MANAGEMENT DISCUSSION AND ANALYSIS

Back Row (from left to right):
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RESULTS OVERVIEW

2013 marked an important milestone for the Group, as we emerged stronger following a challenging 2012, concluded our current Three-Year Plan with solid financial results, and established a firm foundation for our next Three-Year Plan (2014–2016). In 2013, the Group successfully returned our operating financial performance to the 2011 levels, which was a historic high for us. Our three Business Networks of Trading, Logistics, and Distribution have strengthened their respective positions with enhanced capabilities in design, expanded product offerings, and a strengthened foothold in Asia to capture the increasing Asia consumer spend. The Group continued to benefit from tangible synergies realized by leveraging our scale, customer relationships, extensive vendor network, and product and service expertise across all our Networks.

Our Trading Network achieved solid results in 2013 and continued our dominance in this core business. Our Logistics Network cemented its position as a leading in-country logistics services provider in Asia, focusing on its distinct verticals with increased international freight forwarding capabilities. In our Distribution Network, after a year of integration and restructuring, LF USA has recovered and produced positive results through margin expansion and cost control. The new LF USA management team focused considerable effort on rightsizing the LF USA business, optimizing the existing brand portfolios, centralizing merchandizing planning, and completing back-office integration. Despite discontinuing certain brands in the previous year, LF USA has retained and developed an attractive portfolio of brands, continued to grow its overall business year over year, and is on track to recover to its historic margin level.

As we look ahead to our new Three-Year Plan, the underlying strategic objectives will be gaining market share, accelerating organic growth, improving operating efficiency and, where appropriate, making strategic acquisitions to enhance our overall market position.

	2013	2012	**Change**	
	US$mm	US$mm	US$mm	%
Turnover	**20,745.4**	20,221.8	523.6	*3%*
Total margin	**3,304.0**	2,963.8	340.2	*11%*
	15.9%	*14.7%*		
Core operating profit	**870.8**	511.2	359.6	*70%*
Net profit after tax	**755.3**	622.6	132.7	*21%*
Profit attributable to shareholders	**725.3**	617.4	107.9	*17%*

With respect to the Group's turnover for the year ended 31 December 2013, the Trading Network remained a stable core business, the Logistics Network continued its growth momentum, and the Distribution Network recorded growth in Europe, Asia and USA. For the full year, the Group's turnover increased by 3% to US$20,745 million. As discussed previously, the Group's business has been increasingly skewed towards the second half of the year, mainly due to the increased scale of our wholesale distribution business, as well as the seasonality effect with back-to-school sales and the holiday season. As a result, while our first half turnover remained flat as compared to last year, the Group's total turnover in the second half of 2013 increased by 5% year-on-year. We expect the proportion of sales and earnings recorded in the second half of the year to continue to increase in the future as customers want shorter lead times and shipments closer to the peak year-end retail season.

- Core operating profit increased by 70% to US$871 million, and core operating profit margin increased from 2.5% to 4.2%

- Total margin increased by 11% to US$3,304 million, increasing as a percentage of turnover from 14.7% to 15.9%

- Profit attributable to shareholders increased by 17% to US$725 million and included a non-cash gain of US$187 million on the write-back of contingent considerations this year. Excluding such non-cash gains in both years, profit attributable to shareholders increased by 84%

Core operating profit posted a strong recovery during the year, largely due to the positive recovery from LF USA's restructuring, as well as the solid performance of our European wholesale distribution business. Despite additional operating costs incurred as a result of recent acquisitions from building up our LF Asia and LF Logistics businesses to support on-going growth, the Group continued to focus on improving operating efficiency and managed to reduce total operating costs through continued efforts in cost control.

Profit attributable to shareholders increased by 17%. This included a remeasurement gain adjustment on contingent considerations of US$187 million on certain previous acquisitions made before 2013, as compared to a US$326 million adjustment in 2012. The adjustment was due to the remeasurement of contingent consideration payable as at 31 December 2013. In addition, the Group profit attributable to shareholders included the full impact of distributions to holders of perpetual capital securities in 2013.

Overall, our business continued to show resilience amidst an uncertain macroeconomic environment across the regions in which we operate. We continued to gain new customers, expanded our product offerings and made selected strategic investments in certain areas to enhance our competitive advantages. Our investments in Logistics and Asia are starting to bear fruit. The increased scale has allowed us to register strong organic growth and gain market share in a very fragmented Asia market. On the global sourcing front, an increasing number of factories are shifting to new, lower cost production bases. This shift, combined with a stronger industry focus on worker safety, vendor compliance, quality control and sustainability among industry players, have led us to establish a dedicated vendor support services business unit. This business unit will extend its range of services to further support the needs of our vendor and customer base, as well as to raise standards and improve operating efficiency in the global supply chain. We believe our asset-light business model, extensive global network, and high quality supply-chain standards will continue to underscore our leadership in the global sourcing arena.

THREE NETWORKS SEGMENTATION

The Group's business is organized according to three Business Networks: Trading, Logistics and Distribution. The Trading Network provides sourcing services to retailers, brand owners and wholesalers to support their brands on an agency and principal basis. The Distribution Network offers design and products to retailers on a wholesale basis. The Logistics Network is a leading player for in-country logistics in distinct verticals across Greater China and South East Asia interacts between the Trading and Distribution Networks to provide comprehensive logistics solutions and international freight forwarding services for our customers.

TRADING NETWORK

	2013	2012	**Change**	
	US$mm	US$mm	US$mm	%
Turnover	**16,308.0**	16,130.9	177.1	*1%*
Total margin	**1,497.6**	1,450.8	46.8	*3%*
	9.2%	*9.0%*		
Operating costs	**(958.2)**	(924.6)	(33.6)	*4%*
Core operating profit	**539.4**	526.2	13.2	*3%*

The **Trading Network** is comprised of two businesses, Agency and Principal Trading, with five operating groups, LF Sourcing, DSG, LF Fashion, LF Products and LF Beauty. The Agency business, which encompasses LF Sourcing and DSG operates on a commission margin basis where the Group leverages its global scale and capabilities to support the sourcing needs of retailers and brands, as well as to manage their global supply chain on an outsourced basis. The Principal Trading business, which spans LF Fashion, LF Products, and LF Beauty specializes in specific product categories and supplies complete lines of products to retailers and brands on a principal-to-principal basis.

