Management discussion and analysis

Business Review

2014 marks the start of a new chapter for Li & Fung (the "Group") as we continue to solidify our leading position in global supply chain management. As set out in our current Three-Year Plan announced in March, we have reorganized our various operating groups in order to set the stage for our next phase of organic growth. The license and brand business of the Group, named the Global Brands Group, was subsequently spun-off via a 100% distribution in specie with a listing on the Stock Exchange on 9 July 2014. Global Brands will continue to be a vital part of Li & Fung, but in a new way as a valuable customer.

The new, simplified Li & Fung Group will continue to build on its core competencies to maintain its dominant market position in consumer product sourcing by effectively managing the complexities of the global supply chain with the complementary capabilities of an expanded logistics business, to provide comprehensive sourcing and logistics solutions to our customers.

Our Business Model

Our business is to provide global sourcing for our key brands and retail customers through our extensive worldwide network of factories and suppliers, producing a diverse range of products from apparel and accessories to furniture and beauty items.

At Li & Fung, we pride ourselves as being the sourcing partner of choice in providing best-in-class sourcing and logistics solutions for brands and retailers. We focus on three attributes to guide our business to create value in services we provide to our customers.

1. *One-stop Shop for Brands and Retailers*

The sourcing supply chains have become increasingly complex over the years. Within this complex environment, Li & Fung simplifies the procurement process by providing comprehensive solutions to manage our customers' entire supply chain, starting from product design and raw materials procurement, to vendor compliance, production monitoring and warehouse logistics, to the final delivery of goods. We have a broad product range, from hardgoods to softgoods, and operate on a produce-to-order basis. We cater to every buying and product sourcing needs of our diverse customer base whether they source under an agency or principal basis, and whether goods are shipped on a free-on-board (FOB) or landed-duty-paid (LDP) basis.

End-to-end Supply Chain Management

2. *Scale and Efficiency*

The demand for shorter lead times and a wider assortment of products, combined with the broad geographic dispersal of production facilities across a large number of emerging markets, has made effective supply chain management a critical priority. For retailers and brands, operating and managing their supply chain is typically not a core competency and requires substantial resources in terms of fixed cost and management time.

Our Group operates on a scale unparalleled to that of any individual customers' in-house sourcing offices. With our global network and extensive local presence in over 40 countries, we are able to realize significant operating leverage and cost savings. Our scale enables us to consolidate orders and procurement decisions, allocate production globally, standardize factory compliance and quality assurance, plan logistics arrangements, and offer our customers the most competitive pricing for their sourcing needs.

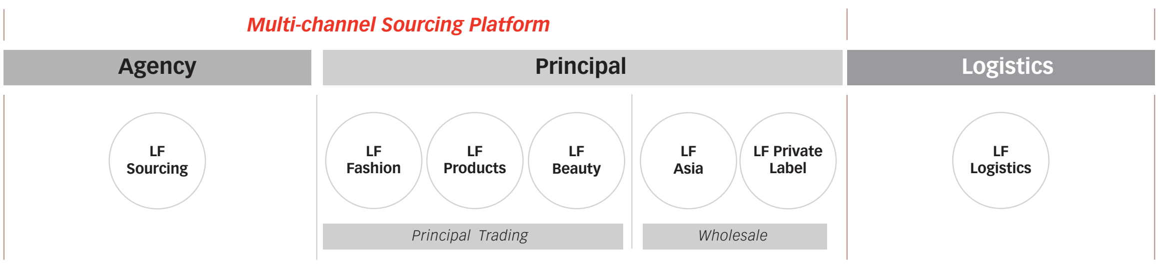
3. *Flexibility and Risk Diversification*

As production is primarily based in emerging markets, the global supply chain is prone to uncertainty and disruption. We witnessed this in the first half of 2014 with the riots in Vietnam and the military coup in Thailand. The Group's flexibility in adapting to the changing needs of the market and our ability to react quickly with solutions to any issues in the supply chain are an important part of the value we bring as a sourcing partner. Our on-the-ground teams, the large amount of transactions we engage in each day and our globally connected systems provide us with valuable insight into market dynamics and real time analysis on the production capacity and the quality of our global network of suppliers. This powerful knowledge and insight support our supply chain planning and management processes, including raw material procurement, order allocation and transfer and distribution of goods, to ensure that we achieve optimal utilization and minimize risks of disruption in each element of the supply chain. Our network provides flexibility and risk diversification in an uncertain world.

