | | | | (9,561) |
| Administration expenses | | | | (33,047) |
| Financial income | | | | 108 |
| Share of profit of associates accounted for using the equity method | | | | 607 |
| Profit before income tax | | | | 129,369 |

| | Year ended 31 December 2014 | | | |
|---|---|---|---|---|
| | **Disposable e-cigarettes** | **Rechargeable e-cigarettes** | **E-cigarettes accessories** | **Total** |
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* |
| **Revenue** | | | | |
| Revenue from external customers | 9,821 | 410,736 | 239,418 | 659,975 |
| Segment gross profits* | 3,352 | 161,799 | 99,971 | 265,122 |
| Other income | | | | 668 |
| Other losses — net | | | | (1,228) |
| Selling and marketing expenses | | | | (11,753) |
| Administration expenses | | | | (80,303) |
| Financial income | | | | 383 |
| Profit before income tax | | | | 172,889 |

| | Year ended 31 December 2015 | | | |
|---|---|---|---|---|
| | Disposable e-cigarettes | Rechargeable e-cigarettes | E-cigarettes accessories | Total |
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* |
| **Revenue** | | | | |
| Revenue from external customers | 22,895 | 205,116 | 8,187 | 236,198 |
| Segment gross profits* | 8,357 | 84,128 | 2,563 | 95,048 |
| Other income | | | | 1,914 |
| Other gains — net | | | | 5,510 |
| Selling and marketing expenses | | | | (12,610) |
| Administration expenses | | | | (36,412) |
| Financial income | | | | 501 |
| Profit before income tax | | | | 53,951 |

* *Segment gross profits represent segment revenue less cost of sales.*

(c) Information regarding the Target Group's revenue by nature.

| | Year ended 31 December | | |
|---|---|---|---|
| | 2013 | 2014 | 2015 |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| **Revenue** | | | |
| Sales of goods | 492,205 | 659,975 | 236,198 |

For the years ended 31 December 2013, 2014 and 2015, approximately 64%, 86%, 65%, respectively, of the Target Group's sales were made to the four major customers below.

| | Year ended 31 December | | |
|---|---|---|---|
| | 2013 | 2014 | 2015 |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Customer A | 115,516 | — | — |
| Wye Industrial Co., Limited | 78,531 | — | — |
| Customer C | 70,964 | 42,474 | 15,056 |
| Customer D | 48,183 | 524,255 | 138,135 |
| | 313,194 | 566,729 | 153,191 |

No other customers individually accounted for 10% or more of the Target Group's revenue during the Relevant Periods.

## 6. OTHER INCOME AND OTHER (LOSSES)/GAINS — NET

| | Year ended 31 December | | |
|---|---|---|---|
| | 2013 | 2014 | 2015 |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| **Other income** | | | |
| Government grants | 23 | 497 | 1,827 |
| Others | — | 171 | 87 |
| | 23 | 668 | 1,914 |
| **Other (losses)/gains — net** | | | |
| Fair value changes on derivative financial instruments | 1,529 | (1,895) | 366 |
| Net foreign exchange (losses)/gains | (3,229) | 382 | 5,198 |
| Sales of scrap materials | 109 | 770 | 107 |
| Sales of raw materials, sample and molds | — | 183 | 474 |
| Income/(losses) on derivative financial instruments | 184 | (663) | 424 |
| Loss on disposal of investments in associates *(Note 29(b)(iii))* | (480) | — | — |
| Loss on disposal of property, plant and equipment *(Note 21(b))* | — | — | (923) |
| Others | (11) | (5) | (136) |
| | (1,898) | (1,228) | 5,510 |

## 7. EXPENSES BY NATURE

| | Year ended 31 December | | |
|---|---|---|---|
| | 2013 | 2014 | 2015 |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Changes in inventories of finished goods and work in progress | 13,785 | (4,654) | 659 |
| Raw materials and consumables used | 219,160 | 290,856 | 87,772 |
| Allowance for impairment of inventory | — | 1,271 | — |
| Employee benefit expenses *(Note 8)* | 99,399 | 119,881 | 47,594 |
| Depreciation and amortisation | 1,390 | 17,896 | 24,543 |
| Water and electricity expenses | 2,512 | 6,624 | 5,009 |
| Transportation and travelling expenses | 3,180 | 1,456 | 1,744 |
| Maintenance expenses | 1,023 | 1,763 | 1,507 |
| Entertainment expenses | 1,025 | 1,635 | 1,966 |
| Start-up cost | 5,256 | 11,699 | — |
| Business tax and surcharge | 5,212 | 2,613 | 2,030 |
| Operating lease payments | 2,140 | 8,508 | 8,883 |
| Advertising costs | 773 | 1,698 | 1,612 |
| Commercial insurance | 386 | 2,824 | 2,602 |
| Bank charges | 430 | 219 | 136 |
| Expenses related to initial public offering | — | 16,765 | — |
| Auditors' remuneration | 20 | 46 | 65 |
| Other expenses | 5,985 | 5,809 | 4,050 |
| **Total cost of sales, selling and marketing expenses and administrative expenses** | 361,676 | 486,909 | 190,172 |

## 8. EMPLOYEE BENEFITS EXPENSES INCLUDING DIRECTORS' EMOLUMENTS

Employee benefits expenses during the Relevant Periods are as follows:

| | Year ended 31 December | | |
|---|---|---|---|
| | 2013 | 2014 | 2015 |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Wages, bonus, salaries and allowances | 96,640 | 115,718 | 47,196 |
| Social security costs | 2,759 | 4,163 | 398 |
| | 99,399 | 119,881 | 47,594 |

## 9. DIRECTORS' AND CHIEF EXECUTIVE'S EMOLUMENTS

### (a) Directors' emoluments

The remuneration of each director of the Target Group during the Relevant Periods is set out below:

Year ended 31 December 2013

| Name of Directors | Fees | Salary | Discretionary bonus | Housing allowance | Other benefits | Employer's contribution to a retirement benefit scheme | Remunerations paid or receivable in respect of accepting office as director | Emoluments paid or receivable in respect of director's other services in connection with the management of the affairs of the company or its subsidiary undertaking | Total |
|---|---|---|---|---|---|---|---|---|---|
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* |
| **Executive Directors** | | | | | | | | | |
| Liu Qiuming (劉秋明) | — | 240 | — | — | — | 1 | — | — | 241 |
| Ai Jianjie (艾建杰) | — | 240 | — | — | — | 1 | — | — | 241 |
| Jiang Lingfan (蔣凌帆) | — | 240 | — | — | — | 1 | — | — | 241 |
| Xiang Zhiyong (向智勇) | — | 240 | — | — | — | 1 | — | — | 241 |
| Yu Dafeng (余大風) | — | 240 | — | — | — | 1 | — | — | 241 |
| Zhang Jian (張健) | — | — | — | — | — | — | — | — | — |
| | — | 1,200 | — | — | — | 5 | — | — | 1,205 |

Year ended 31 December 2014

| Name of Directors | Fees | Salary | Discretionary bonus | Housing allowance | Other benefits | Employer's contribution to a retirement benefit scheme | Remunerations paid or receivable in respect of accepting office as director | Emoluments paid or receivable in respect of director's other services in connection with the management of the affairs of the company or its subsidiary undertaking | Total |
|---|---|---|---|---|---|---|---|---|---|
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* |
| **Executive Directors** | | | | | | | | | |
| Liu Qiuming (劉秋明) | — | 240 | — | — | — | 1 | — | — | 241 |
| Ai Jianjie (艾建杰) | — | 240 | — | — | — | 1 | — | — | 241 |
| Jiang Lingfan (蔣凌帆) | — | 240 | — | — | — | 1 | — | — | 241 |
| Xiang Zhiyong (向智勇) | — | 240 | — | — | — | 1 | — | — | 241 |
| Yu Dafeng (余大風) | — | 240 | — | — | — | 1 | — | — | 241 |
| Zhang Jian (張健) | — | — | — | — | — | — | — | — | — |
| | — | 1,200 | — | — | — | 5 | — | — | 1,205 |

Year ended 31 December 2015

| Name of Directors | Fees | Salary | Discretionary bonus | Housing allowance | Other benefits | Employer's contribution to a retirement benefit scheme | Remunerations paid or receivable in respect of accepting office as director | Emoluments paid or receivable in respect of director's other services in connection with the management of the affairs of the company or its subsidiary undertaking | Total |
|---|---|---|---|---|---|---|---|---|---|
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* |
| **Executive Directors** | | | | | | | | | |
| Liu Qiuming (劉秋明) | — | 240 | — | — | — | 1 | — | — | 241 |
| Ai Jianjie (艾建杰) | — | 240 | — | — | — | 1 | — | — | 241 |
| Jiang Lingfan (蔣凌帆) | — | 240 | — | — | — | 1 | — | — | 241 |
| Xiang Zhiyong (向智勇) | — | 240 | — | — | — | 1 | — | — | 241 |
| Yu Dafeng (余大風) | — | 239 | — | — | — | 1 | — | — | 240 |
| Zhang Jian (張健) | — | — | — | — | — | — | — | — | — |
| | — | 1,199 | — | — | — | 5 | — | — | 1,204 |

(i) There was no directors' retirement benefits, directors' termination benefits, consideration provided to third parties for making available directors' services and no loans, quasi-loans or other dealing in favour of directors, controlled bodies corporate by and connected entities with such directors during the Relevant Periods.

(ii) Directors' material interests in transactions, arrangements or contracts

Saved as disclosed in Note 29, there was no significant transactions, arrangements and contracts in relation to the Target Group's business to which the Company was a party and in which a director of the Target had a material interest, whether directly or indirectly, subsisted at the end of the Relevant Periods or at any time during the Relevant Periods.

**(b) Five highest paid individuals**

The five individuals whose emoluments were the highest in the Group for the Relevant Periods include 4 directors during the year ended 31 December 2015 whose emoluments are reflected in the analysis presented above. The emoluments paid to the remaining 5 individuals during each of the year ended 31 December 2013 and 2014, and 1 individual during the year ended 31 December 2015 during the Relevant Periods are as follows:

| | **Year ended 31 December** | | |
|---|---|---|---|
| | **2013** | **2014** | **2015** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Wages, bonus, salaries and allowances | 1,982 | 1,745 | 244 |

During the Relevant Periods, neither directors nor any of the five highest paid individuals received any emolument from the Group as an inducement to join or upon joining the Target Group or as compensation for loss of office.

The emoluments paid to the remaining individuals fell within the following band:

| | **Number of individuals Year ended 31 December** | | |
|---|---|---|---|
| | **2013** | **2014** | **2015** |
| Emolument bands | | | |
| RMB250,001 – RMB1,000,000 | 5 | 5 | 1 |

## 10. FINANCE INCOME

| | **Year ended 31 December** | | |
|---|---|---|---|
| | **2013** | **2014** | **2015** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| **Finance income:** | | | |
| Interest income | 108 | 383 | 501 |

## 11. INCOME TAX EXPENSE

| | Year ended 31 December | | |
|---|---|---|---|
| | **2013** | **2014** | **2015** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Current income tax | | | |
| — PRC corporate income tax | 35,100 | 12,716 | 3,110 |
| — Hong Kong profits tax | — | 22,419 | 5,120 |
| Subtotal | 35,100 | 35,135 | 8,230 |
| Deferred income tax *(Note 20)* | (2,621) | (2,900) | 3,189 |
| | 32,479 | 32,235 | 11,419 |

### (a) Cayman Islands income tax

The Target is incorporated in the Cayman Islands as an exempted company with limited liability under the Companies Law of Cayman Islands and accordingly, is exempted from Cayman Islands income tax.

### (b) Hong Kong profits tax

Hong Kong profits tax has been provided at the rate of 16.5% on the estimated assessable profit for the Relevant Periods.

### (c) PRC corporate income tax ("CIT")

CIT is provided on the assessable income of entities within the Target Group incorporated in the PRC, calculated in accordance with the relevant regulations of the PRC at the rate of 25% on the estimated assessable profit for the Relevant Periods.

### (d) PRC withholding income tax

According to the CIT Law, starting from 1 January 2008, a withholding income tax of 10% will be levied on the immediate holding companies outside the PRC when their PRC subsidiaries declare dividend out of profits earned after 1 January 2008. A lower 5% withholding income tax rate may be applied when the immediate holding companies of the PRC subsidiaries are established in Hong Kong and fulfil requirements under the tax treaty arrangements between the PRC and Hong Kong.

The taxation on the Target Group's profit before income tax differs from the theoretical amount that would arise using the weighted average tax rate applicable to profit of the Group as follows:

| | Year ended 31 December | | |
|---|---|---|---|
| | **2013** | **2014** | **2015** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Profit before income tax | 129,369 | 172,889 | 53,951 |
| Tax calculated at applicable corporate income tax rate of 25% | 32,342 | 43,222 | 13,488 |
| Effect of differences in tax rates | — | (11,548) | (2,638) |
| Expenses not deductible for tax purposes | 137 | 561 | 569 |
| | 32,479 | 32,235 | 11,419 |

## 12. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the profit for the year by the weighted average number of ordinary shares in issue during the Relevant Periods. In determining the weighted average number of ordinary shares issued:

(a) the 100,000,000 ordinary shares of the Target issued on 7 May 2014 and were treated as if they had been in issue since 1 January 2013;

| | 2013 | 2014 | 2015 |
|---|---|---|---|
| Profit attributable to owner of the Company (RMB'000) | 96,890 | 140,654 | 42,532 |
| Weighted-average number of shares in issue (thousand shares) | 100,000 | 100,000 | 100,000 |
| Basic earnings per share (RMB) | 0.97 | 1.41 | 0.43 |

Diluted earnings per share is the same as basic earnings per share due to the absence of dilutive ordinary shares during the Relevant Periods.

