

REPORT OF THE DIRECTORS

To be presented at the Forty-fourth Annual General Meeting of shareholders to be held at Sheraton Hong Kong Hotel & Towers, 20 Nathan Road, Tsimshatsui, Kowloon, Hong Kong on Monday, 16 April 2007 at 3:00 p.m.

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

PRINCIPAL PLACE OF BUSINESS

San Miguel Brewery Hong Kong Limited (the "Company") is a company incorporated and domiciled in Hong Kong and has its registered office and principal place of business at 9/F, Citimark Building, 28 Yuen Shun Circuit, Siu Lek Yuen, Shatin, New Territories, Hong Kong.

PRINCIPAL ACTIVITIES

The principal activities of the Company are the manufacture and distribution of bottled, canned and draught beers. The principal activities and other particulars of the subsidiaries are set out in note 17 to the financial statements.

The analysis of geographical locations of the operations of the Company and its subsidiaries (the "Group") during the year is set out in note 13 to the financial statements.

As the Group's turnover and profit and loss are almost entirely attributable to these activities, no analysis by activity is provided.

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 year is as follows:

	Percentage of the Group's total	
	Sales	Purchases
The largest customer	16.2%	
Five largest customers in aggregate	45.9%	
The largest supplier		5.8%
Five largest suppliers in aggregate		19.8%

The largest supplier was San Miguel Corporation Group, the ultimate holding company of the Company, in which Messrs Ramon S. Ang, Faustino F. Galang, Chong Yoon Fatt, Minerva Lourdes B. Bibonia, Ma. Belen C. Buensuceso, Ferdinand K. Constantino and Roberto N. Huang have beneficial interests to the extent that they either have equity interests in or are directors.

Save as disclosed above, none of the directors, their associates, or any shareholder of the Company (which to the knowledge of the directors owns more than 5% of the Company's share capital) had any interest in these major customers or suppliers.

FINANCIAL STATEMENTS

The loss of the Group for the year ended 31 December 2006 and the state of the Company's and the Group's affairs as at that date are set out in the financial statements on pages 32 to 64.

TRANSFER TO RESERVES

Loss for the year of HK\$106.3 million (2005 (restated): HK\$65.4 million) has been transferred to reserves. Other movements in reserves are set out in note 29 to the financial statements.

DIVIDENDS

The directors have resolved that no final dividend be declared for the year ended 31 December 2006.

CHARITABLE AND OTHER DONATIONS

Charitable and other donations made by the Group during the year amounted to HK\$8,000 (2005: HK\$17,000).

FIXED ASSETS

The Group spent HK\$55.1 million (2005: HK\$20.1 million) on fixed assets during the year. Details of these acquisitions and other movements in fixed assets are set out in note 14 to the financial statements.

SHARE CAPITAL

Details of the share capital of the Company are set out in note 29 to the financial statements. There were no movements during the year.

DIRECTORS

With the exception of Ms. Minerva Lourdes B. Bibonia, the directors of the Company, whose names appear on page 2 of the Annual Report, were directors for the year and as at the date of this Annual Report.

Ms. Ma. Belen C. Buensuceso and Mr. Roberto N. Huang resigned from the office of director on 6 March 2007.

Messrs Ramon S. Ang, Faustino F. Galang and Ferdinand K. Constantino retire by rotation in accordance with Article 105 of the Company's Articles of Association at the forthcoming Annual General Meeting and, being eligible, offer themselves for re-election.

Messrs Carlos Antonio M. Berba and Francis H. Jardeleza are nominated to fill the vacated office at the forthcoming Annual General Meeting.

None of the directors proposed for election and re-election at the forthcoming Annual General Meeting has an unexpired service contract which is not determinable by the Company or any of its subsidiaries within one year without payment of compensation, other than normal statutory obligations.

