Our Performance

For our Three-Year Plan (2017-2019),
we are diligently executing
our key themes of speed, innovation
and digitalization to create
the supply chain of the future.

Our Performance

We reported positive 2017 results, highlighting that the Three-Year Plan with the goal of creating the supply chain of the future had a strong start in 2017 and is on track to deliver its financial and strategic goals.

Results Overview

Three-Year Plan (2017–2019) on Track

Our new Three-Year Plan got off a strong start in 2017 and we are on track to meet our financial targets and strategic goals. While our turnover continued to face pressure from input price deflation as well as the ongoing destocking and promotional activities among our brand and retail customers, we have seen early signs of stabilization due to our enhanced service offerings. Many of our customers have begun to embrace our speed and digital supply chain model, realizing tangible improvements in their inventory management as well as their sell-through and mark-down rates. We are confident that this trend will continue to attract new customers and increase our market share with existing ones. Meanwhile, our Logistics business maintained strong momentum in organic growth, which was largely driven by e-logistics services, deeper penetration of our core customers and entry to new markets.

Operating with higher productivity, better efficiency and strategic cost control, we were able to grow our profit margin percentage and profitability in a tough operating environment. We will continue to drive productivity with process improvements under our digitalized sourcing platform.

Speed Model and Digitalization

In an increasingly digitalized world, speed has become the new currency for brands and retailers. With the launch of our new Three-Year Plan, we embarked on our journey to create the supply chain of the future – an end-to-end digital supply chain augmented by data analytics that helps our customers optimize their ordering decisions and react to market changes with enhanced speed.

As part of our plan, we are converting the analog components of the supply chain into various digital modules such as 3D virtual design in product development, order tracking, and a raw materials platform. Over this Three-Year Plan, we have earmarked US$150 million for spending on digitalization, and these initiatives have been well-received by our customers. We are on track to deliver a fully-integrated digital platform that connects suppliers, customers and other partners with end-to-end visibility and data analytics. This will serve as the nucleus of our future service offerings, enabling Li & Fung to provide better and faster supply chain services beyond the traditional value-added services.

Strategic Initiatives

In order to strengthen our competitive position further and identify new emerging opportunities, we are focusing on three strategic initiatives as part of this Three-Year Plan. The expanded business development team is spearheading new customer wins and driving market share gain with core customers by orchestrating coordinated sales efforts across various teams. The corporate development team is leveraging our convening power to bring together diverse players from across the supply chain to create an ecosystem that benefits all stakeholders. The data analytics team is generating new insights from our growing data universe so we can design differentiated and timely products for our customers.

Repayment of US$500 Million Bond

With proceeds from the divestment of the Asia consumer and healthcare distribution business and the issuance of US$650 million of perpetual capital securities in 2016, we started 2017 with US$985 million of cash on our balance sheet. We further optimized our capital structure by using our cash on hand to repay the US$500 million bond in May 2017.

Reorganization

At the beginning of 2017, we reorganized our business into two segments, namely Services and Products, to support our new strategy. The Services segment consists of the Supply Chain Solutions and Logistics businesses. The synergistic combination of our Supply Chain Solutions business and Logistics business not only provides end-to-end supply chain solutions to our customers, but also facilitates cross-selling between the two businesses.

The Products segment consisted of the Onshore Wholesale business and three Product Verticals (furniture, beauty and sweaters), which represented our principal-to-principal business and were previously under the Trading network. This new organizational structure was intended to provide the Products segment with a higher level of autonomy to act with greater agility.

Strategic Divestment of Product Verticals and Special Dividend

In December 2017, we announced the strategic divestment of the three Product Verticals, furniture, beauty and sweaters. The strategic divestment will allow the Company to set the foundation for a more simplified organization with greater agility and focus on its core competencies, and enable our senior management team to focus resources on executing the Three-Year Plan. The Product Verticals' growth strategy in each product category necessitates further expansion upstream and downstream, requiring capital investment and management attention, which we believe is best achieved outside the Company and our current strategic direction.

The strategic divestment is expected to bring in an extra US$1.1 billion of cash, of which US$520 million will be distributed as special dividend while the balance will be retained to enhance the Group's financial flexibility. The transaction received approval from our Independent Shareholders on 31 January 2018 and is targeted to close during the first half of 2018, subject to regulatory approval.

Given the strategic divestment, the three Product Verticals are now classified as Discontinued Operations. Our financial results and management discussion and analysis will mainly focus on our Continuing Operations, including Supply Chain Solutions, Logistics and Onshore Wholesale businesses. The Discontinued Operations of the three Product Verticals are being presented separately in the consolidated profit and loss account as a single line item.

Results

The following financial results summary mainly focuses on our Continuing Operations, including Supply Chain Solutions, Logistics and Onshore Wholesale businesses. The three Product Verticals are classified as Discontinued Operations and presented separately as a single line item.

	Continuing Operations[1]					
	Like-for-like[2]			Reported		
	2017 US$m	2016 US$m (Restated)[3]	Change %	**2017 US$m**	2016 US$m (Restated)[3]	Change %
Turnover	**13,534**	14,185	(4.6%)	**13,534**	14,751	(8.3%)
Total Margin	**1,386**	1,408	(1.5%)	**1,386**	1,495	(7.3%)
As % of Turnover	***10.2%***	*9.9%*		***10.2%***	*10.1%*	
Operating Costs	**1,030**	1,094	(5.8%)	**1,030**	1,177	(12.4%)
As % of Turnover	***7.6%***	*7.7%*		***7.6%***	*8.0%*	
Core Operating Profit	**356**	314	+13.3%	**356**	318	+11.8%
As % of Turnover	***2.6%***	*2.2%*		***2.6%***	*2.2%*	
Profit for the Year						
– **Continuing Operations**				**234**	195	+19.7%
– Discontinued Operations				**(543)**	61	
– Total				**(309)**	256	
Profit Attributable to Shareholders[4]						
– **Continuing Operations**				**170**	160	+6.5%
– Discontinued Operations				**(545)**	61	
– Total				**(375)**	221	

1. Group results with Discontinued Operations separately presented given the strategic divestment of three Product Verticals announced in 2017
2. Excluding the Asia consumer and healthcare distribution business, which was divested in June 2016
3. 2016 comparatives restated with adoption of New Accounting Standard HKFRS 15 (Note 1.1 to the financial statements)
4. Excluding profit attributable to holders of perpetual capital securities and non-controlling interests

TURNOVER

Group Turnover, on a like-for-like basis, excluding the impact of the divestment of the Asia consumer and healthcare distribution business in 2016, decreased by 4.6% to US$13.5 billion. This was mainly due to customers' destocking and price deflation. Turnover was also negatively impacted by several customers who experienced bankruptcies last year. On a reported basis, turnover decreased by 8.3%. The rate of decline was lower than that in 2016 as the drop in the turnover of our Supply Chain Solutions business further narrowed.