## 13. PROPERTY, PLANT AND EQUIPMENT

| | Plant and machinery *RMB'000* | Furniture, fixtures and equipment *RMB'000* | Motor vehicles *RMB'000* | Leasehold improvements *RMB'000* | Construction in progress *RMB'000* | Total *RMB'000* |
|---|---|---|---|---|---|---|
| At 1 January 2013 | | | | | | |
| Cost | 625 | 1,878 | 103 | 9,024 | — | 11,630 |
| Accumulated depreciation | (10) | (227) | (39) | (7,480) | — | (7,756) |
| Net book amount | 615 | 1,651 | 64 | 1,544 | — | 3,874 |
| Year ended 31 December 2013 | | | | | | |
| Opening net book amount | 615 | 1,651 | 64 | 1,544 | — | 3,874 |
| Additions | 15,751 | 6,027 | 106 | 3,011 | 34,997 | 59,892 |
| Disposals *(Note 21(b))* | — | (28) | — | — | — | (28) |
| Depreciation | (126) | (506) | (24) | (603) | — | (1,259) |
| Closing net book amount | 16,240 | 7,144 | 146 | 3,952 | 34,997 | 62,479 |
| At 31 December 2013 | | | | | | |
| Cost | 16,376 | 7,877 | 209 | 12,035 | 34,997 | 71,494 |
| Accumulated depreciation | (136) | (733) | (63) | (8,083) | — | (9,015) |
| Net book amount | 16,240 | 7,144 | 146 | 3,952 | 34,997 | 62,479 |
| At 1 January 2014 | | | | | | |
| Cost | 16,376 | 7,877 | 209 | 12,035 | 34,997 | 71,494 |
| Accumulated depreciation | (136) | (733) | (63) | (8,083) | — | (9,015) |
| Net book amount | 16,240 | 7,144 | 146 | 3,952 | 34,997 | 62,479 |

| | Plant and machinery *RMB'000* | Furniture, fixtures and equipment *RMB'000* | Motor vehicles *RMB'000* | Leasehold improvements *RMB'000* | Construction in progress *RMB'000* | Total *RMB'000* |
|---|---|---|---|---|---|---|
| Year ended 31 December 2014 | | | | | | |
| Opening net book amount | 16,240 | 7,144 | 146 | 3,952 | 34,997 | 62,479 |
| Additions | 1,437 | 7,563 | 534 | 10,515 | 33,037 | 53,086 |
| Disposals *(Note 21(b))* | (1,619) | (564) | — | — | — | (2,183) |
| Transfer from construction in progress | 7,633 | 30,455 | — | 29,201 | (67,289) | — |
| Depreciation | (1,350) | (6,237) | (139) | (10,181) | — | (17,907) |
| Closing net book amount | 22,341 | 38,361 | 541 | 33,487 | 745 | 95,475 |
| At 31 December 2014 | | | | | | |
| Cost | 23,696 | 45,009 | 743 | 51,751 | 745 | 121,944 |
| Accumulated depreciation | (1,355) | (6,648) | (202) | (18,264) | — | (26,469) |
| Net book amount | 22,341 | 38,361 | 541 | 33,487 | 745 | 95,475 |
| At 1 January 2015 | | | | | | |
| Cost | 23,696 | 45,009 | 743 | 51,751 | 745 | 121,944 |
| Accumulated depreciation | (1,355) | (6,648) | (202) | (18,264) | — | (26,469) |
| Net book amount | 22,341 | 38,361 | 541 | 33,487 | 745 | 95,475 |
| Year ended 31 December 2015 | | | | | | |
| Opening net book amount | 22,341 | 38,361 | 541 | 33,487 | 745 | 95,475 |
| Additions | 1,711 | 899 | — | 5,094 | 1,115 | 8,819 |
| Disposals *(Note 21(b))* | (572) | (898) | (5) | — | — | (1,475) |
| Transfer from construction in progress | 396 | 723 | — | — | (1,119) | — |
| Depreciation | (2,537) | (9,593) | (140) | (12,260) | — | (24,530) |
| Closing net book amount | 21,339 | 29,492 | 396 | 26,321 | 741 | 78,289 |
| At 31 December 2015 | | | | | | |
| Cost | 24,724 | 43,943 | 640 | 56,845 | 741 | 126,893 |
| Accumulated depreciation | (3,385) | (14,451) | (244) | (30,524) | — | (48,604) |
| Net book amount | 21,339 | 29,492 | 396 | 26,321 | 741 | 78,289 |

Depreciation charges recognised for the years ended 31 December 2013, 2014 and 2015 are as follows:

| | Year ended 31 December | | |
|---|---|---|---|
| | 2013 *RMB'000* | 2014 *RMB'000* | 2015 *RMB'000* |
| Cost of sales | 1,014 | 14,081 | 16,208 |
| Selling and marketing expenses | — | 6 | 10 |
| Administration expenses | 203 | 3,314 | 6,718 |
| | 1,217 | 17,401 | 22,936 |

## 14. INTANGIBLE ASSETS

| | Patents | Computer software | Total |
|---|---|---|---|
| | *RMB'000* | *RMB'000* | *RMB'000* |
| At 1 January 2013 | | | |
| Cost | 1,529 | 100 | 1,629 |
| Accumulated amortisation | — | (25) | (25) |
| Net book amount | 1,529 | 75 | 1,604 |
| Year ended 31 December 2013 | | | |
| Opening net book amount | 1,529 | 75 | 1,604 |
| Additions | 6,880 | — | 6,880 |
| Amortisation charge | (151) | (22) | (173) |
| Closing net book amount | 8,258 | 53 | 8,311 |
| At 31 December 2013 | | | |
| Cost | 8,409 | 100 | 8,509 |
| Accumulated amortisation | (151) | (47) | (198) |
| Net book amount | 8,258 | 53 | 8,311 |
| Year ended 31 December 2014 | | | |
| Opening net book amount | 8,258 | 53 | 8,311 |
| Additions | 4,087 | 1,380 | 5,467 |
| Amortisation charge | (440) | (55) | (495) |
| Closing net book amount | 11,905 | 1,378 | 13,283 |
| At 31 December 2014 | | | |
| Cost | 12,496 | 1,480 | 13,976 |
| Accumulated amortisation | (591) | (102) | (693) |
| Net book amount | 11,905 | 1,378 | 13,283 |
| Year ended 31 December 2015 | | | |
| Opening net book amount | 11,905 | 1,378 | 13,283 |
| Additions | 5,459 | 293 | 5,752 |
| Amortisation charge | (1,288) | (319) | (1,607) |
| Closing net book amount | 16,076 | 1,352 | 17,428 |
| At 31 December 2015 | | | |
| Cost | 17,955 | 1,773 | 19,728 |
| Accumulated amortisation | (1,879) | (421) | (2,300) |
| Net book amount | 16,076 | 1,352 | 17,428 |

Amortisation was included in administrative expenses. No impairment charge was recognised during the Relevant Periods.

## 15. FINANCIAL INSTRUMENTS BY CATEGORY

| | As at 31 December | | |
|---|---|---|---|
| | 2013 | 2014 | 2015 |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| **Assets as per balance sheet** | | | |
| Derivative financial instruments | 1,529 | — | — |
| Loans and receivables: | | | |
| Trade and other receivables (excluding prepayments) | 20,184 | 43,521 | 35,891 |
| Amounts due from related parties | 2,048 | — | 1,983 |
| Restricted bank deposits | 4,401 | 1,914 | — |
| Cash and bank balances | 128,372 | 127,077 | 119,342 |
| | 156,534 | 172,512 | 157,216 |

| | As at 31 December | | |
|---|---|---|---|
| | 2013 | 2014 | 2015 |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| **Liabilities as per balance sheet** | | | |
| Derivative financial instruments | — | 366 | — |
| Liabilities measured at amortized cost: | | | |
| Trade payables (excluding non-financial liabilities) | 34,680 | 30,078 | 22,829 |
| Accruals for expenses and other payables | 11,252 | 17,598 | 10,090 |
| Amounts due to related parties | 1,818 | 15,812 | 109 |
| | 47,750 | 63,854 | 33,028 |

## 16. TRADE AND OTHER RECEIVABLES

| | As at 31 December | | |
|---|---|---|---|
| | 2013 | 2014 | 2015 |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Trade receivables | 2,466 | 15,422 | 21,738 |
| Bills receivable | 6,576 | — | — |
| Prepayments for purchases of raw materials | 2,354 | 829 | — |
| Rental deposits | 273 | 2,001 | 1,946 |
| Custom deposits for raw materials | — | — | 3,132 |
| Other deposits | 236 | 522 | 548 |
| Value added tax allowance | 3,205 | 6,020 | 3,807 |
| Export rebates receivables | 6,031 | 15,113 | 3,315 |
| Prepaid expenses | 1,328 | 3,645 | 1,066 |
| Others | 69 | 798 | 339 |
| | 22,538 | 44,350 | 35,891 |

(a) The carrying amounts of the trade receivables are denominated in the following currencies:

| | As at 31 December | | |
|---|---|---|---|
| | **2013** | **2014** | **2015** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| RMB | 362 | 950 | 14,664 |
| USD | 2,104 | 14,472 | 7,074 |
| | 2,466 | 15,422 | 21,738 |

(b) The credit period granted to customers is generally between 30 and 90 days based on invoices date. The ageing analysis of the trade receivables from the date of sales is as follows:

| | As at 31 December | | |
|---|---|---|---|
| | **2013** | **2014** | **2015** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Less than 3 months | 2,466 | 15,422 | 20,447 |
| More than 3 months but not exceeding 1 year | — | — | 1,291 |
| More than 1 year | — | — | — |
| | 2,466 | 15,422 | 21,738 |

The Target Group's sales are made to various customers. While there is concentration of credit risk within a few major customers, these customers are reputable with good track record.

As at 31 December 2013, 2014 and 2015, trade receivables of RMB Nil, RMB Nil, and RMB1,081,000, respectively, were past due but not considered impaired. These related to a number of independent customers that have a good track record with the Target Group. Based on past experience, management believes that no impairment allowance is necessary in respect of these balances as there has been no significant change in credit quality and the balances are still considered fully recoverable. The Target Group does not hold any collateral over these balances. The ageing analysis of these past due trade receivables is as follows:

| | As at 31 December | | |
|---|---|---|---|
| | **2013** | **2014** | **2015** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Less than 3 months | — | — | 1,081 |
| More than 3 months but not exceeding 1 year | — | — | — |
| More than 1 year | — | — | — |
| | — | — | 1,081 |

As at 31 December 2013, 2014 and 2015, no trade receivables were impaired.

The carrying amounts of other receivables were primarily denominated in RMB and the fair values of trade and other receivables approximate their carrying amounts as at 31 December 2013, 2014 and 2015, respectively.

## 17. INVENTORIES

Inventories are summarized as follows:

| | As at 31 December | | |
|---|---|---|---|
| | 2013 | 2014 | 2015 |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Raw materials | 6,470 | 9,936 | 12,977 |
| Work in progress | 14,939 | 3,892 | 7,325 |
| Finished goods | 5,364 | 11,757 | 8,983 |
| | 26,773 | 25,585 | 29,285 |
| Less: allowance for impairment | — | (1,271) | — |
| | 26,773 | 24,314 | 29,285 |

The cost of inventories included in cost of sales for the year ended 31 December 2013, 2014 and 2015 were RMB313,856,000, RMB392,240,000 and RMB139,120,000, respectively.

The movements of allowance for impairment are analysed as follows:

| | Year ended 31 December | | |
|---|---|---|---|
| | 2013 | 2014 | 2015 |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| At beginning of the year | — | — | 1,271 |
| Allowance for impairment of inventory | — | 1,271 | — |
| Written off | — | — | (1,271) |
| At end of the year | — | 1,271 | — |

The Target Group wrote off an allowance for impairment of inventory of RMB1,271,000 in 2015 as the Group has sold all these finished goods in 2015.

## 18. CASH AND CASH EQUIVALENTS

| | As at 31 December | | |
|---|---|---|---|
| | 2013 | 2014 | 2015 |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Cash and bank balances | 128,372 | 127,077 | 119,342 |

The carrying amounts of cash and cash equivalents approximate to their fair values and represent maximum exposure to credit risk at each of the reporting dates.

Cash and cash equivalents are denominated in the following currencies:

| | As at 31 December | | |
|---|---|---|---|
| | 2013 | 2014 | 2015 |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| HK$ | 314 | 215 | 131 |
| RMB | 37,003 | 33,188 | 7,404 |
| USD | 91,055 | 93,674 | 111,807 |
| | 128,372 | 127,077 | 119,342 |

Cash and cash equivalents including the following for the purpose of the statements of cash flows:

| | As at 31 December | | |
|---|---|---|---|
| | 2013 | 2014 | 2015 |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Cash and cash equivalents | 128,372 | 127,077 | 119,342 |

## 19. RESTRICTED BANK DEPOSITS

As at 31 December 2013 and 2014, bank deposits amounting to the Group are RMB4,401,000 and RMB1,914,000 are deposits held by the bank in a segregated account as security for the foreign exchange forward contracts.

As at 31 December 2013 and 2014, the weighted average interest rates were 3.25% and 3.25%, respectively.

## 20. DEFERRED INCOME TAX ASSETS

The analysis of deferred income tax assets is as follows:

| | As at 31 December | | |
|---|---|---|---|
| | 2013 | 2014 | 2015 |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Deferred income tax assets: | | | |
| to be recovered within 12 months | 2,907 | 5,807 | 2,618 |

The movements in deferred income tax assets are as follows:

| Deferred income tax assets | Provisions | Tax losses | Total |
|---|---|---|---|
| | *RMB'000* | *RMB'000* | *RMB'000* |
| As at 1 January 2013 | 286 | — | 286 |
| Recognised in the profit or loss | 1,310 | 1,311 | 2,621 |
| As at 31 December 2013 | 1,596 | 1,311 | 2,907 |
| As at 1 January 2014 | 1,596 | 1,311 | 2,907 |
| Recognised in the profit or loss | 2,654 | 246 | 2,900 |
| As at 31 December 2014 | 4,250 | 1,557 | 5,807 |
| As at 1 January 2015 | 4,250 | 1,557 | 5,807 |
| Recognised in the profit or loss | (1,632) | (1,557) | (3,189) |
| As at 31 December 2015 | 2,618 | — | 2,618 |

Deferred income tax assets are recognised for tax losses carry forwards to the extent that realisation of the related tax benefit through future taxable profits is probable.

As at 31 December 2013, 2014 and 2015, the Target Group did not recognise deferred tax liabilities of RMB1,859,000, RMB4,763,000 and RMB6,257,000, respectively, on approximately RMB18,594,000, RMB47,628,000 and RMB62,574,000 of profits generated by its PRC subsidiaries since their establishment as the directors confirmed that no dividends would be declared by the Target Group out of those profits in the foreseeable future considering the cash flow requirements of the Target Group.

As of 31 December 2013, 2014 and 2015, the Target Group had tax loss carry forwards of RMB1,311,000, RMB1,557,000 and RMB Nil, which can be carried forward to offset future taxable income. The net operating tax loss carry forwards, excluding Hong Kong subsidiaries, will begin to expire as follows:

| | As at 31 December | | |
|---|---|---|---|
| | 2013 | 2014 | 2015 |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| 2018 | 1,311 | — | — |
| 2019 | — | 1,557 | — |
| | 1,311 | 1,557 | — |

## 21. NOTES TO THE STATEMENTS OF CASH FLOWS

**(a)** Reconciliation of profit before taxation to cash generated from operations:

| | As at 31 December | | |
|---|---|---|---|
| | **2013** | **2014** | **2015** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Profit before income tax | 129,369 | 172,889 | 53,951 |
| Adjustments for: | | | |
| Depreciation of property, plant and equipment *(Note 13)* | 1,217 | 17,401 | 22,936 |
| Amortisation of intangible assets *(Note 14)* | 173 | 495 | 1,607 |
| Loss on disposal of property, plant and equipment *(Note 6)* | — | — | 923 |
| Fair value changes on derivative financial instruments *(Note 6)* | (1,529) | 1,895 | (366) |
| Provision of inventory impairment | — | 1,271 | — |
| Share of profits in equity method investments | (607) | — | — |
| Losses from disposal of investments in associates *(Note 6)* | 480 | — | — |
| Changes in working capital: | | | |
| Inventories | (31) | 1,694 | (3,377) |
| Trade and other receivables | (20,310) | (21,773) | 3,117 |
| Due from related parties | (1,480) | 1,480 | — |
| Trade and other payables | 133,156 | (50,703) | (44,073) |
| Due to related parties | (12,706) | (1,331) | (378) |
| Cash generated from operations | 227,732 | 123,318 | 34,340 |

**(b)** In the consolidated statements of cash flows, proceeds from disposals of property, plant and equipment comprise:

| | Year ended 31 December | | |
|---|---|---|---|
| | **2013** | **2014** | **2015** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Net book amount | | | |
| Other disposals *(Note 13)* | 28 | 2,183 | 1,475 |
| Loss on disposal *(Note 6)* | — | — | (923) |
| Proceeds from disposal | 28 | 2,183 | 552 |

**(c) Non-cash financing transactions**

The non-cash transactions mainly include the deemed distribution and contribution as described in Note 29(b)(v).

Dividends of RMB11,095,000 was settled through the current accounts with the Founder Shareholders in 2014.