REPORT OF THE DIRECTORS

DIRECTORS' INTERESTS

The directors of the Company who held office at 31 December 2006 had the following personal interests in the shares of the Company, its holding companies, subsidiaries and other associated corporations (within the meaning of the Securities and Futures Ordinance ("SFO")) at that date as recorded in the register of directors' interests required to be kept under Section 352 of the SFO:

(I) INTERESTS IN ISSUED SHARES

Directors	Number of ordinary shares of HK\$0.50 each in the Company	
	Number of shares held	% of total issued shares
David K. P. Li	300,000	0.08%

Directors	Number of common shares in San Miguel Corporation	
	Number of shares held	% of total issued shares
Class A (par value of 5 pesos each):		
Ramon S. Ang	6,050	0.000192%
Faustino F. Galang	83,800	0.002662%
Minerva Lourdes B. Bibonia	30,000	0.000953%
Ma. Belen C. Buensuceso	45,018	0.001430%
Ferdinand K. Constantino	89,160	0.002832%
Roberto N. Huang	12,430	0.000395%
Class B (par value of 5 pesos each):		
Faustino F. Galang	60,000	0.001906%
Minerva Lourdes B. Bibonia	30,000	0.000953%
Roberto N. Huang	2,750	0.000087%

(II) INTERESTS IN UNDERLYING SHARES

Certain directors of the Company have been granted stock options to subscribe for common shares in San Miguel Corporation ("SMC") under SMC's stock option scheme. Particulars of stock options in SMC held by directors during the year and as at 31 December 2006 are as follows:

Stock options in San Miguel Corporation							
Directors	Date granted	Exercise period up to	Exercise price per option (pesos)	No. of options outstanding at the beginning of the year	No. of options granted during the year	No. of options exercised during the year	No. of options outstanding at the year end
Class A (par value of 5 pesos each):							
Ramon S. Ang	26 June 2003	26 June 2011	54.50	259,422	—	—	259,422
	1 October 2004	1 October 2012	57.50	266,854	—	—	266,854
	10 November 2005	10 November 2013	65.00	204,654	—	—	204,654
Faustino F. Galang	26 June 2003	26 June 2011	54.50	28,435	—	—	28,435
	1 October 2004	1 October 2012	57.50	87,751	—	—	87,751
	10 November 2005	10 November 2013	65.00	67,090	—	—	67,090
Chong Yoon Fatt	10 November 2005	10 November 2013	65.00	1,027	—	—	1,027
Minerva Lourdes B. Bibonia	26 June 2003	26 June 2011	54.50	11,928	—	—	11,928
	1 October 2004	1 October 2012	57.50	26,750	—	—	26,750
	10 November 2005	10 November 2013	65.00	33,824	—	—	33,824
Ma. Belen C. Buensuceso	26 March 1998	26 March 2006	34.71	7,200	—	(7,200)	—
	26 June 2003	26 June 2011	54.50	36,144	—	—	36,144
	1 October 2004	1 October 2012	57.50	38,854	—	—	38,854
Ferdinand K. Constantino	10 November 2005	10 November 2013	65.00	30,789	—	—	30,789
	26 June 2003	26 June 2011	54.50	16,838	—	—	16,838
	1 October 2004	1 October 2012	57.50	56,643	—	—	56,643
Roberto N. Huang	10 November 2005	10 November 2013	65.00	48,391	—	—	48,391
	26 June 2003	26 June 2011	54.50	36,144	—	—	36,144
	1 October 2004	1 October 2012	57.50	40,529	—	—	40,529
	10 November 2005	10 November 2013	65.00	31,967	—	—	31,967

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DIRECTORS' INTERESTS (Continued)

(II) INTERESTS IN UNDERLYING SHARES (Continued)

