Chairman's Statement

Introduction

Li & Fung performed well in the first half of 2003, a time marked by great global insecurity. Whilst the global economy, and particularly the economy of the United States, was slow to recover, Li & Fung through the strength of its strong management and operations was able to navigate the SARS epidemic and the war in Iraq without impact to the Group's bottom line.

Performance

I am pleased to report robust turnover for the Group which increased 26% to HK$18.1 billion during the first half of the year. Profits attributable to shareholders were HK$414 million, a 22% increase compared with HK$340 million for the same period in 2002. Earnings per share were 14.3 HK cents. The Board of Directors has declared an interim dividend of 10 HK cents per share.

The last six months have been tumultuous globally, but particularly in Hong Kong and Asia. I am happy to report that while the US market remained sluggish, brands and retailers still sought our services due to the Group's proven record as the premier supply chain partner. The successful integration of Janco's business helped to broaden the Group's customer base and contributed to our gross profit.

The Group's continuous expansion of its sourcing network also contributed to the positive results by providing customers with quick response and flexible alternatives throughout our network. It was evident during the time of the SARS epidemic that we were able to offer undisrupted services and alternative sources of products. The Group has expanded its network in the Chinese Mainland China and Vietnam over the past months. We now have sixteen offices in the Mainland and will be adding more offices to ensure a comprehensive network by end of 2004. The recently concluded Closer Economic Partnership Arrangement (CEPA) agreement between Hong Kong and the Mainland will allow Hong Kong based service sectors to integrate rapidly with the Pearl River Delta and the rest of the Chinese Mainland. The Group, being one of the foremost providers in trade related services, is expected to benefit greatly from this.

Prospects for the Rest of the Year

The Group is confident that diversifying our product mix as well as our customer base will put us in good stead to prudently garner better performance in 2003. We anticipate from orders on hand and indications from customers that the Group is set for a double-digit increase in turnover. This success is due in part to greater product diversification within our hardgoods, expansion of the value-retailer segments and increasing value-added services for our customers.

Furthermore, the Group is servicing a number of new customers with good sales potential. The Group is in the process of finalizing a new licensing agreement with Levi Strauss & Co. in which the Group will develop and distribute tops for men, women and children under the Levi Strauss Signature™ label for sales to major mass market retailers. This partnership will be able to provide Li & Fung with an entry into higher margin business models.

Whilst the Group is actively pursuing new ventures, we also maintain our commitment to cost management and margin improvements. This is in line with the Group's Three-Year Plan starting in 2002. Although we had a slow start that first year, we remain committed to pursuing our Three-Year Plan targets by 2004.

To realize these objectives, we will continue to be on the lookout for acquisitions that will help diversify our business. The Group's strong cash position will make these acquisitions possible.

Corporate Governance

The Board is committed to maintaining a strong record in corporate governance. Our Chief Compliance Officer, who heads the Group's Corporate Governance Division, supervises our internal controls and ensures that the Group diligently follows best practices.

Our Audit Committee comprises six non-executive directors, four of whom are independent directors, and the Chief Compliance Officer. The Group's Risk Management Committee is charged with continuously monitoring Li & Fung's risk management and internal control systems.

Conclusion

While the global economy is still in a period of uncertainty, the Group remains confident of its leading market position and its proven track record. This record should provide our investors reassurance through the rest of the year and into the future.

Victor FUNG Kwok King
Chairman

Hong Kong, 13 August 2003

Managing Director's Report

Results Review

Group performance was strong for the first half of 2003 and represented a good rebound against the first half of 2002 when business suffered from the shocks of the US terrorist attacks in September 2001. During the period, although the US retail market has yet to show signs of strengthening, the Group enjoyed good demand from its customer base. Increasingly, our customers are relying on the Group's wide spread sourcing network and capabilities to help them stay competitive in a tough market place.

During the period under review, turnover saw a hefty increase of 26% to HK$18.1 billion. Part of the increase was due to the contribution of Janco Overseas Limited, which was only acquired in August 2002. However, even disregarding Janco's contribution, the Group's organic growth still registered a robust increase of 18% over the previous year.

Although Janco added top line growth, it operates on a much lower margin than the rest of the Group, given its target customers in the value sector. Hence, the Group's Total Margin declined slightly from 9.4% to 9.1%. Our margin without Janco remains unchanged from the year before. Leveraging on our expanded scale, Core Operating Margins before amortisation of goodwill and provision for investments increased from 2.34% to 2.41%. As a result the Group's Core Operating Profit registered a healthy growth of 30%.

Despite strong operating performance, a drop in non-trading income had an unfavorable effect on Group results. Due to the downward trend in interest rates, the Group's interest income generated from cash reserves declined to HK$21 million, from HK$30 million last year. The Group has made a HK$13 million provision for investments to reflect a permanent diminution in value of our venture capital investments. Goodwill amortisation charges also increased from HK$2 million to HK$11 million, reflecting impact for the Janco acquisition.