## 22. TRADE AND OTHER PAYABLES

| | As at 31 December | | |
|---|---|---|---|
| | **2013** | **2014** | **2015** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Trade payables | 34,680 | 30,078 | 22,829 |
| Wages and staff welfare benefits payable | 15,932 | 27,594 | 15,014 |
| Accrual for expenses and other payables | 11,252 | 17,598 | 10,090 |
| Other taxes payable | 5,227 | 11,845 | 13,882 |
| | 67,091 | 87,115 | 61,815 |

(a) The Target Group's trade payables are denominated in the following currencies:

| | As at 31 December | | |
|---|---|---|---|
| | **2013** | **2014** | **2015** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| RMB | 34,680 | 29,781 | 19,320 |
| USD | — | 297 | 3,509 |
| | 34,680 | 30,078 | 22,829 |

The carrying amounts of accrued expenses and other payables were primarily denominated in RMB.

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

| | As at 31 December | | |
|---|---|---|---|
| | **2013** | **2014** | **2015** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Less than 3 months | 19,830 | 29,973 | 20,606 |
| More than 3 months but not exceeding 1 year | 11,070 | 104 | 2,082 |
| More than 1 year | 3,780 | 1 | 141 |
| | 34,680 | 30,078 | 22,829 |

(c) The fair values of trade and other payables approximated their carrying amounts as at 31 December 2013, 2014 and 2015, respectively.

## 23. DIVIDENDS

The Group paid dividends of RMB34,132,000, RMB55,445,000 and RMB19,672,000 to the Founder Shareholders during the year ended 31 December 2013, 2014 and 2015, respectively.

## 24. DERIVATIVE FINANCIAL INSTRUMENTS

| | As at 31 December | | |
|---|---|---|---|
| | **2013** | **2014** | **2015** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Derivative financial assets — Current | 1,529 | — | — |
| Derivative financial liabilities — Current | — | 366 | — |

| | **Amount** | **Notional amount** |
|---|---|---|
| | *RMB'000* | *RMB'000* |
| **As at 31 December 2013** | | |
| Derivative financial Assets — Current | | |
| **Types of contracts** | | |
| Currency forward contracts | 1,529 | 48,000 |
| **As at 31 December 2014** | | |
| Derivative financial liabilities — Current | | |
| **Types of contracts** | | |
| Currency forward contracts | 366 | 5,000 |

Changes in fair values of derivative financial instruments are recorded in 'Other (losses)/gains — net' in the consolidated income statements.

## 25. SHARE CAPITAL AND CAPITAL RESERVES

(i) Share capital of the Target:

| | **Number of ordinary shares** | **Share capital** | **Equivalent to** |
|---|---|---|---|
| | *(thousand shares)* | *USD* | *RMB* |
| Issued and fully paid: | | | |
| Ordinary share of USD0.00001 each, at 7 May 2014 (Date of incorporation), 31 December 2014 and 2015 | 100,000 | 1,000 | 6,000 |

(ii) Capital reserves represents the merger reserve arising from the Reorganisation net off deemed contribution and distribution during the Relevant Periods.

## 26. OTHER RESERVES

Other reserves comprise statutory reserves and exchange reserves of the Target Group.

**Statutory reserves**

In accordance with relevant laws and regulations of the PRC, the PRC subsidiaries of the Target Group are required to make appropriation of not less than 10% of its net income after taxes to reserves. Further appropriation is optional when the accumulated statutory reserve is 50% or more of its registered capital. The statutory reserves can be used to offset accumulated losses of the PRC subsidiaries upon the approval of their respective boards of directors.

## 27. CONTINGENT LIABILITIES

As at 31 December 2013, 2014 and 2015, the Target Group had no significant contingent liabilities.

## 28. COMMITMENTS

**Operating lease commitments**

The Target Group leases premises under non-cancellable operating lease agreements.

The Target Group had future aggregate minimum lease payments under non-cancellable operating leases as follows:

| | As at 31 December | | |
|---|---|---|---|
| | **2013** | **2014** | **2015** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Not later than 1 year | 4,085 | 11,726 | 8,944 |
| Later than 1 year and not later than 5 years | 14,799 | 27,184 | 18,240 |
| Later than 5 years | 3,700 | — | — |
| | 22,584 | 38,910 | 27,184 |

## 29. RELATED PARTY TRANSACTIONS

**(a)** The following companies and individuals were related parties of the Target Group that had transactions or balances with the Target Group during the Relevant Periods:

| **Name of the related party** | **Relationship with the Group** |
|---|---|
| Wye Industrial Co., Limited ("Wye") | A company controlled by shareholders of the Target Group |
| Huizhou Everpower Technology Co., Ltd. ("Huizhou Everpower") | An associate of the Target Group prior to 10 December 2013 |
| Huizhou Huiderui Lithium Battery Technology Co., Ltd. ("Huizhou Huiderui") | An associate of the Target Group prior to 21 October 2013 |
| Founder Shareholders | Shareholders and directors of the Company |

**(b) Transactions with the related parties during the Relevant Periods**

**(i) *Sales of goods***

| | Year ended 31 December | | |
|---|---|---|---|
| | **2013** | **2014** | **2015** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Wye | 78,531 | — | — |

Goods are sold based on the price lists in force and terms that would be available to third parties.

**(ii) *Purchases of raw materials***

| | Year ended 31 December | | |
|---|---|---|---|
| | **2013** | **2014** | **2015** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Huizhou Everpower | 29,179 | 5,356 | 2,787 |
| Huizhou Huiderui | 5,311 | 783 | — |
| | 34,490 | 6,139 | 2,787 |

Goods and services are bought from entities controlled by Founder Shareholders on normal commercial terms and conditions.

**(iii) *Loss on disposal of investment in associates***

| | Year ended 31 December | | |
|---|---|---|---|
| | **2013** | **2014** | **2015** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Net book amount | 7,953 | — | — |
| Loss on disposals | (480) | — | — |
| Proceeds from disposals | 7,473 | — | — |

**(iv) *Key management personnel compensation***

| | Year ended 31 December | | |
|---|---|---|---|
| | **2013** | **2014** | **2015** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Wages, salaries and bonuses | 4,459 | 4,107 | 3,805 |
| Pension costs — defined contribution plans | 7 | 7 | 9 |
| | 4,466 | 4,114 | 3,814 |

**(v) *Deemed contribution and distribution***

| | Year ended 31 December | | |
|---|---|---|---|
| | **2013** | **2014** | **2015** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Deemed contribution *(Note (i))* | 7,008 | — | — |
| Deemed distribution *(Note (ii))* | — | (20,016) | — |
| | 7,008 | (20,016) | — |

*Notes:*

(i) During the year ended 31 December 2013, the Target Group recognised deemed contribution from the Founder Shareholders for additional capital contributions in cash of RMB7,008,000 to the Target Group.

(ii) During the year ended 31 December 2014, the Target Group recognised deemed distributions of RMB20,016,000 to the Founder Shareholders as considerations for the transfer in of Huizhou Kimree Technology Co., Ltd. that had already been included in the financial Information of the Target Group for the Relevant Periods.

**(c) Balances due from related parties**

| | As at 31 December | | | | | |
|---|---|---|---|---|---|---|
| | **Maximum balance outstanding during the year** | **2013** | **Maximum balance outstanding during the year** | **2014** | **Maximum balance outstanding during the year** | **2015** |
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* |
| Wye | 32,085 | 1,480 | 1,480 | — | — | — |
| Founder Shareholders | 568 | 568 | 568 | — | 1,983 | 1,983 |
| | 32,653 | 2,048 | 2,048 | — | 1,983 | 1,983 |

The balances due from related parties were mainly denominated in RMB. They were unsecured and interest-free. The balances with Wye was trading in nature and due within 3 months, all other balances with related parties were non-trading in nature and repayable on demand. Their fair values approximate their carrying amounts at each of the reporting dates.

### (d) Balances due to related parties

| | As at 31 December | | |
|---|---|---|---|
| | **2013** | **2014** | **2015** |
| | *RMB'000* | *RMB'000* | *RMB'000* |
| Huizhou Everpower | 1,194 | 465 | 109 |
| Huizhou Huiderui | 624 | 22 | — |
| Founder Shareholders | — | 15,325 | — |
| | 1,818 | 15,812 | 109 |

The balances due to related parties were mainly denominated in RMB. They were unsecured and interest-free. The balances with Huizhou Everpower and Huizhou Huiderui were trading in nature and due within 3 months, all other balances with related parties were non-trading in nature and repayable on demand. Their fair values approximate their carrying amounts at each of the reporting dates.

## 30. NOTES TO THE BALANCE SHEETS OF THE TARGET

### (a) Investments in subsidiaries

| | As at 31 December | |
|---|---|---|
| | **2014** | **2015** |
| | *RMB'000* | *RMB'000* |
| Unlisted shares, at cost | 86,033 | 86,033 |

### (b) Amounts due to the Founder Shareholders

The amounts due to the Founder Shareholders were denominated in HK$. They were unsecured, interest-free and repayable on demand. Their carrying amounts approximated their fair values at 31 December 2014 and 2015.

## 31. SUBSEQUENT EVENTS

Save as disclosed elsewhere in the report, there is no significant event took place after 31 December 2015.

## III SUBSEQUENT FINANCIAL STATEMENTS

No audited financial statements have been prepared by the Target or any of its subsidiaries in respect of any period subsequent to 31 December 2015 up to the date of this report. No dividend or distribution has been declared or made by the Target or any of its subsidiaries in respect of any period subsequent to 31 December 2015.

Yours faithfully,

**PricewaterhouseCoopers**
*Certified Public Accountants*
Hong Kong

## UNAUDITED PRO FORMA FINANCIAL INFORMATION OF THE ENLARGED GROUP

The following is an illustrative and unaudited pro forma consolidated statement of assets and liabilities of the Enlarged Group as at 31 December 2015 (the "Unaudited Pro Forma Financial Information") which has been prepared based on the basis of the notes set out below for the purpose of illustrating the effect of the proposed acquisition of the entire equity interest of Kimree, Inc. (the "Proposed Acquisition"), as if the Proposed Acquisition had been taken place on 31 December 2015. 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 of the Enlarged Group had the Proposed Acquisition been completed as at 31 December 2015 or at any future date.

The Unaudited Pro Forma Financial Information of the Enlarged Group should be read in conjunction with other financial information included elsewhere in this circular.

## UNAUDITED PRO FORMA CONSOLIDATED STATEMENT OF ASSETS AND LIABILITIES OF THE ENLARGED GROUP

| | | | Pro Forma Adjustments | | |
|---|---|---|---|---|---|
| | **Audited consolidated statement of assets and liabilities of the Group as at 31 December 2015** | **The Target Group as at 31 December 2015** | **Other pro forma adjustments** | | **Unaudited pro forma consolidated statement of assets and liabilities of the Enlarged Group** |
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* |
| | *Note 1* | *Note 2* | *Note 3* | *Note 4* | |
| **ASSETS** | | | | | |
| **Non-current assets** | | | | | |
| Property, plant and equipment | 704,054 | 78,289 | | | 782,343 |
| Investment property | 397,247 | — | | | 397,247 |
| Land use rights | 89,586 | — | | | 89,586 |
| Goodwill | — | — | 418,216 | | 418,216 |
| Intangible assets | 494 | 17,428 | 185,444 | | 203,366 |
| Deferred income tax assets | 627 | 2,618 | | | 3,245 |
| Prepayments | — | 616 | | | 616 |
| | **1,192,008** | **98,951** | | | **1,894,619** |
| **Current assets** | | | | | |
| Inventories | 78,810 | 29,285 | | | 108,095 |
| Trade and other receivables | 313,286 | 35,891 | (3,000) | | 346,177 |
| Due from related parties | — | 1,983 | | | 1,983 |
| Cash and cash equivalents | 214,128 | 119,342 | | (3,900) | 329,570 |
| | **606,224** | **186,501** | | | **785,825** |
| **Total assets** | **1,798,232** | **285,452** | | | **2,680,444** |
| **LIABILITIES** | | | | | |
| **Non-current liabilities** | | | | | |
| Other payables | — | — | 77,267 | | 77,267 |
| Deferred government grants | 40,418 | — | | | 40,418 |
| Deferred income tax liabilities | 11,610 | — | 46,361 | | 57,971 |
| Borrowings | 18,321 | — | 597,000 | | 615,321 |
| | **70,349** | **—** | | | **790,977** |
| **Current liabilities** | | | | | |
| Advance from customers | — | 7,698 | | | 7,698 |
| Trade and other payables | 119,486 | 61,815 | 35,993 | | 217,294 |
| Amounts due to related parties | — | 109 | | | 109 |
| Current income tax liabilities | 30,815 | 59,869 | | | 90,684 |
| Borrowings | 148,500 | — | | | 148,500 |
| | **298,801** | **129,491** | | | **464,285** |
| **Total liabilities** | **369,150** | **129,491** | | | **1,255,262** |

## NOTES TO THE UNAUDITED PRO FORMA CONSOLIDATED STATEMENT OF ASSETS AND LIABILITIES OF THE ENLARGED GROUP

1. The audited consolidated statement of assets and liabilities of the Group as at 31 December 2015 is extracted from the published annual report of the Group for the year ended 31 December 2015.

2. The audited consolidated statement of assets and liabilities of the Target Group as at 31 December 2015 is extracted from the accountant's report of the Target Group as set out in Appendix II to this circular.

3. Upon completion of the Proposed Acquisition, the identifiable assets and liabilities of the Target Group will be accounted for in the consolidated financial statements of the Enlarged Group at their fair value under the acquisition method in accordance with Hong Kong Financial Reporting Standard 3 "Business Combinations" ("HKFRS 3") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA").

   The adjustments represent the recognition of goodwill of approximately RMB418,216,000 arising from the Proposed Acquisition, being the excess amount of the discounted cash consideration transferred of the Proposed Acquisition and deferred tax liabilities over the fair value of acquired identifiable net assets of the Target Group, and is calculated as follows:

| | *Note* | *RMB'000* |
|---|---|---|
| Total cash consideration | | 750,000 |
| Less: discounting effect on contingent payables | | (36,740) |
| **Discounted cash consideration transferred** | *a* | 713,260 |
| **Less: Fair value of identifiable net assets** | *b* | |
| Carrying amount of net assets of the Target Group | | 155,961 |
| Intangible assets identified | *i* | 185,444 |
| Deferred tax liabilities recognised | *ii* | (46,361) |
| Goodwill | | 418,216 |

*Notes:*

(a) In accordance with the Sales and Purchases Agreement ("SPA") entered by the six founding shareholders and the Group on 25 January 2016, the total cash consideration of the Proposed Acquisition is RMB750,000,000, which includes a contingent consideration of RMB150,000,000 stated on the contract. Taking into account of the discount effect of the cash consideration based on the discount rate of 14.49%, the discounted amount is RMB713,260,000. The contingent consideration will be settled based on the future expected profits after tax in the coming three years after the completion of the Proposed Acquisition. In the fiscal year of 2016, a contingent consideration of RMB41,208,800 will be paid if the Audited Consolidated Net Profit of the Target

Company of RMB60,000,000 can be achieved. Another contingent consideration of RMB49,450,500 will be paid if the Audited Consolidated Net Profit of the Target Company of RMB72,000,000 can be achieved in fiscal year of 2017. The last payment of contingent consideration of RMB59,340,700 will be settled in fiscal year of 2018 if the Audited Consolidated Net Profit of the Target Company of RMB86,400,000 can be achieved. For the purpose of preparing the Unaudited Pro Forma Financial Information of the Enlarged Group, the Directors has assumed that the required financial results of the contingent consideration for the year ending 31 December 2016, 2017 and 2018 can be fulfilled.