The Trading Network accounted for the most significant part of the Group's turnover and 62% of core operating profit for the year ended 31 December 2013. Turnover increased by 1% from last year. From a geographical perspective, the US represented approximately 70% of the Trading Network's total turnover, with Europe and Rest of World representing 17% and 13%, respectively. It is noteworthy that Canada and Australia were particularly strong international markets for the Trading Network during 2013. In the US, although total turnover remained at largely the same level as last year, the furniture business within LF Products benefitted from the start of a US housing recovery. Meanwhile, total Trading turnover for Europe decreased by 4% as compared to prior year, offset by a 17% increase in turnover in other regions such as Australasia, and Central and Latin America. While overall weakness in Europe impacted the LF Fashion business for the full year, there was some incremental improvement in the second half from Europe. Pricing was flat compared to last year and unit volumes also remained at a similar level. The Group continued to gain new customers during 2013 and is engaged in on-going negotiations with a large number of potential customers on the possibility of outsourcing activities. We will continue to look for opportunities to gain market share via organic growth and selective acquisitions.

Total margin for the Trading Network increased from 9.0% to 9.2%, which was mainly achieved through LF Sourcing maintaining a stable commission rate and increased scale in LF Products and LF Beauty which enabled these operating units to achieve higher margins from offering value-added services, as well as high quality design and products to customers. Moreover, the acquisition of Whalen Furniture in 2013 further expanded the furniture portfolio within LF Products and provides a higher margin furniture category that can be distributed to multiple channels. Operating costs increased year-on-year by 4%, from US$925 million to US$958 million, mainly due to new acquisitions, which was offset by cost reductions implemented across the five operating groups in the Trading Network. Core operating profit of the Trading Network was US$539 million, an increase of 3% compared to last year. The increase was attributed mainly to the stable performance of LF Sourcing and the positive operating performance of DSG, LF Products and LF Beauty, offset by the challenges faced by LF Fashion due to its heavy focus on European customers.

The Group maintains a global sourcing network covering more than 40 economies, which allows the flexibility of moving orders from one production country to another to handle capacity constraints and satisfy customers' needs. Within this global network, the top three sourcing countries for the Group remained China, Vietnam, and Bangladesh. China held its position as the Group's largest sourcing country with softgoods and hardgoods accounting for 49% and 51%, respectively, while Vietnam and Bangladesh continued to be the second- and third-largest sourcing countries. Both Vietnam and Bangladesh are softgoods-centric, with approximately 95% being apparel.

LOGISTICS NETWORK

	2013	2012	Change	
	US$mm	US$mm	US$mm	%
Turnover	**526.3**	403.7	122.6	*30%*
Total margin	**194.5**	159.8	34.7	*22%*
Operating costs	**(158.7)**	(135.9)	(22.8)	*17%*
Core operating profit	**35.8**	23.9	11.9	*50%*
	6.8%	*5.9%*		

The **Logistics Network** continued to demonstrate robust growth with a 30% increase in turnover and a 50% increase in core operating profit over 2012. This strong set of results is mainly attributable to organic gain through extending existing partnerships with customers, winning new business and cross-selling across Networks. Our strategy at LF Logistics continues to be Asia-focused for its in-country logistics business, specializing in footwear and apparel, consumer products, as well as food and beverage verticals. This was supplemented by its international freight forwarding business for cross-border services. For the year ended 31 December 2013, over 90% of the turnover was in the Asian region.

In March 2014, LF Logistics signed the sale & purchase agreement to acquire China Container Line, a leading sea-freight forwarder in China, handling over 500,000 TEUs, to further expand its freight forwarding capabilities. This transaction will enable our freight forwarding business to further accelerate its growth, thereby providing our customers with an end-to-end services offering.

Through productivity gains and tight cost controls, LF Logistics was able to achieve operating leverage while maintaining organic growth. As a result, the core operating profit of the Logistics Network increased from US$24 million to US$36 million in 2013, with core operating profit margin increasing from 5.9% to 6.8%.

DISTRIBUTION NETWORK

	2013	2012	Change	
	US$mm	US$mm	US$mm	%
Turnover	**6,707.8**	6,435.9	271.9	*4%*
Total margin	**1,611.9**	1,353.2	258.7	*19%*
	24.0%	*21.0%*		
Operating costs	**(1,316.4)**	(1,392.1)	75.7	*–5%*
Core operating profit	**295.5**	(38.9)	334.4	*NA*

The **Distribution Network** is comprised of four operating groups, LF USA, LF Europe, LF Asia (FHBC) and LF Asia (F&H), which cover all major countries across the three continents. The businesses in the Distribution Network operate as wholesale distributors and utilize world class design, brand management, and sourcing to deliver differentiated products to customers.

LF Europe and LF Asia continued to perform well in 2013 while LF USA demonstrated a successful turnaround, and is on track to recover from its restructuring and the discontinuation of certain brands from its portfolio in 2012. Overall, the Distribution Network increased its turnover by 4% to US$6,708 million, while total margin increased by 19% to US$1,612 million and total margin percentage increased from 21.0% to 24.0% as compared to last year. The increase in total margin percentage was due to a recovery of margins at LF USA and an improved product portfolio mix in all three operating regions.

Operating costs decreased by 5% despite investments in LF Asia and new acquisitions made by both LF Europe and LF Asia. Cost reduction was a main focus at LF USA with operating costs decreasing by 14% over last year. As a result, the Distribution Network's core operating profit was US$296 million with a core operating profit margin of 4.4%, as compared to negative US$39 million in 2012.

LF Europe accounted for 24% of the Distribution Network's turnover with the UK and Germany being key markets. Despite the uncertain macroeconomic environment in Europe, the Group's LF Europe wholesale distribution business performed well, with an approximate 13% increase in turnover and 33% increase in total margin as compared to 2012. LF Europe's financial performance benefitted from a number of factors including positive impact from acquisitions made in 2012, market share gains achieved through acquiring new customers, enhanced product and service offerings, and improved performance of our key customers in UK and Germany.