Stock options in San Miguel Corporation							
Directors	Date granted	Exercise period up to	Exercise price per option (pesos)	No. of options outstanding at the beginning of the year	No. of options granted during the year	No. of options exercised during the year	No. of options outstanding at the year end
Class B (par value of 5 pesos each):							
Ramon S. Ang	26 June 2003	26 June 2011	62.50	111,181	–	–	111,181
	1 October 2004	1 October 2012	70.50	114,366	–	–	114,366
	10 November 2005	10 November 2013	89.50	136,436	–	–	136,436
Faustino F. Galang	26 June 2003	26 June 2011	62.50	12,186	–	–	12,186
	1 October 2004	1 October 2012	70.50	37,607	–	–	37,607
	10 November 2005	10 November 2013	89.50	44,727	–	–	44,727
Chong Yoon Fatt	10 November 2005	10 November 2013	89.50	684	–	–	684
Minerva Lourdes B. Bibonia	26 June 2003	26 June 2011	62.50	5,112	–	–	5,112
	1 October 2004	1 October 2012	70.50	11,464	–	–	11,464
	10 November 2005	10 November 2013	89.50	22,550	–	–	22,550
Ma. Belen C. Buensuceso	26 June 2003	26 June 2011	62.50	5,163	–	–	5,163
	1 October 2004	1 October 2012	70.50	16,652	–	–	16,652
	10 November 2005	10 November 2013	89.50	20,526	–	–	20,526
Ferdinand K. Constantino	26 June 2003	26 June 2011	62.50	7,216	–	–	7,216
	1 October 2004	1 October 2012	70.50	24,275	–	–	24,275
	10 November 2005	10 November 2013	89.50	32,260	–	–	32,260
Roberto N. Huang	26 June 2003	26 June 2011	62.50	15,490	–	–	15,490
	1 October 2004	1 October 2012	70.50	17,370	–	–	17,370
	10 November 2005	10 November 2013	89.50	21,312	–	–	21,312

Notes: The only stock option exercised by directors during the year were disclosed above. All interests in the share and underlying shares of the Company, its holding companies, subsidiaries and other associated corporations are long positions.

Apart from the foregoing, at no time during the year was the Company, any of its holding companies, subsidiaries or fellow subsidiaries a party to any arrangement to enable the directors of the Company to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate.

Apart from the foregoing, none of the directors of the Company or any of their spouses or children under eighteen years of age has interests or short positions in the shares, underlying shares or debentures of the Company, or any of its holding company, subsidiaries or other associated corporations, as recorded in the register required to be kept under section 352 of the SFO or as otherwise notified to the Company pursuant to the Model Code for Securities Transactions by directors of listed companies.

SUBSTANTIAL SHAREHOLDERS' INTERESTS IN SHARES AND UNDERLYING SHARES

The Company has been notified of the following interests in the Company's issued shares at 31 December 2006 amounting to 5% or more of the ordinary shares in issue:

Substantial shareholders	Ordinary shares of HK\$0.50 each	
	Number of ordinary shares held	% of total issued shares
Neptunia Corporation Limited (note 1)	245,720,800	65.78%
Conroy Assets Limited (note 2)	13,624,600	3.65%
Hamstar Profits Limited (note 2)	10,078,400	2.70%

REPORT OF THE DIRECTORS

SUBSTANTIAL SHAREHOLDERS' INTERESTS IN SHARES AND UNDERLYING SHARES (Continued)

Notes:

- (1) San Miguel Corporation ("SMC"), San Miguel International Limited ("SMIL"), San Miguel Holdings Limited ("SMHL") and San Miguel Brewing International Limited ("SMBIL") are all deemed to hold the above disclosed interest of Neptunia Corporation Limited ("Neptunia") in the Company because SMC has a controlling interest in SMIL, SMIL has a controlling interest in SMHL, SMHL has a controlling interest in SMBIL and SMBIL has a controlling interest in Neptunia.
- (2) Mr. Li Ka-Shing, Cheung Kong (Holdings) Limited, Li Ka-Shing Unity Trustee Company Limited, Li Ka-Shing Unity Trustee Corporation Limited and Li Ka-Shing Unity Trustcorp Limited are all deemed to hold the above disclosed interest of Conroy Assets Limited ("Conroy") and Hamstar Profits Limited ("Hamstar") in the Company. The aggregate interest of Conroy and Hamstar exceeding 5% of the issued share capital of the Company constitutes a duty of disclosure under the SFO.

All interests in the share of the Company are long positions.