(b) The Directors of the Company have determined the fair values of the identifiable assets and liabilities of the Target Group as at 31 December 2015 with reference to the valuation report (the "Valuation") prepared by an independent valuer, BMI Appraisals Limited. The fair values of the identifiable assets and liabilities of the Target Group, which mainly include property, plant and equipment valued under the market approach and cost approach, intangible assets valued under the income approach and inventories valued under the cost approach.

(i) Intangible assets represent the fair values of non-compete agreement of approximately RMB14,179,000, patents of approximately RMB54,345,000, customer relationships of approximately RMB116,920,000.

The non-compete agreement refers to the non-compete clause in the Acquisition Agreement, of which its fair value is determined using the "with and without" method under the income approach at the discount rate of 14.49% in the Valuation.

The patents represent the e-cigarettes patents. Its fair value is calculated using the relief-from-royalty method under the income approach and the discount rate of patents was 14.99%.

The customer relationships refer to long-time business relationship and history with key customers. According to the Valuation, the fair value of the customer relationships is determined using multi-period excess earnings method under the income approach at the discount rate of 14.99%.

(ii) Deferred tax liabilities arose from the difference between the tax base and fair value of intangible assets. Tax rate of 25% was used to calculate deferred income tax liabilities as it is the tax rate expected to be applied to the Target Group in the period when the liabilities are settled.

(c) For the purpose of preparing the Unaudited Pro Forma Financial Information of the Enlarged Group, fair values of the net assets of Target Group as at 31 December 2015 were used to determine the goodwill of the Proposed Acquisition. Upon completion of the Acquisition, the fair values of the net assets of Target Group as at the date of Completion will be used to determine the actual amount of goodwill of the Proposed Acquisition. Such actual amount may be different from the amount presented herein and such difference may be significant.

The Directors confirm that consistent policies and assumptions have been applied for the purpose of assessing impairment of goodwill and other intangible assets under HKAS 36 "Impairment of Assets", and the Directors of the Company are not aware of any indications that an impairment of the Enlarged Group's goodwill and other intangible assets is required after considering the nature, prospects, financial condition and business risks of the Enlarged Group.

4. The adjustment is made to reflect the accrual for the estimated transaction expenses, such as professional fees and printing costs, of approximately RMB3,900,000 incurred that directly attributable to the Proposed Acquisition.

5. No other adjustment has been made to the Unaudited Pro Forma Financial Information to reflect any trading results or other transactions of the Group and the Target Group entered into subsequent to 31 December 2015.

*The following is the text of a report received from PricewaterhouseCoopers, Certified Public Accountants, Hong Kong, for the purpose of incorporation in this circular.*

pwc 羅兵咸永道

**INDEPENDENT REPORTING ACCOUNTANT'S ASSURANCE REPORT ON THE COMPILATION OF UNAUDITED PRO FORMA FINANCIAL INFORMATION**

To the Directors of China Flavors and Fragrances Company Limited

We have completed our assurance engagement to report on the compilation of unaudited pro forma financial information of China Flavors and Fragrances Company Limited (the "Company") and its subsidiaries (collectively the "Group"), and Kimree, Inc. and its subsidiaries (the "Target Group") (collectively the "Enlarged Group") by the directors for illustrative purposes only. The unaudited pro forma financial information consists of the unaudited pro forma statement of assets and liabilities as at 31 December 2015 and related notes (the "Unaudited Pro Forma Financial Information") as set out on pages III-1 to III-4 of the Company's circular dated 18 April 2016, in connection with the proposed acquisition of the Target Group (the "Transaction") by the Company. The applicable criteria on the basis of which the directors have compiled the Unaudited Pro Forma Financial Information are described on pages III-1 to III-4.

The Unaudited Pro Forma Financial Information has been compiled by the directors to illustrate the impact of the Transaction on the Group's financial position as at 31 December 2015 as if the Transaction had taken place at 31 December 2015. As part of this process, information about the Group's financial position has been extracted by the directors from the Group's financial statements for the year ended 31 December 2015, on which an audit report has been published.

**Directors' Responsibility for the Unaudited Pro Forma Financial Information**

The directors are responsible for compiling 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 with reference to Accounting Guideline 7 "Preparation of Pro Forma Financial Information for Inclusion in Investment Circulars" ("AG 7") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA").

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**Our Independence and Quality Control**

We have complied with the independence and other ethical requirement of the Code of Ethics for Professional Accountants issued by the HKICPA, which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.

Our firm applies Hong Kong Standard on Quality Control 1 issued by the HKICPA and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

**Reporting Accountant's Responsibilities**

Our responsibility is to express 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. We do not accept any responsibility for any reports previously given by us on any financial information used in the compilation of the Unaudited Pro Forma Financial Information beyond that owed to those to whom those reports were addressed by us at the dates of their issue.

We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3420 "Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus", issued by the HKICPA. This standard requires that the reporting accountant plans and performs procedures to obtain reasonable assurance about whether the directors have compiled the Unaudited Pro Forma Financial Information in accordance with paragraph 4.29 of the Listing Rules and with reference to AG 7 issued by the HKICPA.

For purposes of this engagement, we are not responsible for updating or reissuing any reports or opinions on any historical financial information used in compiling the Unaudited Pro Forma Financial Information, nor have we, in the course of this engagement, performed an audit or review of the financial information used in compiling the Unaudited Pro Forma Financial Information.

The purpose of unaudited pro forma financial information included in a circular is solely to illustrate the impact of a significant event or transaction on unadjusted financial information of the entity as if the event had occurred or the transaction had been undertaken at an earlier date selected for purposes of the illustration. Accordingly, we do not provide any assurance that the actual outcome of the Transaction at 31 December 2015 would have been as presented.

A reasonable assurance engagement to report on whether the unaudited pro forma financial information has been properly compiled on the basis of the applicable criteria involves performing procedures to assess whether the applicable criteria used by the directors in the compilation of the unaudited pro forma financial information provide a reasonable basis for presenting the significant effects directly attributable to the event or transaction, and to obtain sufficient appropriate evidence about whether:

- The related pro forma adjustments give appropriate effect to those criteria; and
- The unaudited pro forma financial information reflects the proper application of those adjustments to the unadjusted financial information.

The procedures selected depend on the reporting accountant's judgment, having regard to the reporting accountant's understanding of the nature of the company, the event or transaction in respect of which the unaudited pro forma financial information has been compiled, and other relevant engagement circumstances.

The engagement also involves evaluating the overall presentation of the unaudited pro forma financial information.

We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

**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.

**PricewaterhouseCoopers**
*Certified Public Accountants*
Hong Kong, 18 April 2016

Set out below is the management discussion and analysis of the Target Company for each of the year ended 31 December 2013, 2014 and 2015. The Target Company was incorporated in the Cayman Islands on 7 May 2014 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 Target Company became the holding company of its subsidiaries, which are all located in the PRC, Hong Kong and BVI, now comprising the Target Group through a restructure of companies (the "**Reorganization**") which was completed on 22 August 2014, and conducts its business operations through its subsidiaries.

## BUSINESS REVIEW

The Target Company is a world-leading e-cigarette company and the Target Group designs and manufactures high quality e-cigarette products with production base in Guangdong Province, China. Most of the Target Group's products are sold by tobacco companies, independent e-cigarette makers and other customers under different brands. The Target Group has a strong customer base with customers from over 20 countries. Customers of its e-cigarette products include a majority of global tobacco companies as well as top independent e-cigarette brands. Therefore, the demand for the Target Group's products is driven by the demand and success of its customers' products and the Target Group's revenues are further affected by the demand from customers in different regions. Most of the Target Group's products are sold in the United States and the European Union. According to Frost & Sullivan, the United States and the European Union are the most important e-cigarette markets, each representing 41.6% and 28.5% of global e-cigarette sales in 2013, respectively. The Target intends to maintain its market share in the United States and European Union and further increase market share in the PRC.

The Target Group enjoyed continued business growth in 2014 but recorded lower turnover in 2015. The reduction in turnover was mainly affected by (i) market change of e-smokers preferring bigger-size rechargeable e-cigarettes than mini e-cigarettes and (ii) loss of a big order due to delay in launching new bigger-size rechargeable e-cigarettes to the market in the third quarter of 2015 by the Target Group.

### Segment information

The Target Group has considered the nature of the Target Group's business and determined that it has three reportable segments as follows: (i) disposal e-cigarettes, (ii) rechargeable e-cigarettes and (iii) e-cigarettes accessories. Disposal e-cigarettes are generally equipped with a single-use integrated cartridge and are disposed of when fully depleted. These disposable e-cigarettes resemble traditional cigarettes or cigars in appearance and texture to more novel designs. It can also imitate the ash and smoke effect of traditional cigarettes. Rechargeable e-cigarettes include rechargeable batteries and replaceable cartridges and heating units, allowing users to re-fill liquid solutions on their own. E-cigarette accessories are high quality atomizers and cartomizers compatible with the Target Group's rechargeable e-cigarette products and the Target Group sells cartridges containing liquid solutions with different flavors, such as tobacco, vanilla, coffee and fruits. It can be purchased as replacements or accessories of Ekmizer, a personal vaporizer. Other e-cigarette products and accessories include such as PCC cigarette cases and USB chargers.

**Revenue**

The revenue of the Target Company for each of the year ended 31 December 2013, 2014 and 2015 were approximately RMB492,205,000, RMB659,975,000 and RMB236,198,000 respectively. The growth of revenue in 2014 was in tandem with the growth of the global e-cigarette market based on (i) increasing consumer acceptance of e-cigarette products resulting from the conversion of traditional cigarette smokers and new user uptake; (ii) the entry of tobacco companies with significant resources for marketing activities into the e-cigarette market through acquisitions or the introduction of their own e-cigarette product lines; and (iii) continued innovation and product development by e-cigarette manufacturers.

***Disposable e-cigarettes***

The disposable e-cigarette segment recorded revenue of approximately RMB199,933,000, RMB9,821,000 and RMB22,895,000 for the years of 2013, 2014 and 2015 respectively. The revenue decrease in 2014 was mainly attributable to changing consumer tastes of switching to rechargeable e-cigarettes.

***Rechargeable e-cigarettes***

The rechargeable e-cigarettes segment recorded revenue of approximately RMB155,260,000, RMB410,736,000 and RMB205,116,000 for the years of 2013, 2014 and 2015 respectively. The segment grew significantly in 2014 because it benefitted from e-smokers switching from disposable e-cigarettes to rechargeable e-cigarettes. However, rapid change of trend within the rechargeable e-cigarettes market that e-smokers preferred bigger-size rechargeable e-cigarettes than mini e-cigarettes in 2015 and the Target Group's delay in launching new bigger-size rechargeable e-cigarettes products only in the third quarter of the year resulting reduced order from one major customer, the Target Group recorded significant lower revenue in this segment in 2015.

***E-cigarettes accessories***

The e-cigarettes accessories recorded revenue of RMB137,012,000, RMB239,418,000 and RMB8,187,000 for the years of 2013, 2014 and 2015 respectively. This segment has a tendency to correlate the growth and performance of the rechargeable e-cigarettes.

**Gross Profit**

The gross profit of the Target Company for each of the year ended 31 December 2013, 2014 and 2015 were approximately RMB173,137,000, RMB265,122,000 and RMB95,048,000 respectively and the gross profit margin improved steadily with approximately 35.2%, 40.2% and 40.2% respectively in each of the three years mainly attributable to (i) the stable supply chain with lower raw material prices by leveraging the growing scale of the Target Group's business and higher production volumes and (ii) introduction of automated production lines to streamline production process to increase manufacturing efficiency.

**Expenses**

***Selling and marketing expenses***

The selling and marketing expenses for each of the year ended 31 December 2013, 2014 and 2015 were approximately RMB9,561,000, RMB11,753,000 and RMB12,610,000 respectively and the ratio of such expenses to revenue were 1.9%, 1.8% and 5.3% respectively in each of the three years. These selling and marketing expenses primarily consist of (i) marketing and advertising fees, (ii) staff cost of sales and marketing personnel, including welfare, social insurance, bonus and salary and (iii) shipping charges.

***Administrative expenses***

The administrative expenses for each of the year ended 31 December 2013, 2014 and 2015 were approximately RMB33,047,000, RMB80,303,000 and RMB36,412,000 respectively and the ratio of such expenses to revenue were 6.7%, 12.2% and 15.4% respectively for each of the three years. These administrative expenses primarily consist of staff cost of the administrative and the research and development personnel, including welfare, social insurance, bonus and salary, start-up cost of production plants, general office related expenses and research and development expenses. The rising ratio of these expenses to revenue was generally attributable to (i) continuous recruitment of administrative personnel to support the business expansion of the Target Group, (ii) increased research and development expenses for launch of more products, and (iii) one-off expenses related to attempted initial public offering.

**Net Profit**

The net profit for each of the year ended 31 December 2013, 2014 and 2015 were approximately RMB96,890,000, RMB140,654,000 and RMB42,532,000 respectively and the net profit margin was approximately 19.7%, 21.3% and 18.0% respectively in each of the three years. The net profit margin improved from 2013 to 2014 for the Target Group was overall able to price its e-cigarette products based on manufacturing costs and research and development expenses pursuant to the respective specifications requested by different customers. The Target Group also priced products differently based on the region where they are sold. Reduced costs attributable to the Target Group's automated production lines and economy of scale also contributed to the improvement in net profit margin. Though the aforesaid factors still in play in 2015, the net profit margin of the year incidentally retracted to 18.0% on the backdrop of substantial decline of turnover coupled with increasing depreciation and amortization expenses on fixed assets after the acquisitions of Kimree Huizhou and Geakon Huizhou in the preceding year.

## FINANCIAL REVIEW

As at 31 December 2013, 2014 and 2015, the net current assets of the Target Group were approximately RMB2,472,000, RMB15,686,000 and RMB57,010,000 respectively. The increase in net current assets in 2014 was mainly attributable to the decrease in advance from customers and the increase in net current assets in 2015 was mainly attributable to reduced advance which were mainly advance payments from customers and the decrease in trade and other payables from suppliers in the year. The current ratio for each of the year ended 31 December 2013, 2014 and 2015 were 1.01, 1.09 and 1.44 respectively.

As at 31 December 2013, 2014 and 2015, the cash and cash equivalents of the Target Group were approximately RMB128,372,000, RMB127,077,000 and RMB119,342,00 respectively. The cash and cash equivalents consisted of cash on hand and bank balances, which remained relatively stable in 2013 and 2014 but decreased in 2015 which was mainly attributable to the decrease in trade and other payables at the end of the year.

The Target Group maintains prudent liquidity risk management by maintaining sufficient cash and bank balances. As at 31 December 2013, 2014 and 2015, the Target Group did not have any bank borrowings therefore debt gearing ratio was nil for each of the year ended 31 December 2013, 2014 and 2015.

### Charge on Assets

As at 31 December 2013 and 2014, the Target Group had restricted bank deposits amounting to approximately RMB4,401,000, RMB1,914,000 respectively which were deposits held by bank in a segregated account as security for the foreign exchange forward contracts taken by the Target Group, and nil restricted bank deposits as at 31 December 2015.

### Foreign Exchange Risk

The Target operates mainly in the PRC, and is exposed to foreign currency risks arising from various currency exposures, mainly with respect to HK$ and US dollar which can negatively impact revenue, costs, margins and profit. Therefore the Target Group has adopted foreign currency policy and conducted foreign exchange forward contracts when needs arise. The conversion of RMB into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC Government.

### Contingent Liabilities

The Target Group did not have any material contingent liabilities as at 31 December 2013, 2014 and 2015.

**Capital Structure**

The share capital of the Target Company comprises ordinary shares from 7 May 2014 (date of incorporation), as at 31 December 2014 and 2015.