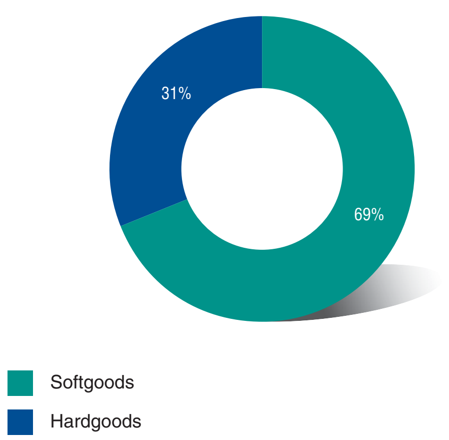
LF Asia accounted for 24% of the Distribution Network's turnover and was successful in maintaining its growth momentum with margin improvement during the period. Compared to 2012, LF Asia achieved a 2% increase in turnover in 2013. The turnover was affected by LF Asia (FHBC)'s reduced exposure to low margin products, as well as LF Asia (F&H)'s sale of the Roots retail business in 2012 and the Roots licensing rights in 2013. Total margin increased by 13% year-on-year, which was attributable to the further build-up of LF Asia as well as a number of small roll-up acquisitions. Since the Group's interim results, LF Asia (F&H) further broadened its geographical coverage, as well as expanded the brand portfolio of its licensing business by adding new licenses and through its acquisition of New Concept in August 2013, its joint venture with Iconix in September 2013, and its acquisition of the distributor of Jeep Kids apparel in October 2013. While we continued to build out our Asia wholesale distribution platform with key retail customer relationships, the Group proceeded cautiously with its region-wide expansion plan in 2013 given the recent slowdown in the China market. Management remains optimistic about the long-term business outlook in Asia.

LF USA continued to be our biggest platform within the Distribution Network, accounting for approximately 52% of total turnover in 2013. Our core strengths at LF USA include our attractive brand portfolio in both licensed and controlled brands, our strengths in design and brand management, and our strong customer relationships with top US retailers. The turnaround of LF USA remained our core focus in 2013 and our efforts are generating positive results. The total turnover at LF USA increased by 2% compared to last year in our brand portfolio despite discontinuing certain brands at the end of 2012. Our brand Frye continued to garner favorable consumer recognition and grew strongly across all distribution channels. Our focus on higher margin products and enhancing our brand portfolio has lifted total margin percentage by 3.4%. This focus, along with implementing measures to reduce operating cost has enabled LF USA's core operating profit margin to recover significantly such that it is on track to return to its 2011 level.

SOFTGOODS, HARDGOODS SEGMENTATION

In 2013, softgoods and hardgoods accounted for 69% and 31% of turnover in our Trading Network, and 46% and 54% in our Distribution Network, respectively.

TRADING NETWORK
– SOFTGOODS / HARDGOODS



Softgoods' overall turnover was flat compared to last year. This was mainly due to the soft consumer market in Europe, which impacted both LF Sourcing and LF Fashion's European business within the Trading Network. This impact, however, was offset by the growth in turnover achieved in our wholesale distribution business in LF Europe within the Distribution Network.

Hardgoods' overall turnover grew by 7%, compared to 2012, resulting from both organic growth and acquisitions. The growth of the hardgoods segment, in particular home and furniture products, benefitted from the start of a US housing recovery in 2013.

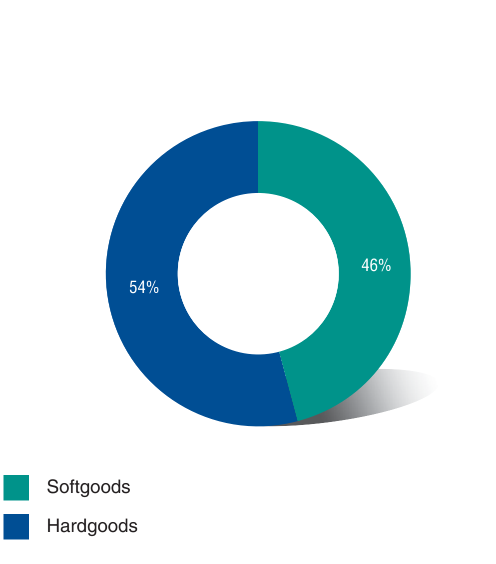
GEOGRAPHICAL SEGMENTATION

Geographically, the **US** continued to be the Group's key export market, representing 62% of total turnover compared to 63% in 2012. The slight decline in percentage of total turnover reflected an increasing diversification of the customer base in Asia and other parts of the world other than the US and Europe.

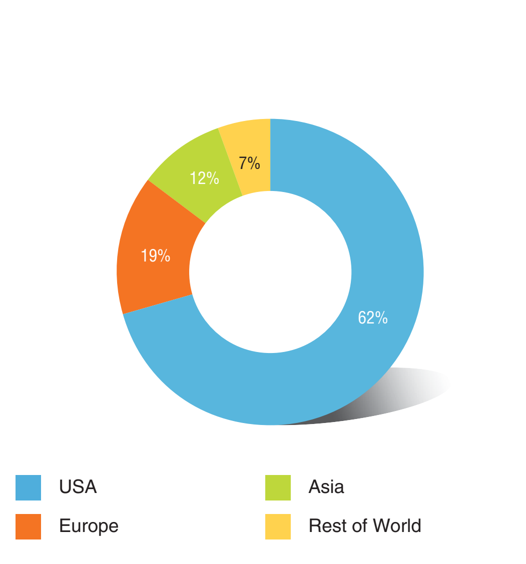
Europe accounted for approximately 19% of turnover, compared to 19% in 2012. In order to shorten lead times, customers in Europe continued to buy more from wholesalers, and less from agents and suppliers, a trend which further advanced LF Europe's wholesale business and enabled the Distribution Network to gain market share in the UK and Germany. On the other hand, the LF Fashion business within the Trading Network was negatively impacted by the overall market sentiment in Europe. Overall, we have seen incremental improvement from the region in the second half of 2013.

