MANAGEMENT DISCUSSION AND ANALYSIS

RESULTS REVIEW

This is the first year of the Group's 2008-2010 Three-Year Plan. The two main components of the new Three-Year Plan are the targets of achieving a turnover of US$20 billion and a Core Operating Profit of US$1 billion by 2010. The Group is very pleased to report that we have made good progress in line with the Plan's targets. Turnover increased by 25% to US$6,076 million for the first half of 2008, reflecting Li & Fung's solid organic growth coupled with contributions from acquisitions made the previous year. The Group is also delighted to report that it has executed a number of key outsourcing deals and acquisitions during the first half of the year.

Core operating profits increased by 30% as a result of better market penetration and contributions from earlier acquisitions. Core operating margins increased slightly to 3.23%, mainly because of the higher margin businesses in the US that were acquired last year (e.g. Regatta and American Marketing Enterprises).

Profit attributable to shareholders reached HK$1,238 million for the first half of 2008, an increase of 18% over 2007.

Despite continued weak consumer sentiment throughout the first half of 2008, Li & Fung continued to perform well. Its scale and flexibility enabled the Group to gain market share in the markets where we operate.

The Group has successfully closed a number of key outsourcing deals in the first half of 2008, reflecting the continuing trend for customers to focus on their core competencies and outsource their sourcing operations to specialists like Li & Fung. Outsourcing deals were signed in the first half of 2008 with Toys"R"Us, Sanrio, Timberland, Kellwood and others.

The Group's total margins increased by 34% and, as a percentage of turnover, saw an increase from 10.81% to 11.50% in first half of 2008. These improved figures reflect the positive impact from our higher margin US onshore business.

SEGMENTAL ANALYSIS

For the first half of 2008, softgoods and hardgoods accounted for 70% and 30% of turnover respectively. **Softgoods** turnover increased by 24% while operating profit increased by 28%. The improvement reflects positive contributions from the 2007 acquisitions and outsourcing deals, which increased our addressable market.

Turnover and operating profit from the **hardgoods** business grew by 29% and 43% respectively.

The **US** market continues to be the Group's key export market, representing 60% of the Group's total turnover during the period under review, a fall from 68% in the first half of 2007. This reflects our continued success in diversifying geographically into Europe. Turnover and operating profit grew by 12% and 28% respectively, caused by our success in increasing our market through our active involvement in the proprietary brand business, in addition to our core private label business.

Europe's share of our business saw a significant jump from 23% to 30% in the first half, reflecting a growth of 68% over the same period last year. Operating profit grew by 45%. This strong growth is driven by a significant increase in business with the Arcandor Group and Tommy Hilfiger's European business.

Other markets such as **Canada, Central and Latin America**, and **Australasia** accounted for 3%, 1%, and 3% of total turnover. Growth in turnover in those markets was 16%, 19%, and 28%, and in operating profit was 13%, 14% and 10% respectively. The Group will continue to grow in these smaller markets where we have dominant positions. **Japan** and the rest of the world represents a turnover share of 2%; turnover and operating profit there grew 32% and 27% respectively.

OUTSOURCING DEALS

As expected in this weak economic environment, we have seen a flow of new outsourcing deals enter our system so far this year. Outsourcing deals were concluded with Toys“R”Us, Sanrio, Timberland, Kellwood and others.

In April 2008, the Group executed an outsourcing transaction with Toys“R”Us – Delaware, Inc to become their key supplier for its private label programme. Also, in April 2008, the Group executed an outsourcing deal with Sanrio Co., Ltd (owner of the Hello Kitty brand). This is expected to deliver synergies with our overall sourcing capabilities for the Japan market, as well as our development effort on Sanrio products.

In June 2008, the Group entered into an outsourcing deal with Timberland. This deal, combined with our global structure and vendor base, provides a great platform for us to grow the apparel business. In the same month, the Group also executed an outsourcing deal with Kellwood Holding Corp.

