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

(Incorporated in Bermuda with limited liability)

(Stock code: 00336)

ANNOUNCEMENT OF INTERIM RESULTS FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2016

FINANCIAL HIGHLIGHTS

Compared with the corresponding period last year:

- Sales increased by approximately 9.8% to HKD1,859,477,000
- Gross profit increased by approximately 3.3%, gross profit margin decreased by approximately 4.1 percentage points
- Operating profit decreased by 9.7% to HKD662,555,000
- Profit attributable to the equity holders of the Company decreased by approximately 1.3% to HKD557,753,000
- Basic earnings per share decreased by approximately 1.4% to HK17.95 cents
- Net cash[+] reached HKD4,723,562,000, increased by 34.8% as compared with 31 March 2016
- The Board does not recommend the payment of any interim dividend for the six months ended 30 September 2016

\+ *"Net cash" means "Restricted bank deposits" plus "Short-term time deposits" and "Cash and cash equivalents" and minus "Borrowings".*

* *For identification purpose only*

TABLE OF FINANCIAL HIGHLIGHTS

	Unaudited For the six months ended 30 September		**Change in percentage**
	2016	2015	
	HK$'000	*HK$'000*	
Sales	**1,859,477**	1,693,019	**+9.8%**
Gross profit	**1,210,843**	1,171,736	**+3.3%**
Gross profit margin	***65.1%***	*69.2%*	
Operating profit	**662,555**	733,809	**-9.7%**
EBITDA margin≠	***42.4%***	*49.2%*	
EBIT margin	***35.6%***	*43.3%*	
Profit before income tax	**686,497**	760,290	**-9.7%**
Profit attributable to the equity holders of the Company	**557,753**	565,340	**-1.3%**
Earnings per share			
– Basic	**17.95 *HK cents***	18.20 *HK cents*	**-1.4%**
– Diluted	**17.95 *HK cents***	18.18 *HK cents*	**-1.3%**

≠ "EBITDA margin" equal to "Earnings before taxes, interest, depreciation, and amortisation" divided by "Sales".

The board of directors (the "Board") of Huabao International Holdings Limited (the "Company" or "Huabao") is pleased to announce the unaudited consolidated interim results of the Company and its subsidiaries (collectively referred to as the "Group") for the six months ended 30 September 2016 together with the comparative figures for the corresponding period in 2015.

The Group's unaudited condensed consolidated interim financial information has been reviewed by the Company's Audit Committee and the Company's auditor, PricewaterhouseCoopers, in accordance with Hong Kong Standard on Review Engagements 2410 "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA"). The auditor's review report will be included in the interim report to be despatched to the shareholders of the Company.

CONDENSED CONSOLIDATED INCOME STATEMENT

For the six months ended 30 September 2016

	Note	Unaudited For the six months ended 30 September **2016** ***HK$'000***	 2015 *HK$'000*
Sales	*3*	**1,859,477**	1,693,019
Cost of goods sold		**(648,634)**	(521,283)
Gross profit		**1,210,843**	1,171,736
Other income and other gains – net	*4*	**138,922**	70,215
Selling and marketing expenses		**(154,069)**	(118,603)
Administrative expenses		**(533,141)**	(389,539)
Operating profit		**662,555**	733,809
Finance income		**24,577**	34,668
Finance costs		**(2,605)**	(6,948)
Finance income – net		**21,972**	27,720
Share of profit/(loss) of associates and a jointly controlled entity		**1,970**	(1,239)
Profit before income tax		**686,497**	760,290
Income tax expense	*6*	**(139,806)**	(187,318)
Profit for the period		**546,691**	572,972
Attributable to:			
Equity holders of the Company		**557,753**	565,340
Non-controlling interests		**(11,062)**	7,632
		546,691	572,972
Earnings per share for profit attributable to the Company's equity holders for the period			
Basic	*7(a)*	**17.95 *HK cents***	18.20 *HK cents*
Diluted	*7(b)*	**17.95 *HK cents***	18.18 *HK cents*

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
For the six months ended 30 September 2016

	Unaudited For the six months ended 30 September	
	2016	2015
	HK$'000	*HK$'000*
Profit for the period	**546,691**	572,972
Other comprehensive income:		
Items that may be reclassified to profit or loss		
Fair value changes on available-for-sale financial assets, net of tax	**937**	(12,472)
Currency translation difference on foreign operations	**(271,157)**	(334,641)
Other comprehensive loss for the period, net of tax	**(270,220)**	(347,113)
Total comprehensive income for the period, net of tax	**276,471**	225,859
Total comprehensive income attributable to:		
Equity holders of the Company	**295,755**	226,645
Non-controlling interests	**(19,284)**	(786)
	276,471	225,859

CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 30 September 2016

	Note	**As at 30 September 2016** *HK$'000* **Unaudited**	As at 31 March 2016 *HK$'000* Audited
Assets			
Non-current assets			
Property, plant and equipment		**1,212,216**	1,307,819
Land use rights		**177,863**	185,688
Intangible assets		**3,132,511**	3,261,635
Investments in associates		**363,535**	337,616
Available-for-sale financial assets		**263,514**	222,488
Deferred income tax assets		**74,429**	79,788
		5,224,068	5,395,034
Current assets			
Inventories		**834,821**	834,024
Trade and other receivables	*9*	**1,585,665**	1,440,690
Financial assets at fair value through profit or loss		**221,740**	229,149
Available-for-sale financial assets		**–**	165,617
Restricted bank deposit		**–**	117,130
Short-term time deposits		**64,562**	220,527
Cash and cash equivalents		**4,746,692**	3,184,051
		7,453,480	6,191,188
Total assets		**12,677,548**	11,586,222
Equity			
Capital and reserves attributable to the Company's equity holders			
Share capital		**310,666**	310,666
Reserves		**876,882**	813,203
Retained earnings		**9,549,617**	9,063,371
		10,737,165	10,187,240
Non-controlling interests		**1,051,134**	343,178
Total equity		**11,788,299**	10,530,418
Liabilities			
Non-current liabilities			
Deferred income tax liabilities		**78,543**	85,329
Trade and other payables	*11*	**35,155**	38,441
		113,698	123,770
Current liabilities			
Borrowings	*10*	**87,692**	18,002
Trade and other payables	*11*	**541,353**	794,679
Current income tax liabilities		**146,506**	119,353
		775,551	932,034
Total liabilities		**889,249**	1,055,804
Total equity and liabilities		**12,677,548**	11,586,222

CONDENSED CONSOLIDATED CASH FLOW STATEMENT
For the six months ended 30 September 2016

	Unaudited For the six months ended 30 September	
	2016	2015
	HK$'000	*HK$'000*
Cash flows from operating activities		
Cash generated from operations	**451,377**	713,829
Income tax paid	**(114,396)**	(195,053)
Net cash generated from operating activities	**336,981**	518,776
Cash flows from investing activities		
Acquisitions of associates	**(148,470)**	(101,890)
Proceeds from disposal of a jointly controlled entity	**–**	6,434
Additions to available-for-sale financial assets	**(160,391)**	(21,617)
Proceeds from disposals of available-for-sale financial assets	**282,926**	–
Purchases of financial assets at fair value through profit or loss	**–**	(330,162)
Proceeds from disposal of financial assets at fair value through profit or loss	**–**	218,729
Purchases of property, plant and equipment, land use right and intangible assets	**(30,339)**	(50,864)
Proceeds from disposal of property, plant and equipment	**189**	300
Release/(increase) in restricted bank deposit	**117,130**	(114,104)
Short-term time deposits released/(placed)	**148,865**	(3,195)
Dividend received	**10,343**	20,805
Interest received	**15,221**	44,914
Net cash generated from/(used in) investing activities	**235,474**	(330,650)
Cash flows from financing activities		
Dividends paid to non-controlling interests	**(11,152)**	(7,992)
Receipts from the issue of new shares to non-controlling interests	**983,686**	–
Proceeds from issue of shares upon exercise of share options	**–**	9,865
New short-term bank borrowings	**94,661**	–
Repayment of short-term bank borrowings	**(24,971)**	(154,120)
Interest paid	**(2,591)**	(7,216)
Net cash generated from/(used in) financing activities	**1,039,633**	(159,463)
Net increase in cash and cash equivalents	**1,612,088**	28,663
Cash and cash equivalents at 1 April	**3,184,051**	2,674,289
Effects of currency translation on cash and cash equivalents	**(49,447)**	(120,028)
Cash and cash equivalents at 30 September	**4,746,692**	2,582,924

Notes:

1. BASIS OF PREPARATION

This condensed consolidated interim financial information for the six months ended 30 September 2016 has been prepared in accordance with Hong Kong Accounting Standard ("HKAS") 34 "Interim Financial Reporting" issued by the HKICPA. This condensed consolidated interim financial information should be read in conjunction with the consolidated financial statements of the Group for the year ended 31 March 2016, which have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRS").