**Employees**

The Target Group had 2,761, 3,480 and 931 employees in the PRC as of 31 December 2013, 2014 and 2015, respectively. The total amounts of remuneration for the years of 2013, 2014 and 2015 were approximately RMB99,399,000, RMB119,881,000 and RMB47,594,000 respectively. The increase in the total remuneration amount of 2014 was mainly attributable to recruitment of additional administrative personnel to support the business growth in the rechargeable e-cigarettes segment. In 2015, the total number of staff went down in the wake of substantial decrease of business in the disposable e-cigarettes segment resulting restructure of human resources and reduction of the relevant production staff so lowering total remuneration amount for the subject year. As required by regulations in the PRC, the Target Group participates in various employee social security plans that are organized by municipal and provincial governments, including housing, pension, medical insurance, unemployment insurance, maternity insurance and work-related injury insurance. The Target Group is required under the PRC law to make contributions to employee benefit plans at specified percentages of the salaries, bonuses and certain allowances of the employees, up to a maximum amount specified by the local government from time to time.

**FUTURE PLANS**

There are no committed material investment, capital assets and expected source of funding. The Target Group shall continue to utilize its strong research and development capabilities and advanced technologies to develop new products and broaden its product portfolio; novel products such as e-waterpipes and personal vaporizers to help capture additional opportunities in its target markets. After company acquisition by the Company, the Target Group shall be able to expand its market share and revenue in the PRC by distributing its e-cigarette products through the Company's existing established network in the PRC. Business synergy would also be achieved with the Company after the Acquisition for tapping into the healthcare industry as explained in the section headed "REASONS FOR AND BENEFITS OF THE ACQUISITION" on page 12 of this circular.

The following is the text of a report prepared for the purpose of incorporation in this circular received from BMI Appraisals Limited, an independent valuer, in connection with its valuation as at 31 December 2015 of the market value of the 100% equity interest in Kimree Inc.

BMI APPRAISALS

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18 April 2016

The Directors
**China Flavors and Fragrances Company Limited**
Room 2101–02, 21st Floor
Wing On House
No. 71 Des Voeux Road Central
Central
Hong Kong

Dear Sirs/Madams,

## 1. INSTRUCTIONS

We refer to the instructions from China Flavors and Fragrances Company Limited (referred to as the "Company") for us to provide our independent opinion on the market value of 100% equity interest in Kimree Inc. (referred to as the "Target Company") as at 31 December 2015 (referred to as the "Date of Valuation").

This report presents the basis of valuation, the background of the Company and the Target Company, an industry overview, the source of information, the scope of work, the valuation assumptions and the valuation approach. It also explains the valuation methodology and valuation parameters utilized and presents our conclusion of value.

## 2. BASIS OF VALUATION

Our valuation has been carried out on the basis of market value. Market value is defined as "the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's-length transaction after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion".

## 3. BACKGROUND OF THE COMPANY AND THE TARGET COMPANY

**Background of the Company**

The Company is a publicly listed company with limited liability. It was incorporated in Cayman Islands and has been listed on the Main Board of the Hong Kong Stock Exchange (stock code: 3318) since 9 December 2005. The Company is principally engaged in researching, developing, manufacturing as well as marketing flavors and fragrances. Its flavors are used in tobacco, beverages, dairy foods, preserved foods, and confectionery products. Its fragrances are used in cosmetics, perfumes, soaps, toiletries, hair care products, deodorant, detergent and air fresheners.

**Background of the Target Company**

The Target Company is an investment holding company incorporated in Cayman Islands. It has been established for more than 10 years, and is principally engaged in research, development, production and sale of electronic cigarettes (e-cigarettes) with production base in the People's Republic of China (referred to as the "PRC"). Patents have been obtained in respect of certain design of the relevant devices of the e-cigarettes of the Target Company. The products of the Target Company are sold in the PRC, the United States of America and Europe.

On 11 November 2015, the Company announced that the vendors of the Target Company and the Company have entered into the Memorandum of Understanding in respect of the Proposed Acquisition (referred to as the "MOU"), pursuant to which the vendors proposed to sell to the Company, and the Company proposed to purchase from the vendors the entire issued share capital of the Target Company. Pursuant to the MOU, the Company shall pay the vendors a deposit in the amount of RMB3 million (equivalent to approximately HK$3.6 million) as earnest money.

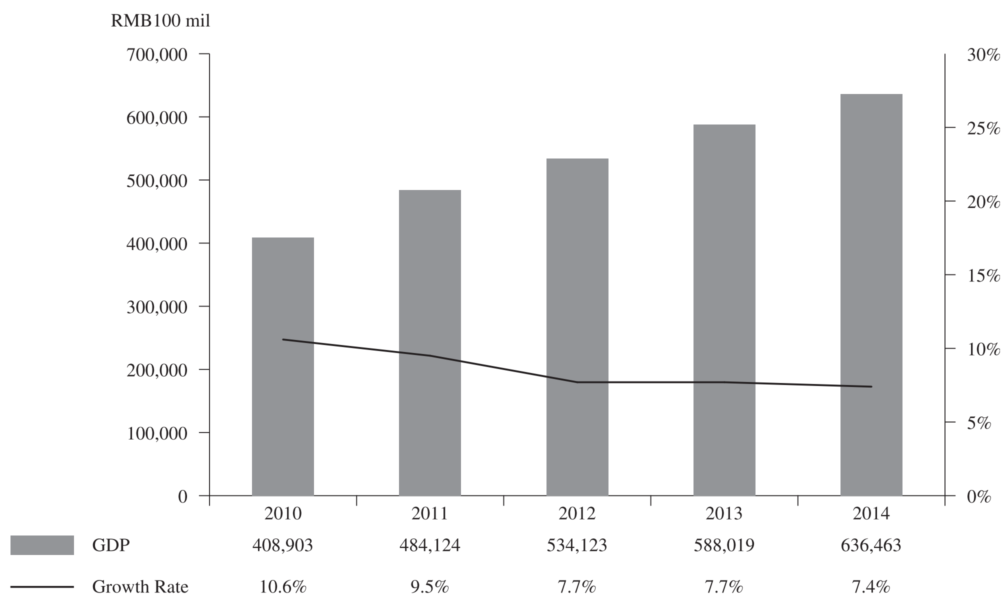
The management of the Company considers that the proposed acquisition would provide an opportunity for the Company to participate in the e-cigarette market in the PRC, and will further enhance the investment portfolio and future earnings of the Company.

## 4. INDUSTRY OVERVIEW

### The PRC Economy

The national economy of the PRC maintained stable growth in 2014. The gross domestic product (GDP) of the year was RMB63,646.3 billion, up by 7.4% over the previous year. Of this total, the value added of the primary industry was RMB5,833.2 billion, up by 4.1%, that of the secondary industry was RMB27,139.2 billion, up by 7.3% and the tertiary industry was RMB30,673.9 billion, up by 8.1%. The value added of the primary industry accounted for 9.2% of the GDP, that of the secondary industry accounted for 42.6%, and that of the tertiary industry accounted for 48.2%.

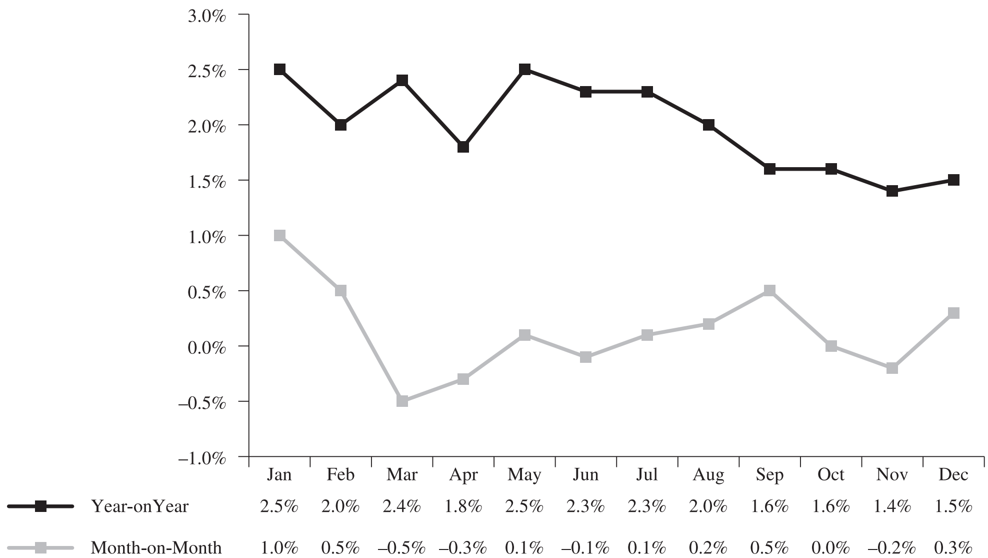
**Gross Domestic Product, 2010–2014**




*Source: National Bureau Statistics of China*

The consumer prices increased slightly. The consumer prices in 2014 went up by 2.0% over the previous year. Of this total, the prices for food went up by 3.1%. The prices for investment in fixed assets increased by 0.5%. The producer prices and the purchasing prices for manufactured goods were down by 1.9% and 2.2% respectively. The producer prices for farm products were down by 0.2%.

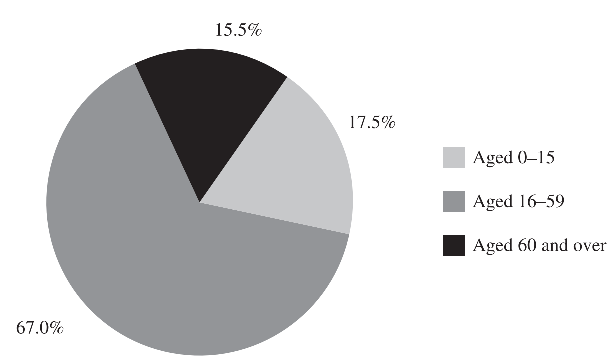
**Monthly Changes in Consumer Prices, 2014**




*Source: National Bureau Statistics of China*

By the end of 2014, the total number of Chinese population at the mainland reached 1,367.82 million, an increase of 7.10 million over that at the end of 2013. Of this total, urban permanent residents numbered 749.16 million, accounting for 54.77%. The year 2014 saw 16.87 million births, a crude birth rate of 12.37 per thousand, and 9.77 million deaths, or a crude death rate of 7.16 per thousand. The natural growth rate was 5.21 per thousand. The number of population who lived in places other than their household registration reached 298 million, of which 253 million were floating population.

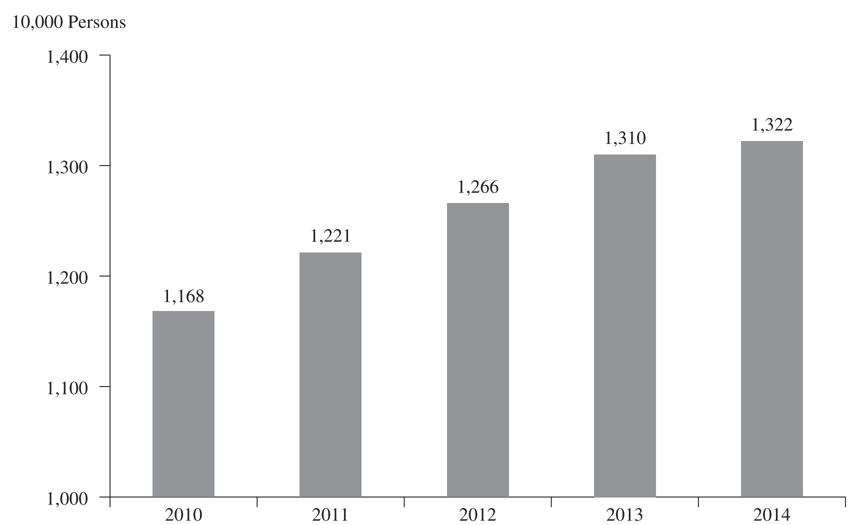
**Population Age Composition, 2014**




*Source: National Bureau Statistics of China*

The employment continued to grow. At the end of 2014, the number of employed people in the PRC was 772.53 million, and that in urban areas was 393.10 million. The newly increased employed people in urban areas numbered 13.22 million. The registered urban unemployment rate was 4.09% at the year end. The total number of migrant workers in 2014 was 273.95 million, up by 1.9% over that of 2013. Of which, the migrant workers who left hometown and worked in other places were 168.21 million, increased by 1.3%, and those who worked in their own localities reached 105.74 million, up by 2.8%.

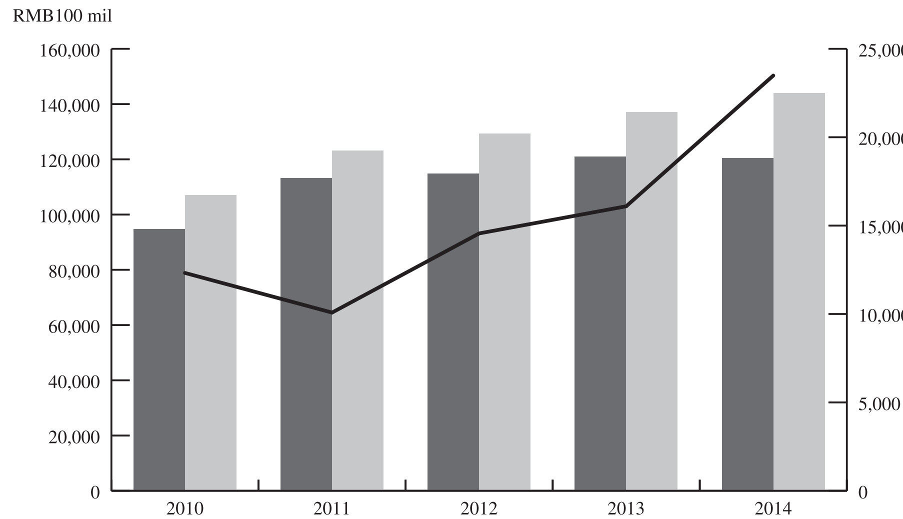
**Newly Increased Employed People in Urban Areas, 2010–2014**




*Source: National Bureau Statistics of China*

The total value of imports and exports of goods in 2014 reached RMB26,433.4 billion, up by 2.3% over the previous year. Of this total, the value of goods exported was RMB14,391.2 billion, increased by 4.9%, and the value of goods imported was RMB12,042.3 billion, up by 0.6%. The balance of imports and exports (exports minus imports) was RMB2,348.9 billion, an increase of RMB739.5 billion over the previous year.

**Imports and Exports of Goods, 2014**




| | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|
| Imports | 94,700 | 113,161 | 114,801 | 121,037 | 120,423 |
| Exports | 107,023 | 123,241 | 129,359 | 137,131 | 143,912 |
| Trade Surplus | 12,323 | 10,080 | 14,558 | 16,094 | 23,489 |

*Source: National Bureau Statistics of China*

## E-Cigarette Industry

The total global e-cigarette market reached a value of US$6.5 billion in 2014 with the US market contributing most heavily, with around US$2.8 billion in sales. The e-cigarette category is still a niche in comparison to traditional cigarettes, but it is growing rapidly and has overtaken nicotine replacement therapy and several other tobacco products categories. Growth of 58% globally in 2014 represented a slightly moderated level of growth from 2013, when the category grew by 79%. 2014 may have marked the end of a hyper-expansion phase in the development of the category, as regulation appears on the horizon.

While very robust growth by the metric of most other fast-moving consumer goods categories, disposable cig-a-likes' 33% value growth in 2014 was the slowest of any e-cigarette product category, indicating the relative dearth of innovation in cig-a-like brands and an ongoing consumer shift to larger tank systems. An estimated 13 million people were regular dual or sole users of e-cigarettes globally in 2014. While survey data vary by market, it is likely that a small majority of consumers continue to smoke traditional cigarettes and use e-cigarettes as they transition from tobacco use.