Apart from the foregoing, no other interests required to be recorded in the register kept under Section 336 of the SFO have been notified to the Company.

SUFFICIENCY OF PUBLIC FLOAT

Based on the information that is publicly available to the Company and within the knowledge of the directors of the Company as at the date of this Annual Report, the Company has maintained the prescribed public float under the Listing Rules.

DIRECTORS' INTERESTS IN CONTRACTS

Pursuant to an Agreement dated 12 June 1963, Neptunia Corporation Limited provides technical and advisory services to the Company and may be paid a General Managers' Commission. Messrs Ramon S. Ang, Faustino F. Galang, Chong Yoon Fatt, Minerva Lourdes Bibonia, Ma Belen C. Buensuceso, Ferdinand K. Constantino and Roberto N. Huang are interested parties to this contract to the extent that they either have equity interests in or are directors of San Miguel Corporation, the ultimate holding company of Neptunia Corporation Limited. General Managers' Commission has not been paid by the Company or charged by Neptunia Corporation Limited since the 1995 financial year.

Save as disclosed above, no contract of significance to which the Company, or any of its holding companies, subsidiaries or fellow subsidiaries was a party, and in which a director of the Company had a material interest, subsisted at the end of the year or at any time during the year.

CONNECTED TRANSACTIONS

(1) CONNECTED TRANSACTIONS MADE WITH GUANGZHOU BREWERY

Guangzhou San Miguel Brewery Company Limited ("GSMB"), a subsidiary of the Company, entered into a factory lease agreement (the "Lease Agreement") with Guangzhou Brewery ("GB"), a substantial shareholder holding 30% interests of GSMB, upon the establishment of GSMB whereby GSMB agreed to lease the factory buildings, brewery equipment and related facilities from GB for production purposes. The Lease Agreement expires on 29 November 2020. However, after reviewing GSMB's operations, the Company believed that it was in its best interests to cease the manufacturing operations of GSMB and to terminate the Lease Agreement. On 29 September 2006, GSMB and GB entered into a Termination Agreement (the "Termination Agreement") in respect of the termination of the Lease Agreement (the "Lease Termination") and the sale of certain production assets owned by GSMB (the "Production Assets") to GB (the "Asset Sale").

CONNECTED TRANSACTIONS *(Continued)***(1) CONNECTED TRANSACTIONS MADE WITH GUANGZHOU BREWERY** *(Continued)*

The handover of the leased assets and the Production Assets from GSMB to GB took place on 31 October 2006. After cessation of the manufacturing operations, GSMB continues the sale and distribution of beer and sources beer products from its fellow subsidiary and other external manufacturers under toll-processing arrangements.

Since GB is a substantial shareholder of GSMB and GSMB is a subsidiary of the Company, GB is a connected person of the Company for the purposes of the Listing Rules. Accordingly, the Lease Termination and the Asset Sale constitute a connected transaction for the Company under Chapter 14 of the Listing Rules and are subject to the reporting, announcement and independent shareholders' approval requirements. An announcement was made by the Company on 29 September 2006 in this connection.

Pursuant to the terms of the Termination Agreement, GSMB paid GB the following amounts, totalling approximately RMB 32.2 million (equivalent to approximately HK\$31.6 million) in respect of the Lease Termination:

- (i) a security deposit already in GB's possession of RMB5 million together with the relevant interest of approximately RMB 1.1 million up to 31 October 2006, in accordance with the provisions in the Lease Agreement;
- (ii) a penalty for early termination of the Lease Agreement of approximately RMB 6.3 million in accordance with the provisions in the Lease Agreement;
- (iii) repairs and maintenance costs of the leased assets of approximately RMB 9.4 million, which were determined based on arm's length negotiations between the parties with reference to, among other things, the obligations of GSMB under the Lease Agreement to repair and maintain the leased assets to keep them in normal working condition, assessments of the working condition of the leased assets and estimates of the costs required to restore certain assets back to normal work condition, as well as book value of certain assets which are not capable of being restored to normal working condition; and
- (iv) gratuity payment of approximately RMB 10.4 million, representing 6 months' rental under the Lease Agreement, which was determined based on arm's length negotiations between the parties with reference to the estimated time that GB may require to return the factory to full scale operation after the completion date of the Termination Agreement.