Although retail consumption gradually improved towards the end of 2017, brands and retail customers continued to face disruptions from online retailers. Our customers responded by rationalizing physical store portfolios, continuing to destock, exercising tighter inventory control and launching their own online strategies.

These developments presented both opportunities and challenges. While conservative procurement by our customers led to smaller orders with shorter lead times – and hence lowered our turnover, it also provided growth opportunity for our speed model. Customers who adopted the speed model have been achieving better sell-through and reduced mark-down rates. In spite of the short-term pressure on our turnover, the speed model is helping us cultivate stickier, longer-lasting customer relationships in the medium term.

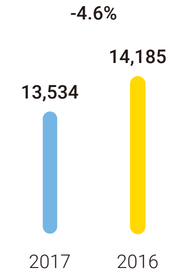
Supply Chain Solutions business, Logistics business and Onshore Wholesale business in the Americas, Europe, and Asia, accounted for 81%, 8% and 11% of Group turnover respectively.

Logistics business turnover increased by 13.3% driven by strong demand for in-country logistics services. The growth momentum of the Logistics business continued to be largely driven by e-logistics, deeper penetration of our core customers and entry to new markets.

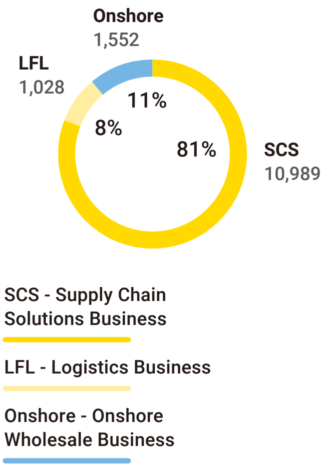
Turnover at Supply Chain Solutions business and Onshore Wholesale business decreased by 6.2% and 2.4% respectively primarily due to destocking and input price deflation. Our Onshore Wholesale business continued to experience turnover decline due to anemic consumer sentiment and an unstable economic environment particularly in Europe as well as short-term customer challenges in the US.

The Products segment has been restated to include only the Onshore Wholesale business in the Americas, Europe and Asia to reflect the strategic divestment of the Product Verticals.

Turnover
US$m

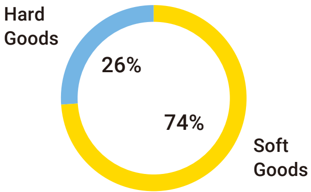


2017 Turnover Breakdown by Segments*
US$m



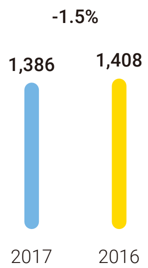
* Before inter-segment elimination

Group Product Mix
(Excluding Logistics Business)



Excluding the Logistics business, the Continuing Operations derived 74% and 26% of 2017 turnover from soft goods and hard goods respectively, compared with 71% for soft goods and 29% hard goods in 2016.

Total Margin
US$m

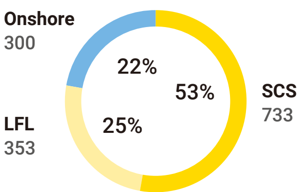


Total Margin Percentage
10.2% | 9.9%
+0.3 percentage point

TOTAL MARGIN

On a like-for-like basis, excluding the impact of the divestment of the Asia consumer and healthcare distribution business in 2016, total margin decreased by 1.5% to US$1,386 million. On a reported basis, total margin decreased by 7.3%. Total margin percentage improved by 0.3 percentage point on a like-for-like basis to 10.2% due to the increased contribution from the higher-margin Logistics business.

2017 Total Margin Breakdown by Segments
US$m



SCS - Supply Chain Solutions Business

LFL - Logistics Business

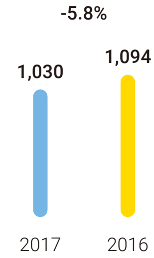
Onshore - Onshore Wholesale Business

Supply Chain Solutions business, Logistics business and Onshore Wholesale business accounted for 53%, 25% and 22% of the Continuing Operations' total margin, respectively, with the increased total margin in Logistics Business (13.1%) offset by the reduction in total margin in both Supply Chain Solutions business (5.5%) and Onshore Wholesale business (6.2%). This was due to the reduction in turnover and continued margin pressure in our Onshore Wholesale business.

OPERATING COSTS

On a like-for-like basis, excluding the impact of the divestment of the Asia consumer and healthcare distribution business in 2016, operating costs decreased by 5.8%. On a reported basis, operating costs decreased by 12.4% to US$1,030 million. The decrease primarily resulted from our sustained efforts to enhance operating efficiency and productivity through the use of technology and process improvement.

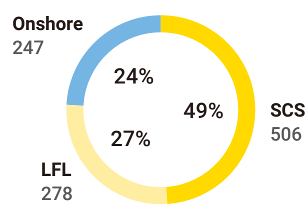
Operating Costs
US$m



As a percentage of turnover
7.6% | 7.7%
-0.1 percentage point

Supply Chain Solutions business, Onshore Wholesale business and Logistics business accounted for 49%, 24% and 27% of operating costs. The operating costs of Supply Chain Solutions business and Onshore Wholesale business decreased by 14.0% and 3.0% respectively as driven by on-going productivity improvement and process streamlining. Operating costs for Logistics business increased by 10.6% as a result of continued business expansion.

2017 Operating Costs Breakdown by Segments
US$m



SCS - Supply Chain Solutions Business

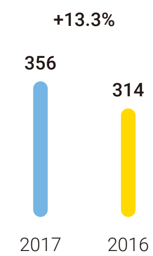
LFL - Logistics Business

Onshore - Onshore Wholesale Business

CORE OPERATING PROFIT

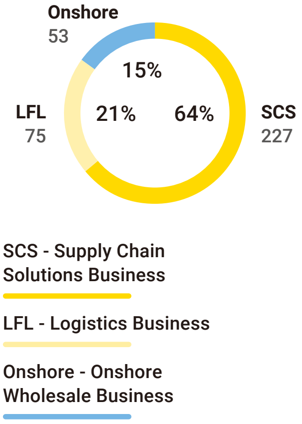
On a like-for-like basis, excluding the impact of the divestment of the Asia consumer and healthcare distribution business in 2016, core operating profit (COP) increased by 13.3% to US$356 million. On a reported basis, core operating profit increased by 11.8%. The increase in COP was largely due to higher total margin percentage and lower operating costs. Both the Services and Products segments achieved reduction in operating costs through productivity gains and strategic cost control. As a result, COP margin increased by 0.4 percentage point to 2.6%.