Recent Reorganization

Following the spin-off of Global Brands, we are focused on further simplifying our organization. As a result, Li & Fung reorganized its businesses into two Networks: Trading and Logistics. The Trading Network focuses on providing global sourcing solutions for customers' brands on an agency or principal basis, while the Logistics Network encompasses our in-country logistics as well as recently enhanced freight forwarding capabilities.

Together, our two Networks form a multi-channel sourcing platform to serve all of the buying needs of our customers, regardless of whether they are national brands or private labels, require on-shore or off-shore services, or sell via physical retail or e-commerce channels. This platform places us in a unique position to capture additional market share for each of our businesses through our vast global network, product diversity and economies of scale.



Strategy in Action

As we look ahead to our current Three-Year Plan (2014-2016), we believe the following themes will be the key drivers of our growth:

1 Organic Growth | **2 New Geographies and Channel Expansion** | **3 Vendor Support Services**

- *Organic growth:* Through our current platform, we will further strengthen our organic growth initiatives by focusing on gaining new customers and developing additional business with existing customers. We continue to invest in nurturing long-term relationships with our customers to stay ahead of their needs by a deeper understanding of their business challenges and opportunities and supply chain requirements. We try our best to maximize the share-of-wallet of our existing customers by exploring new ideas to improve efficiencies in their supply chain, offering differentiated products and services and developing innovative solutions, such as RFID and customer analytics.

- *New geographies and channel expansion:* Traditionally, Li & Fung's business was centered on Europe and US markets. In the previous Three-Year Plan (2011-2013), we broadened our geographic focus by laying the groundwork to capture growing consumer purchasing power in Asia and other countries. This focus will continue to be an important part of our new Three-Year Plan. In addition, our customers worldwide are facing new challenges and opportunities presented by the growth of e-commerce. Li & Fung is expanding our capabilities to support our customers in this new channel of distribution in both the sourcing and logistics businesses.

- *Vendor Support Services ("VSS"):* Treating vendors as customers will open up a whole new arena of opportunities for Li & Fung in this Three-Year Plan. While VSS already has a potential client base of over 15,000 suppliers that have existing relationships with Li & Fung, our addressable market is essentially the entire global vendor base. Our dedicated VSS teams are devoting considerable resources on the ground to support and upgrade our vendor base to meet the highest standards of sustainability and safety in order to enable their factories to move up the value chain. The services that we provide include safety and compliance training and audits; fabric, trims and accessories procurement; product development; trade credit services; handling of letters of credit; product liability insurance and other technical or operations support. Our aim is to develop a holistic relationship with our existing vendors, deepen our local knowledge and partner with additional vendors in new locations around the world. Our focus on this area will further enhance the overall sustainability of the supply chain. In the long-term, we believe our efforts will increase vendor loyalty, strengthen our supply chain and enhance the quality of service we offer to our customers, all of which creates a win-win situation for every stakeholder in the supply chain.

An important goal of the strategies and initiatives that we are undertaking is to create sustainable value for our Shareholders by focusing on the three key priorities:

1 Generate Free Cash Flow	2 Improve ROIC	3 Return Cash to Shareholders

- Generate free cash flow with lower working capital requirement and decrease payments for acquisition payable
- Improve return on invested capital via organic growth and prioritizing investments
- Return cash to Shareholders by maintaining a high dividend payout policy as well as potentially through other forms

Results Overview

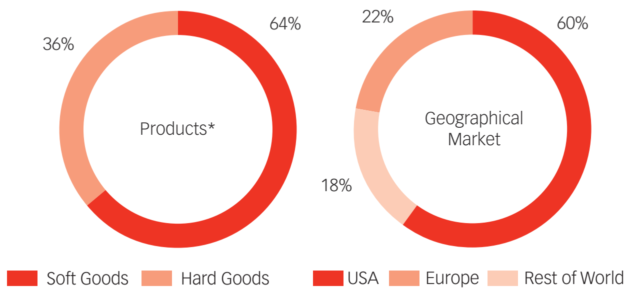
	1H2014 US$m	1H2013 US$m	Change US$m	%
Turnover	**8,710**	8,467	243	*+3%*
Total margin	**995**	985	10	*+1%*
	11.4%	*11.6%*		
Operating costs	**768**	736	32	*+4%*
Core operating profit	**227**	249	(21)	*(9%)*
	2.6%	*2.9%*		
Profit Attributable to Shareholders (ex-Loss from Discontinued Operations)	**210**	145	65	*+45%*
EPS (HK cents)	***19.6***	*13.5*		*+45%*