Asia accounted for 12% of total turnover, relatively the same percentage of turnover as in 2012. However, total turnover in Asia increased by 5% as compared to last year, of which **China** alone accounted for 7% against 6% last year. The **Rest of Asia** accounted for 5%, compared to 6% in 2012. This reflected the continuing expansion of LF Asia and LF Logistics across China.

DISTRIBUTION NETWORK
– SOFTGOODS / HARDGOODS



GEOGRAPHICAL SEGMENTATION



Turnover in **Canada**, **Australasia**, **Central & Latin America**, and **South Africa & the Middle East** collectively accounted for 7% of total turnover against 6% last year. The increase was largely driven by strong growth in **Canada** and **Australia**.

ACQUISITIONS AND JOINT VENTURE

During 2013, the Group supplemented its organic growth strategy with selected acquisitions and a joint venture to enhance its product and service offerings, expand geographical reach, and further develop its brand and licensing portfolio. The Group completed ten acquisitions in 2013, with an aggregate consideration of approximately US$541 million and annualized turnover of US$557 million. The total consideration for these acquisitions included initial payments of approximately US$202 million, and earn-out and earn-up contingent consideration payables of US$339 million. For accounting purposes, the annualized amortization of intangibles for all acquisitions completed in 2013 approximately US$7 million. Among the acquisitions in 2013, the most significant acquisition was Whalen Furniture in May 2013. In addition to acquisitions, the Group also completed one joint venture with Iconix in September 2013. Further, in January, 2014, the Group acquired The Licensing Company Limited, a global licensing agent in Europe with a portfolio of licensed brands to expand our brand management capability.

ENHANCING PRODUCT/SERVICE OFFERINGS AND EXPERTISE

Name	Business	Strategic Rationale
Whalen Furniture *(May 2013 – Trading Network)*	• A leading furniture and furnishing trading company servicing U.S. mass retailers	• Broadening the product offering and complementing the existing furniture business at LF Products within the Trading Network
Chuan Jui Group *(April 2013 – Logistics Network)*	• A transportation company in Taiwan focusing on hypermarket, consumer and retail channels	• Strengthening the Group's logistics platform in Taiwan with distribution center and local transportation capability
The Licensing Company Limited *(January 2014 – Distribution Network)*	• A global brand management and licensing agent based in UK with a portfolio of licensed brands	• Expanding brand management and license extension capability
China Container Line *(March 2014 – Logistics Network)*	• A sea freight forwarding company handling over 500,000 TEUs per year	• Expanding international freight forwarding capability

DISTRIBUTING BRANDS TO ASIAN MARKETS

Name	Business	Strategic Rationale
New Concept *(August 2013 – Distribution Network)*	• A high-end soft home company with nationwide distribution in China	• Strengthening LF Asia (F&H)'s product offerings in the soft home category and its distribution platform
Iconix SE Asia JV *(September 2013 – Distribution Network)*	• A joint venture with Iconix Brand Group to distribute the company's fashion and home brands in South East Asia	• Broadening our fashion and home brand portfolio and leveraging LF Asia (F&H)'s distribution platform
Jiangsu Soho (Jeep Kids) *(October 2013 – Distribution Network)*	• A licensee and distributor of Jeep Kids brand in China	• Broadening our children wear portfolio and complementing LF Asia (F&H)'s distribution platform

EXPANDING CHARACTERS LICENSE PLATFORM

	Name	Business	Strategic Rationale
	Sicem *(November 2013 – Distribution Network)*	• A leading licensing company specializing in character licenses in Italy	• Strengthening LF Europe's character license platform with new distribution in Italy
	R-Tsion (Scemama) *(November 2013 – Distribution Network)*	• The exclusive sales agent for TV Mania in France	• Strengthening LF Europe's character license platform with new distribution in France

EXPANDING GLOBAL BRAND PORTFOLIO

	Name	Business	Strategic Rationale
	Marvin Krasnow Enterprises Ltd (Aquatalia) *(December 2013 – Distribution Network)*	• A woman's footwear company based in Canada specializing in weatherproof, stain resistant technology in Italian leather and suede	• Strengthening LF USA's footwear business with specialized technology and expanding distribution in Canada

BROADENING GEOGRAPHICAL REACH

	Name	Business	Strategic Rationale
	Four Star Group *(February 2013 – Distribution Network)*	• A leading pharmaceutical and medical device distributor in Macau	• Adding considerable scale to the distribution business at LF Asia (FHBC) in Macau
	Group A Limited *(April 2013 – Trading Network)*	• A U.K.-based point-of-sale business, operating primarily in the beauty sector	• Strengthening the point-of-sale footprint in Europe for the beauty business
	RM Enterprises Group *(June 2013 – Distribution Network)*	• A leading licensing agency for the development and promotion of character licensing in Greater China, South Korea, Japan and South East Asia	• Consolidating our global character licensing distribution platform with immediate access to Greater China, South Korea, Japan and various other territories via the wide range of brand characters in the portfolio

ADJUSTMENTS TO PURCHASE CONSIDERATION PAYABLES

Given the unique nature of the Group's acquired businesses, which are private enterprises relying on entrepreneurs' commercial skills to drive their respective business, the Group generally structures its acquisitions with incentive schemes and contingent payments on purchase consideration payables linking to the future performance of the acquired businesses.

As at 31 December 2013, the Group had outstanding contingent consideration payables of US$1,398 million, of which US$694 million was primarily earn-out and US$704 million was earn-up. The Group follows a stringent internal financial and accounting policy in evaluating potential adjustment to the estimated fair value of purchase consideration payable in accordance with the accounting standard HKFRS 3 (Revised) "Business Combination." The Group's contingent consideration payables are performance based payments in the form of "earn-out" and "earn-up" depending on a set of predetermined performance targets mutually agreed with the entrepreneurs in accordance with the sale & purchase agreement. Earn-out payments are generally payable within three to four years whereas earn-up payments have a higher performance target threshold and are typically payable in a period of up to five to six years upon completion of a transaction.

