

Report of the Directors

The directors submit their report together with the audited accounts for the year ended 31 December 2001.

Principal Activities and Geographical Analysis of Operations

The principal activity of the Company is investment holding. The activities of its principal subsidiaries are set out in the Principal Subsidiaries and Associated Companies section on pages 78 to 87.

Details of the analysis of the Group's turnover and contribution to operating profit for the year by principal activities and geographical location is set out in *note 2* to the accounts.

Share Capital

Details of the movements in share capital of the Company are set out in *note 20* to the accounts.

Results and Appropriations

The results for the year are set out in the consolidated profit and loss account on page 37.

The directors declared an interim dividend of HK\$0.08 per ordinary share, totalling HK\$229,848,000, which was paid on 6 September 2001.

The directors recommend the payment of a final dividend of HK\$0.185 per ordinary share, totalling HK\$532,887,000.

Reserves

Movements in the reserves of the Group and the Company during the year are set out in *note 21* to the accounts.

Distributable Reserves

At 31 December 2001, the distributable reserves of the Company available for distribution as dividends amounted to HK\$2,834,656,000, comprising retained earnings of HK\$773,983,000 and the contribution surplus arising from the exchange of shares for the acquisition of Li & Fung (B.V.I.) Limited and the issuance of shares for the acquisition of Colby Group Holdings Limited, as set out in *note 21(c)* to the accounts, amounting to HK\$2,060,673,000.

Under the Companies Act 1981 of Bermuda (as amended), the contributed surplus shall not be distributed to the shareholders if there are reasonable grounds for believing that:

- (i) the Company is, or would after the payment be, unable to pay its liabilities as they become due; or
- (ii) the realisable value of the Company's assets would thereby be less than the aggregate of its liabilities and its issued share capital and share premium account.

Donations

Charitable and other donations made by the Group during the year amounted to HK\$1,306,000.

Fixed Assets

Details of the movements in fixed assets of the Group are set out in *note 11* to the accounts.

Ten-Year Financial Summary

A summary of the results for the year end and of the assets and liabilities of the Group as at 31 December 2001 and for the previous nine financial years are set out in the Ten-Year Financial Summary section on page 88.

Pre-emptive Rights

There are no provisions for pre-emptive rights under the Company's bye-laws though there are no restrictions against such rights under the laws of Bermuda.

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

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

Share Options

On 2 June 1992, a share option scheme (the "Scheme") was approved by the shareholders of the Company. Under the terms of the Scheme, the directors may, at their discretion, invite executive directors and employees of the Group to take up options (the "Share Options") to subscribe for shares in the Company subject to the terms and conditions stipulated therein.

Details of the Scheme are as follows:

(i) Purpose

The Scheme is designed to give executive directors and senior employees holding an executive, managerial or supervisory position in the Company or any of its wholly-owned subsidiaries an equity interest in the Company in order to enhance long-term shareholder value. The granting of options will also help the Company to attract and motivate individuals with experience and ability and to reward individuals for past and future performance.

(ii) Qualifying participants

Any employee including any executive director of the Company or any of its wholly-owned subsidiaries.

(iii) Maximum number of shares

The maximum number of shares subject to the Scheme must not when aggregated with any shares subject to any other share option schemes exceed 10% of the shares in issue from time to time (excluding any shares which have been duly allotted and issued upon the exercise of options granted pursuant to the Scheme and any other schemes). The total number of shares available for issue under the Scheme as at the date of the annual report is 6,234,800, representing approximately 0.2% of the issued share capital of the Company as of that date.

No qualifying participant shall be granted an option which, if exercised in full, would result in such person's maximum entitlement exceeding 25% of the aggregate number of shares for the time being issued and issuable under the Scheme.

(iv) Option period

In respect of any particular option, such period the Board may in its absolute discretion determine, save that such period shall not commence earlier than one year nor more than 10 years from the date on which an option is granted and accepted by the grantee.

(v) Amount payable on application or acceptance

An offer of the grant of an option shall remain open for acceptance for a period of 28 days from the date on which an option is offered to the grantee (the "Offer Date"). An offer of the grant of the option shall be deemed to have been accepted and to have taken effect when the duplicate letter comprising acceptance of the option duly signed by the grantee together with a remittance in favour of the Company of HK\$1 by way of consideration of the grant thereof is received by the Company.

(vi) Exercise price

The exercise price in respect of any particular option shall be (i) not more than 20% less than the average closing price of the Shares for the five business days immediately preceding the Offer Date on which there were dealings in Shares on the Stock Exchange or (ii) the nominal value of a Share (whichever is the greater).