2014 is a year of transition and investment. We have reorganized our three Networks and completed the spin-off of Global Brands and made investments in our operations to position the Group for organic growth. As Global Brands was spun-off in July 2014, we have restated our financials and reclassified Global Brands as discontinued operations in the interim results of 2014. Our discussion of the results therefore does not include contribution from Global Brands for the six months ended both 30 June 2013 and 30 June 2014.

Li & Fung achieved solid results in the first half of 2014 amidst a mixed economic landscape. We delivered modest growth in turnover and total margin. As with previous Three-Year Plans, the first year is when we invest in people and initiatives that usually result in increase in operating costs as we gear up to reach our Three-Year Plan targets set for 2016. While we are investing in new employees in new markets and services, new offices, and IT infrastructure to support the organic growth in the business over the next three years, the investments will negatively impact our core operating profit in 2014.

Key financial highlights for the six months ended 30 June 2014, as compared to the same period in the previous year, are as follows:

- Total turnover increased by 3% to US$8,710 million on the back of moderate growth in the Trading Network and a 44% increase in turnover in the Logistics Network
- Total margin was largely stable and increased by 1% to US$995 million, due to softness in our Principal business
- Core operating profit decreased by 9% to US$227 million, and core operating profit margin decreased from 2.9% to 2.6%, mainly as a result of strategic additional expenditure on people, infrastructure and service initiatives geared towards delivering on the full Three-Year Plan
- Profit attributable to Shareholders (excluding results from discontinued operations) increased by 45% to US$210 million, which included a non-cash gain of US$98 million on the write-back of contingent considerations



* Turnover of Trading Network only

For the six months ended 30 June 2014, the Trading Network accounted for 96% of the Group's turnover and 92% of core operating profit. Softgoods and hardgoods accounted for 64% and 36% of the Trading Network's turnover respectively.

Geographically, the US continued to be the Group's key export market, representing 60.0% of total turnover and up slightly from 59.6% in the same period last year. Overall US turnover grew by 3.5%, mainly driven by the strong growth in retail sales of key customers in home furniture and kids wear products. Europe stayed flat at 18.2% of total turnover (versus 18.0% in first half 2013) with turnover growing by 4.2% as compared to last year, leveraging on the growth of the European business of Global Brands.

Rest of world accounted for 21.8% of total turnover (versus 22.4% in first half 2013). Asia accounted for 13.6% of total turnover, slightly down from 14.3% in the same period last year. China alone accounted for 7.8% against 8.2% last year, mainly from the slower growth in the wholesale business in the first six months of the year, but this was offset by new customer wins in our Trading business and contribution of our new freight-forwarding acquisition. The rest of Asia accounted for 5.8% of total turnover down from 6.1% in the first half 2013 due to the slower growth of the region combined with political uncertainties in Thailand in the first half. Turnover percentage in the rest of the regions remained flat at 8.2% (versus 8.1% in first half 2013) as Canada, Australasia and Central and Latin America continued to deliver steady growth from their respective underlying economies whilst South Africa and Middle East reported a decline.

As part of our current Three-Year Plan reorganization, Li & Fung has begun investing in resources and operating expenses for Vendor Support Services, as well as for new products, services and infrastructure to drive the geographic expansion of our operating groups. We have also incurred one-time reorganization costs relating to redundancies and asset write-offs to formulate our current multi-channel sourcing platform and facilitate the spin-off of Global Brands.