COP
US$m



COP Margin
2.6% | 2.2%
+0.4 percentage point

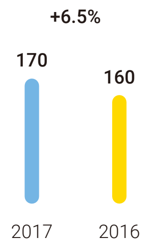
2017 COP Breakdown by Segments
US$m



In 2017, Supply Chain Solutions business and Onshore Wholesale business respectively accounted for 64% and 15% the COP of the Continuing Operations, while Logistics business accounted for 21%.

COP for the Supply Chain Solutions business and Logistics business increased by 21.2% and 23.8% respectively while Onshore Wholesale business' COP decreased by 18.6%.

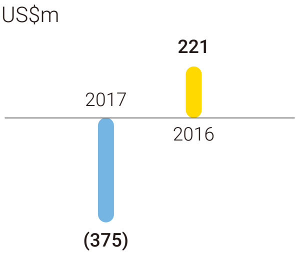
Net Profit Attributable to Shareholders
(Continuing Operations)
US$m



NET PROFIT ATTRIBUTABLE TO SHAREHOLDERS

On a reported basis, net profit attributable to shareholders for Continuing Operations increased by 6.5% to US$170 million. Our net profit attributable to shareholders was impacted by the US$28 million increase in distribution related to the US$650 million in perpetual capital securities raised in 2016 as well as US$34 million in reorganization costs and write-off of legacy IT assets, which was offset by the US$31 million gain on remeasurement of consideration payable.

Net Profit Attributable to Shareholders
US$m



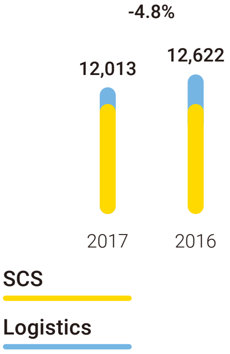
On a reported basis, the Group recorded a net loss of US$375 million attributable to shareholders for 2017 as compared to a net profit of US$221 million in 2016, as a result of the recognition of a one-time non-cash remeasurement loss for the Discontinued Operations of US$592 million in accordance with HKFRS 5, Non-current Assets Held for Sale and Discontinued Operations, offset by US$47 million of net profit attributable to shareholders from Discontinued Operations. The above accounting losses have no impact on our future cash flow, or our future operational and financial performance. The strategic divestment will also trigger the realization of prior period foreign exchange non-cash translation losses in the Company's equity account at the time of closing in 2018. These non-cash translation losses of approximately US$78 million, based on financial position as at 31 December 2017, will be recorded in our 2018 financial results.

Services Segment

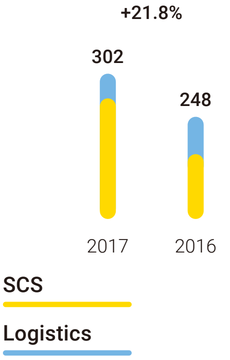
The Services segment is composed of Supply Chain Solutions business and Logistics business. We provide end-to-end supply chain solutions, from product design, raw materials procurement, production and quality control, to warehouse management and last-mile delivery to retail stores or end-consumers.

Cross-selling between Supply Chain Solutions and Logistics businesses has enhanced business opportunities and further solidified our relationships with customers. In 2017, the Services segment as a whole delivered a 21.8% increase in core operating profit. This was largely due to stabilization in turnover and total margin, coupled with strategic cost reduction for Supply Chain Solutions business, together with an increase in turnover and total margin for Logistics business.

Services Segment Turnover
US$m



COP
US$m



Services – Supply Chain Solutions Business

Supply Chain Solutions business, which accounted for 81% of turnover of Continuing Operations, is the largest revenue generator for the Group. It offers strategic supply chain services, from product design and development to raw material and factory sourcing as well as manufacturing control for our brands and retail customers. The business has a diversified customer base that includes brands, specialty stores, department stores, big box retailers, e-commerce players, hypermarkets, off-price retailers and clubs. We also converted our supplier base of more than 15,000 to a new customer base for services that can improve their operational efficiencies and compliance levels. Furthermore, we are on track to deliver a digital platform that connects suppliers, customers and other partners with end-to-end visibility and data analytics. This will serve as the nucleus of our future service offerings enabling Li & Fung to provide better, faster supply chain services beyond the traditional sourcing services.

Supply Chain Solutions Business Results

	2017 US$m	2016 US$m	Change %
Turnover	**10,989**	11,718	(6.2%)
Total Margin	**733**	776	(5.5%)
As % of Turnover	***6.7%***	*6.6%*	
Operating Costs	**506**	588	(14.0%)
As % of Turnover	***4.6%***	*5.0%*	
Core Operating Profit	**227**	188	+21.2%
As % of Turnover	***2.1%***	*1.6%*	

In 2017, despite the continued destocking trend, Supply Chain Solutions business saw a stabilization in turnover with a reduced year-on-year decline. Soft goods remained the largest contributor, accounting for 75% of turnover. Deflationary pressure on input prices for soft goods remained at a low-single-digit percentage year on year. We continued to expand our customer base, especially in the off-price segments. Many of our customers have started to embrace our speed and digital supply chain model, realizing tangible improvements in their inventory management, sell-through and mark-down rates. This trend will continue to drive growth with existing customers and attract new ones.

New customer growth was particularly strong in the off-price sector in Europe, as evidenced by the 4.5% increase in Europe turnover despite weak consumer sentiment in the region. This largely offset pressure from retail store closures and the ongoing destocking trend in the US. Overall, profitability improved through effective cost control and a continued focus on enhanced productivity.

TURNOVER

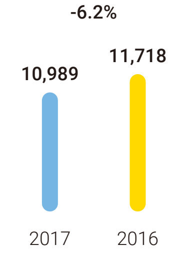
Turnover of our Supply Chain Solutions business decreased by 6.2% to US$11.0 billion. Faced with a weak consumer market and a volatile retail environment, customers remained conservative in their buying programs. In the US, the situation was exacerbated by a high number of store closures which led to even more cautious buying patterns.