ACQUISITIONS

The Group has continued to pursue its two-pronged acquisition strategy to further its product offer and geographical diversification. With that, we have made five smaller, roll-up acquisitions and one large acquisition so far this year.

The Group increased its presence in the better priced fashion label arena by acquiring the Silvereed Group in February 2008 and Wilson & Wong Trading Company Limited in July 2008. Both are based in Hong Kong and are “virtual manufacturers” with focus on design and product development of ladies fashion garments. These deals will add a new portfolio of fashion customers for us.

The Group also continued to strengthen its capabilities in the Health, Beauty and Cosmetics (“HBC”) sector by acquiring Imagine in January and RT Sourcing in July 2008. Imagine is one of the leading companies in Asia designing and developing point-of-sale displays for retailers and manufacturers globally. RT Sourcing is a sourcing and development company that specializes in primary packaging and components for beauty brands and full service beauty products for retailers. With the addition of these two companies, the Group has greatly enhanced its capability to provide products in the HBC sector to brands and retailers alike.

In April 2008, the Group continued to further our US onshore business by acquiring the trademark and assets relating to the T-Shirt licensed business of Giant Merchandising. The transaction helps to provide further category and brand expansion in our licensed products business.

On 13 August 2008, Li & Fung announced that it has entered into an agreement to acquire all of the assets of Van Zeeland, Inc., a leading New York based importer of mid-tier and department store handbag brands including its flagship labels Kathy Van Zeeland Handbags, B. Makowsky and Tignanello. These brands are available in more than 1,300 retail locations including Macy’s and JC Penney. The purchase price was approximately US$330 million (HK$2,574 million) with additional incentives based on company performance. This acquisition will significantly strengthen the Group’s presence in the fashion accessories market and will establish Li & Fung as the leading handbag supplier in the US across all retail distribution channels. Kathy Van Zeeland and Bruce Makowsky will remain co-presidents of the Van Zeeland businesses.

The Group is consolidating the back offices of these acquired companies for integration into the Group’s under proper internal control and management systems.

PROGRESS ON THREE-YEAR PLAN 2008–2010

In March 2008, we announced our new Three-Year Plan. Specific targets to be achieved by the end of 2010:

i) a turnover of US$20 billion,

ii) a Core Operating Profit of US$1 billion, and

iii) operating leverage of doubling Core Operating Profit percentage growth over turnover percentage growth (i.e. 2x).

Although the new Three-Year Plan began against a backdrop of soft consumer markets and tensions between the US and China over product quality issues, the Group is pleased to report a strong flow of orders to date, that sets us firmly on track with the Plan.

Our newly acquired businesses such as CGroup, PB Beauty and Regatta have been fully integrated. Solid progress has been made on building the health, beauty and cosmetics platform and generating synergies with existing customers. Similar progress can be seen in both the proprietary brand businesses and the footwear business. In addition, we are progressing our plans to replicate the onshore business model in Europe, so it can become another engine of growth.

In addition, under the Three-Year Plan, the Group continues its two-pronged strategy of pursuing both large and small acquisitions to augment and complement our organic business growth.

FINANCIAL POSITION AND LIQUIDITY

The Group continued to be in a strong financial position for the half-year under review with cash and cash equivalents amounting to HK$1,361 million at the end of June 2008.

Normal trading operations were well supported by more than HK$19,640 million in bank trading facilities. In addition, the Group had available bank loans and overdraft facilities of HK$3,352 million, out of which HK$2,216 million was utilized.

At balance sheet date, the Group's gearing ratio was about 32%, calculated as net debt divided by total capital. Net debt of HK$4,615 million is calculated as total borrowings (including short-term bank loans of HK$1,341 million, long-term bank loan of HK$768 million and long-term notes of HK$3,867 million) less cash and cash equivalents of HK$1,361 million. Total capital is calculated as total equity of HK$9,617 million plus net debt. The current ratio was 1.2, based on current assets of HK$19,499 million and current liabilities of HK$16,699 million.

