Chairman's Statement

Introduction

The first half of 2004 saw the global economy expanding at a rapid rate, with the US setting the pace. However, rises in international commodity prices such as crude oil, together with the recent increase in interest rates in the US, have served to dampen unbridled optimism. For the time being, there has been no noticeable adverse effect on the pace of global GDP growth, which is forecast to reach 4.6% for 2004.

Against this backdrop, the Group made good progress in terms of its important licensing strategy. The four licensing agreements that are now in place will begin to offer brand-value benefits that will underscore the Group's move towards a higher-margin business model.

Performance

The Group's turnover rose by 9% to HK$19.7 billion in the first half of 2004. Profits attributable to shareholders were HK$502 million, representing a 21% increase when compared with HK$414 million for the same period in 2003. Earnings per share were 17.3 HK cents (2003: 14.3 HK cents).

For the six months ended 30 June 2004, the Board of Directors has resolved to declare an interim dividend of 12 HK cents per share (2003: 10 HK cents).

The Group's overall results were somewhat moderated by a lower-than-expected top-line growth, although margins were good. This was due to shipments being deferred to the second half of the year as more and more of the Group's customers opt for shorter delivery lead times. Total margin grew by 13%, largely from increased apparel exports to the US market, while the hardgoods segment expanded as planned. Margin improvements were a result of the Group's increased share of high value-added services.

Market and Business

Although there was growth in the global and US economies, uncertainty and volatility continued to influence market behavior and business sentiment.

The Group was consistent though, in its pursuit of its licensing strategy and its objective of increasing its share of higher-margin business. An example is the Group's licensing agreement with Official Pillowtex LLC, under which the Group will design, manufacture and distribute Royal Velvet home textile and home décor products worldwide.

The Group also further capitalized on its sourcing network, product development capability and diverse customer base.

Other strategic moves of the Group include the expansion of sourcing networks and capabilities in China, which will help raise gross margins and lower operating costs. The Group also began utilizing its direct export license, which allows the Group to export goods directly from China instead of through a third party.

As for non-US business, the Group has been able to further broaden its geographic reach after the acquisition of the sourcing business of Firstworld Garments Limited and International Porcelain, Inc. This acquisition was also in line with the Group's continuous diversification into the hardgoods business.

Prospects

The Group remains reasonably confident for 2004, based on orders on hand from department store operators and value retailers. Strong relationships developed with new customers should also yield good sales potential in the intermediate term, while the move towards a higher-margin business model should result in meaningful contributions in 2005.

Margins should also continue to increase because of improved operating efficiencies from the consolidation of Janco, elimination of overlapping functions and streamlining of procedures.

The Group sees the need for tempered optimism in terms of its Three-Year Plan 2002-2004 and the target of doubling profit by the end of 2004. But the Group remains committed to pursuing the goal.

Equally important, the Group's Adjacency Strategy, to accelerate future growth and acquisition opportunities, remains on track. The Group continues to actively seek out acquisition targets that specialize in either hardgoods or the European market, both of which would mean diversification in products and customer base for the Group.

The outlook for 2005 remains uncertain, so we're approaching the future with cautious optimism. Questions remain over whether the US retail market might soften after the presidential elections, while oil prices and interest rates could adversely impact consumer sentiment.

One other important development, a result of WTO pressures, is the elimination of the quota system for exporting garments to the US. This will take place in 2005, and the industry is already, understandably, reacting with some anxiety. The various issues however could present the Group with additional opportunities as retailers would need help in navigating through the changes that take place. The Group intends to provide continuity of supply and the fullest support with its well-established and extensive global sourcing network.

The Group will also continue to strengthen its presence in competitive markets such as China and South Asia in order to provide even wider coverage for its customers' manufacturing needs.

In preparation for future growth under the next Three-Year Plan 2005-2007, the Group sees the benefits of broadening its management team by introducing a new management structure. To strengthen its top management, the Group made a major move for two senior appointments. Mr Bruce Rockowitz, Executive Director of the Group, has been promoted to President of our principal trading subsidiary, Li & Fung (Trading) Limited, while Mr Robert Adams has been appointed Chief Operating Officer, a new post created in anticipation of growth-driven needs.