We continued to experience mild deflationary pressure on soft goods, but input prices have largely stabilized. Although the high rate of destocking has lessened, the trend toward tighter inventory control has intensified as brands and retailers continued to show caution in light of ever-changing consumer buying patterns. Our customers have been placing smaller orders, replenishing more often but with very short lead times. As the leader in global supply chain management with decades of experience through many business cycles, we are well equipped to meet customers' requirements.

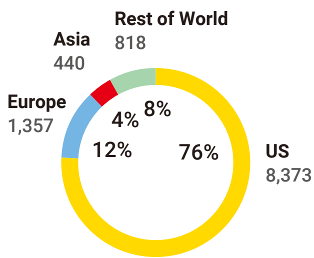
The US, Europe, Asia and Rest of World respectively accounted for 76%, 12%, 4% and 8% of Supply Chain Solutions business turnover in 2017.

Turnover of the business in the US and Rest of World decreased by 7.8% and 9.8% respectively. In Europe and Asia, we achieved 4.5% and 2.1% increase respectively in turnover, which was driven by new customer wins – especially in the off-price retail sector – despite the tough macro environment.

Supply Chain Solutions Business Turnover
US$m



2017 Geographical Market Turnover
US$m

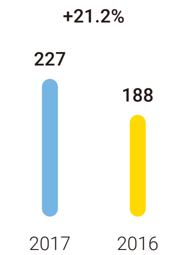


CORE OPERATING PROFIT

Core operating profit (COP) increased by 21.2% to US$227 million while core operating profit margin increased by 0.5 percentage point to 2.1%. This was driven by:

- A 5.5% decrease in total margin on reduced turnover and stable total margin percentage of 6.7%, and
- A 14.0% decrease in operating costs to US$506 million. Cost savings resulted from productivity enhancement initiatives such as greater use of technology, process reengineering and digitalization. In addition, effective credit risk management led to reduced provision in accounts receivable in 2017.

COP
US$m



COP Margin
2.1% | 1.6%
+0.5 percentage point

Services – Logistics Business

Logistics business focuses on four core industry verticals: footwear & apparel, fast-moving consumer goods, food & beverage and healthcare. It consists of two sub-segments, Asia-focused in-country logistics and global freight management.

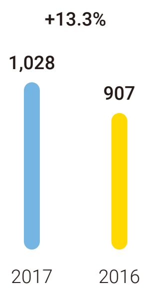
In-country logistics services include warehousing and transportation services, e-logistics, regional and global hub management, reverse logistics and other value-added services. We currently operate approximately 23.7 million square feet of warehouse space across fast-growing markets in Asia. China, our largest market, continues to enjoy strong growth momentum driven by e-commerce. Our state-of-the-art distribution hub in Singapore, opened in 2016 and is one of the largest bonded warehouses in ASEAN, has achieved full utilization much earlier than anticipated. We are now looking to develop another built-to-suit facility in Singapore to support future growth. Following the full implementation of the new Oracle transport management system across all our operations, we are now focusing on aggressively increasing our transport market share by cross-selling to our existing warehousing customers as well as new standalone transport customers. Our focus on labor productivity has started to yield positive results; this combined with initiatives focusing on selective automation and data analytics will continue to impact our profitability favorably going forward. By developing strong partnership with strategic regional customers, we have effectively extended our footprint into the key markets of India and Vietnam, following our successful entry into Korea and Japan.

Global freight management offers cargo consolidation and deconsolidation, freight forwarding and customs clearance services. With more than 600,000 TEUs of shipping volume, we are one of the leading freight forwarders in China. We continue to invest in state-of-the-art information technology platforms to improve our service offering and enhance our productivity.

Logistics Business Results

	2017 US$m	2016 US$m	Change %
Turnover	**1,028**	907	+13.3%
Total Margin	**353**	312	+13.1%
As % of Turnover	***34.3%***	*34.3%*	
Operating Costs	**278**	251	+10.6%
As % of Turnover	***27.0%***	*27.7%*	
Core Operating Profit	**75**	61	+23.8%
As % of Turnover	***7.3%***	*6.7%*	

Logistics Business Turnover
US$m



TURNOVER

Turnover of our Logistics business increased by 13.3% to US$1,028 million driven entirely by organic growth. Our new business wins together with the robust growth of consumption in Asia have provided strong impetus to in-country logistics, in particular, e-logistics. Our continuing success in the new markets of Japan and Korea, our recent expansion into India and Vietnam as well as our strong growth in China, Taiwan and Thailand have enabled us to further expand our market share.

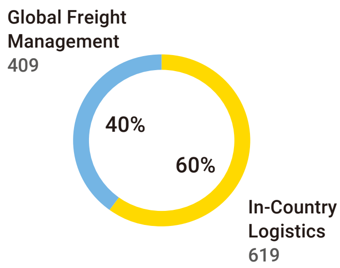
In-country logistics and global freight management accounted for 60% and 40% of the turnover of the Logistics business.

With our new customer wins, we have seen increase in turnover for both in-country logistics and global freight management of 15.3% and 10.5% respectively.

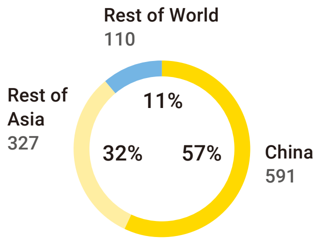
China is our key market for the Logistics business accounting for 57% of turnover. Rest of Asia, including Singapore, the Philippines, Malaysia, Indonesia and Korea accounted for 32% of turnover, while Rest of World accounted for 11%.

China showed the highest growth, registering 19.4% over 2016. Rest of Asia grew by 9.1% while Rest of World decreased slightly by 2.2%.

2017 Turnover Breakdown
US$m



2017 Geographical Market Turnover
US$m

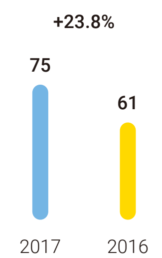


CORE OPERATING PROFIT

Core operating profit (COP) increased by 23.8% to US$75 million. This was mainly driven by new customer wins, geographical expansion and our continued focus on productivity improvement.

Core operating profit margin expanded by 0.6 percentage point to 7.3%. This was largely due to customer mix optimization, productivity gain and increased penetration of the higher-margin value-added services.

