Managing Director's Report

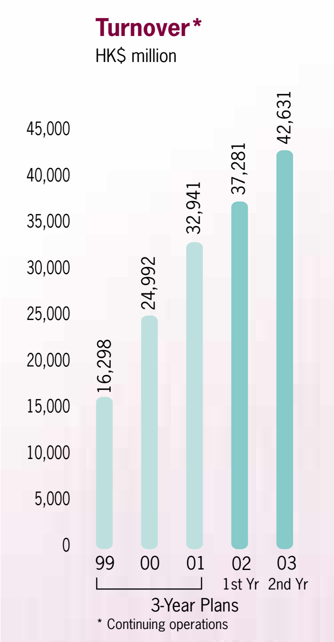
William FUNG Kwok Lun

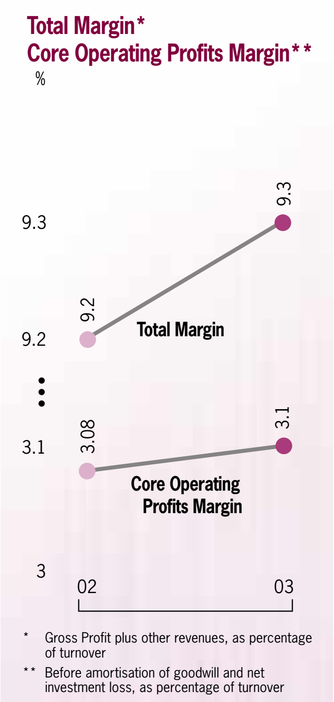
Results Review

2003 was a year of steady progress for Li & Fung. Our business has continued to grow amidst a sluggish retail environment in our major markets. With our extensive sourcing network, the Group has experienced good market share gains within our customers base by helping them stay competitive in a tough market space. Leveraging on our core expertise in the supply chain we have also embarked on new initiatives to build a higher-margin business model with sustainable, high growth prospects.

During the year, turnover increased by 14.3% to HK$42.6 billion. Although this increase is in line with our Three-Year Plan target growth rate, it is not as strong as what management has expected earlier in the year. While generally the Group has been able to increase market share, poor holiday season performance amongst a few large customers led to lower than expected turnover growth for the second half of 2003.

The Group's Total Margin improved from 9.2% to 9.3%, reflecting our continuous move into building more higher-margin businesses. Core Operating Profit Margin also saw an improvement from 3.08% to 3.1%. As a result, the Group's Core Operating Profit saw a slightly higher rate of growth of 15.1%.





Despite a solid operating performance, a drop in non-trading income had an unfavorable effect on Group results. Due to the downward trend in interest rates, interest income generated from cash reserves declined to HK$38 million, from HK$50 million. Net loss from our venture capital investments amounted to HK$8 million. Goodwill amortisation charges increased from HK$12 million to HK$26 million, reflecting the full year impact of the Janco acquisition, the acquisition of International Sources, as well as the increase in our stake in ISG, our wholesale operation in the US.

Taking into account the above, profit attributable to shareholders grew 13.2% to HK$1,223 million.

Segmental Analysis

The Group's hardgoods business continued to see good growth momentum, with turnover and operating profit jumping by 21% and 28% respectively. The full year inclusion of the Janco business contributed partly to this increase. Our original hardgoods business has also benefited from a growing list of anchor customers. Hardgoods now account for 33% of Group turnover, up from 32% in 2002 and 28% from 2001, the end of our last Three-Year Plan.

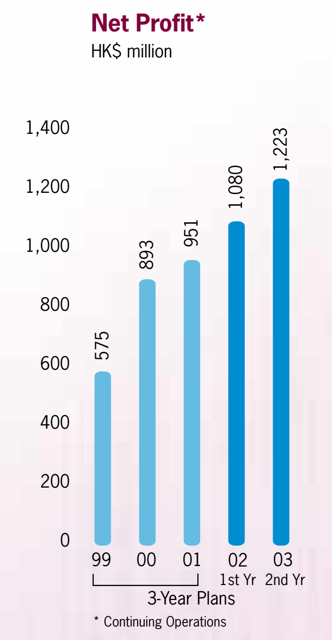
Softgoods business accounted for 67% of total turnover. Due to the poor performance of a few key customers in the holiday season, turnover and operating profit increased by a less than expected rate of 11%.

Geographically, North America is still the Group's largest export market, accounting for 75% of turnover. The retail market has yet to see signs of pick up and turnover and operating profit there increased by 13% and 9% respectively. Benefiting from a stronger Euro the Group saw better performance in Europe with turnover and operating profit increasing by 16%, and 33%. Other markets like East Asia and Southern Hemisphere are small but building steadily.