Corporate Governance

The Group's commitment to good corporate governance has taken another step forward as Independent Non-executive Directors now comprise the majority for three restructured committees (the Nomination, Audit and Compensation Committees).

As has been the case over the past several years, the Group intends to adhere to rigorous standards and practices in this increasingly important area.

Conclusion

The challenges that seem to be emerging for the second half of 2004 and beyond will have to be dealt with firmly and decisively. Given the Group's experience and leading industry position, we believe we are reasonably well placed and we will plan and respond accordingly.

Victor FUNG Kwok King
Chairman

Hong Kong, 12 August 2004

Managing Director's Report

Results Review

The first half of 2004 continued to be a period of steady progress for the Group. Although global, and particularly the US consumer markets were clouded by uncertainties brought by rising oil prices and interest rates, the Group was able to achieve strong profit growth by providing more value-added agency services such as product design and development to our customers. This strategy of focusing on margins has been an important part of our current Three-Year Plan 2002-2004.

During the period under review, the Group's turnover increased by 9% to HK$19.7 billion. This rate of increase is short of our expectation for double-digit growth as certain shipments have been slipped to the second half of the year; more and more of the Group's customers are opting for shorter delivery lead times.

However, with an increased proportion of business achieving higher margins, the Group's Total Margin rate enjoyed a good uplift to 9.4% during the first six months of the year, compared against 9.1% during the corresponding period last year. The Group's Core Operating Profit, before amortisation of goodwill and provision for investments, enjoyed a growth of 22%, reflecting an increase in the Core Operating Profit Margin from 2.4% to 2.7%.

In terms of non-operating income, net interest income generated from the Group's cash reserves continued to decline to HK$15 million from HK$18 million recorded during the first half of last year. Goodwill amortisation charges increased from HK$11 million to HK$21 million during the first half, reflecting the acquisition of International Sources, as well as the increase in the stake of International Sourcing Group, LLC at the end of 2003. Offset by higher contribution from associated companies and investments, the Group's pre-tax profit grew at a higher rate of 24%.

Taking into the account the above, plus minority interests and tax charges, profit attributable to shareholders increased 21% to HK$502 million for the first half of 2004.

Segmental Analysis

The softgoods business accounted for 69% of turnover in the first half of the year, with turnover and operating profits increasing by 8% and 22% respectively. The growth was mainly driven by new customer relationships in the apparel area, as well as an increase in demand for our value-added agency services such as product design and development, and goods delivered on a landed, duty paid basis instead of FOB country of origin.

The Group's hardgoods business maintained solid growth as our strong base of core customers continue to build business with us. Turnover and operating profit increased by 10% and 23% respectively. Hardgoods accounted for 31% of the Group's turnover in the first half and its share is expected to rise going forward.

Geographically, North America continued to be the Group's major export market, accounting for 73% of turnover in the first half. There, turnover and operating profits increased by 6% and 19% respectively.

The Group has made good progress in growing our business outside of North America with new customer additions. In Europe, turnover grew at a higher rate of 10%. Operating profit increased by 21%, reflecting an increase in margin that is in line with the rest of the Group. The Southern Hemisphere accounted for 5% of total turnover in the first half. Turnover and operating profit saw strong increases of 61% and 120% respectively. The Group has signed up major new customers in Australia and has established a strong presence in that market through working with a number of leading retailers there.

Business in East Asia, reflecting mainly the Japanese market, was flat and produced a small profit during the first half of the year. This is somewhat disappointing, and we are rethinking how best to tackle this market. We are currently in direct discussions with a few major retailers that may help us reach a breakthrough in this market. The Group continues to view the Japanese business as a long-term strategy with great eventual potential.

New Business Ventures

The Group has made major efforts over the last Three-Year Plan to broaden the base of value-added services in its core agency business and these efforts will help to set the growth foundation for the next Three-Year Plan. In an important extension of our core business, the Group has signed licensing agreements for Levi Strauss Signature™ tops, men's tops for Levi's Red Tab, home décor products for Royal Velvet, and Disney classic characters plush toys earlier in the year.