2. ACCOUNTING POLICIES

Except as described below, the accounting policies applied are consistent with those of the annual financial statements for the year ended 31 March 2016, as described in those financial statements.

(a) Taxes on income in the interim periods are accrued using the tax rate that would be applicable to expected total annual earnings.

(b) There are no other standards or interpretations that are effective for the first time for this interim period that have a material impact on the Group.

(c) The following new standards, amendments to standards have been issued but are not yet effective and have not been early adopted by the Group:

	Effective for annual periods beginning on or after
HKAS 12 (Amendment) "Income Taxes"	1 January 2017
HKAS 7 (Amendment) "Statement of Cash Flows"	1 January 2017
HKFRS 15 "Revenue from contracts with customers"	1 January 2017
HKFRS 9 "Financial instruments"	1 January 2018
HKFRS 16 "Leases"	1 January 2019
HKFRS 10 and HKAS 28 (Amendments) "Sales or Contribution of Assets between an Investor and its Associate or Joint Venture"	To be confirmed

Management is currently assessing the impact of the above new and amended standards to the Group's consolidated financial statements.

3. TURNOVER AND SEGMENT INFORMATION

The Group has organised its operations into four main operating segments:

- Flavours and fragrances;
- Tobacco raw materials;
- Aroma raw materials; and
- Innovative tobacco products.

The chief operating decision-makers have been identified as the executive directors (the "Executive Directors"). The Executive Directors review the Group's internal reporting in order to assess performance and allocate resources. Management has determined the operating segments based on these reports.

During current reporting period, the Group conducted an internal organizational restructuring. As a result of the restructuring, the operating segments changed in response to the change in internal reporting. The original flavours segment and fragrances segment were combined into a new segment – flavours and fragrances segment. Reconstituted tobacco leaves segment and new materials segment were combined into a new segment – tobacco raw materials segment. In addition, VMR Products, LLC and its subsidiaries, the subsidiary acquired in last financial year, together with other existing entities with similar business formed a new segment – innovative tobacco products segment. Aroma raw materials segment remains unchanged. The comparative figures of last year have been restated according to the new segment information.

The Executive Directors consider the business from the operation's perspective and assess the performance of flavours and fragrances, tobacco raw materials, aroma raw materials and innovative tobacco products segments:

1) Flavours and fragrances segment includes research and development, production and sale of flavours and fragrances products.

2) Tobacco raw materials segment includes research and development, production and sale of paper-making reconstituted tobacco leaves and new materials products that are innovative, functional and applicable to tobacco industry.

3) Aroma raw materials segment includes research and development, manufacture and sale of aroma raw materials products that are extracted from natural materials or generated from chemical process.

4) Innovative tobacco products segment includes research and development, production and sale of e-cigarette.

The Executive Directors assess the performance of the operating segments based on a measure of operating profit.

The segment information for the six months ended 30 September 2016 is presented below:

	Unaudited For the six months ended 30 September 2016					
	Flavours and fragrances *HK$'000*	**Tobacco raw materials** *HK$'000*	**Aroma raw materials** *HK$'000*	**Innovative tobacco products** *HK$'000*	**Others** *HK$'000*	**Total** *HK$'000*
Total turnover	**1,103,124**	**401,672**	**234,261**	**161,113**	**1,465**	**1,901,635**
Inter-segment sales	**(32,400)**	**(7,087)**	**(2,643)**	**(28)**	**–**	**(42,158)**
Segment turnover – net	**1,070,724**	**394,585**	**231,618**	**161,085**	**1,465**	**1,859,477**
Segment result	**609,469**	**131,014**	**36,854**	**(67,666)**	**(47,116)**	**662,555**
Finance income						**24,577**
Finance costs						**(2,605)**
Finance income – net						**21,972**
Share of profit of associates						**1,970**
Profit before income tax						**686,497**
Income tax expense						**(139,806)**
Profit for the period						**546,691**
Depreciation	**22,821**	**46,652**	**6,953**	**2,522**	**161**	**79,109**
Amortisation	**13,111**	**4,385**	**9,520**	**18,907**	**1,509**	**47,432**

	Unaudited As at 30 September 2016					
	Flavours and fragrances *HK$'000*	**Tobacco raw materials** *HK$'000*	**Aroma raw materials** *HK$'000*	**Innovative tobacco products** *HK$'000*	**Others** *HK$'000*	**Total** *HK$'000*
Segment assets	**6,883,461**	**2,304,125**	**649,612**	**415,414**	**2,424,936**	**12,677,548**

The segment information for the six months ended 30 September 2015 is presented below:

	Unaudited For the six months ended 30 September 2015					
	Flavours and fragrances *HK$'000*	Tobacco raw materials *HK$'000*	Aroma raw materials *HK$'000*	Innovative tobacco products *HK$'000*	Others *HK$'000*	Total *HK$'000*
Total turnover	1,258,838	320,930	139,144	1,649	5,822	1,726,383
Inter-segment sales	(8,839)	(22,066)	(2,457)	(2)	–	(33,364)
Segment turnover – net	1,249,999	298,864	136,687	1,647	5,822	1,693,019
Segment result	680,522	106,181	29,826	(40,368)	(42,352)	733,809
Finance income						34,668
Finance costs						(6,948)
Finance income – net						27,720
Share of loss of associates and a jointly controlled entity						(1,239)
Profit before income tax						760,290
Income tax expense						(187,318)
Profit for the period						572,972
Depreciation	24,678	49,565	4,165	235	137	78,780
Amortisation	13,286	5,720	1,603	5	122	20,736

The segment assets as at 31 March 2016 are presented below:

	Audited (restated) As at 31 March 2016					
	Flavours and fragrances *HK$'000*	Tobacco raw materials *HK$'000*	Aroma raw materials *HK$'000*	Innovative tobacco products *HK$'000*	Others *HK$'000*	Total *HK$'000*
Segment assets	5,415,740	2,545,688	777,189	450,826	2,396,779	11,586,222

Segment result represents the profit earned by each segment without inclusion of unallocated expenses, finance costs, finance income and share of results of associates and a jointly controlled entity. This is the measure reported to chief operating decision makers for the purposes of resource allocation and assessment of segment performance.