IMPACT OF CHANGES IN ACCOUNTING STANDARDS

Certain new interpretations to accounting standards have become mandatory for the first time for the financial year beginning 1 January 2008. However, these new interpretations are currently not relevant and have no impact on the Group.

FOREIGN EXCHANGE RISK MANAGEMENT

Most of the Group's cash balances were deposits in HK$ or US$ with major banks in Hong Kong, and most of the Group's assets, liabilities, revenues and payments were held in either HK$ or US$. Therefore, we consider that the risk exposure to foreign exchange rate fluctuations is minimal.

Foreign exchange risks arising from sales and purchases transacted in different currencies is managed by the Group treasury, with the use of foreign exchange forward contracts.

CAPITAL COMMITMENTS AND CONTINGENT LIABILITIES

At the date of this announcement, the Group has a long-running dispute with the Hong Kong Inland Revenue Department related to the non-taxable claims of certain non-Hong Kong sourced income and the deduction of certain marketing expenses of approximately HK$1,288 million for the years of assessment from 1992/1993 to 2006/2007. The disputes were initiated in 1999 and have been disclosed in our annual reports since that year. The Group has been working with its accounting and legal advisors in respect of its dealings with the Hong Kong Inland Revenue Department in relation to these matters. A hearing of the disputes was held before the Board of Review in January 2006 but as at the date of this announcement, the result is not yet known.

The structure of the Group's offshore sourcing and marketing activities was established at the time of the Group's re-listing on the Hong Kong Stock Exchange in 1992, when the Group sought advice from its external professional advisors. The directors consider that sufficient tax provision has been made in the accounts in this regard and no additional material tax liabilities are expected to eventuate.

Other than the above, there are no material contingent liabilities or off-balance-sheet obligations.

HUMAN RESOURCES

At the end of June 2008 the Group had a total workforce of 14,164 of whom 3,703 were based in Hong Kong and 10,461 were located overseas. The Group offers its staff competitive remuneration schemes. In addition, bonuses and share options are also granted to eligible staff based on individual and Group performance.

The Group is committed to nurturing a learning culture in the organization. Emphasis is placed on training and development as the Group's success is dependent upon the efforts of a skilled and motivated workforce. Training programs have been developed to align with the profiles of different job levels and functions. There are different series of training programs in place including: the Management Development Series, Professional Development Series and Supervisory Skills Series focusing on management skills training for managerial and frontline staff; the Functional Competency Training Series focusing on the technical skills training for merchandising and quality assurance functions; and Language Training for all staff. A Global Induction Programme has been developed across the whole group and will be further enhanced during 2008 with the development of e-learning modules which will provide a more efficient and effective learning channel. The programme aims to better integrate new staff and facilitate their development within the company.

In addition, there are two key resourcing programs: the Management Trainee Program and the Merchandising Development Program. The Management Trainee Program, first launched in 2003, is a global corporate management program, aimed at attracting and developing high potential university graduates to become our future leaders through accelerated career development opportunities. The program is now five years old, and 85 trainees recruited from around the world are participating in the program. The Merchandising Development Program, first launched in February 2006, is a corporate resourcing program with the aim of developing a merchandising frontline resource pool through structured training. A customized diploma program for trainees has been developed in collaboration with the Hong Kong Polytechnic University, to obtain industry recognition and to establish industry standards for merchandising skill sets. The program will be "rolled out" to offshore offices in the latter half of this year. In 2007, the Merchandising Development Program won two awards: Most innovative Award and Certificate of Excellence in the Award for Excellence in Training 2007, conferred by the Hong Kong Management Association. In July 2008, 25 trainees in HK graduated from the programme and received their diplomas from the HK Polytechnic University.

The Group invested in sophisticated human resource software during the period under review. Total staff costs for 2008 were HK$2,150 million, compared with HK$1,690 million for 2007.