Effective from 1 September 2001, the exercise price must be at least the higher of (i) the closing price of the Shares on the date of grant, which must be a business day, and (ii) the average closing price of the Shares for the five business days immediately preceding the date of grant in accordance with the new rule 17.03 of the Listing Rules.

(vii) The remaining life of the Scheme

The Board shall be entitled at any time within 10 years between 2 June 1992 and 1 June 2002 to offer the grant of an option to any qualifying participants.

Details of the Share Options granted under the Scheme and remain outstanding as at 31 December 2001 are as follows:

	Options held at 1 January 2001	Options granted during year ³	Options exercised during year	Options held at 31 December 2001	Exercise Price HK\$	Grant date	Exercisable from	Exercisable until
Dr William FUNG Kwok Lun	480,000	—	—	480,000	15.26	7 July 2000	7 July 2001	6 July 2003
	—	480,000 ¹	—	480,000	10.50	18 July 2001	18 July 2002	17 July 2004
	—	480,000 ²	—	480,000	7.98	28 August 2001	28 August 2003	27 August 2005
Mr Henry CHAN	360,000	—	360,000 ⁴	—	2.1575	25 July 1998	25 July 1999	24 July 2001
	1,200,000	—	—	1,200,000	4.1525	16 July 1999	16 July 2000	15 July 2002
	240,000	—	—	240,000	15.26	7 July 2000	7 July 2001	6 July 2003
	—	240,000 ¹	—	240,000	10.50	18 July 2001	18 July 2002	17 July 2004
	—	240,000 ²	—	240,000	7.98	28 August 2001	28 August 2003	27 August 2005
Mr Danny LAU Sai Wing	240,000	—	—	240,000	4.1525	16 July 1999	16 July 2000	15 July 2002
	240,000	—	—	240,000	15.26	7 July 2000	7 July 2001	6 July 2003
	—	240,000 ¹	—	240,000	10.50	18 July 2001	18 July 2002	17 July 2004
	—	240,000 ²	—	240,000	7.98	28 August 2001	28 August 2003	27 August 2005
Ms Annabella LEUNG Wai Ping	240,000	—	—	240,000	15.26	7 July 2000	7 July 2001	6 July 2003
	—	240,000 ¹	—	240,000	10.50	18 July 2001	18 July 2002	17 July 2004
	—	240,000 ²	—	240,000	7.98	28 August 2001	28 August 2003	27 August 2005
Mr. Bruce Philip ROCKOWITZ	—	240,000 ²	—	240,000	7.98	28 August 2001	28 August 2003	27 August 2005
Continuous contract employees	1,980,000	—	1,980,000 ⁵	—	2.1575	25 July 1998	25 July 1999	24 July 2001
	17,454,000	—	7,860,000 ⁵	9,594,000	4.1525	16 July 1999	16 July 2000	15 July 2002
	8,056,000	—	—	8,056,000	15.26	7 July 2000	7 July 2001	6 July 2003
	—	9,468,000 ¹	—	9,468,000	10.50	18 July 2001	18 July 2002	17 July 2004
	—	10,404,000 ²	—	10,404,000	7.98	28 August 2001	28 August 2003	27 August 2005

Notes:

- (1) The closing market price per share at the date preceding the date on which the Share Options were granted was HK\$13.05.
- (2) The closing market price per share at the date preceding the date on which the Share Options were granted was HK\$10.05.
- (3) The above options granted are not recognised in the accounts until they are exercised. Rule 17.08 of the Listing Rules stipulates that the listed issuer is encouraged to disclose in its annual report and interim report the value of options granted to participants as referred to in (i) to (v) of Rule 17.07 during the financial year. The Directors consider it inappropriate to value the Share Options as a number of factors critical for the valuation cannot be determined accurately. Any valuation of the Share Options based on various speculative assumptions would be meaningless and could be misleading to the shareholders. The Directors therefore consider the disclosure of only the relevant market price and exercise price, which are readily ascertainable, will be appropriate.
- (4) The weighted average closing market price per share immediately before the date on which the Share Options were exercised was HK\$13.9.
- (5) The weighted average closing market price per share immediately before the dates on which the Share Options were exercised was HK\$12.71.

Subsidiaries

Details of the Company's principal subsidiaries at 31 December 2001 are set out in the Principal Subsidiaries and Associated Companies section on pages 78 to 87.