The Group is also in the process of acquiring the global licensing rights for the Cannon and Cannon Royal Family brand labels, from Official Pillowtex LLC. This is another leading brand, in addition to Royal Velvet, in the home products market. Cannon will be targeted towards mass-market retailers and supermarkets globally, and a launch is being planned for Fall 2005.

The Brand Business marks an important development in the Group's strategy of building more higher-margin businesses as an extension of our role in the supply chain. The first line of fashion tops under the Levi Strauss Signature™ license has just been shipped to retailers such as Wal-Mart and Target, and sales on all these licensed products are progressing well and in line with expectations.

Financial Position and Liquidity

The Group continues to be in a strong financial position, with cash and cash equivalents amounting to HK$1.7 billion on 30 June 2004. Normal trading operations are well supported by over HK$14 billion in bank trading facilities. In addition, the Group has available bank loans and overdraft facilities of HK$514 million, out of which only HK$293 million has been utilized. As at 30 June 2004, the Group's gearing ratio was 0.6%, based on long-term liabilities of HK$25 million and shareholders' equity of HK$4.1 billion. The current ratio was 1.4, based on current assets of HK$7 billion and current liabilities of HK$5 billion.

At the end of June 2004, charges on assets amounted to HK$143 million to cover banking facilities in the ordinary course of business.

There have been no material changes to the Group's borrowings since 31 December 2003.

As part of the next Three-Year Plan, the Group is reviewing its capital structure and to facilitate this, has obtained international credit ratings of A3 and A- from Moody's and Standard & Poor's respectively. These ratings are a reflection of the Group's prudent management and strong financial position.

Foreign Exchange Risk Management

Most of the Group's cash balances are deposited in HK$ or US$ with major international banks. The Group has a HK$38 million short-term revolving loan denominated in Yen as a currency hedge against shares held in Sojitz Holdings Corporation (formerly Nissho Iwai-Nichimen Holdings Corporation), a strategic investment made in 2001.

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.

Human Resources

As of 30 June 2004, the Group had a total workforce of 6,094, of whom 2,124 were based in our Hong Kong headquarters and 3,970 were located overseas throughout our sourcing network of close to 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 ended 30 June 2004 were HK$802 million, compared against HK$722 million in the first half of 2003.

In a major move to strengthen its top management in preparation for future growth under the next Three-Year Plan 2005-2007, Mr Bruce Rockowitz, Executive Director of the Group, has been promoted to President of Li & Fung (Trading) Limited, the Group's principal trading subsidiary. In addition, a new post of Chief Operating Officer has been created and this position is filled by Mr Robert Adams, who brings with him over 30 years of extensive experience in finance, trading and management to the Group.

Mr Frank Leong, the current Chief Financial Officer, will retire to his homeland in Malaysia and will continue to work in a consultancy role for the Group's controlling shareholder, Li & Fung (1937) Limited. Mr Robert Adams will also assume the role of Chief Financial Officer upon Mr Leong's retirement.

Prospects and Progress on Three-Year Plan 2002-2004

Looking forward to the rest of 2004, there are continued concerns in the US consumer market such as rising oil prices and interest rates, as well as possible uncertainties due to the upcoming presidential election. Despite challenging market conditions, a double-digit increase in turnover could be achieved for the year as a whole. The improvement in profitability experienced in the first half should also be sustained throughout the rest of the year, fuelled by continuing demand for our value-added services and a growing client list.

2004 is the last year of the current Three-Year Plan. During this period, the Group had strong organic growth, and many acquisition opportunities were evaluated. Other than Janco and International Sources, no further acquisitions have been completed up to this point. The Group is still continuing to evaluate other opportunities. However, acquisitions made from this point on will probably impact the Group in the next Three Year Plan.

Management is currently in the process of formulating corporate strategy for the next Three-Year Plan 2005-2007, which we will announce and share with our investors in March of next year. We are excited about the growth opportunities within our core business as well as the opportunities presented by the new strategic move into licensing brands. Coupled with our strong sourcing capabilities, we are confident in building new streams of businesses that can accelerate the growth of the whole company going forward.

William FUNG Kwok Lun
Managing Director

Hong Kong, 12 August 2004