4. OTHER INCOME AND OTHER GAINS-NET

	Unaudited For the six months ended 30 September **2016** ***HK$'000***	 2015 *HK$'000*
Changes in fair value of financial assets at fair value through profit or loss	**(5,985)**	47,317
Profit/(loss) on disposal of financial assets at fair value through profit or loss	**65,952**	(7,270)
Government grants	**85,555**	61,395
Currency exchange loss – net	**(6,145)**	(31,366)
Others	**(455)**	139
	138,922	70,215

5. EXPENSES BY NATURE

Expenses included in cost of goods sold, selling and marketing expenses and administrative expenses are analysed according to their nature (with the exception of "research and development expenses" which are shown as a single item and analysed according to the nature in note (a) below) as follows:

	Note	Unaudited For the six months ended 30 September **2016** ***HK$'000***	 2015 *HK$'000*
Depreciation		**66,391**	65,063
Amortisation		**45,966**	20,686
Employee benefit expenses		**227,956**	161,056
Research and development expenses	*(a)*	**130,496**	111,250
Lease rentals		**25,290**	20,118
Travelling expenses		**55,865**	39,745
Utility expenses		**36,420**	37,510
Delivery expenses		**22,311**	18,616

(a) Depreciation, amortisation and employee benefit expenses included in research and development expenses are set out below:

	Unaudited For the six months ended 30 September **2016** ***HK$'000***	 2015 *HK$'000*
Depreciation	**12,718**	13,717
Amortisation	**1,466**	50
Employee benefit expenses	**47,669**	46,698

6. INCOME TAX EXPENSE

	Note	Unaudited For the six months ended 30 September **2016** ***HK$'000***	 2015 *HK$'000*
Current income tax:			
– Hong Kong profits tax	*(a)*	**4,661**	4,657
– PRC corporate income tax	*(b)*	**137,280**	189,652
– Germany company income tax	*(c)*	**125**	125
– Botswana company income tax	*(d)*	**602**	787
Deferred income tax		**(2,862)**	(7,903)
		139,806	187,318

(a) Hong Kong profits tax has been provided at the rate of 16.5% (2015: 16.5%) on the estimated assessable profit for the period.

(b) PRC corporate income tax has been calculated on the estimated assessable profit for the period at the tax rates applicable to respective companies of the Group.

(c) Germany company income tax has been provided at the rate of 15% (2015: 15%) on the estimated assessable profit for the period.

(d) Botswana company income tax has been provided at the rate of 15% (2015: 15%) on the estimated assessable profit for the period.

(e) The subsidiary in U.S. is a limited partnership and does not chargeable to income tax at partnership level. The corporate owners of the partnership pay tax on its share of the partnership's taxable income at the rate of 35% for the period.

(f) No provision for income tax in other jurisdictions has been made as the Group had no assessable profit in other jurisdictions during the period.

7. EARNINGS PER SHARE

(a) Basic

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

	Unaudited For the six months ended 30 September **2016**	 2015
Profit attributable to equity holders of the Company *(HK$'000)*	**557,753**	565,340
Weighted average number of ordinary shares in issue *('000)*	**3,106,658**	3,106,211
Basic earnings per share *(HK cents per share)*	**17.95**	18.20

(b) Diluted

Diluted earnings per share is calculated based on the weighted average number of ordinary shares outstanding, assuming that all dilutive potential ordinary shares have been issued. For the period ended 30 September 2016, the awarded shares granted by the Company have potential dilutive effect on the earnings per share.

The weighted average number of shares on issue has been adjusted as if all dilutive share options were exercised and awarded shares were granted. The number of shares that could have been issued upon the exercise of all dilutive share options and awarded share less the number of shares that could have been issued at fair value (determined as the Company's average share price for the period) for the same total proceeds is added to the denominator. No adjustment is made to the net profit.

	Unaudited For the six months ended 30 September	
	2016	2015
Profit attributable to equity holders of the Company *(HK$'000)*	**557,753**	565,340
Weighted average number of ordinary shares used to calculate basic earnings per share *('000)*	**3,106,658**	3,106,211
Adjustment for:		
– Exercise of share options *('000)*	**–**	2,957
– Grant of awarded shares *('000)*	**88**	–
Weighted average number of ordinary shares for diluted earnings per share *('000)*	**3,106,746**	3,109,168
Diluted earnings per share *(HK cents per share)*	**17.95**	18.18

8. DIVIDENDS

No interim dividend (2015: Nil) is proposed at the meeting of the Board held on 17 November 2016.

9. TRADE AND OTHER RECEIVABLES

	Note	**As at 30 September 2016** ***HK$'000*** **Unaudited**	As at 31 March 2016 *HK$'000* Audited
Trade receivables	*(a)*	**1,216,993**	994,949
Less: Provision for impairment of receivables		**(20,131)**	(13,763)
Trade receivables – net		**1,196,862**	981,186
Notes receivable		**86,305**	192,647
Prepayments and other receivables		**285,954**	231,930
Advances to staff		**9,815**	15,054
Others		**6,729**	19,873
		1,585,665	1,440,690

Except for prepayments of HKD69,690,000 (31 March 2016: HKD44,028,000), trade and other receivables balances are financial assets categorised under "loans and receivables''. All trade and other receivables are either repayable within one year or on demand. Accordingly, the fair values of the trade and other receivables approximate their carrying amounts.

(a) The credit period granted to customers generally ranges from 0 to 180 days. At 30 September 2016 and 31 March 2016, the ageing analysis of the trade receivables (including amounts due from related parties which are trade in nature) based on the invoice dates were as follows:

	As at 30 September 2016 *HK$'000* **Unaudited**	As at 31 March 2016 *HK$'000* Audited
0 – 90 days	**1,067,782**	869,233
91 – 180 days	**77,397**	55,538
181 – 360 days	**33,141**	41,803
Over 360 days	**38,673**	28,375
	1,216,993	994,949

As at 30 September 2016, unbilled trade receivables of HKD594,090,000 (31 March 2016: HKD371,792,000) was categorised in the aging of 0-90 days.

10. BORROWINGS

	Note	**As at 30 September 2016** *HK$'000* **Unaudited**	As at 31 March 2016 *HK$'000* Audited
Current			
– Secured bank borrowings	*(a)*	**–**	13,201
– Unsecured bank borrowings	*(b)*	**87,692**	4,801
Total borrowings		**87,692**	18,002

(a) The bank borrowings were secured by a pledge of land and buildings located in Jiangsu Province owned by a subsidiary, Yancheng City Chunzhu Aroma Co., Ltd. The borrowings were denominated in RMB, repayable within one year and had been fully repaid before 30 September 2016. During the period, the average interest rate of secured bank borrowings was 6.48% per annum (30 September 2015: 6.3%).

(b) The unsecured bank borrowings are repayable within one year. During the period, the average interest rate was 4.05% (30 September 2015: 1.86%) per annum.

Borrowings are financial liabilities categorised under "financial liabilities measured at amortised cost". The fair values of the Group's borrowings approximate their carrying amounts.

Interest expense on bank borrowings for the six months ended 30 September 2016 amounted to HKD1,120,000 (30 September 2015: HKD6,948,000).

11. TRADE AND OTHER PAYABLES

	Note	As at 30 September 2016 HK$'000 Unaudited	As at 31 March 2016 HK$'000 Audited
Trade payables	*(a)*	**324,075**	371,263
Dividends payable		**978**	8,947
Wages payable		**35,836**	52,659
Other taxes payable		**52,780**	77,004
Accruals for expenses		**38,111**	75,452
Advances from customers		**21,710**	7,124
Payable for acquisition of an associate		**–**	116,806
Payable for licence fee		**35,155**	43,462
Other payables		**67,863**	80,403
		576,508	833,120

Except for other taxes payable of HKD52,780,000 (31 March 2016: HKD77,004,000), wages payable of HKD35,836,000 (31 March 2016: HKD52,659,000) and advances from customers of HKD21,710,000 (31 March 2016: HKD7,124,000), trade and other payables balances are financial liabilities categorised under "financial liabilities measured at amortised cost". The fair values of trade and other payables approximate their carrying amounts.

