

# Chairman's statement

2014 marks the first year of our current Three-Year Plan (2014-16) which outlines our key strategies to strengthen our position as the world's leading global supply chain manager for consumer goods.

We began implementation of the Plan by successfully spinning-off our brands and licensing business, Global Brands, as a standalone entity. The separation of Global Brands enables the newly listed company to focus on growing its brand business with the support of Li & Fung's global sourcing network, while enabling Li & Fung to continue to leverage on Global Brands's growth as a key customer. We believe the reorganization into two companies operating in distinctly different areas of business will deliver long-term benefits to both Li & Fung and Global Brands as well as to shareholders of both companies.

The Spin-off also highlights Li & Fung's determination to simplify and focus on our core business as a pureplay supply chain management company. As part of this transition, Spencer Fung has assumed the role of Group CEO of Li & Fung, effective July 2014, while Bruce Rockowitz has become the CEO of Global Brands. Spencer, Bruce and the senior management team have worked very closely for many years and the succession planning for this transition has been part of that process. Having spent over 13 years in different parts of our company, and most recently as our Group COO, Spencer has been deeply involved in our business and was instrumental in developing our new Three-Year Plan. He is the fourth generation of the Fung family to lead this great company.

Going forward, Li & Fung will continue to position itself as a pureplay supply chain management company with low volatility, maintaining our dominance in the global consumer goods sourcing arena. Whether a customer wishes to use our sourcing services on a buying agency basis at factory cost plus our commission, or on a principal-to-principal basis FOB country of origin, or on a wholesale basis landed, duty-paid in the customer's country; different operating platforms in Li & Fung's sourcing network will cater to each customers' needs. The same customer may work with us in multiple ways. In addition, our Logistics business offers our customers a complete logistics solution, supporting our customer on an in-country basis or in freight forwarding. I believe we have the right strategy, platform and team in place to lead Li & Fung on the path towards sustainable growth while increasing shareholder value.

## Performance

In the first half of 2014, export market conditions remain challenging despite some improvement in consumer confidence in selected regions. A prolonged winter during the first quarter negatively impacted US retail sales in the first six months of 2014. Economic recovery in the Eurozone showed varied progress and the UK and Germany continued to lead the region while the performance of other European countries lagged. A slowdown in the broader economy negatively affected consumer sentiment in China and various geo-political events in several Southeast Asian countries added to slow down of our business in Asia.



Despite this challenging environment, turnover increased by 3% while our total margin was up slightly at 1%. As with previous Three-Year Plans, the first year is when we invest in people, new initiatives and infrastructure that usually result in an increase in operating costs and this holds true as we gear up to reach our Three-Year Plan targets set for 2016. Hence, core operating profit decreased by 9% to US\$227 million mainly due to those additional investments. Profit attributable to Shareholders (excluding the loss from Global Brands) increased by 45% to US\$210 million and we ended the first half of 2014 with a solid cash balance of US\$544 million. The Board has resolved to declare an interim dividend of 13 HK cents per share (2013 interim: 15 HK cents).

Looking to the second half of 2014, we anticipate that the pace of global economic growth will be tepid, political uncertainties abound and the outlook remains mixed with both challenges and opportunities.

### **Key Challenges and Opportunities**

China, our key production country, is undergoing a major structural reform as it shifts away from an export-driven economy to a more domestic consumption-oriented growth model. Policy driven increases in minimum wage across the country has impacted labor costs in recent years. The consequential shift of production to more remote parts of China as well as to South and Southeast Asia has also begun. However, this shift is slow as new supply chains need to be built and industrial safety and

political events in markets like Bangladesh and Vietnam affected their production in the first half of this year. We expect this production shift to accelerate in the year ahead and Li & Fung is well-positioned to facilitate and benefit from this trend. Our large sourcing network already covers and is well established in all of the alternative markets to China. As production shifts to these countries, we will be supplying factories there with raw materials, primarily and initially from China.

While China, as a market to sell to, will be a huge potential market for Li & Fung in the future, in the near term, there is a slowdown in the broader economy which has negatively affected consumer spending. This trend is reflected in the slower growth recorded by our LF Asia business in the first half. However, our Logistics business in China and throughout Asia continues to grow strongly, increasing market share. The longer term prospect of an expanding middle class in Asia bodes well for both LF Asia and LF Logistics with their pan-Asian footprint.

With global online sales surpassing US\$1 trillion, the ability to integrate online and offline sales channels has become the key differentiator of success for brands and retailers globally. As a key sourcing partner for these brands and retailers, our ability is no longer judged by cost alone, but by a combination of speed, flexibility and services that can adapt to the evolving needs of our customers, characterized by shorter lead times, a more complex assortment of products, and the ability to do more online. We have been helping our existing traditional brand and retail

customers to manage this e-commerce progression, providing them with efficient omni-channel sourcing solutions. E-commerce pureplays are relatively new in the retail market and the majority is still trying to increase customer penetration levels and improve profitability. Some are going in the direction of developing their own private label businesses, and we are starting to help them develop their sourcing. We believe that over time, this sector will grow in importance to us.

In January of this year, we announced a whole new initiative in our relationship with our vendor base. Instead of working with vendors as a part of our customer oriented supply chains, we will treat them as customers in their own right and offer, a whole range of vendor-related services such as procurement support for raw materials and parts, compliance training, risk management, product testing and trade credit services. Our Vendor Support Services business unit has been up and running since the early part of the year to coordinate and consolidate our existing teams under one umbrella. Especially in view of the anticipated migration of production, we are able to offer advice, training and services to assist vendors in achieving required international standards both in terms of upgrading their own capabilities as well as benefiting Li & Fung's business and customers.

## Prospects

Whilst developed markets such as the US and Europe will continue their modest recovery, consumption growth will largely come from Asia, particularly China. Over the next three years, we will devote

our resources to growing our businesses organically, broadening our client base and expanding services to existing customers. By treating our vendor base as an important client, we will build a stronger link for our supply chain and produce an additional revenue stream for the business. Our new freight forwarding platform will complement existing sourcing services and we will focus on enhancing cross-selling and nurturing our Logistics business. Our established business presence and in-depth local market knowledge will best position us to take advantage of the growing affluence across Asian markets.

With our global presence and multi-channel sourcing platform, we are well-equipped to capture opportunities in the value chain. We see tremendous opportunities to win new customers and cross-sell between our operating groups to grow our business. It is a truly exciting time for Li & Fung and we are confident in our ability to achieve the goals that we have set forth in the current Three-Year Plan.

**William FUNG Kwok Lun**

*Group Chairman*

Hong Kong, 21 August 2014





**We connect the supply chain to bring  
our customers the goods they rely on every day.**