The first half of 2014 was characterized by a general weakness in retail sales and uncertain political and macroeconomic conditions. The outlook of our key markets, US and Europe, continues to be uncertain and we expect market conditions to remain challenging. We have witnessed customers buying closer and closer to the season. While we have good visibility in back-to-school and early holiday season orders, we have less visibility in Q4 and Spring season orders. Most customers are delaying order decisions until they get better indications about consumer confidence in Q3. Furthermore, the recent Russia and Ukraine crisis has reduced foreign travel by Russian nationals, which is starting to impact the European retail markets favored by Russian tourists. This development is still in the early stages and we are monitoring the situation carefully. In China, which remains Asia's most important economy, the government's focus on fighting corruption and its pull back on being an export driven economy is impacting consumption in the short term. However, we still see ample opportunities in this market over the long term. In the second half of 2014, we will continue to focus our efforts on capturing market share and new customer wins to provide catalysts for further strengthening our business. At the same time, we will continue to implement our plans for organic growth and invest in key strategic areas to support our Three-Year Plan.

Strong Liquidity Profile

Li & Fung relies on a strong and stable cash flow conversion business to fund its working capital, dividends, interest expenses and capital expenditures.

As disclosed in our 2013 annual consolidated results, we started this year with a cash and bank balances of US$460 million. Excluding the US$115 million cash and bank balances belonging to Global Brands, the pro forma cash and bank balances for the Group was US$344 million at the beginning of 2014. Our cash balance rose by US$199 million to US$544 million by the end of June 2014 mainly due to:

- Operating cashflow of US$201 million, which is in line with core operating profit after tax payments
- Capital expenditure and acquisition-related payments of US$143 million, including consideration payable for previous acquisitions and new acquisitions such as China Container Lines
- US$594 million shareholders' loans repayment from Global Brands, offset by capital injection of US$15 million to Global Brands
- Dividends paid for the 2013 financial year final dividend of US$367 million
- Interest expenses paid and distribution to perpetual capital securities holders of US$66 million

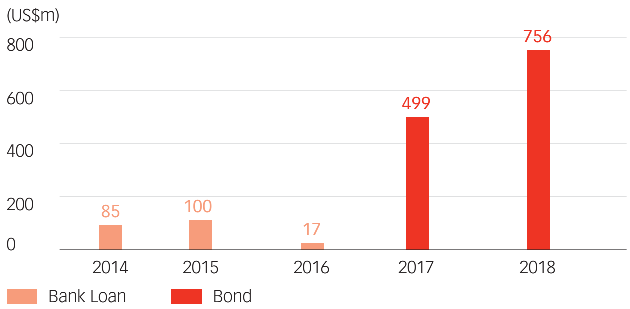
As of 30 June 2014, we have available bank loans and overdraft facilities of US$1,618 million, out of which US$202 million were drawn down. The unused limits amounted to US$1,416 million, with US$704 million being unused committed facilities.

Given that our priority to return cash to Shareholders and that we have the ability to generate positive cash flow, the Group's approach is to maintain a reasonable cash balance only at a level to fund seasonal working capital needs on an on-going basis. Hence, we have proposed an interim dividend of 13 HK cents per share (or US$139 million in total) and shall explore additional options of distributing cash to Shareholders.

Solid Balance Sheet

Our financial position remained strong with a cash position of US$544 million, and a decrease in the Group's net debt (total borrowings minus cash) from US$1,006 million as of 31 December 2013 to US$913 million as of 30 June 2014. The Group's gross debt was US$1,457 million as of 30 June 2014, with a weighted average tenor of over 4 years. The majority of our debt is at a fixed rate and denominated in US dollars.

Below is the debt maturity profile of the Group as of 30 June 2014:



Our net gearing ratio as stated in the unaudited consolidated balance sheet was 15% as of 30 June 2014 (versus 15% as of 31 December 2013). If we assumed that the spin-off and distribution of Global Brands had occurred on 31 December 2013 or 30 June 2014, our total equity would decrease to US$3,177 million or US$3,024 million respectively. Our pro forma net debt would be US$1,119 million as of 31 December 2013 and US$913 million as of 30 June 2014. Our pro forma net gearing would be 26% as of 31 December 2013 and 23% as of 30 June 2014.

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. As at 30 June 2014, the Group maintained credit ratings from Moody's and Standard & Poor's of Baa1 (stable outlook) and BBB+ (stable outlook) respectively.

Network Segmentation

Following our reorganization, Li & Fung is now structured into two Business Networks:

Trading Network

The Trading Network comprises our agency, principal trading and on-shore wholesale businesses.

Our Agency business is the Group's core business and continued to be the biggest turnover contributor in the first half of the year. LF Sourcing, the sole operating group under the Agency business, enters into long-term strategic buying agreements with customers and oversees and manages the entire global sourcing process. This provides customers with full transparency and control in their supply chains.