(a) As at 30 September 2016 and 31 March 2016, the ageing analysis of the trade payables (including amounts due to related parties which are trade in nature) based on invoice dates was as follows:

	As at 30 September 2016 HK$'000 Unaudited	As at 31 March 2016 HK$'000 Audited
0 – 90 days	**255,913**	289,879
91 – 180 days	**46,395**	56,234
181 – 360 days	**7,398**	6,546
Over 360 days	**14,369**	18,604
	324,075	371,263

MANAGEMENT DISCUSSION AND ANALYSIS

Industry Review

Overview of the tobacco industry

As an important component of the national economy, the tobacco industry is closely related to the national economy and social development. When macro economy grows rapidly and external development environment becomes relaxed, the sales of tobacco tend to show a trend of fast growth. With China's economy entering into a period of the New Normal, tobacco sales growth tend to slow down as well. The current factors, including those of continuing downward trend of the macro economy, the tobacco control becoming more stringent and the tobacco consumption reaching a turning point, have posed sustained pressure on the cigarettes sales. In the first half of 2016, total sales volume of cigarettes was about 24.37 million cases, representing a decrease of approximately 7.5% as compared to the corresponding period of the previous year; production volume of cigarettes was about 23.23 million cases, representing a decrease of approximately 6.5% as compared to the corresponding period of the previous year. Sales volume was slightly higher than the production, which could help reduce the inventory, but the total inventory still stayed high. By the end of September 2016, the inventory of the industry amounted to 5.54 million cases, increased by 650,000 cases, or approximately 13.3% as compared to the corresponding period of the previous year. Except Class II cigarettes which achieved growth, the sales volume of cigarettes of all other classes all recorded various levels of decreases as compared to the corresponding period of the previous year. In particular, the sales volume of Class I cigarettes dropped most significantly by 678,000 cases, representing a decrease of 11.0%, which was 4.5 percentage points more than the nation-wide average of decrease. However, the slim cigarette showed a trend of rapid growth. In the first half of this year, the overall sales volume for slim cigarettes amounted to 633,000 cases, representing an increase of 316,000 cases or 100.3% as compared to the corresponding period of the previous year. (Source: "The Tobacco Market of China")

With various smoking ban legislations and tobacco controlling policies imposed by central and local governments, the no-smoking area and implementation in public places have been expanding, and as a result the tobacco control policies and legislations have become stricter and the consumption environment of cigarettes has become more complicated. Following the promulgation and implementation of the new Advertising Law in 2015, tobacco control measures have been gradually streamlined. The restrictions on cigarette marketing environment, areas, methods and means have in turn become more rigid, and consequently the marketing space of the tobacco market is becoming narrower and narrower. On the other hand, the tax-induced price hike policy which has raised the consumption tax and wholesale price and subsequently escalated the consumption cost of cigarettes, as well as the slowdown of population growth and the improvement of people's health awareness, all of which to a certain extent have suppressed the demand for cigarette consumption. In general, cigarette consumption targets, consumption venues and consumption methods have been changing gradually. Cigarette consumption has become more rational. Cigarette smoking per capita and the demand for high-priced cigarettes have shown a distinctive downward trend, which has posed certain pressure on the growth of cigarette sales volume and the upgrade of consumption structure.

However, despite the mounting downward macroeconomic pressure, the tobacco industry continues to make large contributions to the fiscal revenue of China. In 2015, the total profit tax from the industry amounted to RMB1,143.6 billion, representing an increase of 8.7% as compared with the corresponding period of the previous year. The total amount for the period from January to September this year was RMB841 billion. The general cigarette consumption in the international market shows that the market demand for cigarettes consumption in the low-to-medium income stage continues to grow, but becomes saturated when their income increases to a certain level, while the market demand in the high-income stage continues to decline. The overall cigarette consumption market in our country is declining, but some niche markets still have certain room to grow. A new round of industrial adjustment will start again. New regulatory requirements, new industry standards, new market demands will lead to a new industry pattern.

Overview of the food & beverage and fragrances industries

With the macro-economy of our country entering into the New Normal, the food and beverage industry, as a traditional necessity industry, has also faced tremendous challenges. In the first half of 2016, although total corporate revenue of the food industry in China still recorded a certain degree of growth, the growth rate of revenue slowed down. Although dairy products saw a rebound, the dramatic increase of imported dairy products generated a huge impact on the domestic market. Although the total production volume of the beverage industry increased as compared to the same period of the previous year, the production volumes of carbonated drinks and fruit and vegetable juice drinks decreased in certain degrees as compared to the same period of the previous year.

In recent years, although people's income level has been increasing year after year, the proportion of disposable income of every household on fast-moving consumer goods has been gradually decreasing. Zero growth was recorded last year. With the improvement of people's health consciousness, more and more consumers want to seek more balanced life through spending on healthier and safer food. The food safety scandals exposed in recent years have intensified such trend. Besides the health trend, food and beverages have also demonstrated a trend of moving upmarket. Healthy, personalized, natural and functional food products have become more and more popular among consumers.

In respect of the fragrances industry, under the current situation where the economy growth slows down and competition becomes more intense, consumers tend to remain cautious on consumption. The overall growth rate of the fragrances industry in China has slowed down, but the trend of consumption upgrade has never stopped. Consumers' demand for high-quality products continue to rise, and the competition in the fragrances consumer goods market becomes increasingly fierce. According to the statistics of the National Bureau of Statistics, the GDP growth in the first half of 2016 was 6.7% as compared to the same period of the previous year. The total retail sales volume of social consumer goods increased by 10.3% as compared to the same period of the previous year. The growth rate hit a record low this year. Among them, the cosmetic was still the fastest growing sector of the fragrances industry. Also, the soap and synthetic detergent manufacturing sectors developed rapidly. Some surveys have shown that consumers' consumption habits of laundry have already changed. Nearly 80% of consumers prefer laundry detergents, while soap and washing powder are only the second and the third choices for consumers. Concentrated laundry detergents gradually become a new trend, because from the perspective of suggested usage amounts, concentrated laundry detergents can save more money. Currently, the market share of concentrated laundry detergents is less than 4%, and there will be more room to grow in the future.

Overview of the reconstituted tobacco leaves ("RTL") industry

In recent years, the market demand for RTL has presented a downward trend, which is primarily due to the impact of decreasing sales volume of cigarettes in the PRC. In fact, the demand for RTL is positively correlated to the sales volume of cigarettes, the development trends of RTL and cigarettes are basically the same. In respect of supply, the market of RTL is still overwhelmed by oversupply due to the newly released RTL production capacities all over the country. Furthermore, as the inventory level of tobacco leaves remains high, the tobacco companies' willingness to use RTL has been indirectly reduced.

At the end of 2014, the State Tobacco Monopoly Administration ("STMA") formulated a three-year adjustment plan with respect to the production of tobacco leaves, pursuant to which it plans to adjust the tobacco leaves inventory to a reasonable level by progressive adjustments on the purchase plan of tobacco leaves in three consecutive years. In addition, through a five-year optimization adjustment process, the STMA also plans to achieve a new situation of production of tobacco leaves, in which sales and production are balanced, the demand is properly met, and the production is highly efficient. As this year is the last year of the three-year adjustment plan with respect to the production of tobacco leaves, it is reported that the actual planting area for tobacco leaves this year amounted to 16.195 million mu, representing a decrease of approximately 285,000 mu as compared with the plan. However, due to the backdrop of continuing decline in the production and sales volumes of cigarettes, the inventories of tobacco leaves in industry enterprises did not show any signs of significant relief. By the end of 2015, the overall industrial and commercial inventories of tobacco leaves were approximately 5.15 million tonnes, which were available to use for more than 37 months, occupying industrial capital of RMB370 billion. As such, to clear the inventories is still a difficult task. (Source: "The Tobacco Market of China")

Overview of the innovative tobacco products industry

In recent years, due to the impact of the ever-tightening smoking ban policies in public area, continuous increase in cigarette tax, and the constant changes in market environment as well as economic policies, sales volume of cigarettes has shown a certain degree of decline in many countries, especially in Europe and other developed countries. In contrast to the declining market share of traditional tobacco products, the market size of innovative tobacco products has been steadily expanding in recent years. Innovative tobacco products have become more and more popular among tobacco manufacturers, technology companies and consumers around the world.

Among the innovative tobacco products, e-cigarettes top other innovative tobacco products in terms of its development speed, consumer growth and market impact. Currently, the biggest market for e-cigarettes is still the North American market, and the sales volume of e-cigarettes in North America accounted for more than 40% of the global sales in 2015. It is expected that the market growth rate of e-cigarettes will reach 27% by 2021, while the market share of e-cigarettes in Asia Pacific is expected to reach 21% by 2021, and the global market size of e-cigarettes will amount to USD32.0 billion. (Source: <E-cigarette Market Forecast from 2016 to 2021>)

With the market size of e-cigarettes continuously expanding, the product types have become more diversified, and the related legislation and regulation also tend to be tightening. In 2016, the U.S. FDA Regulation and the TPD Order of the European Union were promulgated and came into effect, which implied that every e-cigarette product must comply with the entry requirements before entering into the markets of the U.S. and the European Union in the future and obtain relevant certification before sale. The implementation of these regulations has undoubtedly raised the entry barrier of the e-cigarette market. The launch of these new regulations may bring some difficulties to the industry development in a short term, and some underqualified small and medium-sized e-cigarette manufacturing enterprises may be eliminated by the market. In the long term, however, the implementation of these new regulations will guide the development of e-cigarette industry in an orderly way, help promote the standardization of the industry, and accelerate the maturity of the market.