COP
US$m



COP Margin
7.3% | 6.7%
+0.6 percentage point

Products Segment

The Products segment consisted of our Onshore Wholesale business in three markets – the Americas, Europe, and Asia and three main Product Verticals, furniture, beauty and sweaters. We announced the strategic divestment of the three Product Verticals on 14 December 2017 and obtained our Shareholders' approval on 31 January 2018 with 99.94% of Independent Shareholder votes in favor of the transaction. The strategic divestment will allow the Company to set the foundation for a more simplified organization with greater agility and focus on its core competencies, and enable our senior management team to focus resources on executing the Three-Year Plan.

Onshore Wholesale Business

Going forward, the Products segment will consist of the Onshore Wholesale business operating as an onshore supplier in the Americas, Europe and Asia, primarily supplying apparel to largely the same customer base as our Supply Chain Solutions business. Onshore Wholesale business acts as an onshore importer for customers, and while the terms of each order are agreed on a per-program basis, its relationships with customers are typically long-term and strategic in nature. The business accounted for 11% of the Continuing Operations' turnover in 2017. It has faced challenges with lower turnover and total margin percentage due to customers' promotional activities and on-going margin pressure. We will reposition this business and continue to promote cross-selling between our Onshore Wholesale and Supply Chain Solutions businesses to enhance growth.

Onshore Wholesale Business Results

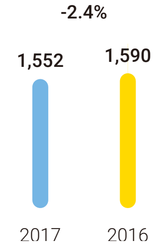
	2017 US$m	2016 US$m	Change %
Turnover	**1,552**	1,590	(2.4%)
Total Margin	**300**	320	(6.2%)
As % of Turnover	***19.4%***	*20.1%*	
Operating Costs	**247**	255	(3.0%)
As % of Turnover	***15.9%***	*16.0%*	
Core Operating Profit	**53**	66	(18.6%)
As % of Turnover	***3.4%***	*4.1%*	

TURNOVER

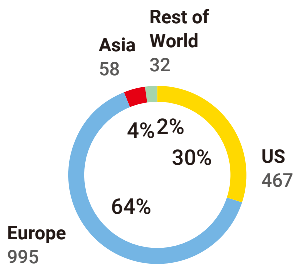
Turnover of Onshore Wholesale business decreased by 2.4% year on year to US$1,552 million, largely due to anemic consumer sentiment and an unstable economic environment, particularly in Europe. Short-term customer challenges in the Americas impacted the business in that region.

The US, Europe and Asia respectively accounted for 30%, 64%, and 4% of segment turnover. Turnover in the US increased by 3.8%, the growth rate was negatively impacted by some of our proposed apparel programs not being chosen by our customers during the 2017 seasons, as well as promotional activities in the US. Turnover in Europe dropped by 6.6% amidst a weak economy. Turnover in Asia increased by 34.0% as we continue to build out our wholesale business for our Asia customers.

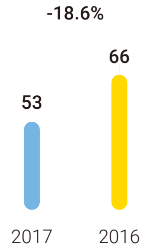
Onshore Wholesale Business Turnover
US$m



2017 Geographical Market Turnover
US$m



COP
US$m



COP Margin
3.4% | 4.1%
-0.7 percentage point

CORE OPERATING PROFIT

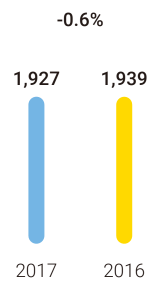
Core operating profit (COP) for Onshore Wholesale business decreased by 18.6% to US$53 million due to a reduction in total margin of 6.2% which resulted from the decrease in total turnover, offset by a 3.0% reduction in operating cost as we contained our cost base to remain competitive.

Core operating profit margin decreased by 0.7 percentage point to 3.4%, which was largely driven by a 0.7 percentage point reduction in total margin percentage due to a highly promotional retail environment and margin pressure, while our operating costs as a percentage of turnover remained flat.

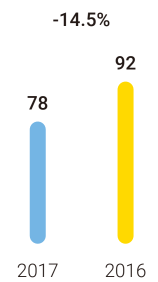
Product Verticals – Discontinued Operations

With the expected completion of the strategic divestment following Shareholders' approval in January 2018, the three Product Verticals have been classified as Discontinued Operations. While turnover for the Product Verticals was relatively flat year on year, core operating profit decreased by 14.5% to US$78 million due to on-going investment needs to fund the Product Verticals. The financial performance of the discontinued business is presented separately in the consolidated profit and loss account as one line item below the results of Continuing Operations.

Product Verticals Turnover
US$m



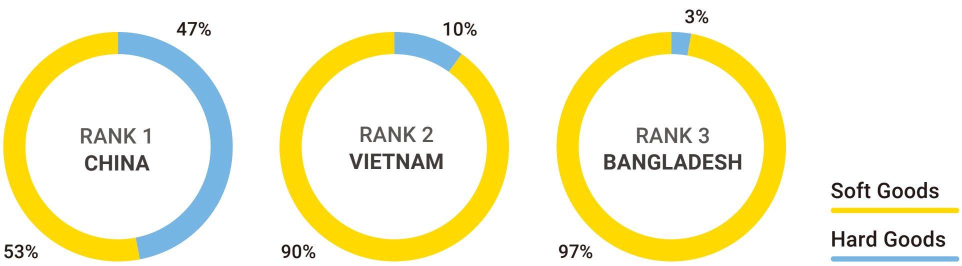
COP
US$m



Top Sourcing Countries

Our global network of more than 15,000 suppliers, spanning over 40 economies, allows for flexibility when moving orders from one production country to another to better manage manufacturing constraints and optimize customers' margins. In 2017, our top three sourcing countries were China, Vietnam and Bangladesh. We also have sizeable sourcing operations in other countries such as Cambodia, Indonesia and India. We are among the largest exporters in our product categories in our major sourcing countries. This comprehensive global network, combined with strong local presence, long operating history and critical mass, is one of Li & Fung's unique competitive strengths. As the sourcing landscape continues to evolve with changes in trade policies and sourcing requirements, we are very well positioned to scale our existing operations to source in the most efficient way possible for our customers.

Top Three Sourcing Countries (Continuing Operations)



People

Our people are our most valuable assets. As at 31 December 2017, we had a total workforce of 21,322 (21,510 as at 31 December 2016). Excluding Discontinued Operations, we had a total work force of 17,371 as at 31 December 2017 (17,798 as at 31 December 2016). The 17,371 workforce included 6,789 warehouse-related employees primarily for our Logistics business. Total manpower costs of Continuing Operations for 2017 were US$755 million compared with US$802 million in 2016. We will continue to enhance the productivity of our workforce and equip our people for the new digital world. We are grateful for our colleagues' commitment to build the supply chain of the future.