Our Principal business is organized into Principal Trading, which is comprised of three operating groups, LF Fashion, LF Products and LF Beauty, and Wholesale, which is comprised of LF Asia and LF Private Label. This structure allows for a greater degree of product specialization within our team and closer alignment with the needs of our customers. Depending on customers' requests, we are able to act as a wholesaler (deliver products to countries on an on-shore basis) or as a principal (customers trade at sourcing countries on FOB basis), always providing customized end-to-end and value-added services in either arrangement. Irrespective of the arrangement, customers rely on our extensive product knowledge and deep expertise to manage their supply chains.

	1H2014	1H2013	Change	
	US$m	US$m	US$m	%
Turnover	**8,369**	8,232	137	*+2%*
Total margin	**893**	894	(1)	–
	10.7%	*10.9%*		
Operating costs	**685**	660	24	*+4%*
Core operating profit	**208**	234	(26)	*(11%)*
	2.5%	*2.8%*		

From a geographical perspective, the US represented approximately 62% of the Trading Network's total turnover, with Europe and Rest of World representing 18% and 20%, respectively.

In the US, total turnover increased by 3.5% as LF Products' home furniture business benefitted from a recovering US housing market; however this was offset by the lackluster demand in fashion and apparel products in our US on-shore wholesale business. Total turnover in Europe increased by 2.1% as we continued to see a mild recovery in the UK and Germany. Total turnover in rest of the world decreased by 4.0% as LF Asia faced an economic slowdown in China and political disruption in Thailand.

Following completion of the reorganization, management is able to refocus on delivering organic growth and reaping the synergistic benefits of product development and cross-selling in the second half of this year. In first half of 2014, we started a number of new sourcing deals with major customers in the US and achieved new customer gains via cross-selling. For instance, LF Asia secured the China on-shore distribution business for Coty, which is a key customer of LF Beauty, despite an economic slowdown in China.

Total margin for the Trading Network was flat and percentage to turnover remained similar at 10.7% (first half 2013: 10.9%). Operating costs increased year-on-year to US$685 million, mainly from the full period operating costs of Whalen Furniture, which we acquired in May 2013, and the increase in investments in human resources and product development capabilities in our Principal Trading and Wholesale businesses to provide holistic solutions to our customers. We also invested in resources for our Vendor Support Services as a medium to long-term strategy to improve our operational efficiencies and supply chain sustainability. The 11% decline in core operating profit to US$208 million, representing a decrease of US$26 million from the same period last year, was mainly attributed to the above reasons.

The Group maintains a global Trading Network covering more than 40 economies, which allows for flexibility when 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, with 91% and 99% being softgoods respectively.

Logistics Network

The Logistics Network comprises our in-country logistics and freight forwarding businesses.

In-country logistics offers Asia-focused in-country logistics solutions and specializes in key verticals, namely footwear and apparel, fast-moving consumer goods, retail and food and beverage.

Freight forwarding offers cross-border logistics services at origin and destination to supplement our in-country logistics solutions. The scale of this business has increased significantly subsequent to the acquisition of China Container Line, a leading sea-freight forwarder in China, in first half of 2014.

	1H2014	1H2013	**Change**	
	US$m	US$m	US$m	%
Turnover	**349**	243	106	*+44%*
Total margin	**102**	90	12	*+13%*
Operating costs	**84**	76	7	*+10%*
Core operating profit	**19**	14	4	*+31%*
	5.3%	*5.9%*		

In the first half of 2014, the Logistics Network continued to demonstrate robust growth with a 44% increase in turnover and a 31% increase in core operating profit compared to the same period in 2013. This strong set of results comes from organic growth through new business wins and cross-selling across Networks, as well as from the acquisition of China Container Line. For first half 2014, 43% of the turnover was from China, 36% of the turnover was from the rest of Asia, and 21% of the turnover came from the rest of the world.

Core operating profit increased by 31% while core operating margin declined from 5.9% to 5.3% as a result of the acquisition of China Container Line. Compared with our existing in-country logistics business, freight forwarding has a lower operating margin in line with the industry.