Regarding the Asset Sale, pursuant to the Termination Agreement, GSMB will sell the Production Assets to GB for a consideration of approximately RMB 37.3 million (equivalent to approximately HK\$36.8 million), which consideration comprised buildings and structures of approximately RMB 12.2 million, and plant and machinery of approximately RMB 25.1 million. The consideration was determined based on arm's length negotiations with reference to the net book value of the Production Assets as shown in GSMB's accounts as at 31 August 2006.

The Company obtained a written approval from Neptunia Corporation Limited, which controls approximately 65.78% of the issued capital of the Company, in respect of the Termination Agreement and the transactions contemplated thereunder (which includes the Lease Termination and Assets Sale), and The Stock Exchange of Hong Kong Limited has granted the Company a waiver from strict compliance with the requirement to hold a shareholders' meeting for the approval of such connected transactions. The independent board committee ("IBC") established to advise the independent shareholders on the terms of the Termination Agreement and the independent financial adviser to the IBC have expressed that the terms of the Termination Agreement are fair and reasonable, and in the interests of the Company and its shareholders as a whole.

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CONNECTED TRANSACTIONS *(Continued)*

(2) CONNECTED TRANSACTIONS MADE WITH SAN MIGUEL CORPORATION AND ITS SUBSIDIARIES

In order to comply with the Listing Rules, the Company entered into an agreement (the "Agreement") with San Miguel Corporation ("SMC"), the ultimate holding company of the Company, on 11 March 2005 to govern the terms upon which the continuing connected transactions will be carried out between members of the Group and members of the SMC Group. The Agreement will expire on 31 December 2007. Under the Agreement, the Group entered into the following continuing connected transactions during the year. Each of the continuing connected transactions is not expected to exceed the following caps.

The Agreement was approved by independent shareholders at the Extraordinary General Meeting of the Company held on 7 April 2005.

	2006 Actual HK\$'000	2006 Cap HK\$'000	2007 Cap HK\$'000
Purchase of packaging materials (comprising cans, bottles, crown seals and crates) by the Group from the SMC Group	33,569	92,600	105,700
Purchase of packaged beer by the Group from the SMC Group	2,873	4,700	5,000
Sales of packaged beer by the Group to the SMC Group	23,373	53,600	60,700
Payment of commission by the Group to the SMC Group in respect of sales of packaged beer by the Group directly to customers in certain countries (other than Hong Kong, Macau and the PRC)	1,244	1,300	1,600

The on-going transactions had been reviewed by the independent non-executive directors of the Company who had confirmed that the on-going transactions were entered into:

- (1) in the ordinary and usual course of business of the Group;
- (2) on normal commercial terms and on terms in accordance with the Agreement that were fair and reasonable so far as the shareholders of the Company were concerned; and
- (3) the aggregate amount of the on-going transactions did not exceed the relevant caps as set out in the announcement dated 11 March 2005.

The Company has received from the auditors a letter reporting that the on-going transactions:

- (1) have received the approval of the board of directors of the Company;
- (2) were entered into in accordance with the pricing policies of the Group for those transactions involve provision of goods by the Group;
- (3) have been entered into in accordance with the Agreement dated 11 March 2005; and
- (4) have not exceeded the relevant caps as set out in the announcement dated 11 March 2005.

RETIREMENT AND PENSION PLANS, PERSONNEL AND PAYROLL

The Company and its subsidiaries in Hong Kong have sponsored a non-contributory defined benefit scheme, The San Miguel Brewery Hong Kong Limited Retirement Fund (the "Fund"), covering local permanent employees, which was registered in September 1995 under the Occupational Retirement Schemes Ordinance. The Fund is formally established under trust and the assets are separately held in an independently administered fund. The members' benefits are determined based on the employees' final remuneration and length of service. Contributions to the Fund are made in accordance with the recommendations of independent actuaries who value the retirement scheme at regular intervals, usually triennially.