Balance Sheet and Capital Structure

Strong Cash Position

After taking into account the strategic divestment of Product Verticals, Li & Fung continues to have stable and strong cash flow conversion in the Continuing Operations, which comprises Supply Chain Solutions, Logistics and Onshore Wholesale businesses. Our operating cashflow, together with US$985 million cash on hand carried forward from the previous year, more than adequately funded our working capital, interest expenses, capital expenditure, distribution, dividends and repayment of bonds in 2017. To summarize key cashflow statement items:

- Operating cash flow from Continuing Operations: US$313 million, in line with core operating profit after working capital, depreciation and tax payments

- Capital expenditures: US$91 million

- Payments for consideration payable for previous acquisitions: US$68 million

- Net interest expenses: US$54 million

- Distribution to perpetual capital securities holders: US$64 million

- Dividend payments: US$250 million

In terms of future commitments, the remaining balance of total purchase consideration payable for acquisitions was reduced to US$62 million by the end of December 2017, of which US$44 million is earn-out payments to be substantially paid over the course of next two years. We continue to be asset-light, and our on-going total capital expenditures mainly include digitalization investments, Logistics business expansion and capital expenditures for continuing maintenance.

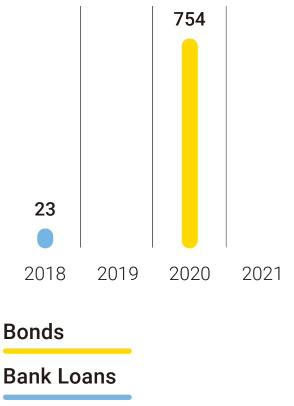
In 2017, we utilized US$500 million of cash on hand to repay the bond due in May 2017 and further solidify and deleverage our balance sheet.

Strong Balance Sheet

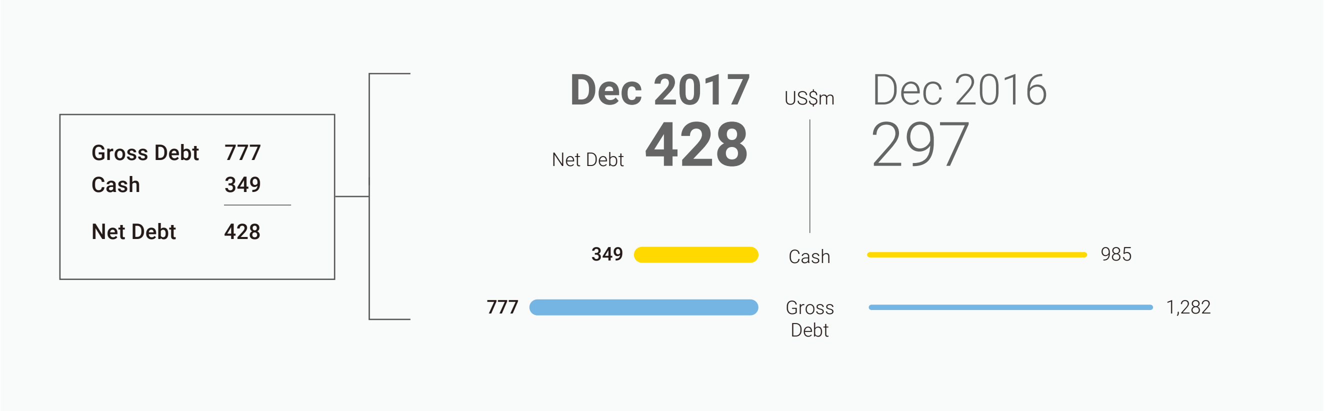
As at 31 December 2017, the cash position of our Continuing Operations was US$349 million after the repayment of US$500 million in bonds and payments of the 2016 final and 2017 interim dividends. Our total borrowings of US$777 million mainly represented a decrease of US$500 million following the repayment of the bonds in May, using proceeds from the issuance of perpetual capital securities in 2016. The cash position of the Discontinued Operations as at 31 December 2017 was US$193 million, which could be transferred to the Continuing Operations at the time of closing of the strategic divestment as part of the purchase consideration adjustments on cash free/debt free basis, along with the working capital and other closing adjustments, subject to the operating cash needs of the Discontinued Operations during the stub period from 31 December 2017 to the time of closing.

Our net debt (total borrowings minus cash) was US$428 million as at 31 December 2017. Our weighted average tenure of total borrowing is over two years. We have US$727 million in committed bank loan facilities with tenure in both 2019 and 2020. The majority of our debt is at a fixed rate and denominated in US dollars. Given the uncertainties in the global macroeconomic and geopolitical environments, we remain cautious in how we manage our balance sheet and maintain maximum financial flexibility to provide assurance to our customers and suppliers.

Debt Maturity Schedule
(Continuing Operations)
US$m

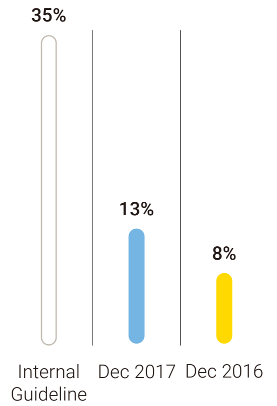


Cash and Gross Debt*
US$m



* 2017 figures represent Continuing Operations; 2016 figures represent reported balance sheet as at 31 December 2016

Gearing Ratio*



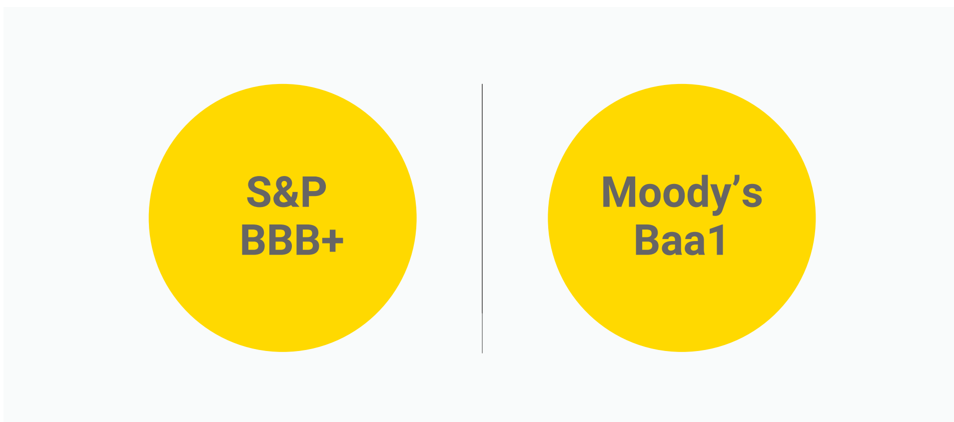
* 2017 ratio represents Continuing Operations; 2016 ratio represents reported balance sheet as at 31 December 2016

Gearing Ratio and Current Ratio

Our gearing ratio and current ratio of the Continuing Operations were 13% and 1.4 respectively as at 31 December 2017 (8% and 1.1 respectively for the Group as at 31 December 2016). The gearing ratio is calculated as net debt divided by total capital. Net debt is calculated as total borrowings (including short-term bank loans, long-term bank loans and long-term notes) less cash and cash equivalents. Total capital is calculated as total equity, as shown in the consolidated balance sheet, plus net debt.

