

Report of the Directors

The directors submit their report together with the audited financial statements for the year ended 31 December 2006.

Principal Activities and Analysis of Operations

The principal activity of the Company is investment holding. The activities of its principal subsidiaries are set out in note 32 to the financial statements.

Details of the analysis of the Group's performance for the year by business segments and geographical segments are set out in note 5 to the financial statements.

Results and Appropriations

The results of the Group for the year are set out in the consolidated income statement on page 82.

The directors declared an interim dividend of HK7 cents per share, totalling HK\$21,630,000, which was paid on 22 September 2006.

The directors recommended the payment of a final dividend of HK28 cents per share, absorbing HK\$86,790,760.

Reserves

Movements in the reserves of the Group and of the Company during the year are set out in note 14 to the financial statements.

Donations

Charitable and other donations made by the Group during the year amounted to approximately HK\$30,000.

Property, Plant and Equipment

Details of the movements in property, plant and equipment of the Group are set out in note 8 to the financial statements.

Share Capital

Details of the movements in share capital of the Company are set out in note 13 to the financial statements.

Distributable Reserves

Distributable reserves of the Company as at 31 December 2006, calculated under the Companies Act 1981 of Bermuda (as amended), amounted to US\$522,000 (2005: Nil).

Five-Year Financial Summary

A summary of the results and of the assets and liabilities of the Group for the last five financial years is set out on page 140.

Pre-emptive Rights

There is no provision for pre-emptive rights under the Company's Bye-laws and there are no restrictions against such rights under the laws of Bermuda.

Purchase, Sale or Redemption of the Company's Listed Shares

The Company has not redeemed any of its listed shares during the year. Neither the Company nor any of its subsidiaries has purchased or sold any of the Company's listed shares during the year.

Share Option Scheme

By the written resolutions of the then sole shareholder of the Company dated 4 November 2004 and amended by a committee of the Board on 22 November 2004, the Company had adopted a share option scheme (the "Scheme").

(i) Purpose

The purpose of the Scheme is to enable the Company to grant options to selected eligible participants as incentives or rewards for their contributions to the Group and those companies in the equity share capital of which the Company, directly or indirectly, has a 20% or greater beneficial interest but excluding the Company's subsidiaries ("Associated Companies").

(ii) Qualifying participants

Any employee including Executive Director, Non-executive Director (including Independent Non-executive Director) and officer of the Group or any Associated Companies, any business partner, agent, consultant or representative of the Group or any Associated Companies, a person who is seconded to work for any member of the Group and Associated Companies, where at least 40% of his time is devoted to the business of a member of the Group and Associated Companies (collectively referred to as Eligible Person), and any trust for the benefit of an Eligible Person or his immediate family members and a company controlled by an Eligible Person or his immediate family members.

(iii) Maximum number of shares

The overall limit on the number of shares which may be issued upon exercise of all outstanding options granted and yet to be exercised under the Scheme and other schemes must not exceed 30% of the shares in issue from time to time. Subject to the aforesaid limit, the total number of shares available for issue under options which may be granted under the Scheme and any other schemes must not, in aggregate, exceed 30,000,000 shares unless separate shareholders' approval has been obtained.

As at 31 December 2006, the number of shares available for issue under the Scheme is 92,700,000 shares representing 30% of the issued share capital of the Company of which 21,718,500 share options were granted and remained outstanding.

(iv) Limit for each participant

The total number of shares of the Company issued and to be issued upon exercise of options (including exercised, cancelled and outstanding) granted in any 12-month period to each participant must not exceed 1% of the shares of the Company in issue.

(v) Option period

The period within which the shares must be taken up under an option shall be determined by the Board in its absolute discretion at the time of grant, but such period must not exceed 10 years from the date of grant of the relevant option.

The Board has the authority to determine the minimum period for which an option must be held before it can be exercised. The Scheme itself does not specify any minimum holding period.

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(vi) Payment on application and acceptance

An offer of the grant of an option shall remain open for acceptance for a period of 28 days from the date of offer (or such other period as the Board may specify in the offer and acceptance letter).

HK\$1 is payable by the grantee to the Company on acceptance of the offer.

(vii) Subscription price

The exercise price shall not be less than the higher of (i) the closing price of the shares as stated in the Stock Exchange's daily quotations sheet on the date of grant; (ii) the average closing prices of the shares as stated in the Stock Exchange's daily quotation sheets for the five business days immediately preceding the date of grant; and (iii) the nominal value of the shares.