Associated Companies

Details of the Company's principal associated companies at 31 December 2001 are set out in the Principal Subsidiaries and Associated Companies section on pages 78 to 87.

Major Customers and Suppliers

During 2001, the Group purchased less than 30% of its goods and services from its five largest suppliers. The percentage of sales attributable to the Group's largest customer and the five largest customers combined were 13.4% and 33.5% respectively. None of the directors, their associates or any shareholders (which to the knowledge of the directors own more than 5% of the Company's issued share capital) had an interest in the customers noted.

During 2000, the Group purchased less than 30% of its goods and services from its five largest suppliers and sold less than 30% of its goods and services to its five largest customers.

Pension Scheme Arrangements

With effect from 1 December 2000, the mandatory provident fund (the "MPF Scheme") was set up by the Mandatory Provident Fund Authority of Hong Kong. The MPF Scheme is a defined contribution retirement benefit scheme and administered by independent trustees. Both the employer and the employees have to contribute an amount equal to 5% of the relevant income of such employee to the MPF Scheme. Contributions from the employer are 100% vested in the employees as soon as they are paid to the relevant MPF Scheme and subject to certain conditions being met, all benefits derived from the mandatory contributions must be preserved until the employee either reaches the normal retirement age of 65 or meets certain specified conditions whichever is the earlier.

In Taiwan, the Group operated a defined contribution provident scheme for its employees with the contribution set at 6% of the employees' basic salaries. In addition, the Group also participated in a retirement benefit plan in accordance with local statutory requirements. Under this plan, the Group recognised pension cost monthly at 2% of the employees' salaries, which is contributed monthly to an independent fund. An employee earns two units for each year of service during the first fifteen years and one unit for each year of service thereafter, up to a maximum of 45 units. Employees retiring under compulsory retirement or due to job related mental or physical impairment are entitled to receive an additional 20% on benefits accrued. Upon retirement, an employee is entitled to receive a lump sum payment based on the units earned.

In Korea, the Group and each of its employees are required to contribute 4.5% of the employee's monthly salary to a government established pension corporation pursuant to the statutory requirement. Upon retirement, an employee is entitled to receive a lump sum payment.

The provident fund schemes for staff of the Group in other regions follow the local statutory requirements.

The Group's pension scheme contributions charged to the consolidated profit and loss account for the year are as follows:

	HK\$'000
Contributions to the MPF Scheme	20,940
Contributions forfeited by employees	(10,704)
Contributions to the defined contribution provident scheme and defined benefit plan in Taiwan	4,809
Contributions pursuant to the statutory requirements in Korea	7,015
Contributions pursuant to statutory requirements in other overseas regions	13,994
	36,054

Directors

The directors during the year were:

Non-Executive Directors:

Dr Victor FUNG Kwok King, Chairman
 Mr Paul Edward SELWAY-SWIFT *
 Mr Allan WONG Chi Yun *
 Professor Franklin Warren McFARLAN *
 Mr LAU Butt Farn
 Mr Leslie BOYD
 Mr Steven Murray SMALL
(alternate to Mr Leslie BOYD)
 Mr Makoto YASUDA*
(appointed on 10 May 2001)

Executive Directors:

Dr William FUNG Kwok Lun, Managing Director
 Mr Henry CHAN
 Mr Danny LAU Sai Wing
 Ms Annabella LEUNG Wai Ping
 Mr Bruce Philip ROCKOWITZ
(appointed on 10 May 2001)

* *independent non-executive directors*

In accordance with bye-law 110 of the Company's bye-laws, Mr Paul Edward SELWAY-SWIFT, Mr Allan WONG Chi Yun and Mr LAU Butt Farn retire and, being eligible, offer themselves for re-election.

In accordance with bye-law 101 of the Company's bye-laws, Mr Makoto YASUDA and Mr Bruce Philip ROCKOWITZ retire and, being eligible, offers themselves for re-election.

Independent non-executive directors are subject to retirement by rotation in Annual General Meetings in accordance with bye-law 110 of the Company's bye-laws.

The biographical details of the directors as at the date of this Report are set out in the Directors and Senior Management section on pages 19 to 24.

Directors' Service Contracts

Under a service contract dated 2 June 1992 between the Company and Dr William FUNG Kwok Lun and a service contract dated 2 June 1992 between Li & Fung (B.V.I.) Limited and Dr William FUNG Kwok Lun, Dr William FUNG Kwok Lun has been appointed to act as Managing Director of the Company, Li & Fung (Trading) Limited, Li & Fung (Properties) Limited and Li & Fung (B.V.I.) Limited, in each case for an initial period of five years from 1 April 1992 and thereafter unless terminated by not less than 12 calendar months' notice in writing expiring at the end of such initial period or any subsequent month.