Taking into account the above, plus contribution from associated companies, tax and minority interests, the Group's profit attributable to shareholders was HK$414 million, a 22% increase from the year before.

Segmental Analysis

In line with our strategy to achieve a more balanced business mix, the hardgoods business again performed well, with turnover and operating profit increasing by 44% and 53% respectively. The addition of Janco helped fuel this growth but organic growth was also strong as the Group continues to build more anchor customers in categories such as home products and toys. The hardgoods business accounted for 31% of Group turnover in the first half of 2003, up from 27% in the same period last year.

Softgoods business accounted for 69% of turnover during the first half of 2003, and enjoyed a healthy growth of 20% with particular strength coming from the value sector. With better leverage on the existing cost base operating profit for softgoods grew at a higher rate of 26%.

Geographically, the Group experienced strong demand from its customers across the board. In all markets, turnover and operating profit saw increases of over 20%. In particular, our European business benefited from the stronger Euro. Our Japan business alliance with Nichimen is also starting to reach economies of scale. After some startup losses last year, East Asia produced a small profit for the first half of 2003.

Financial Position and Liquidity

The Group continues to be in a strong financial position, with cash and cash equivalents amounting to HK$1.9 billion on 30 June 2003. Normal trading operations are well supported by over HK$10 billion in bank trade finance. In addition, the Group has available bank loans and overdraft facilities of HK$505 million out of which only HK$199 million has been utilized. As at 30 June 2003, the Group's gearing ratio was 0.85%, based on long term liabilities of HK$30 million and shareholder's equity of HK$3.6 billion. The current ratio was 1.4, based on current assets of HK$5.6 billion and current liabilities of HK$4 billion.

At the end of June 2003, charges on assets amounted to HK$118 million to cover banking facilities in the ordinary course of business.

There were no material changes to the Group's borrowings since 31 December 2002.

The Hong Kong Society of Accountants has issued a revised Statement of Standard Accounting Practice No. 12 (revised) "Income Taxes" ("SSAP 12 (revised)") which is effective for accounting periods commencing on or after 1 January 2003. The SSAP 12 (revised) has introduced a new basis of accounting for income taxes (including both current and deferred tax) and additional disclosure requirements to the financial statements. With the adoption of the SSAP 12 (revised), there was a net deferred tax of HK$3 million credit to the profit and loss account for the half year.

Foreign Exchange Risk Management

Most of the Group's cash balances are deposited in HK$ or US$ with major international banks in Hong Kong. The Group has a HK$35 million short term revolving loan denominated in Yen as a currency hedge against shares held in Nissho Iwai-Nichimen Holdings Corporation, a strategic investment made in 2001 in the Business Alliance to open up the Japanese market.

Apart from the above, most of the Group's assets, liabilities, revenues and payments are either in HK$ or US$. Therefore, we consider our risk exposure to foreign exchange rate fluctuations minimal.

Capital Commitments and Contingent Liabilities

There are no material contingent liabilities or off-balance sheet obligations other than trade bills discounted in the ordinary course of business as noted in the accounts.

Human Resources

As at 30 June 2003, the Group had a total work force of 5,710, of which 1,918 were based in our Hong Kong headquarters and 3,792 were located overseas throughout our sourcing network across 40 countries and territories.

The Group offers its staff competitive remuneration schemes. In addition, discretionary bonuses and share options are also granted to eligible staff based on individual and Group performance. The Group is committed to nurturing a learning culture in the organization. Heavy emphasis is placed on training and development, as the Group's success is dependent on the efforts of a skilled, motivated work force. Total staff costs for the six months ending 30 June 2003 were HK$722 million, compared against HK$613 million in 2002.

Prospects and Progress on Three-Year Plan 2002-2004

Due to the slow start to the plan in 2002, the Group is behind in its Three-Year Plan to double our profits by 2004. However, management remains committed to pursuing this target for the remainder of the plan. The second half of 2002 and the first half of 2003 has seen satisfactory growth broadly in line with the plan.

Judging from orders on hand and indications from our customers, the Group anticipates that double-digit increase in turnover can be achieved for the rest of the year. The Group is also starting to service a number of new customers with good sales potential in the medium term.

In the area of new initiatives, the Group is in the process of negotiating and finalizing a licensing arrangement with the Levi Strauss & Co., in which we will design, source and distribute men's, women's, boys' and girls' tops under the Levi Strauss Signature™ label for sales to major mass market retailers. The line is expected to be delivered to stores for the Fall Season of 2004. This initiative also represents an important foray into the higher margin business area in line with the Group's Three-Year Plan Strategy.

Apart from developing higher margin businesses, management continues to actively evaluate acquisition opportunities to accelerate our growth. Progress in this area was somewhat delayed by the outbreak of SARS but activity has since resumed vigorously. The Group has a strong capacity in this respect with close to HK$2 billion in cash reserves.

William FUNG Kwok Lun
Managing Director

Hong Kong, 13 August 2003