(viii) Remaining life of the scheme

The Board may at any time within 10 years commencing on 7 December 2004 make offers for the grant of options under the Scheme.

Details of the share options granted under the Scheme and remain outstanding as at 31 December 2006 are as follows:

	Number of Share Options				Exercise price HK\$	Grant Date	Exercise period
	As at 1/1/2006	Granted (Note 1)	Lapsed (Note 2)	As at 31/12/2006			
Benedict CHANG	750,000	–	–	750,000	4.825	14/12/04	01/01/07-31/12/08
Yew Teck	750,000	–	–	750,000	4.825	14/12/04	01/01/08-31/12/09
	750,000	–	–	750,000	4.825	14/12/04	01/01/09-31/12/10
	380,000	–	–	380,000	8.600	16/12/05	01/01/08-31/12/09
	380,000	–	–	380,000	8.600	16/12/05	01/01/09-31/12/10
	380,000	–	–	380,000	8.600	16/12/05	01/01/10-31/12/11
	–	380,000	–	380,000	15.100	15/12/06	01/01/09-31/12/10
	–	380,000	–	380,000	15.100	15/12/06	01/01/10-31/12/11
	–	380,000	–	380,000	15.100	15/12/06	01/01/11-31/12/12
Joseph Chua PHI	375,000	–	–	375,000	4.825	14/12/04	01/01/07-31/12/08
	375,000	–	–	375,000	4.825	14/12/04	01/01/08-31/12/09
	375,000	–	–	375,000	4.825	14/12/04	01/01/09-31/12/10
	210,000	–	–	210,000	8.600	16/12/05	01/01/08-31/12/09
	210,000	–	–	210,000	8.600	16/12/05	01/01/09-31/12/10
	210,000	–	–	210,000	8.600	16/12/05	01/01/10-31/12/11
	–	265,000	–	265,000	15.100	15/12/06	01/01/09-31/12/10
	–	265,000	–	265,000	15.100	15/12/06	01/01/10-31/12/11
	–	265,000	–	265,000	15.100	15/12/06	01/01/11-31/12/12

	Number of Share Options				Exercise price HK\$	Grant Date	Exercise period
	As at 1/1/2006	Granted (Note 1)	Lapsed (Note 2)	As at 31/12/2006			
Rajesh Vardichand	345,000	–	–	345,000	4.825	14/12/04	01/01/07-31/12/08
RANAVAT	345,000	–	–	345,000	4.825	14/12/04	01/01/08-31/12/09
	345,000	–	–	345,000	4.825	14/12/04	01/01/09-31/12/10
	135,000	–	–	135,000	8.600	16/12/05	01/01/08-31/12/09
	135,000	–	–	135,000	8.600	16/12/05	01/01/09-31/12/10
	135,000	–	–	135,000	8.600	16/12/05	01/01/10-31/12/11
	–	210,000	–	210,000	15.100	15/12/06	01/01/09-31/12/10
	–	210,000	–	210,000	15.100	15/12/06	01/01/10-31/12/11
	–	210,000	–	210,000	15.100	15/12/06	01/01/11-31/12/12
Continuous contract	2,787,000	–	177,000	2,610,000	4.825	14/12/04	01/01/07-31/12/08
employees	2,787,000	–	177,000	2,610,000	4.825	14/12/04	01/01/08-31/12/09
	2,787,000	–	177,000	2,610,000	4.825	14/12/04	01/01/09-31/12/10
	941,500	–	117,000	824,500	8.600	16/12/05	01/01/08-31/12/09
	941,500	–	117,000	824,500	8.600	16/12/05	01/01/09-31/12/10
	941,500	–	117,000	824,500	8.600	16/12/05	01/01/10-31/12/11
	–	755,000	–	755,000	15.100	15/12/06	01/01/09-31/12/10
	–	755,000	–	755,000	15.100	15/12/06	01/01/10-31/12/11
	–	755,000	–	755,000	15.100	15/12/06	01/01/11-31/12/12

Notes:

- (1) The closing price per share immediately before the date on which the options were granted was HK\$14.98.
- (2) 882,000 options lapsed following the cessation of employment of certain grantees.
- (3) During the year, no options were exercised or cancelled.
- (4) The average fair value of the options granted during the year is HK\$3.66 based on the Black-Scholes Valuation model. The significant inputs into the model were share price of HK\$15.10 at the grant date, exercise price shown above, standard deviation of expected share price returns of 34%, expected life of options from 4 to 6 years, expected dividend yield of 3% and average annual risk-free interest rate of 3.72%. The volatility measured at the standard deviation of expected share price returns is based on statistical analysis of daily share prices over the last year. The Black-Scholes Valuation model is developed to estimate the fair value of European share options. The fair values calculated are inherently subjective and uncertain due to the assumptions made and the limitations of the model used. The value of an option varies with different variables of certain subjective assumptions. Any change in variables so adopted may materially affect the estimation of the fair value of an option.

Report of the Directors

Directors

The directors during the year were:

Non-executive Directors

Dr. Victor FUNG Kwok King (*Chairman*)

William Winship FLANZ*

John Estmond STRICKLAND*

Dr. FU Yu Ning*

Prof. LEE Hau Leung*

Dr. William FUNG Kwok Lun

Jeremy Paul Egerton HOBBS

LAU Butt Farn

Executive Directors

Benedict CHANG Yew Teck (*Group Managing Director*)

Joseph Chua PHI

Rajesh Vardichand RANAVAT

* *Independent Non-executive Director*

In accordance with Bye-law 87 of the Company's Bye-laws, Dr. William FUNG Kwok Lun, Mr. Joseph Chua PHI, Mr. John Estmond STRICKLAND, Dr. FU Yu Ning and Prof. LEE Hau Leung will retire at the forthcoming annual general meeting. All retiring directors, being eligible, will offer themselves for re-election.

Directors' Service Contracts

None of the directors who are proposed for re-election at the forthcoming annual general meeting has a service contract with the Group which is not determinable within one year without payment of compensation, other than statutory compensation.

Directors' Interests in Contracts

No contracts of significance in relation to the Group's business to which the Company or its subsidiaries was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year except as disclosed under Connected Transactions stated below and note 31 to the financial statements.

Biographical Details of Directors and Senior Management

Brief biographical details of the directors and senior management are set out on pages 46 to 54.

Directors' and Chief Executives' Interests and Short Positions in Shares, Underlying Shares and Debentures

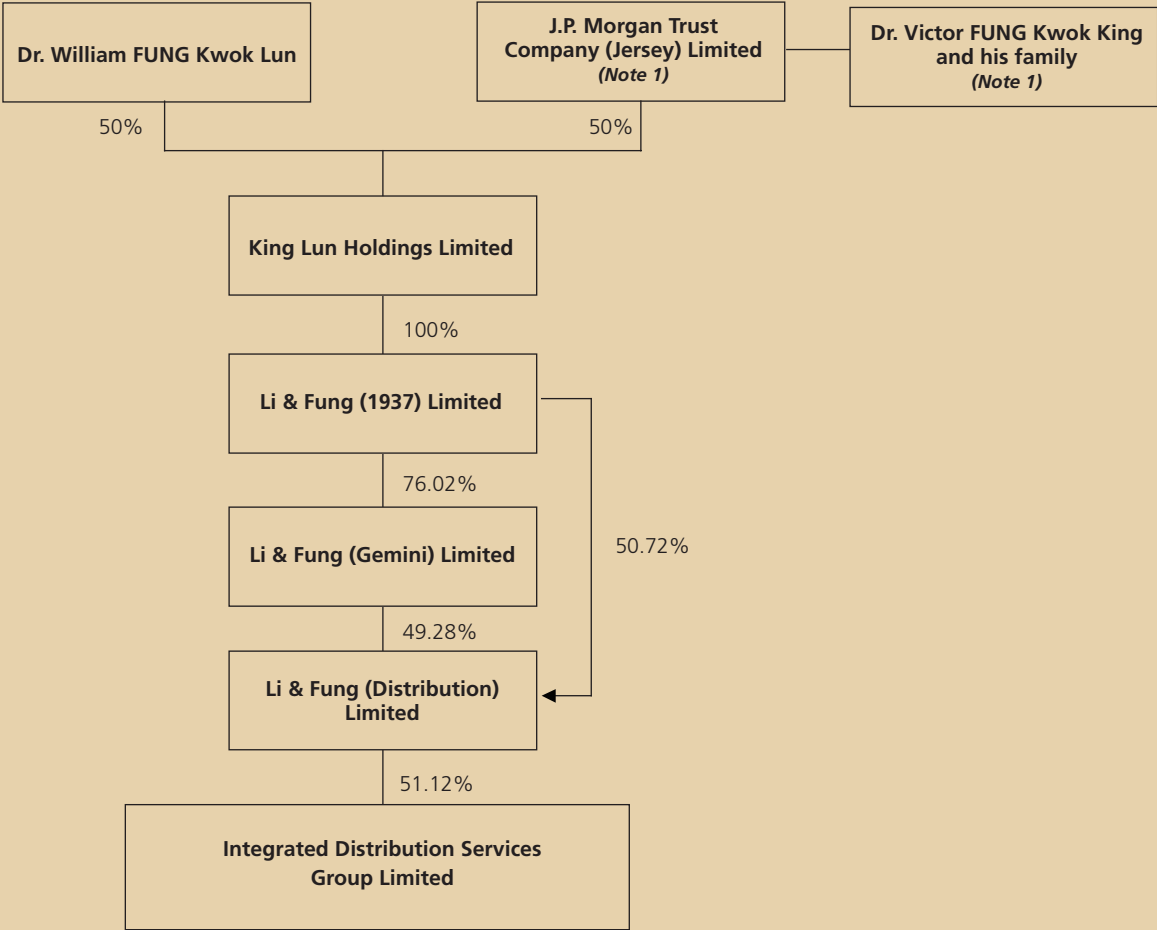
As at 31 December 2006, the directors and chief executives of the Company and their associates had the following interests in the shares, underlying shares and debentures of the Company and its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) as recorded in the register required to be kept under Section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies ("Model Code"):

