

REPORT OF THE DIRECTORS

The board of directors (the “Board”) has pleasure in submitting the annual report together with the audited financial statements of First Natural Foods Holdings Limited (the “Company”) and its subsidiaries (collectively the “Group”) for the year ended 31 December 2006.

Principal Activities

The principal activity of the Company is investment holding. The principal activities of the Company’s subsidiaries are set out in note 18 to the financial statements.

Segmental Information

The analysis of the principal activities and geographical locations of the operations of the Group are set out in note 15 to the financial statements.

Financial Statements

The consolidated income statement of the Group for the year ended 31 December 2006 and the state of the Group’s affairs as at that date are set out in the financial statements on pages 39 to 93.

Dividends

The Board has recommended the payment of a final dividend of HK\$0.045 per share (approximately equivalent to RMB0.044) for the year ended 31 December 2006 (2005: HK\$0.015 per share (approximately equivalent to RMB0.0156)) and subject to members’ approval at the forthcoming annual general meeting to be held on 11 June 2007, to the members whose names appear on the Register of Members of the Company on 11 June 2007 and payable on or before 25 June 2007.

No interim dividend was declared for the six months ended 30 June 2006 (2005: Nil).

Closure of Register of Members

The Register of Members of the Company will be closed from Thursday, 7 June 2007 to Monday, 11 June 2007, both days inclusive, during which period no transfer of shares will be registered. In order to qualify for the final dividend, all completed transfer forms together with the relevant share certificates must be lodged with the Company’s share registrar in Hong Kong, namely, Hong Kong Registrars Limited at Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen’s Road East, Wanchai, Hong Kong not later than 4:00 p.m. on Wednesday, 6 June 2007.

Property, Plant and Equipment

Details of the movements in property, plant and equipment are set out in note 16 to the financial statements.

Share Capital

Details of the movements in share capital of the Company are set out in note 29 to the financial statements.

Reserves

Details of the movements in reserves of the Group and the Company during the year are set out in note 30 to the financial statements.

Pre-Emptive Rights

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

Directors

The directors of the Company during the year and up to the date of this report are:

Executive directors:

Mr. Yeung Chung Lung (*Chairman*)
Mr. Yang Le (*Chief Executive Officer*)
Mr. Ni Chao Peng
Mr. Yip Tze Wai, Albert

Independent non-executive directors:

Mr. Tsui Chun Chung, Arthur
Mr. Lu Ze Jian
Mr. Leung Chiu Shing

In accordance with bye-law 87 of the Company's Bye-laws, Mr. Yeung Chung Lung, Mr. Tsui Chun Chung, Arthur and Mr. Lu Ze Jian will retire by rotation at the forthcoming annual general meeting and, being eligible, offer themselves for re-election.

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Directors' Service Contracts

Each of Mr. Yeung Chung Lung, Mr. Yang Le, Mr. Ni Chao Peng and Mr. Yip Tze Wai, Albert has entered into a service contract with the Company all dated 17 January 2002, except for Mr. Ni Chao Peng dated 18 January 2002, for a term of one year commencing on 11 February 2002 and shall continue thereafter unless and until terminated by either party giving not less than three months' notice in writing.

Each of Mr. Tsui Chun Chung, Arthur and Mr. Lu Ze Jian has entered into a letter of appointment with the Company for a term of one year commencing on 11 February 2002 and shall continue thereafter unless and until terminated in accordance with the terms and conditions stated in the letter of appointment.

Mr. Leung Chiu Shing has entered into a letter of appointment with the Company for a term of one year commencing on 27 September 2004 and shall continue thereafter unless and until terminated in accordance with the terms and conditions stated in the letter of appointment.

Save as disclosed above, none of the directors proposed for re-election at the forthcoming annual general meeting has an unexpired service contract which is not determinable by the Company within one year without payment of compensation, other than statutory compensation.

Biographical Information of Directors and Senior Management

Brief biographical information of Directors and senior management are set out on pages 16 to 17.

Directors' Interests in Competing Business

During the year ended 31 December 2006, none of the Directors of the Company is interested in any business which competes or is likely to compete, either directly or indirectly, with the business of the Group.

Directors' and Chief Executives' Interests in Securities

As at 31 December 2006, the interests and short positions of the Directors and Chief Executives in the shares, underlying shares and debentures of the Company or any associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (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 of Hong Kong Limited (the "Stock Exchange") pursuant to the Model Code for Securities Transactions by Directors of Listed Companies (the "Model Code") as set out in the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules") were as follows:—

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Long positions in shares of the Company

Name of Director	Number of ordinary shares			Total	Approximately percentage of issued share capital
	Personal interests	Family interests	Corporate interests		
Yeung Chung Lung	-	-	374,175,000 (Note)	374,175,000	38.58%
Ni Chao Peng	2,000,000	-	-	2,000,000	0.22%

Note: Held through Regal Splendid Limited which is wholly-owned by Mr. Yeung Chung Lung.