We continued to take a conservative approach in managing our balance sheet and capital structure. As at 31 December 2017, our credit rating was Baa1 according to Moody's and BBB+ according to Standard & Poor's. We are committed to maintaining a strong balance sheet, healthy cash flow and strong credit ratios, with the long-term target of retaining an investment-grade rating.

Credit Rating



Banking Facilities

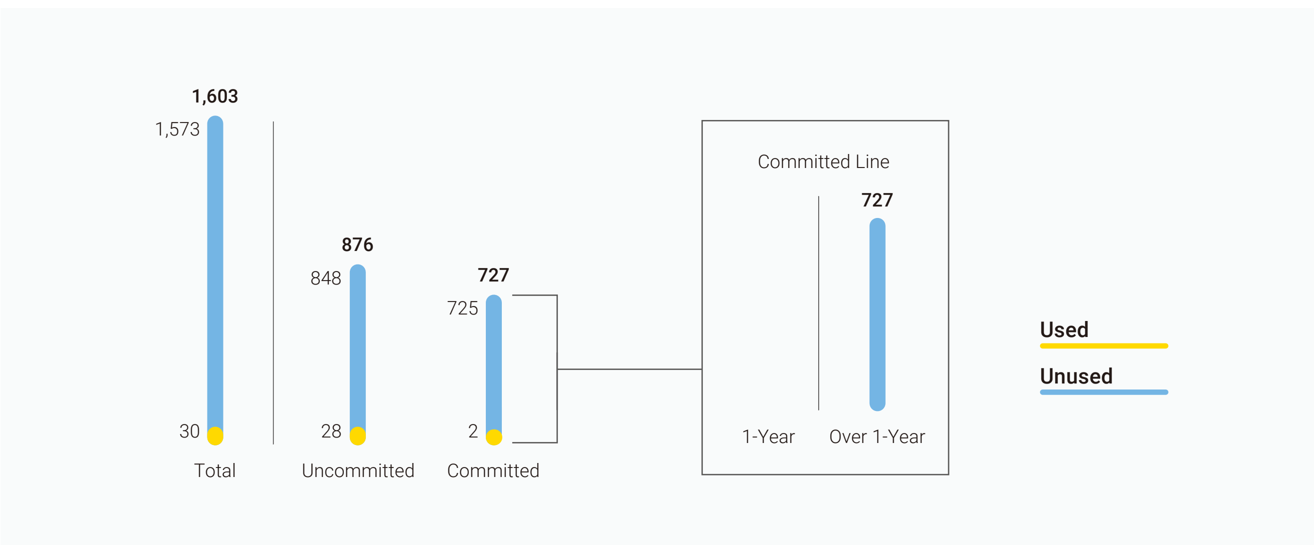
Bank Loans and Overdrafts

As at 31 December 2017, we had available bank loans and overdraft facilities of US$1,603 million, of which US$727 million were committed facilities. The majority of the committed facilities have tenure up to 2019. Only US$30 million of the Group's bank loans and overdraft facilities was utilized, of which US$25 million and US$5 million were utilized by the Continuing Operations and the Discontinued Operations respectively. Unused limits for bank loans and overdraft facilities amounted to US$1,573 million, with US$725 million being unused committed facilities.

Trade Finance

The Group's normal trading operations are well supported by US$2.5 billion in bank trading facilities that mainly include letters of credit issued to suppliers and bills discounting. Given the strategic divestment of the Product Verticals, we expect that the required available bank facilities will be reduced proportionately after the transaction closes. 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 2017, only approximately 12% of the trade finance facilities was used.

Unused Bank Loans
US$m



Contingent Liabilities and Goodwill

Adjustments to Purchase Consideration Payables

Given the unique nature of our acquired businesses, which are private enterprises that rely on their respective entrepreneurs' commercial skills to drive their success, we generally structure our acquisitions with incentive schemes and contingent payments on purchase consideration payables linked to the future performance of the acquired businesses. We follow 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 Combinations.

Our contingent consideration payables are performance-based payments in the form of "earn-out" and "earn-up" payments, which depend on a set of predetermined performance targets mutually agreed upon with entrepreneurs in accordance with sale and purchase agreements.

Earn-out payments are generally payable within three to four years upon completion of a transaction.

Earn-up payments have a high performance target threshold and, if earned, are typically payable over a period of up to five to six years upon completion of a transaction.

While many of our acquired businesses remain profitable and are growing, we may still be required to make a downward fair value adjustment to certain purchase consideration payables should the acquired businesses be unable to achieve the predetermined performance threshold within the specific timeframe as stipulated in the sale and purchase agreement. Given that the contingent consideration entitlement is usually contractual in nature and based on a specific formula linking to a particular threshold, the underlying performance of the acquired businesses could continue to grow, yet we may still be required to adjust the purchase consideration payable, especially if the high performance thresholds of earn-ups are not reached. In 2017, there was a US$31 million write-back of acquisitions payable.

Goodwill Impairment Tests

We perform goodwill impairment tests based on the cash-generating units (CGU) that manage acquired businesses in accordance with HKAS 36, Impairment of Assets. Based on our assessment of all of the CGUs under the current operating structure of the Group, we have determined that there was no goodwill impairment as at 31 December 2017, as the recoverable amount of each CGU was in excess of its respective carrying value of the goodwill. We will continue to perform goodwill impairment tests on an on-going basis.