(A) Long position in shares and underlying shares of the Company

Name of Director	Number of shares				Number of underlying shares under equity derivatives (Share Options)	Total interest	Approximate percentage of issued share capital (%)
	Personal interest	Family interest	Corporate/trust interest	Other interest			
Dr. Victor FUNG Kwok King	2,405,509	–	157,960,917 (Note 1)	–	–	160,366,426	51.90
Dr. William FUNG Kwok Lun	–	–	157,960,917 (Note 1)	–	–	157,960,917	51.12
Benedict CHANG Yew Teck	1,412,573	–	–	–	4,530,000	5,942,573	1.92
Joseph Chua PHI	1,047,632	–	–	–	2,550,000	3,597,632	1.16
Rajesh Vardichand RANAVAT	305,375	–	–	–	2,070,000	2,375,375	0.77
Jeremy Paul Egerton HOBBS	1,202,754	–	–	–	–	1,202,754	0.39
LAU Butt Farn	610,549	–	–	–	–	610,549	0.20
John Estmond STRICKLAND	–	–	–	22,000 (Note 2)	–	22,000	0.00

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The interests of Dr. Victor FUNG Kwok King and Dr. William FUNG Kwok Lun in shares of the Company are summarized in the following chart:



Notes:

- (1) King Lun Holdings Limited (“King Lun”) through its indirect non-wholly owned subsidiary, Li & Fung (Gemini) Limited (“LFG”), held a 49.28% interest in Li & Fung (Distribution) Limited (“LFD”). In addition, King Lun also through its wholly owned subsidiary, Li & Fung (1937) Limited, held 50.72% interest in LFD. LFD held 157,960,917 shares, representing 51.12% of the issued share capital of the Company. King Lun are owned (a) as to 50% by J.P. Morgan Trust Company (Jersey) Limited (which also indirectly held 8.77% of the issued share capital of LFG), the trustee of a trust established for the benefit of the family members of Dr. Victor FUNG Kwok King and (b) as to 50% by Dr. William FUNG Kwok Lun. Dr. Victor FUNG Kwok King and Dr. William FUNG Kwok Lun are deemed to have interests in these shares through their respective interests in King Lun and indirect interests in LFD as set out above.
- (2) Mr. John Estmond STRICKLAND and his wife, Mrs. Anthea Evadne STRICKLAND are joint beneficial owners of these shares.