The successful integration of the newly acquired freight forwarding business will accelerate the growth of the logistics business and provide synergies with the rest of our businesses. This in turn should benefit the Group in terms of both revenue growth and profitability. We will sustain our organic growth momentum supplemented by strategic acquisition in freight forwarding.

Discontinued Operation – Global Brands

With the spin-off of Global Brands, its first half 2014 results have been reclassified to discontinued operations. Global Brands' business, cash flow and profitability are typically skewed towards the second half of the year due to the impact of seasonality on its distribution business. With the increase in operating expenses associated with the launch of new brands in the second half of 2014, as well as costs incurred in relation to the reorganization and listing, Global Brands recorded a loss of US$98 million for the six months ended 30 June 2014, as compared to a loss of US$49 million for the first half of 2013.

Contingent Liabilities and Goodwill

Adjustments to Purchase Consideration Payables

Given the unique nature of the Group's acquired businesses, which are private enterprises relying on their respective entrepreneurs' commercial skills to drive their success, 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.

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 over a period of up to five to six years upon completion of a transaction. As at 30 June 2014, the Group had outstanding contingent consideration payables of US$683 million, of which US$492 million was primarily earn-out and US$192 million was earn-up.

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 reached. For the six months ending 30 June 2014, there was approximately US$98 million of write-back of contingent considerations.

Goodwill Impairment Tests

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 of 30 June 2014, 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.

Banking Facilities

Trade Finance

The Group's normal trading operations are well supported by over US$2,600 million 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 of the terms and conditions specified in the related contractual documents. As at 30 June 2014, approximately 34% of the bank trade facilities were utilized.

Bank Loans and Overdrafts

The Group (excluding the Global Brands) had available bank loans and overdraft facilities of US$1,618 million, out of which US$821 million were committed facilities. As at 30 June 2014, US$202 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$1,416 million, with US$704 million being unused committed facilities.

Bank Loans and Overdraft Facilities as of 30 June 2014:

	Limit US$m	Outstanding US$m	Unused Limit US$m
Committed	821	117	704
Uncommitted	797	85	712
Total	1,618	202	1,416

Net Current Assets

As the spin-off and listing of the Global Brands was completed on 9 July 2014, its assets and liabilities were recorded as "assets held for distribution" and "liabilities held for distribution" in our balance sheet and amounted to US$4,795 million and US$2,029 million respectively as of 30 June 2014.

Our current ratio as stated in the audited consolidated balance sheet was 1.1 as of 31 December 2013. Assuming the Spin-off and distribution occurred on 30 June 2014, the Group has a pro-forma current ratio of 1.0. The pro-forma current ratio is calculated based on current assets of US$3,685 million (including US$478 million trade receivable from Global Brands arising from our sourcing arrangement with them) and the current liabilities of US$3,613 million.

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:

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

- A significant portion of trade receivable balances are covered by trade credit insurance or factored to external financial institutions on a non-recourse basis;
- A new system with a dedicated team and tightened policies has been established to ensure on-time recoveries from trade debtors; and
- Rigid internal policies which govern provisions made for both inventories and receivables are in place to motivate 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 are deposits in HK$ and US$ with major global financial institutions, and most of the Group's borrowings are denominated in US$.

The Group's revenues and payments are transacted mainly in the same currency, and are predominantly in US$. Therefore, the Group does not 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 fluctuations 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 possible within our global network.

The Group in general does not enter into foreign currency hedges with respect to its long-term equity investment. In particular, the Group's net equity investments in non-US$ denominated on-shore wholesale businesses are subject to unrealized translation gain or loss on consolidation. Fluctuation of relevant currencies against the US$ 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 Report, the Group has disputes with the Hong Kong Inland Revenue Department ("HKIR") involving additional tax assessments amounting to approximately US$251 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 Report, further direction and decisions from the Board of Review are awaited.

The Group has also filed objections with HKIR against the remaining additional tax assessments of US$208 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 Report, the hearing date for the judicial review application is yet to be fixed.

People

As at 30 June 2014, Li & Fung had a total workforce of 28,793. Excluding Global Brands, we have a total of 25,797 employees, of whom 6,439 are warehouse operations employees. In terms of geography, 4,078 employees were based in Hong Kong, 9,402 were based in Mainland China and 12,317 were based overseas.

Total manpower costs excluding Global Brands for the first half of 2014 were US$479 million, compared with US$435 million for the first half of 2013.