While many of its acquired businesses remain profitable and are growing, the Group may still be required to make a downward fair value adjustment to certain consideration payable should the acquired businesses be unable to achieve the predetermined performance threshold within the specific timeframe as stipulated in the sale & purchase agreement. Given that the contingent consideration entitlement is usually contractual in nature and is based on a specific formula linking to a particular threshold, the underlying business performance of the acquired businesses could continue to perform and grow, yet the Group may still be required to adjust the consideration payable, especially if the high performance thresholds of earn-ups are not reach.

The Group conducted a detailed review of all the transactions entitled to contingent consideration payments in the form of earn-out or earn-up, and identified five transactions which required adjustment to the fair value of consideration payable, resulting in a corresponding remeasurement gain. The total remeasurement gain of US$187 million for 2013, as compared to US$326 million in 2012, reflected the amount that the Group would no longer be required to pay based on management estimates according to the terms and conditions of the sale & purchase agreement. Similar to the remeasurement gain in 2012, the majority of the adjustment was related to the earn-up portion of the transactions, totaling US$145 million. The Group will continue to perform regular reviews of consideration payable and closely examine potential adjustments in accordance with HKFRS 3 (Revised).

GOODWILL IMPAIRMENT TEST

The Group also performs regular assessments of the acquired businesses to determine any potential permanent impairment for both goodwill and intangible assets according to HKAS 36 "Impairment of Assets". Unlike the assessment of the potential adjustment of consideration payables, which is formula-driven and based on predetermined thresholds during a specific time frame, the goodwill impairment test is conducted based on an assessment of the long-term prospects of the acquired businesses. As such, any goodwill impairment would need to be permanent in nature, when the long-term performance prospects of the acquired businesses no longer generate adequate present value cash flow to support the carrying value of the goodwill and intangibles.

The Group performed goodwill impairment tests based on the cash generating units ("CGU") which manage the acquired businesses in accordance with HKAS 36. Based on the Group's assessment of all of the CGUs under the current operating structure, the Group has determined that there is no goodwill impairment as at 31 December 2013, as the recoverable amount of each CGU was in excess of its respective carrying value of the goodwill. The Group will continue to perform goodwill impairment tests on an on-going basis.

THE NEW THREE-YEAR PLAN (2014-2016)

As we prepare for the new Three-Year Plan, we reflected on our experience over the last three years in navigating through an uncertain and challenging macro environment, internal restructuring, as well as the evolving changes in our industry. In developing this new Plan, we adopted the same approach as in previous Three-Year Plans with establishing a zero base from which to adapt our business model while reflecting and anticipating the future operating and competitive environment. Over the past few years, we firmly established the three business Network model of Trading, Logistics, and Distribution, allowing us to better support our customers and capture a higher market share in the consumer goods supply chain. We have enhanced our design capabilities and ability to manage a nimble supply chain, and also developed a multi-channel sourcing platform to better serve our customers. We also enhanced our product offerings in home furniture and beauty products, optimized our brand portfolio, and gained a stronger foothold in Asia to capture the increasing Asia consumer spend.

In addition to building on those strengths, the structure of our new Three-Year Plan is designed to address several key global themes impacting our industry:

- The deflationary era in China has come to an end, driven by changes in the wage and macroeconomic policies, which means that in the long run, prices are trending upwards. This has accelerated the movement of factories to inland China and to lower cost production countries. The impact of this ensuing shift in the supply chain will take time to play out but it will require that new trusted partners and factories will be needed for our retail and brand customers.

- Due to recent tragedies in Bangladesh, there will be intensified focus on worker safety and factory compliance globally as well as increased demand for high quality, transparent and ethical sourcing.

- The retail industry landscape has changed rapidly. Information technology and social media have ushered in a new wave of consumer behavior by allowing consumers to discover products, engage brands, customize features, and make purchases in different ways than in the past. The increased competition from e-commerce is a major challenge for many of our customers most of whom rely on brick-and-mortar channels. As a result, fast response time and multi-channel supply chain management have become critical success factors for our customers.

Our new Three-Year Plan is structured around Li & Fung's competitive strengths, and is designed to leverage the Group's existing platform and adapt the business model to address the above key global themes impacting our industry, as well as to meet the ever-changing market.

Focus on Organic Growth Across all Areas of the Business: After expanding our global reach, enhancing our range of product offerings, and strengthening key customer relationships in the last three years, the Group is poised to accelerate organic growth among the three interconnected Networks. Our Trading Network has solidified its position as a world leader in multi-channel sourcing, providing good value and high quality products to customers regardless of their buying process and product categories through either agency or principal trading business model. Both the brand owners and retail customers with private brands will continue to need sourcing partners to supply their own brands. Our organic growth strategy is to gain market share from existing customers as they develop and grow their brands, as well as to expand new channels, gain new customers, and develop new product categories.

Extend Value-Added Services to Our Vendors: To support the shifting of vendor base away from the traditional sourcing countries, we have established a new Vendor Support Services unit within the Trading Network to help factories relocate to other countries and to improve operational efficiencies, enhance factory and worker safety, and raise compliance standards in the global supply chain. We recognize the importance of enhanced collaboration with our vendor base to raise compliance standards and improve efficiency of the global supply chain to better serve our customers.

We believe our vendors welcome our skills, expertise, and services to help them tackle the challenges they face and upgrade their operations. Further, as the leading sourcing company in the world, we believe it is our responsibility to play a key role in speeding up systematic, positive change that will improve the supply chain overall. The Vendor Support Services unit will provide services to our vendor base to enhance their competitiveness in terms of product development and technical and operations support, raw material procurement, trade credit services, as well as safety and compliance training and audits. These services are particularly aimed at vendors who seek to move factories to lower cost production countries, and in the process often face challenges in adapting to local regulations, language, worker training, raw material procurement, and logistics. The Group's global presence and established network can assist vendors in setting up sustainable production operations in new, emerging regions. The Group's 15,000 strong vendor base will evolve from being suppliers of products to also becoming customers of the Group for these vendor support services.

The creation of this new business unit is consistent with Li & Fung's commitment to the industry to be a leader in sustainability, worker safety and ethical labor practices. We have taken active leadership roles in recent years to enact change in the industry. We are a founding member of the Advisory Board of the Alliance for the Bangladesh Worker Safety, alongside major North American retailers and brands, and support the European-based Accord on Fire and Building Safety. For both of these important initiatives, Li & Fung was appointed as Advisor.