Long positions in underlying shares of the Company

Share Options in the Company

Name of Director	Date of grant	Exercise price HK\$	Exercisable period	No. of shares in respect of options outstanding as at 31 December 2006
Yeung Chung Lung	23/07/2004	0.489	23/07/2004-22/07/2014	3,000,000
	28/04/2006	0.690	28/04/2006-27/04/2016	5,000,000
Yang Le	23/07/2004	0.489	23/07/2004-22/07/2014	2,000,000
	28/04/2006	0.690	28/04/2006-27/04/2016	5,000,000
Ni Chao Peng	28/04/2006	0.690	28/04/2006-27/04/2016	5,000,000
Yip Tze Wai, Albert	23/07/2004	0.489	23/07/2004-22/07/2014	930,000
	28/04/2006	0.690	28/04/2006-27/04/2016	1,000,000
Tsui Chun Chung, Arthur	19/01/2005	0.560	19/01/2005-18/01/2015	500,000
Leung Chiu Shing	28/04/2006	0.690	28/04/2006-27/04/2016	500,000

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Save as disclosed above, none of the directors, chief executives or their associates had any interests and short positions 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) which are recorded in the register required to be kept by the Company under Section 352 of the SFO or which are notified to the Company and the Stock Exchange pursuant to the Model Code.

Substantial Shareholders' Interests in Securities

As at 31 December 2006, so far as is known to the Directors, the following parties (other than the Directors and Chief Executives of the Company) had interests or short positions in the shares and underlying shares of the Company as recorded in the register required to be kept under Section 336 of the SFO:

Long positions in shares of the Company

Name	Capacity	Number of ordinary shares	Approximately percentage of issued share capital
Regal Splendid Limited (<i>Note 1</i>)	Beneficial owner	374,175,000	38.58%
Value Partners Limited (<i>Note 2</i>)	Investment manager	57,675,000	6.07%
Cheah Cheng Hye (<i>Note 2</i>)	Beneficial owner	1,100,000	6.99%
	Interest of child/spouse	300,000	
	Corporation	64,110,000	
		65,510,000	
The SFP Value Realization Co. Ltd (<i>Note 3</i>)	Investment manager	56,435,000	6.10%
The SFP Asia Master Fund Ltd (<i>Note 4</i>)	Beneficial owner	56,435,000	6.10%
The SFP Asia Fund Ltd (<i>Notes 3 & 4</i>)	Corporation	56,435,000	6.10%
The SFP Asia Fund L.P. (<i>Notes 3 & 4</i>)	Corporation	48,945,000	5.29%

Notes:

1. Regal Splendid Limited is a company incorporated in the British Virgin Islands with limited liability which is legally and beneficially owned as to 100% by Mr. Yeung Chung Lung.
2. Value Partners Limited is a company incorporated in the British Virgin Islands with limited liability which is owned as to 35.67% by Mr. Cheah Cheng Hye.
3. The SFP Asia Fund Ltd and The SFP Asia Fund L.P. are wholly-owned by The SFP Value Realization Co. Ltd.
4. The SFP Asia Fund Ltd and The SFP Asia Fund L.P. whom are interested in The SFP Asia Master Fund Ltd of 79.5% and 20.5% respectively.

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Long positions in underlying shares of the Company

Name	Category of underlying shares	Number of ordinary shares
DKR SoundShore Oasis Holding Fund Ltd	Unlisted derivatives – cash settled	136,470,588
DKR Management Co. Inc.	Unlisted derivatives – cash settled	136,470,588
DKR Capital Inc.	Unlisted derivatives – cash settled	136,470,588
DKR Capital Partners LP	Unlisted derivatives – cash settled	136,470,588
DKR Oasis Management Company LP	Unlisted derivatives – cash settled	136,470,588
Oasis Management Holdings LLC	Unlisted derivatives – cash settled	136,470,588

Note:

DKR Oasis Management Company LP is controlled as to 49% by Oasis Management Holdings LLC and as to 51% by DKR Capital Partners LP which is controlled as to 50% by DKR Management Co. Inc.. DKR Management Co. Inc. is controlled as to 100% by DKR Capital Inc..

DKR Capital Inc., DKR Management Co. Inc., DKR Capital Partners LP, DKR Oasis Management Company LP, Oasis Management Holdings LLC and DKR SoundShore Oasis Holding Fund Ltd have total interests in 136,470,588 underlying shares.

Directors' Rights to Acquire Shares or Debt Securities

Other than as disclosed under the headings "Share Option Scheme" below and "Directors' and Chief Executives' Interests in Securities" above, at no time during the year was the Company or any of its subsidiaries, or any of its fellow subsidiaries, a party to any arrangement to enable the Directors or Chief Executives of the Company (including their spouses or children under 18 years of age) to have any right to subscribe for securities of the Company or any of its associated corporations as defined in the SFO or to acquire benefits by means of acquisition of shares in, or debentures of, the Company or any other body corporate.

Directors' and Controlling Shareholders' Interests in Contracts

There was no contract of significance in relation to the Company's business, to which the Company or any of its subsidiaries was a party, subsisted at the end of the year or at any time during the year, and in which a Director had, whether directly or indirectly, a material interest, nor there was any other contract of significance in relation to the Company's business between the Company or any of the Company's subsidiaries and a controlling shareholder or any of its subsidiaries.