Comparing with overseas markets, the development of e-cigarettes in China is obviously lag behind. Due to adopting the practice used in the overseas market, some consumers were led into a misconception of the consumption. During the past year, some physical stores collapsed due to business failure. Moreover, the promulgation of new regulations added more uncertainties to the domestic e-cigarette market. However, the e-cigarette sector, being an emerging sector, is still in general full of opportunities for further development, presenting a huge room for growth in either products or channel development, or brand building.

RESULTS

For the six months ended 30 September 2016, the Group's sales revenue reached approximately HKD1,859 million, representing an increase of approximately 9.8% over the corresponding period last year. Gross profit margin reached approximately 65.1%, representing a decrease of approximately 4.1 percentage points as compared with the corresponding period last year. EBIT margin reached approximately 35.6%, representing a decrease of 7.7 percentage points as compared with the corresponding period last year. Profit attributable to equity holders of the Company was approximately HKD558 million, representing a decrease of approximately 1.3% over the corresponding period last year. Basic earnings per share was HKD17.95 cents, representing a decrease of approximately 1.4% over the corresponding period last year.

Business Review

In order to implement and promote the Group's overall strategy as well as to facilitate the integration of various segments and to fully benefit from their synergies, the Group has made necessary adjustments to the organizational structure during the reporting period. In particular, the fragrances segment has been combined with the flavours segment to form the flavours and fragrances segment, which are principally engaged in the R&D, production and sales of flavours and fragrances products. RTL segment and new materials segment have been merged into the tobacco raw materials segment, which are principally engaged in the business of tobacco raw materials (including the RTL and new materials products applicable for tobacco industry). Other segments include the aroma raw materials segment which were set up earlier this year, innovative tobacco products segment and financial investment business.

In September 2016, the Group's indirect wholly-owned subsidiary Huabao Flavours & Fragrances Co., Ltd. ("Huabao Flavours") entered into a capital increase agreement with the investors, at a total consideration of RMB846,924,000 (about HKD983,686,000), to issue an aggregate of 54,290,000 new shares, accounting for approximately 9.8% of the enlarged capital of Huabao Flavours. The Group's ownership in Huabao Flavours decreased from 100% to 90.2%. The capital increase has been duly completed by the end of September 2016.

During the reporting period, the Group invested RMB30,000,000 (approximately HK$35,425,000) to acquire 20% equity interests in Beijing Infosin Technology Co., Ltd. ("Infosin"). Infosin is a high-tech enterprise specialized in the Internet of Things technology and data intelligence solutions. The company, based on the Internet of Things, has integrated big data, cloud computing, mobile Internet and other technologies to provide business application software products based on the Internet of Things technology, as well as professional system integration, solution and technical advice services to its customers with a focus on customers in tobacco industry.

Review of flavours & fragrances business

For the six months ended 30 September 2016, sales revenue of the flavours and fragrances business of the Group amounted to HKD1,070,724,000, representing a decrease of approximately 14.3% as compared with that of HKD1,249,999,000 for the corresponding period last year, and accounting for approximately 57.6% of the total revenue of the Group. The operating profit of the flavours and fragrances segment was approximately HKD609,469,000, representing a decrease of approximately 10.4% as compared with the corresponding period last year. The EBIT margin of the flavours and fragrances segment was approximately 56.9%, representing an increase of 2.5 percentage points as compared with approximately 54.4% for the corresponding period last year. The decline in sales and profits was mainly due to the slowdown of macroeconomic growth, the sluggish tobacco industry, the high inventory level of tobacco products and the decrease in both production and sales volumes, which resulted in the decline of flavours and fragrances sales.

a) Tobacco flavours

In the first half of 2016, due to the combined impact of various unfavourable factors, the tobacco industry faced an array of challenges. Firstly, the external macroeconomic growth continued to slow down, smoking bans and tobacco controls were further intensified, and the cigarettes consumption environment and the views on consumption were changing. Secondly, there was a lingering impact of the decline in cigarette output to reduce cigarette inventories and the rise in cigarette prices due to tax increases in the industry. Thirdly, the product portfolio upgrades slowed down and the tobacco inventories remained at a high level. In response to the gradual decline in the total number of smokers and the consumption volume of cigarettes, the Group will cater for young smokers and help tobacco enterprises to develop cigarette products suitable for the youth by introducing various youth-oriented design elements.

b) Food flavours

Against the backdrop of weak economic growth in the country and development of depression in the whole flavours industry, Shanghai H&K Flavours & Fragrances Co. Ltd. ("Huabao Kongque"), being one of the leaders of sweet flavours producer, and Guangzhou Huabao Food Co., Ltd. ("Guangzhou Huabao"), specializing in savoury flavours, are both keen to develop new products and explore new customers while maintaining good relationships with their large customers. Among the flavours, the fruits flavours for the beer industry is what the Group has endeavored to develop over the years, and the Group has established a partnership with a number of beer groups. During the reporting period, Huabao Kongque successfully sold its new products to a new renowned beer group. As for dairy products, Huabao Kongque also catered for the customers to develop new flavours, and thus increased its sales volume. Guangzhou Huabao, based on an in-depth research and study carried out on snack food in the first half of the year, proactively developed new flavours while upgrading its existing products, and applied its self-developed technologies, such as supercritically extracted flavours (熟香超臨界萃取) and microencapsulated flavour, to the ingredients of meat products, which were well recognized by its large customers and Guangzhou Huabao will focus on promotion in the second half of the year.

The new "Food Safety Law" is more stringent than before with higher production standards, more specific sales regulations and more severe penalties. Although the new law will increase the operating costs of enterprises to some extent, its promulgation and implementation will further expedite industry integration and promote product innovation and high-standard development, while being conducive to fostering a good consumption environment, improving consumers' confidence in food safety and facilitating the sustainable and healthy development of the industry.

c) Fragrances

Xiamen Amber Daily Chemical Technology Co. Ltd. ("Xiamen Amber"), one of the subsidiaries of the Group, has been holding the leading position in the incense and disinfectant & insecticide sectors, the two subdivisions of the fragrance market, and has been trying to maintain and consolidate its leadership in the sector of incense and household hygiene & insecticide products. During the year, Xiamen Amber stepped up its marketing efforts with the extract from the eucalyptus leaf oil, a natural insect repellent ingredient found in the plants, by widening the application of such extract while improving its R&D capability, so as to enhance its competitiveness and maintain its industry-leading position.

While securing its market share in the incense and disinfectant & insecticide sectors, Xiamen Amber was trying to penetrate the market of fragrances for detergent and skin-care products by promoting the concept of natural, health and safety, with an aim of accelerating the pace of development of its flavour business. In the laundry detergent sector, flavours for detergent powder, kitchen detergent, soap and laundry accounted for over 50% of the total demand, while Xiamen Amber shows huge potential and ample room for market expansion in this area, and has made agreeable progress in overcoming the entry barriers of the laundry and soap market. It will strive to advance market development with R&D and drive research and innovation with market development in line with the development trend of the detergent market. Meanwhile, Xiamen Amber will continue to step up its R&D efforts and increase capital investment in this area, with the aim of gaining greater market share in the daily chemical industry.