Solidify our Multi-Channel Sourcing Platform to Meet Customers' Evolving Needs: Customers source their products through multiple channels with different buying patterns to suit their needs. With the increasing importance of e-commerce, the Trading Network is exploring new strategic sourcing opportunities with core retail and brand customers, as well as with e-commerce companies to capture the opportunities from this growing distribution channel. In addition, we are positioning the Trading Network as the sourcing partner of choice for Asian retailers and brands who are increasingly looking for support in designing and sourcing goods for their own domestic and overseas markets. The Logistics platform will continue to focus on footwear and apparel, consumer products, retail, as well as food and beverage verticals, and leverage its unique pick-and-pack logistics to provide in-country logistics services to existing and new customers, and enter additional Asian countries.

Separate Brands and Private Label Businesses in Distribution: The Distribution platform has gained sufficient scale and evolved to become a truly global business and one of the world's largest wholesalers in its product categories. The wholesale distribution business comprises of brands and private labels, which are two distinct businesses with different core competencies requiring specific expertise and management skills. The brand business, which includes a portfolio of licensed and owned brands for sale to wholesalers, retailers, and end consumers, requires expertise in design, brand management and marketing, contrasted with private label business which relies more heavily on sourcing skills.

As part of the new Three-Year Plan, the Group will distinguish private label operations from brand operations globally. We will aggregate our wholesale private label business and our LF Asia non-brand business from the Distribution Network into the Trading Network. By combining the wholesale private label business with our agency and principal trading businesses, the Trading Network will operate as a global multi-channel sourcing platform providing all manner of products and services to customers across all buying channels.

The remaining businesses in the Distribution Network, comprised of owned and licensed brands, will be aggregated under a newly formed Global Brands Group ("GBG"). GBG will leverage its design capabilities, brand management experience and product expertise in multiple categories to create new product extensions and derivative brands for brand owners. GBG aims to provide fully integrated global solutions to enable licensors of international brands to expand into new product categories and new geographical regions. As part of this reorganization, we plan to eventually spin-off GBG as a separately listed entity in order to fully capitalize its growth potential.

In our new Three-Year Plan, the Group will continue to invest in its operating platform and infrastructure, as well as in select areas such as vendor support services and logistics, especially during the early part of the new Three-Year Plan to support organic growth. The new Three-Year Plan targets achieving a standalone core operating profit for the Trading Network that is larger than the entire Group's current core operating profit, a doubling of core operating profit for the Logistics Network and a more than doubling of core operating profit for the Global Brands Group by 2016. While accelerating organic growth as a means to gain market share will be the primary focus, the Group will also continue to pursue strategic acquisitions on a selective basis to boost overall competitiveness. The Group expects the new Three-Year Plan will result in a number of specific benefits to Li & Fung's overall business and will enable the Company to meet several key operating and financial targets, thereby increasing shareholder value.

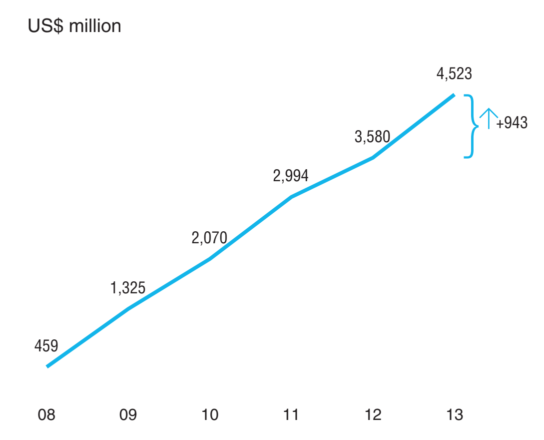
FINANCIAL POSITION

CASH POSITION AND CASH FLOW

The Group operates a cash accretive business, and has a proven track record of utilizing its positive operating cash flow to fund working capital, dividends, interest expenses, capital expenditures and selected small-scale acquisitions. It is normally when we have opportunities for large acquisitions that we seek external funding sources to meet payment obligations.

We started 2013 with a substantial cash balance of US$680 million, with part of the cash being a carry-over from the US$500 million perpetual capital securities issuance in November 2012. A significant portion of proceeds from this capital securities issuance was being earmarked for new acquisitions as well as outstanding contingent consideration payables relating to previous acquisitions as part of our capital structure management.

CUMULATIVE OPERATING CASH FLOW



SUMMARY OF CONSOLIDATED CASH FLOW STATEMENT

	2013 US$mm	2012 US$mm	Change US$mm
Cash and cash equivalents at 1 January	**680**	426	254
Net cash flow from operating activities	**943**	586	357
Investing activities	**(685)**	(763)	78
Financing activities	**(481)**	428	(909)
Effect on foreign exchange rate changes	**3**	3	–
Cash and cash equivalents at 31 December	**460**	680	(220)

Cash flow from operating activities

In 2013, operating activities generated cash inflow of US$943 million, which was a significant improvement compared to US$586 million in 2012 and above our operating cash flow level in 2011. The improved operating cash flow was mainly the result of improved core operating profit and more effective working capital management, in particular the collection of accounts receivable. We also employed a more prudent approach in inventory build-up for our wholesale distribution business, with part of such inventory being supported by the corresponding increase in accounts payable.

Cash flow from investing activities

Cash outflow from investing activities totaled US$685 million, mainly including consideration payments for prior years' acquisitions of US$409 million, new acquisition payments of US$178 million and capital expenditures.

Cash flow from financing activities

In 2013, the Group did not have any major new funding exercises from the capital markets. Financing activities mainly comprised dividend payments of US$332 million, interest expenses and distribution to perpetual capital securities holders resulting in net cash outflow of US$481 million. Both the investing activities and financing activities cash outflow were sufficiently supported by our internally generated operating cash flow as well as cash on hand carried over from the previous year.

As at 31 December 2013, the Group's cash position was US$460 million, compared to US$680 million at the beginning of the year. Given our positive cash flow-generating capabilities, the Group's intention is to maintain only a reasonable cash balance to fund our seasonal working capital needs on an on-going basis.