## 5. SOURCE OF INFORMATION

We have been furnished with information provided by the senior management of the Company. The valuation required the consideration of pertinent factors, including, but not limited to, the following:

- The nature of the Target including the industry sector and geographical location;
- The information provided by the senior management of the Company; and
- Other factors that will materially affect the operation of the Target.

Apart from the information provided by the senior management of the Company, we also obtained market data, industrial information and statistical figures from Bloomberg Terminal and other publicly available sources.

## 6. SCOPE OF WORK

The following processes have been conducted by us in the course of our valuation:

- Interviewed with the senior management of the Company and the Target Company in respect of the core operation of the Target Company;
- Obtained relevant financial and operational information in respect of the Target Company from the senior management of the Company;
- Examined the basis and assumptions of the financial and operational information in respect of the Target Company provided by the senior management of the Company;
- Conducted appropriate research to obtain sufficient market data, industry information and statistical figures from Bloomberg Terminal and other publicly available sources; and
- Prepared the valuation and this report in accordance with generally accepted valuation procedures and practices.

## 7. VALUATION ASSUMPTIONS

Due to the changing economic and market conditions, a number of assumptions have to be adopted in our valuation. The major assumptions adopted in our valuation are as follows:

**General Market Assumptions**

- There will be no material change in the existing political, legal, fiscal, technological, economic and market conditions in the jurisdiction where the Target Company is currently or will be situated;

- There will be no material change in the taxation laws and regulations in the jurisdiction where the Target Company is currently or will be situated, that the tax rates will remain unchanged and that all applicable laws and regulations will be complied with;

- The market return, market risk, interest rates and exchange rates will not differ materially from those of present or expected;

- The supply and demand, both domestically and internationally, of the products and/or services of the Target Company or similar products and/or services will not differ materially from those of present or expected;

- The market prices and the relevant costs, both domestically and internationally, of the products and/or services of the Target Company or similar products and/or services will not differ materially from those of present or expected;

- The products and/or services of the Target Company or similar products and/or services are marketable and liquid, that there are active markets for the exchange of the products and/or services of the Target Company or similar products and/or services; and

- The market data, industrial information and statistical figures obtained from Bloomberg Terminal and other publicly available sources are true and accurate.

**Company-specific Assumptions**

- All licenses, permits, certificates and consents issued by any local, provincial or national government or other authorized entity or organization that will affect the operation of the Target Company have been obtained or can be obtained upon request with an immaterial cost;

- The core operation of the Target Company will not differ materially from those of present or expected;

- The financial and operational information in respect of the Target Company have been prepared on a reasonable basis that have been arrived at after due and careful consideration by the senior management of the Company;

- The Target Company currently has, or will have, adequate human capital and capacity required for the production and/or provision of the products and/or services of the Target Company, and the required human capital and capacity will be acquired in a timely manner that will not affect the operation of the Target Company;

- The Target Company has acquired, or will acquire, adequate financial capital for the investments in projected capital expenditure and working capital from time to time, and any scheduled interest or repayment of loan and payable will be paid on time;

- The senior management of the Target Company will implement only those prospective financial and operational strategies that will maximize the efficiency of the operation of the Target Company;

- The senior management of the Target Company has sufficient knowledge and experience in respect of the operation of the Target Company, and the turnover of any director, management or key person will not affect the operation of the Target Company;

- The senior management of the Target Company has adopted reasonable and appropriate contingency measures against any human disruption such as fraud, corruption and strike, and the occurrence of any human disruption will not affect the operation of the Target Company; and

- The senior management of the Target Company has adopted reasonable and appropriate contingency measures against any natural disaster such as fire, flood and hurricane, and the occurrence of any natural disaster will not affect the operation of the Target Company.

## 8. VALUATION APPROACH

### General Valuation Approaches

The following generally accepted valuation approaches have been considered in the course of our valuation: (1) the income approach; (2) the market approach; and (3) the cost approach.

*Income Approach*

The income approach provides an indication of value based on the principle that an informed buyer would pay no more than the present value of anticipated future economic benefits generated by the subject asset.

The discounted cash flow (DCF) method is the most fundamental and prominent method of the income approach. In applying the DCF method, the free cash flows of the subject asset in future years were determined from the net income after tax plus non-cash expenses, such as depreciation and amortization expenses, and after-tax interest expense; the result was then less non-cash incomes, investment in capital expenditure and investment in net working capital.

*Market Approach*

The market approach provides an indication of value by comparing the subject asset to similar assets that have been sold in the market, with appropriate adjustments for the differences between the subject asset and the assets that are considered to be comparable to the subject asset.

Under the market approach, the guideline company method computes a price multiple for publicly listed companies that are considered to be comparable to the subject asset and then applies the result to a base of the subject asset. The sales comparison method computes a price multiple using recent sales and purchase transactions of assets that are considered to be comparable to the subject asset and then applies the result to a base of the subject asset.

*Cost Approach*

The cost approach provides an indication of value based on the principle that an informed buyer would pay no more than the cost of producing the same or a substitute asset with equal utility as the subject asset.

Under the cost approach, the historical cost method measures the cost incurred throughout the development of the subject asset at the time it was developed. The replication cost method measures the amount of investment that would be required to develop an asset similar to the subject asset. The replacement cost method measures the amount of investment that would be required to develop the subject asset as it currently exists.

**Selected Valuation Approach**

The selection of a valuation approach is based on, among other criteria, the quantity and quality of the information provided, access to available data, supply of relevant market transactions, type and nature of the subject asset, purpose and objective of the valuation and professional judgment and technical expertise.

The income approach was considered to be the most appropriate valuation approach in the valuation, as it takes the future growth potential and firm-specific issues of the Target Company into consideration.

The market approach, instead, relies generally on deriving value through a measure of the values of industry comparables or market transactions. Given the characteristics of the Target Company, there was a lack of explicitly industry comparables or market transactions available as at the Date of Valuation to derive an indicative value of the Target Company with sufficient level of accuracy. Accordingly, the market approach was not adopted. The cost approach was also considered inappropriate as the replication cost of the Target Company may not represent the value of the Target Company.

## 9. VALUATION METHODOLOGY

Under the income approach, the discounted cash flow (DCF) method was adopted in the valuation. The DCF method is the most fundamental and prominent method of the income approach. In applying the DCF method, the free cash flows were computed using the following formula:

$$FCF = NOPAT + NCE - NCI - InvFA - InvNWC$$

Where:

| | | |
|---|---|---|
| *FCF* | = | free cash flow |
| *NOPAT* | = | net operating profit after tax |
| *NCE* | = | non-cash expenses |
| *NCI* | = | non-cash incomes |
| *InvFA* | = | investment in capital expenditure |
| *InvNWC* | = | investment in net working capital |

The results were then discounted using a discount rate, or the cost of capital, to determine the present value of the expected cash flows.

The present value of the expected cash flows was computed using the following formula:

$$PVFCF = FCF_1/(1 + r)^1 + FCF_2/(1 + r)^2 + ... + FCF_n/(1 + r)^n$$

Where:

| | | |
|---|---|---|
| *PVFCF* | = | present value of free cash flows |
| *FCF* | = | free cash flow |
| *r* | = | discount rate |
| *n* | = | number of year of projections |

**Revenue**

The projected revenue was prepared based on financial projections of the Target Company. The Target Company has three kinds of products which are the disposable e-cigarette, the rechargeable e-cigarette and the accessories. The Target Company had been switching its main products from the disposables to the rechargeables, especially the large size rechargeables since 2015. According to the senior management of the Target Company, the revenue growth of the large size rechargeables would be the main driver of total revenue growth. Revenue from accessories, accompanying other products, would also be a second driver. Revenue generated from the disposables is projected to grow with relative low rate. After five years, the revenue was projected to increase at the long-term growth rate. The table below presents the first ten years' revenue.

| RMB'000 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 |
|---|---|---|---|---|---|---|---|---|---|---|
| Revenue | 329,248 | 390,950 | 464,786 | 527,954 | 571,750 | 588,902 | 606,569 | 624,766 | 643,509 | 662,815 |

### Costs of Goods Sold and Operating Expenses

The costs of goods sold (COGS) and operating expenses were determined with reference to the historical financial statements of the Target Company and were expected to be in line with the constant to revenue ratios in the future years. The projected COGS and operating expenses of first ten years are presented in the following table:

| RMB'000 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 |
|---|---|---|---|---|---|---|---|---|---|---|
| COGS | 191,734 | 227,510 | 270,312 | 316,772 | 343,050 | 353,341 | 363,942 | 374,860 | 386,106 | 397,689 |
| Operating Expenses | 54,326 | 64,507 | 76,690 | 87,112 | 94,339 | 97,169 | 100,084 | 103,086 | 106,179 | 109,364 |

### Depreciation and Capital Expenditure

Most fixed assets of the Target Company are plant and machinery, furniture, fixtures and equipment, and leasehold improvements, of which the average useful life is estimated as 5 years. The capital expenditure (CAPEX) was projected to maintain the fixed assets. The projected depreciation was calculated based on current fair value of net fixed asset and projected CAPEX, which equals projected depreciation of last year. The table below presents the projected depreciation and CAPEX.

| RMB'000 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 |
|---|---|---|---|---|---|---|---|---|---|---|
| Depreciation | 31,494 | 37,792 | 45,351 | 30,340 | 34,244 | 35,844 | 36,714 | 36,499 | 34,728 | 35,606 |
| CAPEX | 26,245 | 31,494 | 37,792 | 45,351 | 30,340 | 34,244 | 35,844 | 36,714 | 36,499 | 34,728 |

### Net Working Capital

The net working capital represents the current assets less the cash and cash equivalents minus the current liability less the short-term borrowings.

The net working capital (NWC) was projected to move with revenue based on variable NWC to revenue ratios, which were forecasted to approach median of the ratios of comparable companies from the current ratio of the Target Company. The projected change of NWC is presented as below table:

| RMB'000 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 |
|---|---|---|---|---|---|---|---|---|---|---|
| Change of NWC | (8,849) | 5,311 | 9,732 | 17,556 | 24,075 | 27,658 | 395 | 406 | 419 | 431 |

**Free Cash Flows**

The projected free cash flows from 2016 to 2025 were as follows:

| RMB'000 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 |
|---|---|---|---|---|---|---|---|---|---|---|
| Free Cash Flow | 78,461 | 77,161 | 88,137 | 62,457 | 82,574 | 79,709 | 109,356 | 111,466 | 112,875 | 117,268 |

## 10. VALUATION PARAMETERS

**Comparable Companies**

For the purpose of our valuation, we referred to the information in respect of publicly listed companies that are considered to be comparable to the Target Company (referred to as the "Comparable Companies").

*Selection Criteria of the Comparable Companies*

The selection of the Comparable Companies was based on the comparability of the overall industry sector and geographical location. Although no two companies are ever exactly alike, behind the differences there are certain business universals such as required capital investment and overall perceived risks and uncertainties that guided the market in reaching the expected returns for companies with certain similar attributes.

The selection criteria of the Comparable Companies are as follows:

- The principal markets of the company is worldwide;
- The company is engaged in the production of e-cigarette and the related operation;
- Shares of the company are listing in a major stock exchange and are actively trading in a reasonable period of time; and
- Detailed financial and operational information in respect of the company are available at Bloomberg Terminal or other publicly available sources.

*Selected Comparable Companies*

After a thorough research on the available sources, we found that companies which mainly engage in e-cigarette operation are not enough for comparing purpose; therefore we relaxed the criteria of business field to that the company is engaged in both e-cigarette and cigarette. Given the abovementioned selection criteria, we have identified four Comparable Companies. Apart from the Comparable Companies that were selected, we were not aware of any other listed companies that fulfill the selection criteria, and we considered that the selected Comparable Companies are exhaustive. Details of the Comparable Companies are as follows:

**Comparable Company 1**

| | | |
|---|---|---|
| Name of Company | : | Japan Tobacco Inc. |
| Bloomberg Ticker | : | 2914 JP |
| Stock Exchange | : | Tokyo |
| Company Description | : | Japan Tobacco Inc. operates as a tobacco product company. The company manufactures, markets, and sells cigarettes and other tobacco products internationally. Japan Tobacco is also engaged in pharmaceutical and food businesses. |

**Comparable Company 2**

| | | |
|---|---|---|
| Name of Company | : | British American Tobacco p.l.c. |
| Bloomberg Ticker | : | BATS LN |
| Stock Exchange | : | London |
| Company Description | : | British American Tobacco p.l.c. is the holding company for a group of companies that manufacture, market, and sell cigarettes and other tobacco products, including cigars and roll-your-own tobacco. |

**Comparable Company 3**

| | | |
|---|---|---|
| Name of Company | : | Philip Morris International Incorporation |
| Bloomberg Ticker | : | PM US |
| Stock Exchange | : | New York |

| | | |
|---|---|---|
| Company Description | : | Philip Morris International Incorporation through its subsidiaries, affiliates, and their licensees produces, sells, distributes, and markets a wide range of branded cigarettes and tobacco products in markets outside of the United States of America. The company's portfolio comprises both international and local brands. |

**Comparable Company 4**

| | | |
|---|---|---|
| Name of Company | : | Reynolds American Incorporation |
| Bloomberg Ticker | : | RAI US |
| Stock Exchange | : | New York |
| Company Description | : | Reynolds American Incorporation through its subsidiaries manufacturer tobacco and smokeless tobacco products. The company's subsidiary sells its products in the United States and its territories. |

**Discount Rate**

The Weighted Average Cost of Capital (WACC) was adopted as the discount rate for the valuation. It is the required return on the capital investment of a company. The cost of capital will be different for each source of capital and class of securities a company has, reflecting the different risks. The WACC is the weighted average of the costs of each of the different types of capital, and the weights are proportion of the company's capital that comes from each source.

The WACC was computed using the following formula:

$$WACC = R_e\ (E/V) + R_d\ (D/V)\ (1 - T_c)$$

Where:

| | | |
|---|---|---|
| $WACC$ | = | weighted average cost of capital |
| $R_e$ | = | cost of equity |
| $R_d$ | = | cost of debt |
| $E$ | = | value of the firm's equity |
| $D$ | = | value of the firm's debt |
| $V$ | = | sum of the values of the firm's equity and debt |

$T_c$ = corporate tax rate

The WACC comprises two components: the cost of equity and the cost of debt. The cost of equity was determined using the Capital Asset Pricing Model (CAPM). The CAPM describes the relationship between the risk of a particular asset, its market price and the expected return to the investor, that investors required additional return to compensate additional risk associated.

The cost of equity under the modified CAPM was computed using the following formula:

$$R_e = R_f + \beta * MRP + RP_S + RP_U$$

Where:

$R_e$ = cost of equity

$R_f$ = risk-free rate

$\beta$ = beta coefficient

$MRP$ = market risk premium

$RP_S$ = size premium

$RP_U$ = company-specific risk premium

*Risk-free Rate*

$R_f$ The risk-free rate ($R_f$) represents the time value of money. It is the theoretical rate of return of an investment with no risk of financial loss The yield rate of bonds issued by a government or agency where the risks of default are so low as to be negligible are commonly applied as the risk-free rate.

The yield rate of the 10-year Central Government Bond of the PRC as at the Date of Valuation, as extracted from Bloomberg Terminal, was adopted as the risk-free rate in the valuation.

*Beta Coefficient*

$\beta$ The beta coefficient ($\beta$) measures the risk of an asset relative to the overall market. It reflects the sensitivity of an asset's value to economic variables or risks that affect the values of all risky assets, including economic growth rates, interest rates, exchange rates and inflation rates.