(B) Long position in shares and underlying shares of associated corporations

Name of Director	Name of associated corporation	Class of shares	Number of shares	Nature of interest	Approximate percentage of interests (%)
* Dr. Victor FUNG Kwok King	King Lun Holdings Limited	Ordinary	1,332,840	beneficiary of a trust	50.00
	Li & Fung (Gemini) Limited	Ordinary	5,825,438	as above	84.80
* Dr. William FUNG Kwok Lun	King Lun Holdings Limited	Ordinary	1,332,840	controlled corporation	50.00
	Li & Fung (Gemini) Limited	Ordinary	5,222,807	as above	76.02
Benedict CHANG Yew Teck	Li & Fung (Gemini) Limited	Ordinary	462,018	controlled corporation (Note 1)	6.73
Rajesh Vardichand RANAVAT	Convenience Retail Asia Limited	Ordinary	26,000	beneficial owner	0.004
Jeremy Paul Egerton HOBBS	Convenience Retail Asia Limited	Ordinary	180,000	beneficial owner	0.03
	Li & Fung (Gemini) Limited	Ordinary	462,018	controlled corporation (Note 2)	6.73
LAU Butt Farn	Convenience Retail Asia Limited	Ordinary	2,390,000	beneficial owner	0.35

* Dr. Victor FUNG Kwok King and Dr. William FUNG Kwok Lun, by virtue of their interests in King Lun Holdings Limited ("King Lun") and the Company, are deemed to be interested in the shares and underlying shares of certain associated corporations of the Company under the SFO. A waiver application was submitted to the Stock Exchange for exempt from disclosure of their interests in the shares and underlying shares of the associated corporations (save for King Lun and Li & Fung (Gemini) Limited) of the Company, and a waiver was granted by the Stock Exchange on 4 April 2007.

Notes:

(1) 462,018 shares in Li & Fung (Gemini) Limited, representing 6.73% of its issued share capital, are held by Mikenwill Investments Limited which is owned by Mr. Benedict CHANG Yew Teck.

(2) 462,018 shares in Li & Fung (Gemini) Limited, representing 6.73% of its issued share capital, are held by Martinville Holdings Limited which is owned by Mr. Jeremy Paul Egerton HOBBS.

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(C) Short positions in shares and underlying shares of the Company and associated corporations

None of the directors and chief executive of the Company or their associates had any short position in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) as recorded in the register required to be kept under Section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code.

(D) Share options

The interests of the directors and chief executives in the share options (being regarded as unlisted physically settled equity derivatives) of the Company are detailed in the Share Option Scheme section stated above.

Save as disclosed above, at no time during the year, the directors and chief executives (including their spouse and children under the age of 18) had any interest in, or had been granted, or exercised, any rights to subscribe for shares of the Company or its associated corporations required to be disclosed pursuant to the SFO.

Interests and Short Positions of Substantial Shareholders

As at 31 December 2006, other than the interests of the directors or chief executive of the Company as disclosed above, the following persons had interests or short positions in the shares or underlying shares of the Company as recorded in the register required to be kept under Section 336 of the SFO:

(A) Long positions in shares of the Company

Name of Shareholders	Capacity	Number of Shares	Approximate percentage of issued share capital (%)
Li & Fung (Distribution) Limited	Beneficial owner	157,960,917	51.12
Li & Fung (Gemini) Limited	Interest of controlled corporation	157,960,917	51.12
Li & Fung (1937) Limited	Interest of controlled corporation	157,960,917	51.12
King Lun Holdings Limited	Interest of controlled corporation	157,960,917	51.12
J.P. Morgan Trust Company (Jersey) Limited	Interest of controlled corporation	157,960,917	51.12
Matthews International Capital Management, LLC	Investment manager	22,065,000	7.14
Brookside Capital Investors, L.P.	Interest of controlled corporation	15,473,000	5.01
JPMorgan Chase & Co.	Note	15,670,000	5.07

Note:

The capacities of JPMorgan Chase & Co. in holding the 15,670,000 shares were, as to 201,000 shares as Beneficial Owner, as to 1,556,000 shares as Investment Manager and as to 13,913,000 shares in the Lending Pool as custodian corporation/approved lending agent.

(B) Short positions in shares and underlying shares of the Company

As at 31 December 2006, the Company had not been notified of any short position being held by any substantial shareholder in the shares or underlying shares of the Company.

Management contracts

No contracts concerning the management and administration of the whole or any substantial part of the business of the Company were entered into or existed during the year.

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Major customers and suppliers

During 2006, the Group sold less than 30% of its goods and services to its 5 largest customers.