Remeasurement Loss on Assets Classified as Held for Sale

As a result of the strategic divestment, the three Product Verticals were recognized as assets classified as held for sale in accordance with HKFRS 5, Non-current Assets Held for Sale and Discontinued Operations, and were required to be marked down to the lower of their carrying value and fair value less costs to sell. In such respect, an unrealized non-cash remeasurement loss of US$592 million was recognized as at 31 December 2017, estimated based on the carrying value of the relevant goodwill and other asset/liabilities of the three Product Verticals as at 31 December 2017, on cash free/debt free basis and adjusted for relevant closing adjustments. The strategic divestment is targeted to close during the first half of 2018, subject to regulatory approval. Any true-up amount based on the then prevailing carrying value of the net assets of the Discontinued Operations will be recognized as gain/loss on disposal at closing in 2018.

In respect of the three Product Verticals, the Group has already recognized US$288 million in gain on remeasurement of contingent consideration payable in previous years. Should the above write-back be taken into overall consideration, the loss on remeasurement of assets held for sale from the strategic divestment of the three Product Verticals would have been adjusted to US$305 million.

Adoption of New Accounting Standard, HKFRS 15, Revenue from Contracts with Customers

To augment the consistency of our financial information throughout the period, we have elected to apply HKFRS 15, Revenue from Contracts with Customers, in 2017. This new accounting standard provides clear guidance on the timing and basis of recognition for revenue. Timing of recognition is based on the transfer of control of goods or services rather than transfer of risks and rewards. Basis of recognition is determined based on the assumption of primary responsibility to the customers, risk associated with inventories and control of price determination. Prior period comparatives have been retrospectively restated. Applying this new accounting standard resulted in decrease in turnover and costs of goods sold by approximately US$94 million and decrease in operating profit by approximately US$2 million for 2016. Further information about the application has been set out in Note 1.1 to the financial information.

Risk Management

We have 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. Our principal trading business carries a higher credit risk profile given that we are acting as a supplier and therefore take full counterparty risk for our customers in terms of accounts receivable and inventory.

In addition, as we provide working capital solutions to our suppliers via LF Credit by selectively settling accounts payable earlier at a discount, we also assume direct counterparty risk for our customers for such receivables. With the increased insolvency risk among global brands and retail customers, we have deployed a global credit risk management framework with a tightened risk profile, and applied prudent policies to manage our credit risk with such receivables that include, but are not limited to, the measures set out below:

- We select customers in a cautious manner. Our credit control team uses a risk assessment system to evaluate the financial strength of individual customers prior to agreeing on trade terms. It is not uncommon for us to require securities (such as standby or commercial letters of credit, or bank guarantees) from customers who fall short of the required minimum score under our risk assessment system

- A significant portion of trade receivable balances is covered by trade credit insurance or factored to external financial institutions on a non-recourse basis

- We have established a credit risk system with a dedicated team, and tightened policies to ensure on-time recoveries from trade debtors

- We have put in place rigid internal policies that govern provisions made for both inventories and receivables 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 our cash balances are HK dollar and US dollar deposits with major global financial institutions, and most of our borrowings are denominated in US dollars.

Our revenues and payments are predominantly transacted in US dollars. Therefore, we do 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 we arrange hedging through foreign exchange forward contracts.

For transactions that are subject to foreign exchange risk, we hedge our foreign currency exposure once we receive confirmed orders or enter into customer transactions. To mitigate the impact from changes in foreign exchange rates, we regularly review our operations in these countries and make necessary hedging arrangements in certain currencies against the US dollar.

However, we do not enter into foreign currency hedges with respect to the local financial results and long-term equity investments of our non-US dollar foreign operations for either our income statements or balance sheet reporting purposes. Since our functional currency is the US dollar, we are subject to exchange rate exposure from the translation of foreign operations' local results to US dollars at the average rate for the period of group consolidation. Our net equity investments in non-US dollar-denominated businesses are also 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.

From a medium-to long-term perspective, we manage our operations in the most cost-effective way possible within our global network. We strictly prohibit any financial derivative arrangement merely for speculation.

Outlook

Retail sentiment turned more positive in the last quarter of 2017 and the recovery trend seemed intact as of early 2018. However, macroeconomic uncertainties remain as the Federal Reserve continues to strike a delicate balance along the interest rate cycle. We are also expecting more retail store closures this year as retailers continue to rationalize their store portfolios.

Destocking will continue as tight inventory control, which grew out of the tough retail environment of past years, is unlikely to relax. In fact, conservative and just-in-time inventory management has become the new norm as consumer demand is changing at a much more rapid pace in a digital market place. This requires our customers to be more agile and flexible in order to excel in the fast-changing market. Many of them are relying on our digitalized supply chain to achieve speed-to-market and we believe the adoption rate of our speed model and other digital services will continue to rise.

We target to complete the strategic divestment of our three Product Verticals during the first half of 2018, subject to regulatory approval. The transaction will enhance our financial flexibility and allow us to focus our resources on core competencies. The remaining business will consist of Supply Chain Solutions, Logistics and Onshore Wholesale businesses. Supply Chain Solutions and Logistics businesses of Services segment together offer end-to-end solutions to our customers. Complemented with our Onshore Wholesale business of our Products segment, we are offering our customers with great flexibility and deep product design expertise; a unique supply chain solution that can help our customers to compete better in the marketplace.

We have developed solid capabilities to capture revenue streams with strong growth potential. The development of omni-channel retailing – the integration of brick-and-mortar and online retailing – by both pure online and traditional retailers have been generating incremental demand for us. We are already serving customers operating in different retail formats and providing insightful analytics from our proprietary database.

Our in-country logistics business will continue to benefit from our expanded geographical coverage, strong demand for regional and global hubbing and e-logistics services as well as an aggressive push on growing our transportation offering. With the continuing robust performance of the existing markets and with the successful penetration into new growth markets such as India and Vietnam, we are poised to ride on the medium-to long-term trend of rapidly rising middle-class consumption in Asia for years to come. Our global freight management business promises exciting growth opportunities on the back of our recently implemented IT platform and enhanced agent network. Overall, we feel sanguine about the growth prospects of the Logistics business for years to come.

Our new Three-Year Plan has enjoyed a strong start and we will remain laser-focused on achieving our goal to create the supply chain of the future. The strategic divestment of the three Product Verticals will allow us to streamline our operations further and focus on our core business. We are on track to deliver a digital platform that connects suppliers, customers and other partners with end-to-end visibility and data analytics to enhance procurement decision-making. This will serve as the nucleus of our future service offerings, enabling Li & Fung to provide better, faster supply chain services beyond the traditional value-added services, ultimately creating new opportunities and revenue streams for the Group in the future.