Review of tobacco raw materials business

For the six months ended 30 September 2016, the Group's tobacco raw materials business recorded a sales revenue of HKD394,585,000, representing an increase of approximately 32.0% as compared with the HKD298,864,000 for the same period of last year, accounting for approximately 21.2% of the Group's total revenue. The operating profit of the tobacco raw materials segment amounted to HKD131,014,000, representing an increase of approximately 23.4% as compared with the same period of last year; and the EBIT ratio was about 33.2%, representing a decrease of 2.3 percentage points as compared with the 35.5% for the same period of last year. The increase in the revenue was mainly due to the increase in sales volume after clearing the RTL inventory of tobacco industry, but the situation continued to be grim for RTL industry.

The tobacco raw materials segment is a new segment established recently by the Group, which consists of RTL and new cigarette materials. During the reporting period, in response to the unfavourable situation of simultaneous decline in both production and sales in the tobacco industry as well as the increasingly fierce competition, Guangdong Golden Leaf Technology Development Co., Ltd. ("Guangdong Jinye") promptly adopted a number of effective measures such as reducing costs, improving quality, developing new products and exploring new markets, and included overseas markets into the coverage of its marketing campaign for RTL, so as to ensure the smooth development of its RTL business. Firstly, Guangdong Jinye placed great emphasis on the improvement of raw materials and process, and upgraded the products quality according to the personalized needs of customers, aiming to win customers and market shares by offering high quality products. Secondly, Guangdong Jinye developed personalized products with customized functions according to the customers' specific needs, and concentrated its technical resources in the development of proprietary technologies with prominent effect, industrialization feasibility and viable cost control, aiming to provide functional products that can meet customers demand for personalization. Thirdly, while improving the quality of products, Guangdong Jinye remained committed to ensuring environmental friendliness in its production process. Its calcium carbonate and fine fibre renovation project completed construction in August 2016. The project, through the systematic recovery of calcium carbonate and fine fibre in the plain water used for the production of RTL, not only saved costs and achieved direct economic benefits, but also reaped satisfactory results in quality assurance and environmentally friendly production.

RTL products have three important features, including less tar and harm, more taste, and being controllable and adjustable. RTL products, being flexible, can serve as substitutes for tobacco leaves and play a positive role in easing the structural contradiction of raw materials. The huge price difference between RTL and tobacco leaves demonstrates the competitive value of RTL products, which is also one of the driving forces for future development.

As for the new tobacco materials, in order to create a completely new smoking experience, the Group kicked off a full exploration in the function, novelty and uniqueness of the cigarette filter rods, forming a leading position in this area. During the reporting period, due to the downturn of tobacco industry and the decrease in demand, the sales revenue of the new tobacco material products reported a certain decrease, but two types of products, blast beads and wires, still had a good momentum of development and got high market recognition. With the lessening pressure on the tobacco market as well as the R&D progress in new products, demands for new tobacco materials will continue to grow in the future.

Review of aroma raw materials business

For the six months ended 30 September 2016, sales revenue of the Group's aroma raw materials business was HKD231,618,000, representing an increase of approximately 69.5% as compared to HKD136,687,000 for the corresponding period last year, and accounting for approximately 12.5% of the total revenue of the Group. Operating profit of the aroma raw materials business was HKD36,854,000, representing an increase of approximately23.6% from the corresponding period last year. EBIT margin was approximately 15.9%, as compared to 21.8% for the corresponding period last year. The increases in sales and profit were mainly attributable to the consolidation of Yancheng City Chunzhu Aroma Co. Ltd. ("Yancheng Chunzhu")'s financial statements into the Group's consolidated financial statements upon the acquisition. Profit margin declined mainly due to the amortisation of intangible assets recognized in the acquisition of the Yancheng Chunzhu and the profit margin of this sector business is lower than before.The aroma raw materials segment is a new segment established subsequent to the successful acquisition of Yancheng Chunzhu last year. It mainly comprises Zhaoqing Perfumery Co., Ltd. (Guangdong) ("Guangdong Zhaoqing"), Yancheng Chunzhu and Yongzhou Shanxiang Flavour Co., Ltd. ("Yongzhou Shanxiang"), and the main products are various types of natural and synthetic aroma raw materials.

Due to the increasing pressure on the downturn of domestic economy, the food industry growth slowed down, which brought certain challenges to the development of the industry. During the reporting period, Guangdong Zhaoqing, adhering to the development strategy of "Big Customers, Big Brands", actively developed new customers while maintaining its relationship with the existing customers, achieving a steady growth in the overall sales. Exports remained stable with a 29% growth in the Southeast Asian market. It is now endeavouring to establish relationship with large customers and agents in Europe and the United States. Relying on the capital and technological advantages of the Group, Yancheng Chunzhu spent tremendous energy into R&D activities and focused on continuous innovation, thus resulting in a substantial increase in both production output and sales volume as compared with the corresponding period last year. Certain newly developed products were in short supply and became new growth points for the Company, which plans to expand production. Yongzhou Shanxiang actively adjusted its production and marketing strategies, especially a major breakthrough made in marketing of eugenol and recorded a relatively significant increase in sales volume in the first half of the year.

The aroma raw materials sector belongs to the fine chemical industry, but is different from a general one. Its major customer base comprises downstream flavor formula enterprises. As the country elevates environmental protection standards and manufacturing safety requirements, small-scale workshop-style factories will be bound to be phased out. The Group will seize the opportunity of industry consolidation and reinforce its efforts to develop the aroma raw materials business. In order to better adapt to the market and serve the customers, the Group plans to build a professional aroma raw materials production base with an annual production capacity of more than 10,000 tons, which will integrate the upstream and downstream industrial chains, diversify product lines, and create greater profit margins.

Review of the innovative tobacco products business

For the six months ended 30 September 2016, sales revenue of the Group's business of innovative tobacco products was HKD161,085,000, representing a significant increase of approximately 97 times compared with HKD1,647,000for the corresponding period last year and accounting for approximately 8.7% of the Group's total revenue. Operating loss of the innovative tobacco products business amounted to HKD67,666,000. The significant increase in sales revenue was mainly due to the consolidation of VMR Products, LLC ("VMR")'s financial statements into the Group's consolidated financial statements upon the acquisition. However, VMR was still in loss position during the reporting period.

Following acquisition of VMR, an American independent e-cigarette producer, the Group carried out integration with Standpoint Electronic Technology Development (Shanghai) Co., Ltd. ("SPV") in terms of R&D, warehousing, procurement and sales. VMR is mainly responsible for the European and American market, while SPV is mainly responsible for the domestic and surrounding markets. With respect to brand building, VMR launched its Vertx series products this year. Many designs of the series products, such as leakage-free design, plug and play atomizer, touch-screen-based pressure regulation technology and battery information display function, all use the disruptive technologies of e-cigarettes and lead the trend of e-cigarettes. With respect to channel building, the Group endeavored to establish an integrated online and offline sales network. Besides opening of more SPV brand flagship stores on e-commerce giant JD.com Inc and Tmall.com, the Group also actively introduced world-famous e-cigarette brands in an effort to build an e-cigarette platform. With the introduction of the platform and the deepening of channels building, the e-cigarette sales made certain progress in the first half of this year.

As for offline development, SPV set up a strategic partnership with Sunpower Group and successfully extended presence to many of Sunpower flagship stores all over the country and Brookstone stores. On top of that, SPV brand physical store located at Global Harbor Shanghai was officially opened in July 2016. As the first e-cigarette brand at Global Harbor Shanghai, SPV aimed to bring a new fashion experience to all the consumers. From electronic smoking devices to high-quality tobacco oil, and all kinds of parts and components, customers' real one-stop shopping becomes true.

Research and development ("R&D") and innovation capabilities

The Group has a leading R&D platform in the fields of tobaccos, flavours and fragrances and a R&D team of international calibre. The Group has constructed a State-recognised technical centre and a post-doctorate scientific research workstation in Shanghai, and has established joint laboratories with several major tobacco enterprises. It has also established a designated RTL production and R&D base in Shantou, Guangdong province as authorised by the STMA, and overseas R&D centres in Germany. The Group possesses a R&D team that is comprised of experienced personnel, both domestically and abroad, with its R&D capability continuing to lead its peers in the domestic industry. As for its R&D investment, for the six months ended 30 September 2016, R&D expenses of the Group were approximately HKD130,496,000, accounting for approximately 7.0% of its total sales revenue, which increased further from that of approximately 6.6% for the corresponding period last year.