In the valuation, as the Target Company is not listing in any major stock exchange or be marketable in any over-the-counter market, it is not possible to determine its beta coefficient directly. Instead, the beta coefficient for the Target Company was determined as the average of the betas of the Comparable Companies, with adjustment for differences in corporate tax rates and leverage compositions.

The adjusted betas of the Comparable Companies, which measure their risks relative to the market, as extracted from Bloomberg Terminal, were derived from the corresponding raw betas, modified by the assumption that a security's beta moves toward the market average over time with the following generally accepted formula:

*Adjusted Beta = (1/3) + (2/3) * Raw Beta*

The unlevered beta was calculated to consider the differences in corporate tax rates and leverage compositions of the Target Company and the Comparable Companies. The unlevered beta removes the effects of the use of leverage on the capital structure of a firm. Removing the debt component allows an investor to compare the base level of risk between various companies.

The unlevered beta was computed using the following formula:

$$\beta_{unlevered} = \beta_{levered}/[1 + (1 - T_c)(D/E)]$$

Where:

| | | |
|---|---|---|
| $\beta_{unlevered}$ | = | unlevered beta |
| $\beta_{levered}$ | = | levered beta |
| $T_c$ | = | corporate tax rate |
| $D$ | = | value of the firm's debt |
| $E$ | = | value of the firm's equity |
| $D/E$ | = | debt-to-equity ratio |

The average of the unlevered betas of the Comparable Companies was then being relevered based on the specific corporate tax rate and the expected debt-to-equity ratio applied to the Target Company.

The relevered beta was computed using the following formula:

$\beta_{relevered} = \beta_{unlevered} * [1 + (1 - T_c)\ (D/E)]$

Where:

| | | |
|---|---|---|
| $\beta_{relevered}$ | = | relevered beta |
| $\beta_{unlevered}$ | = | unlevered beta |
| $T_c$ | = | corporate tax rate |
| $D$ | = | value of the firm's debt |
| $E$ | = | value of the firm's equity |
| $D/E$ | = | debt-to-equity ratio |

*Market Risk Premium*

*MRP* The market risk premium (*MRP*) is the implied risk premium expected from the market using forecasted growth rates, earnings, dividends, payout ratios and current values. It represents the additional return required by an investor as compensation for investing in equities rather than a risk-free instrument.

The market risk premium of the PRC as at the Date of Valuation was computed by adding up market risk premium of the United States and the country risk premium of the PRC.

The market risk of the United States of 6.21% was determined with reference to "2015 Valuation Handbook — Guide to Cost of Capital", published by Duff & Phelps Corporation. Duff & Phelps Corporation is a global valuation and corporate finance advisor. Duff & Phelps Corporation was founded in 1932 and is headquartered in New York City. The firm currently has over 1,400 employees with offices across North America, Europe and Asia.

The PRC country risk premium of 0.90% was referenced to the "Country Default Spreads and Risk Premiums", published by Aswath Damodaran in January 2016, who is a well-known author of several widely used academic textbooks on valuation and related subjects.

*Size Premium*

By considering the size of the Target Company, a size premium of 3.74% was adopted in the valuation, which was referenced to "2015 Valuation Handbook — Guide to Cost of Capital", published by Duff & Phelps Corporation.

*Company-specific Risk Premium*

By considering the additional risk associated with the operation of the Target Company, a company-specific risk premium of 3.00% was adopted in the valuation.

*Cost of Equity*

The cost of equity was determined using the CAPM.

*Cost of Debt*

The cost of debt was determined by the expected lending rate of the Target Company.

*After-tax Cost of Debt*

Since the interest paid on debts are tax-deductible expense for a company, the cost of the company of obtaining debt funds is less than the required rate of return of the suppliers of the debt capital. The after-tax cost of debt was calculated by multiplying one minus the corporate tax rate of the PRC by the cost of debt.

*Weight of Debt*

The weight of debt was determined by the average of the weights of debt of the Comparable Companies, assuming that the weight of debt of the Target Company moves toward that of the average of the Comparable Companies over time.

*Weight of Equity*

The weight of equity was determined by the average of the weights of equity of the Comparable Companies, or calculated as one minus the weight of debt of the Target Company.

**Terminal Value**

In a DCF method, the cash flow is projected for each year into the future for a certain number of years, after which unique annual cash flows cannot be forecasted with reasonable accuracy. At that point, rather than attempting to forecast the varying cash flow for each individual year, a terminal value is used to represent the discounted value of all subsequent cash flows.

The terminal value was computed using the following formula:

$$TV_t = CF_{t+1}/(r - g)$$

Where:

$TV_t$ = terminal value at the final year of projection

$CF_{t+1}$ = cash flow in one year after the final year of projection

$r$ = discount rate

$g$ = long-term growth rate

The long-term growth rate represents the rate at which the cash flow will grow perpetually after the final year of projection. The long-term growth rate was determined referred to average inflation rate of PRC of years from 2006 to 2014.

After determining the terminal value at the final year of projection, the result was then discounted to the Date of Valuation to derive the present value of the terminal value.

**Discount for Lack of Marketability**

The discount for lack of marketability is a downward adjustment to the value of an investment to reflect its reduced level of marketability. The concept of marketability deals with the liquidity of an ownership interest, that is, how quickly and easily it can be converted into cash if the owner chooses to sell.

The discount for lack of marketability reflects the fact that there is no ready market for shares in a closely held company. Ownership interests in closely held companies are typically not readily marketable compared to similar interests in publicly listed companies. Therefore, a share of stock in a privately held company is usually worth less than an otherwise comparable share in a publicly listed company.

As the Target Company is unlikely to undergo public offering and shares of the Target Company are unlikely to be listed in any major stock exchange or be marketable in any over-the-counter market in the near future, a discount for lack of marketability has been adopted in the valuation.

With reference to the "Determining Discounts for Lack of Marketability — A Companion Guide to The FMV Restricted Stock Study", published by FMV Opinions, Inc. in 2015, the median discount is calculated as around 15.00%.

**Adopted Values of Valuation Parameters**

In the valuation, the adopted values of the abovementioned valuation parameters are as follows:

| | Valuation Parameter | As at 31 December 2015 |
|---|---|---|
| a. | Risk-free Rate | 2.86% |
| b. | Beta Coefficient | 0.909 |
| c. | Market Risk Premium | 7.11% |
| d. | Size Premium | 3.74% |
| e. | Company-specific Premium | 3.00% |
| f. | Cost of Equity | 16.06% |
| g. | Cost of Debt | 4.90% |
| h. | After-tax Cost of Debt | 3.68% |
| i. | Weight of Debt | 12.71% |
| j. | Weight of Equity | 87.29% |
| k. | Discount Rate | 14.49% |
| l. | Long-term Growth Rate | 3.00% |
| m. | Discount for Lack of Marketability | 15.00% |

**Sensitivity Analysis on the Discount Rate**

The discount rate is an important input for valuation under DCF method, since systematic risk as well as non-systematic risks like size premium and company specific risk premium, are all considered in the calculation of the discount rate. The sensitivity analysis has been carried out to determine the impact of changes in discount rate on the valuation result. The results of the sensitivity analysis were as follows:

| Percentage Change in Discount Rate | Applied Discount Rate | Market Value *(RMB'000)* | Percentage Change in Market Value |
|---|---|---|---|
| +10% | 15.93% | 680,199 | –9.70% |
| +5% | 15.21% | 714,508 | –5.14% |
| 0% | 14.49% | 753,236 | 0.00% |
| –5% | 13.76% | 797,281 | 5.85% |
| –10% | 13.04% | 847,800 | 12.55% |

**Sensitivity Analysis on the Estimated Revenue**

We have also tested sensitivity of value of the Target Company to changes of the estimated revenue, using the range from -10% to 10%. In the sensitivity analysis, net profit target guaranteed by the profit guarantee was considered. The results were presented in the table below:

| Percentage Change in Estimated Revenue | Market Value *(RMB'000)* | Percentage Change in Market Value |
|---|---|---|
| +10% | 839,638 | 11.47% |
| +5% | 796,437 | 5.74% |
| 0% | 753,236 | 0.00% |
| –5% | 716,271 | –4.91% |
| –10% | 683,905 | –9.20% |

## 11. REMARKS

For the purpose of our valuation, we have been furnished with information provided by the senior management of the Company. We have had no reason to doubt the truth and accuracy of the information provided to us by the Company. We have also sought and received confirmation from the Company that no material facts have been omitted from the information supplied.

To the best of our knowledge, all data set forth in this report are true and accurate. Although gathered from reliable sources, no guarantee is made or liability assumed for the accuracy of any data, opinions or estimates identified as being furnished by others, which have been used in formulating our analysis.

Unless otherwise stated, all money amounts stated herein are in Renminbi (RMB).

## 12. CONCLUSION OF VALUE

Our conclusion of value is based on accepted valuation procedures and practices that rely on the use of numerous assumptions and the consideration of a lot of uncertainties, not all of which can be easily ascertained or quantified.

Further, whilst the assumptions and consideration of such matters are considered to be reasonable, they are inherently subject to uncertainties and contingencies that are beyond the control of the Company, the Target Company or us.

Based on our investigation and analysis outlined in this report, it is our opinion that the market value of the 100% equity interest in Kimree Inc. (i.e. the Target Company) as at 31 December 2015 was **RMB753,000,000 (RENMINBI SEVEN HUNDRED AND FIFTY THREE MILLION ONLY)**.

We hereby certify that we have neither present nor prospective interest in the Company, the Target Company or the result reported.

Yours faithfully,
For and on behalf of
**BMI APPRAISALS LIMITED**
**Dr. Tony C. H. Cheng**
*BSc(Bldg), MUD, MBA(Finance), MSc.(Eng), PhD(Econ), FSOE, FIPlantE, CEnv, MIPA, CPA UK, SIFM, FCIM, MCIArb, MASCE, MIET, MIEEE, MASME, MIIE*
*Managing Director*

*Note:* Dr. Tony C. H. Cheng has various engineering and accounting & finance qualifications. He is currently the Chairman of the Institute of Mechanical Engineers, China. He is also a Fellow member of the Society of Operations Engineers and the Institution of Plant Engineers, and a member of the Institute of Industrial Engineers and the American Society of Mechanical Engineers. Besides, Dr. Cheng is a member of the Institute of Public Accountants. He has extensive experience in valuing similar assets in different industries in Hong Kong and the PRC.

*The following is the text of a report received from PricewaterhouseCoopers, Certified Public Accountants, Hong Kong, for the purpose of incorporation in this circular.*

pwc 羅兵咸永道

**INDEPENDENT REPORTING ACCOUNTANT'S ASSURANCE REPORT ON THE CALCULATION OF DISCOUNTED FUTURE ESTIMATED CASH FLOWS IN CONNECTION WITH THE BUSINESS VALUATION OF KIMREE, INC.**

**TO THE BOARD OF DIRECTORS OF CHINA FLAVORS AND FRAGRANCES COMPANY LIMITED**

We have completed our assurance engagement to report on the calculations of the discounted future estimated cash flows on which the business valuation (the "**Valuation**") dated 18 April 2016 prepared by BMI Appraisals Limited in respect of the appraisal of the fair value of the 100% equity interests in Kimree, Inc. (the "**Target Company**") is based. The Valuation is set out in Appendix V of the circular of China Flavors and Fragrances Company Limited (the "**Company**") dated 18 April 2016 (the "**Circular**") in connection with the acquisition by the Company of a 100% equity interest in the Target Company by the Company. The Valuation based on the discounted future estimated cash flows is regarded as a profit forecast under Rule 14.61 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "**Listing Rules").**

**Directors' Responsibility for the Discounted Future Estimated Cash Flows**

The directors of the Company are responsible for the preparation of the discounted future estimated cash flows in accordance with the bases and assumptions determined by the directors and as set on pages V-7 to V-9 of the Circular. This responsibility includes carrying out appropriate procedures relevant to the preparation of the discounted future estimated cash flows for the Valuation and applying an appropriate basis of preparation; and making estimates that are reasonable in the circumstances.

**Our Independence and Quality Control**

We have complied with the independence and other ethical requirement of the Code of Ethics for Professional Accountants issued by the Hong Kong Institute of Certified Public Accountants (the "**HKICPA**"), which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.

*PricewaterhouseCoopers, 22/F Prince's Building, Central, Hong Kong*
*T: +852 2289 8888, F: +852 2810 9888,* www.pwchk.com

Our firm applies Hong Kong Standard on Quality Control 1 issued by the HKICPA and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

**Reporting Accountant's Responsibilities**

It is our responsibility to report, as required by paragraph 29(2) of Appendix 1B of the Listing Rules, on the calculations of the discounted future estimated cash flows on which the Valuation is based. We are not reporting on the appropriateness and validity of the bases and assumptions on which the discounted future estimated cash flows are based and our work does not constitute any valuation of the Target Company.

We conducted our work in accordance with the Hong Kong Standard on Assurance Engagements 3000 (Revised) "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" issued by the HKICPA. This standard requires that we plan and perform the assurance engagement to obtain reasonable assurance on whether the discounted future estimated cash flows, so far as the calculations are concerned, has been properly compiled in accordance with the bases and assumptions as set out on pages V-7 to V-9 of the Circular. We reviewed the arithmetical calculations and the compilation of the discounted future estimated cash flows in accordance with the bases and assumptions.

The discounted cash flows do not involve the adoption of accounting policies. The discounted cash flows depend on future events and on a number of assumptions which cannot be confirmed and verified in the same way as past results and not all of which may remain valid throughout the period. Our work has been undertaken for the purpose of reporting solely to you under paragraph 29(2) of Appendix 1B of the Listing Rules and for no other purpose. We accept no responsibility to any other person in respect of our work, or arising out of or in connection with our work.

**Opinion**

In our opinion, based on the foregoing, so far as the calculations are concerned, the discounted future estimated cash flows, has been properly compiled in all material respects in accordance with the bases and assumptions made by directors of the Company as set out on pages V-7 to V-9 of the Circular.

**PricewaterhouseCoopers**
*Certified Public Accountants*

Hong Kong, 18 April 2016

*The following is the full text of a letter received from I-Access Investors Ltd, a financial adviser of the Company, for the purpose of incorporation in this circular.*

一通投資者有限公司
I-Access Investors Ltd
香港上環文咸東街50號寶恒商業中心13樓1301室
Unit 1301, 13/F, Bonham Trade Centre, 50 Bonham Strand, Sheung Wan, HK
電話 Tel 2890 8019 傳真 Fax 2850 5786 電郵 Email *info@i-access.com*

一通
*i-access.com*

18 April 2016

The Board of Directors
China Flavors and Fragrances Company Limited
Room 2101–02, 21/F
Wing On House
71 Des Voeux Road Central
Central
Hong Kong

Dear Sirs/Madam,

**Re: Comfort Letter relating to the valuation on the market value of 100% equity interest in Kimree, Inc.**

We refer to the valuation (the "**Valuation**") prepared by BMI Appraisals Limited ("**BMI**") dated 18 April 2016 in relation to the appraisal of the market value of 100% equity interest in Kimree, Inc. as at 31 December 2015. As stated in the valuation report from BMI, the Valuation has been arrived at and based on the income approach, which taken into account the discounted cash flow projection of the business relating to Kimree, Inc. (the "**Projection**"). As such, the Projection is regarded as a profit forecast (the "**Profit Forecast**") under Rule 14.61 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "**Listing Rules**"). Capitalised terms used in this letter shall have the same meanings as defined elsewhere in the circular of the Company dated 18 April 2016 (the "**Circular**"), of which this letter forms part, unless the context requires otherwise.