Apart from the above, 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.

Directors' Interests in Equity or Debt Securities

As at 31 December 2001, the directors, chief executives and their associates had the following interests in the share capital and share options of the Company and its associated corporations (within the meaning of the Securities (Disclosure of Interests) Ordinance ("SDI Ordinance")) which require notification pursuant to Section 28 of the SDI Ordinance or the Model Code for Securities Transactions by Directors of Listed Companies ("the Model Code") or as recorded in the register maintained pursuant to Section 29 of the SDI Ordinance:

Shares of the Company of HK\$0.025 each

	Number of Shares				Total Interests
	Personal interest	Corporate interest	Family interest	Other interest	
Dr Victor FUNG Kwok King	—	1,180,500,000 ¹	—	50,750,000 ²	1,231,250,000
Dr William FUNG Kwok Lun	68,502,300	1,180,500,000 ¹	8,000	—	1,249,010,300
Mr Henry CHAN	2,080,000	—	—	—	2,080,000
Mr Danny LAU Sai Wing	7,000,000	—	—	—	7,000,000
Ms Annabella LEUNG Wai Ping	2,880,000	—	—	—	2,880,000
Mr Bruce Philip ROCKOWITZ	8,000	50,374,100 ³	—	—	50,382,100
Mr LAU Butt Farn	2,200,000	—	—	—	2,200,000
Professor Franklin Warren McFARLAN	52,000	—	—	—	52,000

Notes:

(1) As at 31 December 2001,

- (a) King Lun Holdings Limited ("King Lun"), a private company incorporated in the British Virgin Islands, held 49,950,800 Shares.
- (b) King Lun through its wholly-owned Hong Kong incorporated subsidiary, Li & Fung (1937) Limited, held 996,000,000 Shares.
- (c) Li & Fung (1937) Limited, through Orient Ocean Holdings Limited ("Orient Ocean"), a private company incorporated in the British Virgin Islands, held 134,549,200 Shares. Li & Fung (1937) Limited held 50% voting rights with no beneficial interest in Orient Ocean.

Dr Victor FUNG Kwok King and Dr William FUNG Kwok Lun are deemed to have interests in the 1,180,500,000 Shares, i.e. the total number of Shares mentioned in notes (1)(a), (b) and (c) above through their personal or other interests in King Lun as set out below :-

- (i) 1,332,840 shares in King Lun, representing 50% of its issued share capital, are owned by Chase Bank & Trust Company (CI) Limited, the trustee of a trust established for the benefit of the family of Dr Victor FUNG Kwok King.
 - (ii) 1,332,840 shares in King Lun, representing 50% of its issued share capital, are owned by Dr William FUNG Kwok Lun.
- (2) 50,750,000 Shares in the Company are held by Chase Bank & Trust Company (CI) Limited, the trustee of a trust established for the benefit of the family of Dr Victor FUNG Kwok King.
- (3) 50,374,100 Shares in the Company are held by Hurricane Millennium Holdings Limited, a company beneficially owned by a trust which has been set up for the benefit of family members of Mr Bruce Philip ROCKOWITZ.

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

Substantial Shareholders

At 31 December 2001, the register of substantial shareholders maintained under Section 16(1) of the SDI Ordinance shows that the Company had been notified of the following substantial shareholder's interests, being 10% or more of the Company's issued share capital:-

	Number of Shares
Li & Fung (1937) Limited	996,000,000
The Capital Group Companies, Inc.	288,877,644

Senior Management

The biographical details of the senior management as at the date of this Report are set out in the Directors and Senior Management section on pages 19 to 24.

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.

Corporate Governance

Principal corporate governance practices as adopted by the Company are set out in the Corporate Governance section on pages 13 to 18.

Directors' Responsibilities for the Accounts

The Directors are responsible for the preparation of accounts for each financial period which give a true and fair view of the state of affairs of the Group and of the results and cash flows for that period. In preparing these accounts for the year ended 31 December 2001, the Directors have selected suitable accounting policies and applied them consistently; made judgements and estimates that are prudent and reasonable; and have prepared the accounts on the going concern basis. The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group.

Auditors

The accounts have been audited by PricewaterhouseCoopers who retire and, being eligible, offer themselves for re-appointment.

On behalf of the Board

Victor FUNG Kwok King

Chairman

Hong Kong, 21 March 2002