BANKING FACILITIES

Trade Finance

The Group's normal trading operations are well supported by over US$2.7 billion in bank trading facilities including mainly letters of credit issued to suppliers and bills discounting. A letter of credit is a common means of payment to suppliers to support cross-border trades. The Group's payment obligations on letters of credit issued to suppliers will only be crystallized when our suppliers have shipped the merchandise to our customers or to the Group in accordance with all the terms and conditions specified in the related contractual documents. As at 31 December 2013, only approximately 30% of the bank trade facilities were utilized.

Bank Loans and Overdrafts

The Group had available bank loans and overdraft facilities of US$1.6 billion, out of which US$789 million were committed facilities. As at 31 December 2013, only US$211 million of the Group's bank loans and overdraft facilities were drawn down, with US$117 million being committed facilities. The unused limits on bank loans and overdraft facilities amounted to US$1,373 million, with US$672 million being unused committed facilities.

Bank Loans and Overdraft Facilities as at 31 December 2013

	Limit US$mm	Outstanding US$mm	Unused Limit US$mm
Committed	789	117	672
Uncommitted	795	94	701
Total	1,584	211	1,373

NET CURRENT ASSETS

As of 31 December 2013, the Group's current ratio was 1.1, based on current assets of US$4,298 million and the current liabilities of US$4,082 million, which was consistent with the ratio of 1.1 as of 31 December 2012. Since the previous Three-Year Plan (2008-2010) during which the Group was undertaking fast expansion in its Distribution Network (which required the maintenance of receivables and inventories at certain levels), the current ratio has not seen any significant deterioration. The Group has effective controls in place, with special focus on minimizing its trade receivables and inventories, and at the same time maximizing the use of supplier credit to assist its cash flow.

AVERAGE NET WORKING CAPITAL

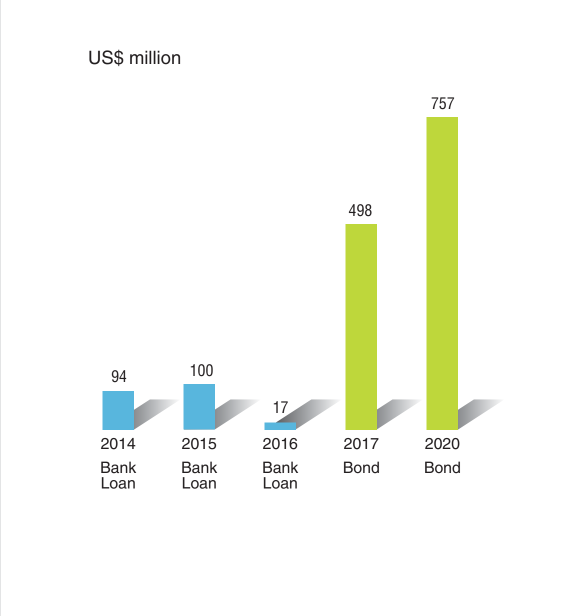
Net Working Capital is defined as total trade and other receivables, as well as inventories, less total trade and other payables. In 2008, the Group's Net Working Capital was US$477 million, with Average Net Working Capital to turnover at 3.5%. Since then the Group has been able to gradually maintain a steady decline in Net Working Capital to approximately US$431 million as at the end of 2013, with Average Net Working Capital to turnover declining to 2.0%.

CAPITAL STRUCTURE

The Group continued to adopt a conservative approach in managing its balance sheet and capital structure with a solid equity base, low gearing, and strong investment-grade credit ratings.

The Group's total equity remained at a solid position at US$5,550 million as at 31 December 2013, compared to US$5,137 million as at 31 December 2012 due mainly to the increase of retained earnings in 2013.

DEBT MATURING DATE



The Group's gross debt was US$1,466 million as at 31 December 2013, consistent with the 2012 year-end balance of US$1,473 million, with maturities spreading out over the next six years. As at 31 December 2013, the majority of the Group's gross debt was at fixed rates. Due to having less cash on hand at the period end, total net debt amounted to US$1,006 million as at 31 December 2013, resulting in a gearing ratio of 15%, which was well below the Group's internal guideline of 35%. The gearing ratio is defined as total borrowings, net of cash, divided by total net debt plus total equity.

As at 31 December 2013, the Group maintained credit ratings from Moody's and Standard & Poor's of Baa1 (stable outlook) and BBB+ (stable outlook), respectively. From a capital structure perspective, the Group is committed to maintaining a solid balance sheet, healthy cash flow and strong credit ratios, with the overall long-term target of retaining an investment grade rating to support our growth.

RISK MANAGEMENT

The Group has strict policies governing accounting control, credit and foreign exchange risk and treasury management.

CREDIT RISK MANAGEMENT

Credit risk mainly arises from trade and other receivables. The Group has stringent policies in place to manage its credit risk with such receivables, which include but are not limited to the measures set out below:

(i) The Group selects customers in a cautious manner. Its credit control team has implemented a risk assessment system to evaluate its customers' financial strengths prior to agreeing on the trade terms with individual customers. It is not uncommon for the Group to require securities (such as standby or commercial letters of credit, or bank guarantee) from a small number of its customers who fall short of the required minimum score under its Risk Assessment System;

(ii) A significant portion of trade receivable balances are covered by trade credit insurance or factored to external financial institutions on a non-recourse basis;

(iii) It has in place a new system with a dedicated team and tightened policies to ensure on-time recoveries from its trade debtors; and

(iv) It has set up rigid policies internally on provisions made for both inventories and receivables to motivate its business managers to step up their efforts in these two areas and to avoid any significant impact on their financial performance.

FOREIGN EXCHANGE RISK MANAGEMENT

Most of the Group's cash balances were deposits in HK$ and US$ with major global financial institutions, and most of the Group's borrowings were denominated in US$.

The Group's revenues and payments were transacted mainly in the same currency, and predominantly in US$. Therefore, the Group doesn't believe there is significant risk exposure in relation to foreign exchange rate fluctuations. There are small portions of sales and purchases transacted in different currencies, for which the Group arranges hedging by means of foreign exchange forward contracts.

