

## A Letter from Our Chairman

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We are at the mid-point of our transformative Three-Year Plan.

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Dear Shareholders,

This interim results report carries particular significance because we are mid-way through one of the most interesting three-year plans in Li & Fung's history. Creating the supply chain of the future demands a fundamental transformation of mindset and way of working, not only from us, but also from our customers and all stakeholders along the supply chain. While our business is morphing, seismic shifts are occurring in our ecosystem, coupled with cyclical economic and geopolitical turbulence, and all these changes reinforce each other's impact. Steering a business during a time of exponential change is never easy but our commitment is unwavering. While we create the supply chain of the future and future-proof our business, we are also countering traditional economic and geopolitical turbulence with our tried and true model of a flexible and global sourcing network.

### **Economic Recovery and Geopolitical Risks**

Our biggest market, the United States, continued to report strong economic growth in the first half of 2018 and is now in its second-longest economic expansion in history. The national unemployment rate improved steadily, dipping below 4% in April for the first time in nearly two decades, and the job creation figure exceeded economists' forecasts. The inflation rate has been edging up steadily year-to-date and the expectation is that the Fed will continue its rate hike cycle.

Growth in Europe eased slightly from the strong momentum we saw last year. However, the recent currency turmoil in Turkey may present a risk to this steady growth trajectory and the deadline for Brexit and pressure to reach an agreement between the United Kingdom and European Union will intensify closer to the date. These uncertainties will pose higher headline risks and have a negative influence on economic and consumer sentiment.

China has concerns over a heated housing market and potential disruption from trade conflict with the US, but the country has maintained a steady growth rate in the first half of the year and continued to grow its ever-increasing middle class market.

The Korean peninsula crisis that put the world at the brink of war a year ago moderated significantly as North Korea has started striking a more reconciliatory tone towards the US after the Singapore summit in June. However, while the risk of major military conflicts in East Asia has abated, tension in other hotspots like the Middle East may potentially pressure oil prices upward, which will translate to higher raw material and transportation prices for consumer goods.

### **Trade Agreements and Tariffs**

Negotiations over Brexit and NAFTA Modernization, both initiated in 2017, remain a work-in-progress. The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), a reincarnation of the Trans-Pacific Partnership after the US withdrawal, was signed in March but less than half of the partner countries have ratified the agreement. Meanwhile the Transatlantic Trade and Investment Partnership (TTIP), once held back by trade tension between Europe and the US, recently regained momentum. We believe these negotiations are part of a complex process of global trade realignment and may take years to conclude.

At the center stage of all this is the friction between China and the US. The recent escalation of tension casts further uncertainty over tariffs and the barrier to entry for products on both sides. We do not know when the two governments will resolve their differences. The need for contingency plans by our customers has clearly become more pressing and we are confident that our traditional comprehensive network of suppliers in over 50 economies provides the best cushion against any potential shock to



the supply chain. Furthermore, as a company with a long history, we have a successful track record of operating under turmoil from protectionism and are already helping our customers reconfigure their production bases to weather this present storm.

## Evolution of China's Place in Global Trade

Regardless of the outcome of the ongoing US/China trade negotiations, decanting of low-value added production away from China will continue because of multiple drivers. First of all, the demographic shift in China is shrinking its working population and pushing labor costs higher. Coupled with the tense relationship with the US, the Chinese government is encouraging its labor-intensive manufacturers to move overseas and re-orient the economy towards a domestic consumption, service and technology-led growth model. This economic evolution will contribute to an increasing middle class and consumption, which will have far-reaching implications for intra-Asia trade and logistics. While we continue to cultivate new customers in our traditional markets and help customers mitigate impact from any trade war, we are focused on capitalizing on this long-term trend in China, in particular, and in Asia in general.

## Omni-Channel Development

Consumer trends and changes have accelerated and spread globally. Consumer expectation has changed permanently and businesses are deriving tangible value from being omni-channel. E-commerce is more than just a retail format, it is also an enabler for data analytics on consumer behavior that leads to more accurate prediction of consumer taste and purchases.

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The new norm for retail calls for a new supply chain paradigm that is characterized by quicker turnaround, more frequent, but smaller, orders and leaner inventory. Li & Fung is proactively reshaping its supply chains and will continue to lead the change. A by-product of this transformation is multi-year destocking by brands and retailers. We are addressing the headwinds from this destocking trend with sharper focus on converting new business. An even more strategic focus is on building and aligning our core competencies with the most adaptable and innovative customers who we believe will emerge as winners in the current retail reshuffling.

## The Supply Chain of the Future

When we launched the current Three-Year Plan, the supply chain of the future was an ambitious vision. Today, the vision is materializing and our services are generating tangible benefits for our customers. For the rest of the Three-Year Plan, we expect more partners to join our efforts in transforming the retail supply chain and our digitalization efforts will accelerate. I am grateful to our colleagues, our customers and our suppliers for their open minds, perseverance and patience as together we continue to turn our vision of the supply chain of the future into a reality.

Yours sincerely,

**William Fung Kwok Lun**  
Group Chairman