As for the flavours and fragrances segment, Guangzhou Huabao, with its R&D efforts over the years, had successfully resolved key issues in developing the supercritical extracted flavours in the first half of the year and would start industrial production subsequently. In addition, the microencapsulation technology, developed by Guangzhou Huabao independently, could makes products high-temperature resistance, good performance and allows for customization of the microencapsulated flavour, which is thus expected to erect technical barriers and become a high margin product. With regards to the aroma raw materials segment, Yancheng Chunzhu invested more in R&D and the new purchased R&D equipment Micro-channel Reactor (微通道反應器) could provide support for its new high-tech products. Its self-developed product Galbanum (格蓬脂) has been launched into the market, and were well recognized by the market.

As for RTL technology, through its R&D efforts over the years, the Group, after years of research, has successfully developed a new processing technology-coordinated dilation of microwave and vapour (微波蒸汽協同膨脹處理技術), which improved treatment of tobacco stems, enhanced quality of cigarette products and reduced production wastage. Such an achievement has great significance and long-term value in enhancing the industry's independent innovation capabilities for workmanship and technologies, and in shaping up core processing technologies for the Chinese-style cigarettes. Meanwhile, the Group also made a breakthrough progress in low-temperature materials and new filters for cigarettes. The R&D of low-temperature cigarette materials is of great significance for promoting the development of the RTL technology and innovation of the low-temperature cigarette technology.

Future Prospects

Although the current domestic and overseas economic and operating environment remains complicated, the management is still cautiously optimistic about the business outlook for the full year. The management believes that, with the inventory backlog of tobacco leaves and cigarettes further cleared, the Group's business will continue to develop steadily in the second half of the year. In respect of capital operations, the Group believes that it is very important for the Group to build multiple capital platforms in order to develop itself into an investment holding group. In the future, the Group will continue to push forward the relevant projects.

In line with the development and strategic upgrading of the Company, the Group encourages company assets securitization and put its matured and well established business segments into the capital market through multi-channels by way of securitization, so that these business segments will be able to develop their own operating mechanism and face the market independently. In 2016, the Board of Directors of the Group considered the feasibility of a proposed spin-off and separate listing of the flavours and fragrances business by way of proposed A shares listing of the spin-off company on a stock exchange in the PRC. Currently, the Stock Exchange of Hong Kong Limited ("Stock Exchange") has confirmed that the Group could proceed the proposed spin-off and the proposed A share listing and granted waiver from strict compliance with applicable requirements in relation to the assured entitlement of A shares to the then shareholders under the Rules Governing the Listing of Securities on the Main Board of the Stock Exchange ("Listing Rules"). However, the proposed spin-off and the proposed A share listing are still subject to the approval from relevant PRC regulators, including China Securities Regulatory Commission, and fulfillment of other relevant conditions.

With the rise of the Chinese economy, the steady progress of RMB internalization, the capital market in China will play an even more important role in the world. The management would like to take this opportunity to create an additional finance platform for the flavours segment in order to enable it to operate more independently and professionally and to fully realize its core value in the future. On the one hand, new finance platforms and new supervising regulatory authorities will strengthen the Group's corporate governance; on the other hand, they will also help the Group to build a strong foundation for establishing multi-layered finance platforms.

FINANCIAL REVIEW

Analysis of interim results for the six months ended 30 September 2016

Sales revenue

The Group's sales revenue amounted to HKD1,859,477,000 for the six months ended 30 September 2016, representing an increase of 9.8% as compared with HKD1,693,019,000 for the corresponding period last year. The increase in the sales revenue is mainly attributable to significant increase of sales revenue of tobacco raw materials as compared with the corresponding last year, and increase in sales revenue of aroma raw materials and innovative tobacco products due to consolidation of financial statements of Yancheng Chunzhu and VMR after last year's acquisitions. However, sales revenue from flavours and fragrances segment fell due to the sluggishness of macroeconomics. For the six months ended 30 September 2016, sales revenue from flavours and fragrances decreased by 14.3% to HKD1,070,724,000; sales revenue from tobacco raw materials increased by 32.0% to HKD394,585,000; sales revenue from aroma raw materials increased by 69.5% to HKD231,618,000; sales revenue from innovative tobacco products reached HKD161,085,000.

Cost of goods sold

The Group's cost of goods sold amounted to HKD648,634,000 for the six months ended 30 September 2016, representing an increase of 24.4% as compared with HKD521,283,000 for the corresponding period last year.

Gross profit and gross profit margin

The gross profit of the Group increased from HKD1,171,736,000 for the six months ended 30 September 2015 to HKD1,210,843,000 for the six months ended 30 September 2016, representing an increase of 3.3%. The Group's gross profit margin for the first half of the year is about 65.1%, representing a decrease of 4.1 percentage points as compared with 69.2% for the corresponding period last year. This was mainly due to sales proportion of products with relatively lower gross profit increased as compared with the corresponding period last year.

Other income and other gains – net

Other income and other gains – net of the Group was HKD138,922,000 for the six months ended 30 September 2016, representing an increase of HKD68,707,000 as compared with HKD70,215,000 for the six months ended 30 September 2015. The increase in other income and other gains – net was mainly attributable to the increase in gain on disposal of financial assets at fair value through profit or loss, increase in government grants and decrease in foreign exchange loss as compared with corresponding last year.

Selling and marketing expenses

The selling and marketing expenses of the Group comprised mainly travelling expenses, transportation cost, advertising and promotion expenses, salaries and office expenses. The selling and marketing expenses of the Group for the six months ended 30 September 2016 were HKD154,069,000, representing an increase of 29.9% as compared with HKD118,603,000 for the corresponding period last year. Selling and marketing expenses to total sales revenue for the six months ended 30 September 2016 and 2015 amounted to approximately 8.3% and 7.0% respectively. The increase in such ratio was mainly attributable to the acquisition of VMR and Yancheng Chunzhu whose financial statements were consolidated into the Group's consolidated financial statements.

Administrative expenses

The Group's administrative expenses amounted to HKD533,141,000 for the six months ended 30 September 2016, representing an increase of 36.9% as compared with HKD389,539,000 for the corresponding period last year. The ratio of administrative expenses to total sales was approximately 28.7%, representing an increase of 5.7 percentage points as compared with 23.0% for the corresponding period last year. The increase in the ratio of administrative expenses to total sales revenue was mainly attributable to an increase in administrative expenses for innovative tobacco products; an increase in amortisation expense of intangible assets arising from acquisition of VMR and Yancheng Chunzhu whose financial statements were consolidated into the Group's consolidated financial statements.

Operating profit

The operating profit of the Group for the six months ended 30 September 2016 was HKD662,555,000, representing a decrease of approximately 9.7% as compared with HKD733,809,000 for the corresponding period last year, while the operating profit margin decreased by 7.7 percentage points to approximately 35.6% during the first half of the year from approximately 43.3% for the first half of last year. The decrease in operating profit was mainly attributable to the increase of selling expenses, marketing promotion expenses and administrative expenses.

Income tax expenses

The income tax expenses of the Group for the six months ended 30 September 2016 was HKD139,806,000, representing a decrease of 25.4% as compared with HKD187,318,000 for the corresponding period last year. Income tax rate of the current period was approximately 20.4%, representing a decrease of 4.2 percentage points as compared with the corresponding period of last year. It was mainly attributable to the decrease of withholding tax resulting from distribution of profits by PRC subsidiaries as compared with the corresponding period of last year.

Profit attributable to the equity holders of the Company

Profit attributable to the equity holders of the Company was HKD557,753,000 for the six months ended 30 September 2016, representing a decrease of 1.3% as compared with HKD565,340,000 for the corresponding period last year.

Net current asset value and financial resources

As at 30 September 2016, the net current asset value of the Group was HKD6,677,929,000 (31 March 2016: HKD5,259,154,000). The Group generates its working capital mainly through its operating activities to maintain a sound financial position. As at 30 September 2016, the Group's cash and bank balances amounted to HKD4,811,254,000 (31 March 2016: HKD3,521,708,000). The Group neither had any forex hedging products nor structured investment products.