New Ventures

During the year, the Group has entered into a licensing agreement with Levi Strauss & Co to design, manufacture and market fashion tops under the Levi Strauss Signature™ label in the US and is our first major venture into the brands arena. Leveraging on our sourcing network, product development capability and diverse customer base, we see a good opportunity to build a higher margin business model to augment our core business. The Group will adopt a prudent approach, licensing only well-known brand names with mass appeal. On the sales side, we seek to partner with leading retailers with scale, to build substantial business and minimize risk in the supply chain. The brand strategy will enable us to increase market share with existing customers and also penetrate new customers in the mass market channel such as Wal-Mart and Target.

In early 2004, the Group has been granted another license by the Official Pillowtex LLC to manufacture and distribute home textiles and home décor items under the well-known Royal Velvet brand name. With high consumer recognition, a very broad product range and the rights to distribute globally, this license is expected to contribute significantly to future profits.



Acquisitions

In September 2003, the Group has increased the stake in a US subsidiary ISG, from 67% to 100%. The consideration of HK$41 million was satisfied by an issue of 3.8 million new shares. This move helps to consolidate our product development and marketing capabilities in the US in order to better implement the brand strategy.

In December 2003, the Group acquired International Sources for a total consideration of US$27 million. International Sources is an apparel trading company that specializes in supplying a number of leading retailers in Mexico and will dramatically increase the Group's share of this growing market. Our extensive sourcing capabilities and expertise with similar customers worldwide will help grow International Sources' business substantially.

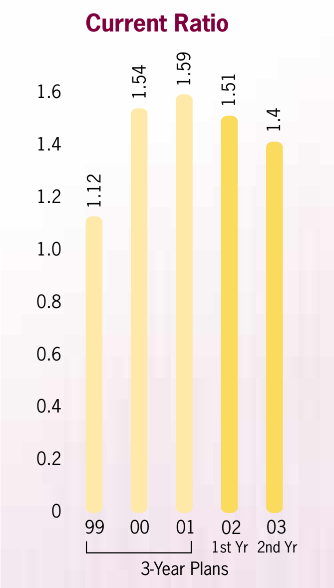
Financial Results and Liquidity

The Group continues to be in a strong financial position, with cash and cash equivalents amounting to HK$2.4 billion at the end of 2003. Normal trading operations are further supported by HK$13 billion in bank trade finance. In addition, the Group has available bank loans and overdraft facilities of HK$512 million out of which only HK$243 million has been utilized. As at 31 December 2003, the Group's gearing ratio stood low at 0.6%, based on long term liabilities of HK$25 million and shareholder's equity of HK$4.2 billion. The current ratio was 1.4, based on current asset of HK$7 billion and current liabilities of HK$5 billion.

At the end of 2003, charges on asset amounted to HK$234 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$6 million credit to the profit and loss account for 2003.



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$39 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 a business alliance to develop the Japanese market.

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

Contingent Liabilities and Off-Balance Sheet Obligations

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

Human Resources

At the end of 2003, the Group had a total work force of 5,956, of which 2,055 were based in our Hong Kong headquarters and 3,901 were located overseas throughout our sourcing network across 38 countries and territories.

The Group offers its staff competitive remuneration schemes. In addition, discretionary bonuses and share options are granted to eligible staff based on individual and Group performance. The Group is committed to nurturing a learning culture in the organisation. Heavy emphasis is placed on training and development, as the Group's success is dependent on a skilled motivated work force. Total staff costs for 2003 amounted to HK$1,546 million, compared against HK$1,375 million in 2002.

Prospects and Progress on Three-Year Plan 2002 – 2004

2004 is the final year of our current Three-Year Plan and management is committed to pursue the plan targets in the remainder of the year. Owing to a slow start to the plan in 2002 and slower than expected growth in the second half of 2003, the Group is currently behind the plan targets. We will continue to pursue additional acquisition opportunities to accelerate our growth.

Looking forward to the rest of the year, orders on hand are pointing towards an acceleration in earnings growth compared to 2003. The Group is also continuing to maintain a tight control on costs to bring about more efficiency in the business.

Shipments for the Levi Strauss Signature™ and the Royal Velvet licenses will commence towards the end of the year. Although the impact of this brand strategy is limited in the current Three-Year Plan, it is expected to be an important growth driver for the next Three-Year Plan and beyond. In this regard, the Group is currently in discussions to pursue other licensing opportunities for well-known brand names.

William FUNG Kwok Lun
Managing Director

Hong Kong, 24 March 2004