The Fund was granted exemption from Mandatory Provident Fund regulations by the Mandatory Provident Fund Scheme Authority on 24 July 2000, following modifications to the Fund benefits which comply with Mandatory Provident Fund regulations.

Pursuant to Government legislation, Allianz Global Investors Hong Kong Limited was selected by the Company as an alternative Mandatory Provident Fund ("MPF") service provider for employees of the Company who do not wish to remain in or join the Fund. The MPF scheme is a defined contribution retirement scheme administered by independent trustees. Under the MPF scheme, the employer and its employees are each required to make contributions to the scheme at 5% of the employees' relevant income, subject to a cap of monthly relevant income of HK\$20,000. Contributions to the MPF scheme vest in employee members immediately.

Employees in the subsidiaries in the People's Republic of China are members of the Central Pension Scheme operated by the Chinese government. The subsidiaries are required to contribute a certain percentage of their covered payroll to the Central Pension Scheme to fund the benefits. Contributions to the Central Pension Scheme vest in employee members immediately. The only obligation for the subsidiaries with respect to the Central Pension Scheme is the associated required contribution under the Central Pension Scheme.

A formal actuarial assessment of the San Miguel Brewery Hong Kong Limited Retirement Fund with the recommendations on the level of contributions to the Fund in the coming three years was carried out as at 31 December 2006 and the results were as follows:

- (a) The actuary of the Fund is Mr A. Wong, Fellow of the Canadian Institute of Actuaries and Fellow of the Society of Actuaries. In the actuarial valuation, the attained age method was used. Other major assumptions used in the valuation were: Investment return 6.5% per annum; Long term salary escalation 3% per annum; Mortality Rates 2001 Hong Kong Life Tables; Normal retirement age 60; Early retirement rates allowed between ages 55 to 60.
- (b) The unaudited market value of the Fund assets was HK\$88.7 million as at 31 December 2006.
- (c) The minimum level of funding as recommended by the Fund actuary was 16% of salary for 2007, 2008 and 2009.
- (d) The solvency deficit was HK\$19.9 million, i.e. the obligation under this Fund was 86% covered by the Fund's assets, at 31 December 2006.

For the purposes of preparing the financial statements, an independent actuarial valuation was also carried at 31 December 2006 following the methodology set out in Hong Kong Accounting Standard 19, Employee benefits. Details of this valuation are set out in note 27 to the financial statements.

Particulars of the number of personnel and payroll expenses of the Group are set out on page 4 of this Annual Report.

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LIQUIDITY AND FINANCIAL RESOURCES

Working capital at the end of the year was \$328.6 million compared with \$360.9 million in 2005.

Cash and bank deposits at year end were \$416.3 million (2005: \$383.3 million) and are sufficient to fund working capital requirements and capital expenditure in 2007.

BANK LOANS

The Group has short term credit facilities of \$207.4 million (2005: \$169.0 million) of which \$80.4 million (2005: \$50.4 million) had been utilised as at 31 December 2006.

Long term loans at year end amounted to \$95.0 million (2005: \$95.0 million).

Total borrowing at the year end for the Company were \$95.0 million (2005: \$95.0 million) and for the Group of \$175.4 million (2005: \$145.4 million).

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

FIVE YEAR 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 66 of the Annual Report.

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

During the year ended 31 December 2006, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of its listed shares.

CODE OF BEST PRACTICE

Principal corporate governance practices adopted by the Company are set out in the Corporate Governance section on pages 18 to 24.

CONFIRMATION OF INDEPENDENCE

The Company has received from each of the independent non-executive directors an annual confirmation of independence pursuant to Rule 3.13 of the Listing Rules and considers all the independent non-executive directors to be independent.

AUDITORS

KPMG retire and, being eligible, offer themselves for re-appointment. A resolution for the re-appointment of KPMG as auditors of the Company is to be proposed at the forthcoming Annual General Meeting.

By order of the board



Ramon S. Ang
Chairman

Hong Kong, 6 March 2007