We have reviewed the Profit Forecast upon which the Valuation has been made for which you as the Directors are responsible and discussed with you and BMI the information and documents provided by you which formed part of the bases and assumptions upon which the Profit Forecast has been prepared. We have also considered the letter from PricewaterhouseCoopers ("**PwC**") dated 18 April 2016 as set out in Appendix VI of the Circular addressed to yourselves regarding the calculations upon which the Profit Forecast has been made. We noted that in the opinion of PwC, so far as the arithmetical accuracy of the calculations are concerned, that the Profit Forecast has been properly compiled, in all material respects, in accordance with the bases and assumptions adopted by the Directors. The Profit Forecast is based on a number of bases and assumptions pertaining to the business of Kimree, Inc. As the relevant bases and assumptions are about future events which may or may not occur, the actual financial performance of the businesses of Kimree, Inc. may or may not achieve as expected and the variation may be material.

On the basis of the foregoing and without giving any opinion on the reasonableness of the valuation methods, bases and assumptions adopted by BMI on the Valuation, for which BMI and the Company are responsible, we are of the opinion that the Profit Forecast upon which the Valuation has been made, for which you as the Directors are solely responsible, have been made after due and careful enquiry by you. Our opinion has been given for the sole purpose of compliance with Rule 14.62(3) of the Listing Rules and for no other purpose.

Yours faithfully,
For and on behalf of
**I-Access Investors Limited**
**Leung Chui San, Anthea**
*President, Financing*

## 1. RESPONSIBILITY STATEMENT

This circular, for which the Directors collectively and individually accept full responsibility, includes particulars given in compliance with the Listing Rules for the purpose of giving information with regard to the Company. The Directors, having made all reasonable enquiries, confirm that, to the best of their knowledge and belief, the information contained in this circular is accurate and complete in all material respects and is not misleading or deceptive, and there are no other matters the omission of which would make any statement herein or this circular misleading.

## 2. DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS AND SHORT POSITIONS IN SHARES UNDERLYING SHARES AND DEBENTURES

As at the Latest Practicable Date, the interests or short positions of each Director and chief executive of the Company in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("**SFO**")) which were required pursuant to (a) Divisions 7 and 8 of Part XV of the SFO, to be notified to the Company and the Stock Exchange; or (b) Section 352 of the SFO, to be entered in the register required to be kept by the Company under such provision, or (c) the Model Code for Securities Transactions by Directors of Listed Issuers of the Listing Rules, to be notified to the Company and the Stock Exchange were as follows:

**Long position in the Shares — Ordinary Shares**

(i) *Interests in Shares and underlying Shares of the Company*

| Name of Director | No. of Shares Personal interests | No. of Shares Corporate interests | Derivative or share option Personal interests | Total | Percentage of aggregate interests to the total number of Shares in issue |
|---|---|---|---|---|---|
| Mr. Wang Ming Fan | 67,846,938 | 348,895,389 *(Note 1)* | 17,500,000 *(Note 2)* | 434,242,327 | 64.87% |
| Mr. Qian Wu | 4,974,900 | — | 5,025,100 *(Note 2)* | 10,000,000 | 1.49% |
| Ms. Sy Wai Shuen | 3,000,000 | — | 3,000,000 *(Note 2)* | 6,000,000 | 0.90% |

*Notes:*

1. By virtue of the SFO, Mr. Wang is deemed to be interested in all the 348,895,389 Shares of which (i) 330,562,056 Shares being held by Creative China Limited, in which 41.19% of the issued share capital of Creative China Limited is owned by Mr. Wang; and (ii) 18,333,333 Shares being held by Full Ashley Enterprises Limited, a company which is wholly-owned by Mr. Wang.

2. Further information of the share options herein are set out in "(iv) Long positions in underlying shares of share option of the Company" of this circular.

(ii) *Interests in Dongguan Boton Flavors and Fragrances Company Limited (東莞波頓香料有限公司) (formerly known as Dongguan Tian Cheng Fragrances and Technology Company Limited) (東莞天成香料科技有限公司) (the "**JV Company**"), an associated corporation (as defined in the SFO) of the Company*

| Name of Director | Amount of paid-up registered capital of the JV Company | Percentage of registered capital of the JV Company |
|---|---|---|
| Mr. Wang Ming Fan | approximately RMB40,000,000 *(Note)* | 47% |

*Note:*

The total paid-up registered capital of the JV Company is RMB85,000,000.

(iii) *Interests in the shares of Creative China Limited, an associated corporation (as defined in the SFO) of the Company*

| Name of Director | Class and number of shares held in associated corporation | Percentage of issued shares |
|---|---|---|
| Mr. Wang Ming Fan | 4,559 ordinary shares | 41.19% |
| Mr. Qian Wu | 763 ordinary shares | 6.89% |
| Mr. Li Qing Long | 436 ordinary shares | 3.94% |

(iv) *Long positions in underlying Shares of share option of the Company*

| Name of Director | Company/Name of associated company | Capacity/Nature of Interest | Number of Shares held | Approximate percentage of the shareholding |
|---|---|---|---|---|
| Mr. Wang Ming Fan | Company | Beneficial owner | 17,500,000 | 2.61% |
| Mr. Qian Wu | Company | Beneficial owner | 5,025,100 | 0.75% |
| Ms. Sy Wai Shuen | Company | Beneficial owner | 3,000,000 | 0.45% |

*Note:* These represent the Shares to be issued and allotted by the Company upon exercise of shares options granted by the Company to the Directors on 22 April 2015, with an exercise period from 11 May 2015 to 21 April 2025 for Ms. Sy Wai Shuen and from 29 May 2015 to 21 April 2025 for Mr. Wang Ming Fan and Mr. Qian Wu and the same exercise price of HK$1.34 per share.

Save as disclosed above, none of the Directors or chief executive of the Company and/or any of their respective associates had registered any interests or short positions in any Shares and underlying Shares in, and debentures of, the Company or any associated corporations as at the Latest Practicable Date, as recorded in the register required to be kept by the Company pursuant to Section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to Part XV of the SFO or the Model Code for Securities Transactions by Directors of Listed Issuers of the Listing Rules.

## 3. SUBSTANTIAL SHAREHOLDERS' AND OTHERS' INTERESTS AND SHORT POSITIONS IN SHARES AND UNDERLYING SHARES

As at the Latest Practicable Date, the register of substantial shareholders maintained by the Company pursuant to Section 336 of the SFO shows that other than the interests disclosed in the section headed "Directors' and Chief Executives' Interests and Short Positions in Shares Underlying Shares and Debentures" above, the following shareholder had notified the Company of its relevant interests in the issued share capital of the Company

**Long Positions — Ordinary Shares**

| **Name of Shareholder** | **Capacity/Nature of Interest** | **Number of Shares** *(Note 1)* | **Percentage of issued Shares** |
|---|---|---|---|
| Mr. Wang | Beneficial owner and interest in controlled corporations | 416,742,327 *(Note 2)* | 62.26% |
| Creative China Limited | Beneficial owner | 330,562,056 *(Note 3)* | 49.38% |
| Full Ashley Enterprises Limited | Beneficial owner | 18,333,333 *(Note 4)* | 2.74% |

*Notes:*

1. Long position in the Shares (other than pursuant to equity derivatives such as share options, warrants to subscribe or convertible bonds).

2. By virtue of the SFO, Mr. Wang is deemed to be interested in 330,562,056 Shares being held by Creative China Limited (which is duplicated in the interests described in Note 3); and 18,333,333 Shares being held by Full Ashley Enterprises Limited (which is duplicated in the interests described in Note 4). Together with his personal shareholding of 67,846,938 shares, Mr. Wang was taken to be interested in 416,742,327 shares (approximately 62.26% of the total issued share capital of the Company) as at the Latest Practicable Date.

3. Creative China Limited is owned as to 41.19% by Mr. Wang, as to 28.11% by Mr. Wong Ming Bun (a former director of the Company), as to 19.87% by Mr. Wang Ming You (a former director of the Company), as to 6.89% by Mr. Qian Wu and as to 3.94% by Mr. Li Qing Long. As at the Latest Practicable Date, Mr. Wang, Mr. Qian Wu and Mr. Li Qing Long were Directors of the Company and also directors of Creative China Limited.

4. Full Ashely Enterprises Limited is a private company which is wholly-owned by Mr. Wang who has a duty of disclosure under SFO in the issued share capital of the Company as Director of the Company, therefore Full Ashley Enterprises Limited is taken to have a duty of disclosure in relation to the Shares of the Company under the SFO.

Save as disclosed above, the Company has not been notified of any other relevant interests or short positions in the issued share capital of the Company as at the Latest Practicable Date which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, or which were recorded in the register required to be kept by the Company under Section 336 of the SFO.

## 4. DIRECTORS' OTHER INTERESTS

(a) Save as disclosed in this circular, none of the Directors was materially interested, directly or indirectly, in any contract or arrangement entered into by any member of the Enlarged Group subsisting as at the Latest Practicable Date which was significant in relation to the business of the Enlarged Group.

(b) None of the Directors has any direct or indirect interest in any assets acquired or disposed of by or leased to any member of the Enlarged Group or is proposed to be acquired or disposed of by or leased to member of the Enlarged Group since 31 December 2015, being the date to which the latest published audited accounts of the Group were made up.

(c) None of the Directors or any of their respective associates has any interest in any business that competes or is likely to compete, either directly or indirectly, with the business of the Enlarged Group.

## 5. DIRECTORS' SERVICE CONTRACTS

As at the Latest Practicable Date, there was no existing or proposed service contract, excluding contract expiring or terminable by the employer within one year, without payment of compensation (other than statutory compensation) between any of the Directors with any member of the Enlarged Group.

## 6. LITIGATION

As at the Latest Practicable Date, there were no litigations or claims of material importance pending or threatened against any member of the Enlarged Group which was known to the Directors.

## 7. MATERIAL CONTRACTS

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

(a) An agreement of equity transfer of and capital increase in Dongguan Tian Cheng Flavors and Fragrances Technology Company Limited* (東莞天成香料科技有限公司) (the "**JV Company**") entered into between Champion Sharp International Investment Limited (盛冠國際投資有限公司), Shenzhen Boton Spice Company Limited* (深圳波頓香料有限公司) ("**Shenzhen Boton**") and the JV Company dated 6 November 2014; where the contribution made by Shenzhen Boton in connection of the equity transfer of and capital increase in the JV Company was in the amount of approximately RMB45 million (equivalent to HK$56,962,025) in kind by way of transferring assets which included, *inter alia*, the equipment and machineries owned by Shenzhen Boton for manufacturing the food flavors and fine fragrances;

(b) a loan agreement entered into between Shenzhen Boton (as lender) and the JV Company (as borrower) dated 6 November 2014 for a loan amount of RMB30 million (equivalent to HK$37,974,684);

(c) a lease agreement entered into between Shenzhen Boton (as landlord) and the JV Company (as tenant) dated 6 November 2014 with total rental amount of RMB4,048,800 (equivalent to HK$5,125,056) for the whole contract;

(d) a trade licence agreement entered into between Shenzhen Boton (as licensor) and the JV Company (as licensee) dated 6 November 2014 with nil consideration;

(e) a supplemental agreement to item (a) above dated 19 November 2014 with nil consideration as it was solely to revise one of the conditions precedent in connection of completion of item no. 7(a) above that the relevant completion was subject to the sale and purchase agreement in respect of the land use right of the piece of land (under acquisition then by the JV Company) having been signed by the relevant parties;

(f) a rental contract entered into between Shenzhen Boton (as landlord) and Shenzhen Vanke Yuncheng Real Estate Development Limited* (深圳市萬科雲城房地產開發有限公司) (as tenant) dated 10 October 2015 with an annual rental income of approximately RMB1.9 million for two years from the date of confirmation of handover of property which is pending at the date of this circular;

(g) a rental contract entered into between Shenzhen Boton (as landlord) and Shenzhen Vanke Industry Property Operation Management Limited* (深圳市萬科產業地產運營管理有限公司) (as tenant) dated 20 October 2015 with an annual rental income of approximately RMB3.6 million for six years from the date of confirmation of handover of property which is pending at the date of this circular;

(h) a rental contract entered into between Shenzhen Boton (as landlord) and Shenzhen Vanke Industry Property Operation Management Limited* (深圳市萬科產業地產運營管理有限公司) (as tenant) dated 1 November 2015 with an annual rental income of approximately RMB20.0 million for eight years from the date of confirmation of handover of property which is pending at the date of this circular; and

(i) the Acquisition Agreement.

## 8. EXPERTS AND CONSENTS

The following are the qualifications of the experts who have been named in this circular or have given opinions or advice which are contained in his circular:

| Name | Qualification |
|---|---|
| BMI Appraisals Limited | independent valuer |
| PricewaterhouseCoopers | Certified Public Accountants, Hong Kong |
| I-Access Investors Limited | financial adviser |

Each of the above experts has given and has not withdrawn their written consent to the issue of this circular with the inclusion herein its letter or report or references to its name in the form and context in which it appears.

As at the Latest Practicable Date, each of the above experts did not have any shareholding, directly or indirectly, in any member of the Group or any right or option (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in any member of the Group.

As at the Latest Practicable Date, each of the above experts did not have any direct or indirect interests in any assets which have been, since 31 December 2015 (being the date to which the latest published audited accounts of the Group were made up), acquired or disposed of by or leased to any member of the Group, or which are proposed to be acquired or disposed of by or leased to any member of the Group.

## 9. DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents are available for inspection at the principal place of business of the Company at Room 2101–02, 21/F, Wing On House, 71 Des Voeux Road Central, Central, Hong Kong Hong Kong during normal business hours on any weekday other than public holidays for a period of 14 days from the date of this circular:

(a) the Memorandum and Articles of Association of the Company;

(b) the material contracts referred to in the paragraph headed "Material Contracts" in this Appendix;

(c) the written consents of the experts referred to in the section headed "Expert and Consent" in this Appendix;

(d) the accountant's report on the Target Group from PricewaterhouseCoopers, the text of which is set out in Appendix II;

(e) the unaudited pro forma financial information of the Enlarged Group from PricewaterhouseCoopers, the text of which is set out in Appendix III;

(f) the valuation report of the Target Group from BMI Appraisals Limited, the text of which is set out in Appendix IV;

(g) the letter from PricewaterhouseCoopers on the discounted cash flows in relation to the valuation of the Target Group, the text of which is set out in Appendix VI;

(h) the letter from I-Access Investors Limited in relation to the valuation of the Target Group, the text of which is set out in Appendix VII;

(i) the annual reports of the Group for the three financial years ended 31 December 2015; and

(j) this circular.

**10. MISCELLANEOUS**

(a) The company secretary of the Company is Mr. Ma Man Wai who is a fellow member of the Hong Kong Institute of Certified Public Accountants.

(b) The registered office of the Company is located at Century Yard, Cricket Square, Hutchins Drive, P.O. Box 2681 GT, George Town, Grand Cayman, Cayman Islands, British West Indies. The head office and the principal place of business in Hong Kong is Room 2101–02, 21/F, Wing On House, 71 Des Voeux Road Central, Central, Hong Kong.

(c) The principal share registrar and transfer office of the Company in Cayman Islands is Appleby Trust (Cayman) Limited at Clifton House, 75 Fort Street, P.O. Box 1350 Grand Cayman KY1-1108 Cayman Islands.

(d) The Hong Kong branch share registrar and transfer office of the Company is Tricor Investor Services Limited at 22/F., Hopewell Center, 183 Queen's Road East, Wanchai, Hong Kong.

(e) The English text of this circular shall prevail over the Chinese text.