Bank borrowings and gearing ratio

As at 30 September 2016, the Group had bank borrowings of HKD87,692,000 (31 March 2016: HKD18,002,000), all of which were due within one year and unsecured loans. For the six months ended 30 September 2016, the average annual interest rate of such unsecured loans was 4.1% (2015: 1.9%); the average annual interest rate of the secured loans which had been fully repaid was 6.5% (2015: 6.3%). As at 30 September 2016, the Group's gearing ratio (total borrowings, include current and non-current borrowings, divided by total equity (excludes non-controlling interests)) was 0.8%, which was slightly increased from 0.2% as of 31 March 2016.

Trade receivables turnover period

Trade receivables turnover period is calculated on the basis of the average amount of trade receivables as at the beginning and at the end of a relevant financial period divided by the total sales revenue for the corresponding period and multiplied by 180 days. The Group generally offers its customers a credit period of approximately 0-180 days, depending on the business volume of, and the length of business relationship with the customers. For the six months ended 30 September 2016, the Group's average trade receivables turnover period was 107 days, representing an increase of 18 days as compared with 89 days for the last financial year ended 31 March 2016, and an increase of 7 days as compared with 100 days for the corresponding period last year. The increase of the trade receivables turnover days was mainly attributable to the relocation of the flavours and fragrances business which caused the continuous changes of the company name and in turn resulted in the delay of issuing invoices.

Trade payables turnover period

Trade payables turnover period is calculated on the basis of the average amount of trade payables as at the beginning and at the end of a relevant financial period divided by the cost of goods sold for the corresponding period and multiplied by 180 days. Credit periods granted by suppliers to the Group ranged from 0-180 days. For the six months ended 30 September 2016, the Group's average trade payables turnover period was 96 days, representing a decrease of 17 days as compared with 113 days for the last financial year ended 31 March 2016, and representing a decrease of 19 days as compared with 115 days for the corresponding period last year. The decrease in trade payable turnover day was mainly attributable to acquisitions of Yancheng Chunzhu and VMR with relatively short turnover period, which affected the Group's consolidated figures.

Inventory and inventory turnover period

As at 30 September 2016, the Group's inventory balance amounted to HKD834,821,000 (31 March 2016: HKD834,024,000). For the six months ended 30 September 2016, the inventory turnover period (calculated on the basis of the average amount of inventory balances as at the beginning and at the end of a relevant financial period divided by the total cost of goods sold for the corresponding period and multiplied by 180 days) was 232 days, representing a decrease of 11 days as compared with 243 days for the last financial year ended 31 March 2016. The decrease in inventory turnover period was mainly attributable to the effectiveness of the Group's implementation of destocking policy.

Foreign exchange and exchange rate risk

The principal businesses of the Group are located in Mainland China and the majority of the sales revenue is denominated in RMB, with the exception of only a certain amount of imported raw materials and equipment which are denominated in foreign currency such as USD or EUR. The Group's bank deposits are mainly denominated in RMB, USD and HKD. The management concurs the view of the People's Bank of China on the exchange rate of RMB, i.e., the exchange rate of RMB has the capability to continuously remain basically stable within reasonable range of equilibrium.

Pledge of assets

As at 30 September 2016, the secured bank loan of the Group had been fully repaid.

Capital Commitments

As at 30 September 2016, the Group had capital commitments in respect of the purchase of property, plant, equipment and available-for-sale financial assets, contracted for but not provided in the financial statements amounted to approximately HKD130,246,000 (31 March 2016: HKD166,714,000), with investment in high-tech fund amounted to HKD102,901,000.

Contingent liabilities

According to the information available to the Board, the Group had no contingent liabilities as at 30 September 2016.

Human resources

As at 30 September 2016, the Group employed a total of 2,312 employees in the PRC, Hong Kong, Germany, U.S., Botswana and Korea. By external recruitment and internal nomination approach to recruit talents, the Group established a comprehensive recruitment system. In respect of building the reserve talent pool, the Group ensured healthy and systematic growth of the reserve talent team through regular internal recruitment and training courses, providing new talents for the Group at appropriate time.

Departments of the Group carried out different training activities from time to time according to different work requirements so as to improve the quality and capability of its employees. In the first half of this year, the Group organized administrative line training and human resources system training, which improved the professional qualities of the department employees in order to meet the company's requirements on the employees' continuous improvement under the new circumstances, so as to achieve the mutual development between the Company and its employees. In July 2016,, the Group provided a two-week induction training for fresh graduates to help them quickly adapt to the new working environment of Huabao. The second phase of the third session of the training program of the High Potential Talent Project (HPTP) undertaken in the first half of this year tried to provide a reliable source of talents for the sake of the Group's rapid development.

CORPORATE GOVERNANCE

Compliance with the Corporate Governance Code

Throughout the reporting period, the Company had complied with the code provisions in the Corporate Governance Code (the "CG Code") contained in Appendix 14 to the Listing Rules and, where appropriate, adopted the recommended best practice as set out in the code provisions, except for code provisions A.2.1 and A.4.1:

Code provision A.2.1 provides that the roles of chairman and chief executive should be separate and should not be performed by the same individual. Ms. CHU Lam Yiu, Chairwoman of the Board and Executive Director of the Company, took up the position of Chief Executive Officer ("CEO") starting from 9 April 2013. As the Board meets regularly to consider matters relating to business operations of the Group, the Board is of the view that the above arrangement will not impair the balance of power and authority of the Board and the executive management. The effectiveness of corporate planning and implementation of corporate strategies and decisions will generally not be affected.

Code provision A.4.1 stipulates that non-executive directors should be appointed for a specific term and subject to re-election. The Independent Non-executive Directors ("INEDs") of the Company were not appointed for a specific term as they are subject to retirement by rotation no later than the third annual general meeting of the Company since their last appointment or re-election and are eligible for re-election in accordance with the Company's bye-laws. As such, the Company considers that sufficient measures have been taken to ensure that the Company's corporate governance practices are no less exacting than those set out in the CG Code.

Model Code for Securities Transactions by Directors of Listed Issuers

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers ("Model Code") as set out in Appendix 10 to the Listing Rules as the code of conduct regarding dealing in the securities of the Company by the directors of the Company. Having made specific enquiries of all directors, the Company has received their written confirmations that they have complied with the required standard as set out in the Model Code throughout the six months ended 30 September 2016.

INTERIM DIVIDEND

The Board does not recommend the payment of any interim dividend for the six months ended 30 September 2016 (2015: Nil).

PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SECURITIES

During the six months ended 30 September 2016, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

AUDIT COMMITTEE

The Board has formed an Audit Committee in accordance with the Listing Rules to fulfill the functions of reviewing and monitoring the financial reporting procedure and internal control of the Company. The Audit Committee comprises all of the INEDs of the Company, namely Dr. DING Ningning, Mr. LEE Luk Shiu, Ms. MA Yun Yan and Mr. WU Chi Keung. The Audit Committee and the Board have reviewed and approved the Group's unaudited condensed consolidated interim financial information for the six months ended 30 September 2016.

PUBLICATION OF THE INTERIM RESULTS AND INTERIM REPORT

The interim results announcement is published on the website of HKExnews (www.hkexnews.hk) as well as the website of the Company (www.huabao.com.hk). The Company's 2016-17 interim report will be dispatched to shareholders and will be published on the aforementioned websites in due course.

By Order of the Board
Huabao International Holdings Limited
CHU Lam Yiu
Chairwoman and CEO

Hong Kong, 17 November 2016

As at the date of this announcement, the Board comprises four executive directors, namely Ms. CHU Lam Yiu (Chairwoman and CEO), Messrs. XIA Li Qun, POON Chiu Kwok and LAM Ka Yu, and four independent non-executive directors, namely Dr. DING Ningning, Mr. LEE Luk Shiu, Ms. MA Yun Yan and Mr. WU Chi Keung.