While the Group's net revenue is substantially in US$, we are exposed to currency fluctuation on operating costs in sourcing countries such as China, Bangladesh, Vietnam, Korea and India to a certain extent. We manage such foreign currency risks through the following measures:

- From a short-term perspective, we arrange foreign exchange forward contracts for hedging on operating costs in individual countries as and when appropriate; and

- From a medium-to-long-term perspective, we manage our sourcing operations in the most cost-effective way within our global network.

The Group in general does not enter into foreign currency hedges with respect of its long-term equity investment. In particular, the Group's net equity investments in non-US dollar-denominated onshore wholesale businesses under the Distribution Network are subject to unrealized translation gain or loss on consolidation. Fluctuation of relevant currencies against the US dollar will result in unrealized gain or loss from time to time, which is reflected as movement in exchange reserve in the consolidated statement of changes in equity.

The Group strictly prohibits any financial derivative arrangement merely for speculation.

TAX DISPUTE UPDATE

As at the date of this Annual Report, the Group has disputes with the Hong Kong Inland Revenue ("HKIR") Department involving additional tax assessments amounting to approximately US$249 million on both the non-taxable claim of certain non-Hong Kong sourced income ("Offshore Claim") and the deduction claim of marketing expenses ("Deduction Claim") for the years of assessment from 1992/93 to 2012/13.

The Commissioner of the HKIR issued a determination on 14 June 2004 to one of our subsidiaries, Li & Fung (Trading) Limited ("LFT"), confirming additional tax assessments totaling US$43 million relating to the years of assessment from 1992/93 to 2001/02. Based upon professional advice then obtained, the directors believed that the Group had meritorious reasons to justify appealing against the Commissioner's determination. Accordingly, LFT lodged a notice of appeal to the Board of Review on 13 July 2004. The appeal was heard before the Board of Review in January 2006.

The Board of Review issued its decision on 12 June 2009 ("the Board of Review Decision") and held partially in favour of LFT. It agreed that the Offshore Claim for the years of assessment from 1992/93 to 2001/02 is valid. In other words, the relevant assessments in respect of such Offshore Claim should be annulled. On the other hand, the Board of Review disagreed with the Deduction Claim for the years of assessment from 1992/93 to 2001/02. Therefore, the relevant assessments in respect of such Deduction Claim should be confirmed.

The Group considered the reasoning of the Board of Review Decision and, having obtained professional advice, decided to lodge an appeal against the Board of Review Decision in respect of the Deduction Claim.

The HKIR also lodged an appeal against the Board of Review Decision in respect of the Offshore Claim.

On 19 March 2010, the Board of Review stated a case on questions of law in respect of both LFT's appeal on the Deduction Claim, and the HKIR's appeal on the Offshore Claim. On 1 April 2010, both LFT and HKIR transmitted the stated case to the High Court for determination.

The appeal by HKIR in respect of the Board of Review Decision on the Offshore Claim was dismissed by the Court of First Instance on 18 April 2011, which upheld the Board of Review Decision. LFT was also awarded costs of the appeal by the Court of First Instance.

On 16 May 2011, the HKIR lodged an appeal against the judgment of the Court of First Instance to the Court of Appeal, which was heard by the Court of Appeal on 14 and 15 February 2012. On 19 March 2012, the Court of Appeal delivered its judgment. It upheld the judgment of the Court of First Instance, dismissed HKIR's appeal and awarded costs of the appeal of LFT. Any appeal against the judgment of the Court of Appeal to the Court of Final Appeal requires permission of the Court of Appeal or the Court of Final Appeal. As no application for such permission was submitted by the HKIR within the prescribed time limit, the Court of Appeal judgment on the Offshore Claim is considered final.

Regarding LFT's appeal on the Deduction Claim, upon the consent of the parties, the Court of First Instance has remitted the case stated to the Board of Review and directed it to make further findings of fact and to determine certain issues. As at the date of this Annual Report, further directions/decisions from the Board of Review are awaited.

The Group has also filed objections with HKIR against the remaining additional tax assessments of US$206 million. The case before the Board of Review and eventually the Court of Appeal only applies to the additional tax assessments in respect of LFT for the years of assessment from 1992/93 to 2001/02. The Group's dispute with HKIR regarding the remaining additional tax assessments in respect of certain other subsidiaries for the years of assessment from 1992/93 to 2001/02, and in respect of the Group for the period after the 2001/02 assessment years is ongoing and has not yet been determined. Such dispute is therefore not yet before the Board of Review, and no hearing is currently scheduled.

Based on the assessment of the Group's professional advisers on the merits of LFT's further appeal in respect of the Deduction Claim and HKIR's further appeal in respect of the Offshore Claim (which has now been dismissed by the Court of Appeal), and having taken into account the impact and ramification that the Board of Review Decision has on the tax affairs of LFT, the directors consider that no material tax liabilities will finally crystallize and sufficient tax provision has been made in the accounts in this regard.

On 11 June 2010, the Group also applied for a judicial review of the decision of the Commissioner of the HKIR rejecting LFT's application for an unconditional holdover of tax for the year of assessment 2008/09 pending the determination of the objection lodged with the HKIR. The Group purchased tax reserve certificates in respect of LFT for the year of assessment 2008/09 as directed by the Commissioner of the HKIR pending the decision of the judicial review application. As at the date of this Annual Report, the hearing date for the judicial review application is yet to be fixed.

PEOPLE

As of the end of 2013, Li & Fung had a total workforce of 28,210, of whom 4,153 were based in Hong Kong, 9,428 in the Chinese Mainland and 14,629 overseas. Total manpower costs for 2013 were US$1,281 million, compared with US$1,324 million for 2012.

LEARNING AND DEVELOPMENT

Li & Fung has a clear vision and people strategy for long-term business sustainability. The focus is on building employee competencies and strengthening organizational capabilities.

In 2013, over 19,023 employees in 32 locations participated in 1,285 in-house learning programs and collectively over 2.6 training hours per person were provided. We also offered 190 face-to-face, formal learning sessions and 17 e-modules, with 7,597 of our Merchandisers participating throughout the year.