

Report of the Directors

The directors submit their report together with the audited accounts for the year ended 31 December 2002.

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 81 to 89.

Details of the analysis of the Group's turnover and contribution to operating profit for the year by principal activities and geographical location are 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 21* to the accounts.

Results and Appropriations

The results for the year are set out in the consolidated profit and loss account on page 40.

The directors declared an interim dividend of HK\$0.085 per ordinary share, totalling HK\$245,651,000, which was paid on 6 September 2002.

The directors recommend the payment of a final dividend of HK\$0.22 per ordinary share, totalling HK\$635,803,000.

Reserves

Movements in the reserves of the Group and the Company during the year are set out in *note 22* to the accounts.

Distributable Reserves

At 31 December 2002, the distributable reserves of the Company available for distribution as dividends amounted to HK\$2,950,713,000, comprising retained earnings of HK\$890,040,000 and 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 22(b)* 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\$1,210,000.

Fixed Assets

Details of the movements in fixed assets of the Group are set out in *note 12* 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 2002 and for the previous nine financial years are set out in the Ten-Year Financial Summary section on page 90.

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

Currently, the Company has no share option scheme. The previous share option scheme (the "Scheme") of the Company was adopted on 2 June 1992 and expired on 1 June 2002. As at 31 December 2002, there are options ("Share Options") relating to 31,196,000 Shares granted by the Company pursuant to the Scheme which are valid and outstanding and which will remain valid under the Scheme.

Details of the Scheme are as follows:

(i) Purpose

The Scheme was 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 would 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). No share will be available for issue under the Scheme as at the date of the annual report as the Scheme has expired on 1 June 2002.

No qualifying participant were 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 might in its absolute discretion determine, save that such period should not commence earlier than one year nor more than 10 years from the date on which an option was granted and accepted by the grantee.

(v) Amount payable on application or acceptance

An offer of the grant of an option should remain open for acceptance for a period of 28 days from the date on which an option was offered to the grantee (the "Offer Date"). An offer of the grant of the option should 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 was received by the Company.

(vi) Exercise price

The exercise price in respect of any particular option should 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 rule 17.03 of the Listing Rules.

(vii) The remaining life of the Scheme

The Board was 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 2002 are as follows:

	Options held at 1 January 2002	Options granted during the year	Options exercised during the year	Options lapsed during the year	Options held at 31 December 2002	Exercise Price HK\$	Grant date	Exercisable from	Exercisable until
Dr William FUNG	480,000	—	—	—	480,000	15.26	7 July 2000	7 July 2001	6 July 2003
Kwok Lun	480,000	—	—	—	480,000	10.50	18 July 2001	18 July 2002	17 July 2004
	480,000	—	—	—	480,000	7.98	28 August 2001	28 August 2003	27 August 2005
Mr Henry CHAN	1,200,000	—	1,200,000 ¹	—	—	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	—	—	—	240,000	10.50	18 July 2001	18 July 2002	17 July 2004
	240,000	—	—	—	240,000	7.98	28 August 2001	28 August 2003	27 August 2005
Mr Danny LAU	240,000	—	240,000 ¹	—	—	4.1525	16 July 1999	16 July 2000	15 July 2002
Sai Wing	240,000	—	—	—	240,000	15.26	7 July 2000	7 July 2001	6 July 2003
	240,000	—	—	—	240,000	10.50	18 July 2001	18 July 2002	17 July 2004
	240,000	—	—	—	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	—	—	—	240,000	10.50	18 July 2001	18 July 2002	17 July 2004
	240,000	—	—	—	240,000	7.98	28 August 2001	28 August 2003	27 August 2005
Mr Bruce Philip ROCKOWITZ	240,000	—	—	—	240,000	7.98	28 August 2001	28 August 2003	27 August 2005
Continuous contract employees	9,594,000	—	9,594,000 ¹	—	—	4.1525	16 July 1999	16 July 2000	15 July 2002
	8,056,000	—	—	184,000	7,872,000	15.26	7 July 2000	7 July 2001	6 July 2003
	9,468,000	—	—	148,000	9,320,000	10.50	18 July 2001	18 July 2002	17 July 2004
	10,404,000	—	—	240,000	10,164,000	7.98	28 August 2001	28 August 2003	27 August 2005

Note:

- (1) The weighted average closing market price per Share immediately before the dates on which the Share Options were exercised was HK\$11.77.

Subsidiaries

Details of the Company's principal subsidiaries at 31 December 2002 are set out in the Principal Subsidiaries and Associated Companies section on pages 81 to 89.

Associated Companies

Details of the Company's principal associated companies at 31 December 2002 are set out in the Principal Subsidiaries and Associated Companies section on pages 81 to 89.

Major Customers and Suppliers

During 2002, 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 16.5% and 33.8% 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 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.

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 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 operates a defined contribution provident scheme for its employees with the contribution set at 6% of the employees' basic salaries. In addition, the Group also participates in a retirement benefit plan in accordance with local statutory requirements. Under this plan, the Group recognises pension cost monthly at 2% of the employees' salaries, which is contributed monthly to an independent fund.

In the United Kingdom, the Group participates in a defined benefit scheme for its employees. Under which, the Group and its employees made monthly contributions to the scheme based on 12% to 19.5% and 5% to 7% of the employees' salary respectively.

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 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	22,854
Contributions forfeited by employees	(1,043)
Contributions to the defined contribution provident scheme and defined benefit plan in Taiwan	7,615
Contributions to the defined benefit scheme in the United Kingdom	4,535
Contributions pursuant to the statutory requirements in Korea	9,242
Contributions pursuant to local requirements in other overseas regions	17,869
	61,072

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 Makoto YASUDA *
 Mr LAU Butt Farn
 Mr Leslie BOYD
 (Mr Steven Murray SMALL —
alternate to Mr Leslie BOYD)

* *independent non-executive directors*

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

In accordance with bye-law 110 of the Company's bye-laws, Mr Henry CHAN, Professor Franklin Warren McFARLAN and Mr Leslie BOYD retire and, being eligible, offer 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 22 to 27.

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 2002, 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:

(A) 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	4,000	—	1,249,006,300
Mr Henry CHAN	3,280,000	—	—	—	3,280,000
Mr Danny LAU Sai Wing	7,240,000	—	—	—	7,240,000
Ms Annabella LEUNG Wai Ping	3,200,000	—	—	—	3,200,000
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 ⁴	52,000
Mr Leslie BOYD	—	—	—	10,000 ⁵	10,000

Notes:

(1) As at 31 December 2002,

- (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 J.P. Morgan Trust Company (Jersey) Limited (formerly known as: Chase Bank & Trust Company (C.I.) 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 J.P. Morgan Trust Company (Jersey) Limited (formerly known as: Chase Bank & Trust Company (C.I.) 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.
- (4) 52,000 Shares in the Company are held by a trust established for the benefit of Professor Franklin Warren McFARLAN and managed by Fleet Bank, Boston.
- (5) 10,000 Shares in the Company are held by Maitland Trustees Limited, the trustee of a trust, in respect of which the family of Mr Leslie BOYD are potential discretionary beneficiaries.

(B) Share Options

The interests of the directors and chief executives in the Share Options of the Company are detailed in the Share Options section stated above.

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 2002, 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 shareholders' 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.	348,961,945

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 22 to 27.

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 15 to 21.

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 2002, 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, 24 March 2003