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Connected Transaction

Neither significant related party transactions nor connected transactions under the Listing Rules had entered by the Group during the year ended 31 December 2006.

Share Option Scheme

Details of the share option scheme of the Company and movement in share options are set out in note 31 to the financial statements.

2.5% Coupon Bonds With Detachable Warrants Attached

Details of coupon bonds and movements in warrants are set out in notes 24 and 32 respectively to the financial statements.

Issue of HK\$116,000,000 Convertible Notes Due 2011

Details of the convertible notes are set out in note 25 to the financial statements.

During the year ended 31 December 2006, no convertible notes was converted into conversion shares by the noteholders.

Purchase, Sale or Redemption of Listed Securities

During the year ended 31 December 2006, the Company purchased and cancelled 380,000 shares of HK\$0.05 each in the capital of the Company in October 2006 at prices ranging from HK\$0.69 (approximately equivalent to RMB0.73) to HK\$0.71 (approximately equivalent to RMB0.75) per share on the Stock Exchange. Such purchases involved a total cash outlay of HK\$265,800 (approximately equivalent to RMB282,000) and were for the purpose of enhancing the Company's return on equity.

Save as disclosed above, the Company and its subsidiaries have not purchased, sold or redeemed any of the Company's shares during the year ended 31 December 2006.

Bank Loans

Particulars of bank loans of the Group as at 31 December 2006 are set out in note 23 to the financial statements.

Disclosure Pursuant to Rule 13.18 of the Listing Rules

On 21 July 2006, the Company had entered into a loan agreement (the “Loan Agreement”) with a syndicate of banks relating to a 3-year term loan facility of up to HK\$195,000,000. Under the Loan Agreement, it would be an event of default if (i) Mr. Yeung Chung Lung and his family members cease to be the beneficial owner of at least 35% of the entire issued share capital and ownership interests of the Company; or (ii) Mr. Yeung Chung Lung ceases to be the chairman of the Company and to be the single largest shareholder of the Company or no longer actively involved in the management and business of the Group (being the Company, the Guarantors and their respective subsidiaries); or (iii) the Company fails at any time to beneficially own (directly or indirectly) the entire issued share capital of any of the guarantors.

As at 31 December 2006, the outstanding amount owed by the Company in respect of this loan facility was approximately HK\$185,750,000 (approximately equivalent to RMB185,049,000).

Major Customers and Suppliers

The information in respect of the Group’s sales and purchases attributable to the major customers and suppliers respectively during the financial year are as follows:

	Percentage of the Group’s total	
	Sales	Purchases
The largest customer	33%	
Five largest customers in aggregate	78%	
The largest supplier		10%
Five largest suppliers in aggregate		38%

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 94 of the annual report.

Retirement Scheme

Details of the retirement benefit scheme of the Group and the employer’s costs charged to the consolidated income statement for the year ended 31 December 2006 are set out in notes 7(b) and 14 to the financial statements.

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Model Code for Securities Transactions by Directors

The Company has adopted the Model Code for Securities Transactions by Directors as set out in Appendix 10 to the Listing Rules as its own code of conduct regarding securities transactions by the directors of the Company (the “Model Code”). Having made specific enquiry of the directors of the Company, all the directors confirmed that they had complied with the required standards as set out in the Model Code during the year ended 31 December 2006.

Independence of Independent Non-executive Directors

The Company has received from each of the independent non-executive directors an annual confirmation for independence pursuant to rule 3.13 of the Listing Rules. The independent non-executive Directors have confirmed that they are independent.

Public Float

On the basis of information that is publicly available to the Company and within the knowledge of the Directors as at the date of this report, the Company has maintained sufficient public float.

Remuneration Committee

The Board of the Company has established a remuneration committee. The remuneration committee, currently comprising executive director Mr. Yeung Chung Lung, and independent non-executive directors Mr. Tsui Chun Chung, Arthur and Mr. Leung Chiu Shing, is responsible for advising the Board on the remuneration policy and framework of the Company’s directors and senior management, as well as review and determine the remuneration of all executive directors and senior management with reference to the Company’s objectives from time to time.

Audit Committee

The audit committee comprises three independent non-executive directors of the Company, namely, Mr. Tsui Chun Chung, Arthur, Mr. Lu Ze Jian and Mr. Leung Chiu Shing. The audit committee is responsible to review the Company’s accounting principles and practices adopted by the Group and to discuss auditing, internal control and financial reporting matters with the management. The audited annual financial statements of the Company for the year ended 31 December 2006 have been reviewed by the audit committee.

Post Balance Sheet Events

Details of non adjusting post balance sheet events of the Group are set out in note 35 to the financial statements.

Auditors

The financial statements were audited by CCIF CPA Limited, Certified Public Accountants, who will retire at the conclusion of the forthcoming annual general meeting and being eligible, offer themselves for re-appointment. A resolution for the re-appointment of CCIF CPA Limited as auditors of the Company is to be proposed at the forthcoming annual general meeting.

On behalf of the Board

Yeung Chung Lung

Chairman

Hong Kong, 23 April 2007