The percentage of purchases attributable to the Group's largest supplier and the 5 largest suppliers are as follows:

– the largest supplier	20%
– the five largest suppliers combined	48%

None of the directors, their associates or any shareholder (which to the knowledge of the directors own more than 5% of the Company's share capital) held more than 1% of the issued share capital of the five largest customers or suppliers noted above.

Connected transactions

(A) Continuing connected transactions

Save as disclosed above, during the year, the Group had the following non-exempt continuing connected transactions, details of which were disclosed in the prospectus of the Company dated 24 November 2004:

(a) *Distribution and sale of goods*

The Group distributes consumer and healthcare products to the retail operations of the members of Li & Fung (1937) Limited ("LF 1937"), a substantial shareholder of the Company, at market rates.

(b) *Provision of shipping, handling and other logistics services*

Members of the Group have been providing shipping, handling services and a variety of other logistics services, including storage, cargo handling, container devanning, administration, labelling, goods return sorting and delivery to subsidiaries of LF 1937 and companies controlled by LF 1937 ("Parent Group"). The fees charged by the Group to members of the Parent Group are either at market rates or at rates similar to those offered to third party clients.

(c) *Lease arrangements*

The Group has been leasing certain office and warehouse premises to and from members of the Parent Group. Rental for the lease arrangements were negotiated between parties with reference to the then prevailing market rates.

Below is a table setting out the aggregate value for each of the non-exempt continuing connected transactions for the year ended 31 December 2006:

	US\$'000
(a) Distribution and sale of goods	
– members of Convenience Retail Asia Limited (“CRA Group”)	1,004
– other members of the Parent Group	23
(b) Provision of shipping, handling and other logistics services	
– members of Li & Fung Limited	639
– other members of the Parent Group	2,592
(c) Rental recharge	
(i) received from	
– members of CRA Group	342
– other members of the Parent Group	746
(ii) paid to	
– members of Li & Fung (Distribution) Limited	2,219
– other members of the Parent Group	180

In respect of the above continuing connected transaction, the Stock Exchange has granted a waiver to the Company from strict compliance with the announcement and independent shareholders’ approval requirements subject to some conditions.

(B) Connected transaction

On 9 March 2005, IDS Marketing (Philippines), Inc. (“IDS Marketing (Philippines)”), a subsidiary of the Company entered into an acquisition and service agreement with JDH (Philippines), Inc. (“JDH (Philippines)”), a member of Li & Fung (Distribution) Limited, pursuant to which IDS Marketing (Philippines) has conditionally agreed to acquire from JDH (Philippines) certain inventory, motor vehicles and IT equipment (“the Assets”) and to provide certain services to JDH (Philippines) (“the Service”). The aggregate purchase price for the acquisition of the Assets will not exceed US\$2,520,000 and the service fees payable by JDH (Philippines) for the Service will be not more than US\$1,293,000.

During the year, the Group had the following connected transactions with JDH (Philippines):

	US\$'000
Information Technology fee recharge to	144
Fee for collection service	8

The nature and reasons for the above connected transaction have previously been disclosed in the Company’s announcement dated 9 March 2005.

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The Independent Non-executive Directors have reviewed the above continuing connected transactions and confirmed that the transactions have been entered into:

- (i) in the ordinary and usual course of business of the Company;
- (ii) either on normal commercial terms or, on terms no less favourable to the Company than terms available to or from independent third parties; and
- (iii) in accordance with the relevant agreement governing them on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

The Directors of the Company have engaged the auditors to perform certain agreed-upon procedures on the aforesaid continuing connected transactions and on a sample basis with respect to items 2 and 3 below. The auditors have, based on the work performed, provided a letter to the Directors of the Company stating that:

1. the transactions have been approved by the Company's Directors;
2. the transactions selected were entered into in accordance with the pricing policies of the Company;
3. the transactions selected were entered into in accordance with the terms of the relevant agreements governing such transactions; and
4. the transactions did not exceed the relevant annual limits as set out in the prospectus of the Company dated 24 November 2004 and as disclosed in the announcement of the Company dated 9 March 2005, respectively.

Sufficiency of public float

Based on information that is publicly available to the Company and within the knowledge of the Directors of the Company as at the date of this report, there is sufficient public float of more than 25% of the Company's issued shares as required under the Listing Rules.

Auditor

The financial statements have been audited by PricewaterhouseCoopers who retire and, being eligible, offer themselves for reappointment.

On behalf of the Board

Victor FUNG Kwok King

Chairman

Hong Kong, 20 March 2007