Management Discussion & Analysis

Chairman's Statement

Victor FUNG Kwok King

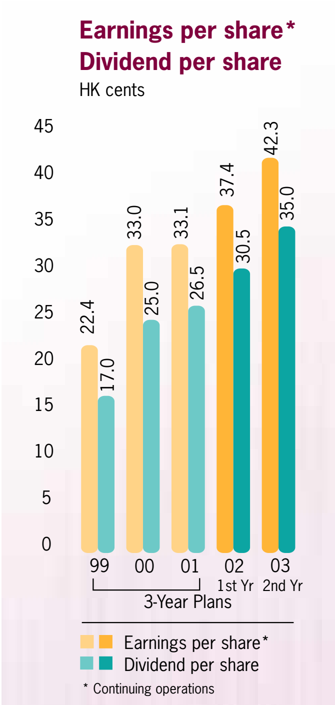
Introduction

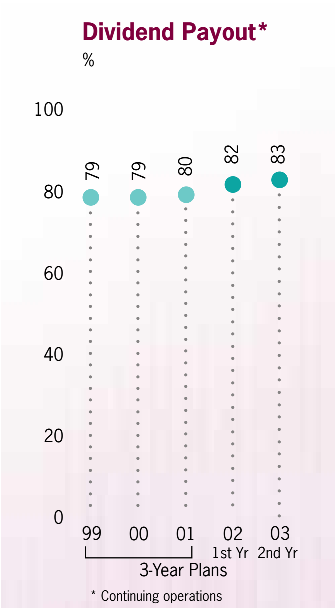
I am pleased to report that 2003 was a year of measured growth for Li & Fung Limited (the "Group"). The Group was able to increase turnover by 26% in the first half despite the dampening effects of the Gulf War and the SARS epidemic but U.S. orders in the second half were a little less than expected. The Group made another strategic acquisition, and continued to build out higher margin business, secure licensing arrangements and expanded selectively its sourcing networks.

At the end of 2003, the Group had become one of very few global consumer products export trading companies with the geographic flexibility and depth of expertise that will be conducive to success in the future.

Performance

In 2003, Group turnover increased by 14.3% to HK$42.6 billion. Profit attributable to shareholders amounted to HK$1.22 billion, representing a 13.2% increase over the HK$1.08 billion of 2002. Earnings per share were 42.3 HK cents, an increase of 4.9 HK cents in 2002.





The Board of Directors has proposed an increase in final dividend to 25 HK cents per share which, together with an interim dividend of 10 HK cents per share, will give a total dividend of 35 HK cents per share for the whole year (2002 total: 30.5 HK cents per share).

Market and Business

Market uncertainty continued to be a challenge in 2003. Orders remained positive throughout the Iraq War and SARS in the first half of the year, but US demand was softer than expected in the latter part of the year, especially for the festive seasons.

The Group's strategy to increase its share of higher margin business led to the signing of a licensing agreement with Levi Strauss & Co and the signing of a memorandum of understanding that covered the principal terms of a license with Official Pillowtex L.L.C. The latter marks the Group's entry, with the established Royal Velvet brand, into the US home textiles' US$18 billion market. This fits well with the needs of the Group's existing and target customers, and the growth potential is substantial.

In August 2003, the Group acquired the remaining one-third of the equity interest in US garment importer International Sourcing Group, LLC ("ISG") for a total consideration of US$5.22 million. This was done through a share transaction. ISG is now a wholly owned subsidiary of the Group, offering a more comprehensive service to mass-market retailers in the US.

In December 2003, the Group acquired the sourcing business of Firstworld Garments Limited and International Porcelain, Inc. for a total consideration of US$27 million. The two companies, which together operate under the trade name of "International Sources", provide the Group with the opportunity to increase its hard goods business and grow its non-US business, specifically in Mexico.

The Group has also become the first wholly owned foreign trading company in China to be issued a wholly owned license granting direct export rights. This enables the Group to directly export products from China to its customers worldwide, thereby offering an even more complete supply chain service. The Group currently has 16 offices throughout the Chinese Mainland, where its annual sourcing volume exceeds US$2 billion.

Strategies for Further Growth

The Group's drive for growth remains a key focus for 2004 and beyond, and several initiatives are already in place to ensure sustainable growth:

Selective and opportunistic acquisitions remain a focus for the Group, and efforts to identify and secure value-enhancing acquisitions will continue.

Broader geographic reach has already been created with the acquisition of International Sources. This has opened up new potential in Mexico and paved the way for other geographic regions to be pursued.

Higher margin business, especially arising from licensing agreements such as those with Levi Strauss Signature™ and Royal Velvet, will allow the Group to add financial quality to its operations. The brand-value benefits of such agreements, to the Group and to its licensors, are also noteworthy. The direct contribution to earnings from the branding and licensing business is unlikely to be immediate but the potential beyond 2004 is significant.

New opportunities from China goes beyond just sourcing and manufacturing. The Group's export company license from the Ministry of Commerce of the People's Republic of China delivers a complete supply-chain service advantage that the Group intends to maximize. The Group is now able to import raw materials and export under its own name, as well as benefit from VAT rebates.

Diversification of customer base through an expanding product mix will also continue to provide fresh momentum for growth. The Group's global role in managing the supply chain for high-volume, time-sensitive consumer goods such as garments, fashion accessories, toys, sporting goods, promotional merchandise, handicrafts, shoes, travel goods and household items will be further enhanced as more brand names and more products are added.

The above in fact reflects the Group's constant evaluation of growth opportunities and impetuses that already sit adjacent to the core business of the Group, and which make good business sense to consider. The Group refers to this as its 'Adjacency Strategy' – one that is designed to open up possibilities that the Group's various businesses readily offer; from the on-shore business development and marketing opportunities that companies such as International Sources and ISG represent, to the design and branding initiatives involving licensing agreements as well as the overall extension of the Group's agency role within a global market.

One final word on change. Although economic recovery and growth is the prevailing theme that is currently echoing around the commercial capitals of the world, unpredictability and volatility are likely to remain permanent features of the global landscape. It is against this backdrop that the Group will be positioning its future growth and identifying the opportunities that come with some degree of risk. Here too, the Group's significant global presence and operations offer the kind of flexibility and critical mass that is even more relevant in today's global economy.

Looking further ahead, the Group has already started to examine its internal synergies and assess the external environment in preparing for the Group's next Three-Year Plan, from 2005 to 2007. Global outsourcing and licensing trends are being taken into account in the Group's scenario building and response strategies, as are factors such as trade and competitiveness issues, geographic opportunities, channel shifts in marketing and branding trends, and behavioral changes in the retail sector.

Corporate Governance

The Board constantly seeks to advance its commitment to the practice of good corporate governance, and it is with this as the catalyst that a number of changes took place in 2003.

To further reinforce independence, three committees were restructured to comprise a majority of Independent Non-executive directors: the Nomination, Audit and Compensation Committees. In addition, I have retired as Chairman of the Audit Committee in favour of Mr Paul Selway-Swift, while remaining as a member of the committee.

In overall terms, the Audit Committee, Risk Management Committee and Corporate Governance Division provide continuous monitoring of the Group's risk management and internal control systems.

Last but not least, I wish to express my gratitude to the members of the Board for their diligent guidance and support, and to thank the Group's management team and staff for their unstinting efforts and dedication in ensuring the continued success of the Group.

Victor FUNG Kwok King
Chairman

Hong Kong, 24 March 2004