

# A Letter from Our Chairman

Dear Shareholders,

With just a few months left in our current Three-Year Plan (2017–2019), and a few months away from a new decade, I would like to examine the current state of our business, the opportunities and challenges we face, and what the future may look like.

At the time of this letter, signals for the global economy has turned from mixed to slightly negative. The US Federal Reserve has recently lowered interest rates for the first time in 10 years, yet financial markets continue to indicate a future recession in the US. Germany experienced negative growth in the second quarter, dragging the momentum in Europe to near-zero. The uncertainty around Brexit continues to hold off business decisions and undermines economic prospects in both the UK and Europe. The Pound recently broke a new low in more than thirty years as a hard Brexit became more and more imminent. China's economic growth continued to moderate through the first half of 2019 and the friction between China and the US continues to be an overhang and optimism has become more measured. While the current economic climate appears gloomy, there may hopefully be respite coming from the US which historically experiences economic optimism during an election year.

## Retail industry – supply chain as the key differentiator

The competitive landscape in the global retail industry is being profoundly shaped by technology especially at the consumer interface. By now, the race to omni-channel ("O-to-O") is largely over as major brands and retailers are already omni-channel. In the meantime, digitally-native companies continue to capture consumer wallet share. The advent of data analytics allows retailers to be more targeted in their marketing and product offering. However, it also heightens consumer expectations of personalized retail experience, further fueling the rapid shift in consumer preferences, so enhancement in the front-end alone is not enough.

The retail battlefield has already shifted to the supply chain which has stayed largely analog but will be increasingly digitalized by companies like Li & Fung – favoring procurement systems that supports the dynamics of omni-channel retail and seamless integration between the front-end and back-end. Only two years ago, early adopters of our speed model were considered pioneers. Today, shortening of merchandizing calendars

to deliver speed is the marching order of the industry. This is good news for us at Li & Fung because customers are investing more in speeding up procurement and our vision of creating the Supply Chain of the Future addresses exactly these business needs. Our digital services offerings such as end-to-end 3D virtual design are powerful enablers for customers who expect ever-greater speed to market. Our leadership in 3D is well-recognized in the industry and has already led to new revenue opportunities. Building on what we have already accomplished on the digital platform, our new Chief Digital Officer is charting the next phase of our digitalized supply chain.

## Escalation of the US-China trade war

The US-China trade war is becoming more protracted than anyone imagined when the first tariff-related announcement was made in March 2018, signaling the beginning of the trade conflict. Despite the escalation of tariff rates and expanding scope of products impacted by tariffs, an agreement seemed to be on the horizon several times in the past 18 months. 2019 started off on a calm note, briefly interrupted in May by announcements of tariff increase from 10% to 25% on US\$200 billion worth of Chinese goods, and retaliatory Chinese tariffs on American products. Expectations ran high again after the two leaders left the G20 Osaka Summit on a relatively reconciliatory tone. Unfortunately, the subsequent truce lasted for one month only.

On 1 August, the US announced an additional 10% tariff on remaining US\$300 billion worth of Chinese products. China reacted by stopping the purchase of US agricultural products. On 23 August, both countries unveiled retaliatory tariffs. If these tariffs go into effect as scheduled, over US\$500 billion worth of Chinese goods will face tariffs of between 15% and 30% starting in October. In the same month, the US Treasury labeled China a currency manipulator as the Renminbi depreciated against the US dollar, adding another worrying dimension to the conflict.

It seems that the trade tension between China and the US will therefore continue to escalate and the situation is likely to remain volatile for the foreseeable future. This could be partially attributed to the election cycle in the US. However, there are more fundamental issues frustrating the relationship between the two countries. The issues emerge from areas such as technology leadership, intellectual property, ideological beliefs – all of which

are far-reaching and may take a long time to resolve. Furthermore, the friction is part of the unraveling of the multilateral trade framework enshrined under the World Trade Organization (WTO).

In place of the WTO rules, there is a proliferation of bilateral trade regimes and free trade agreements. This emergence of bilateral free trade agreements has caused the complexity of global supply chain to expand exponentially. This complexity presents deep challenges for the global retail supply chain – yet at the same time – the biggest opportunity not seen in almost 20 years for our particular business model of dispersed production, operating in multiple countries.

### Our global sourcing network

Having been in the supply chain business for generations, we appreciate there is no constancy in global trade. We have a well-diversified sourcing network that spans more than 50 economies and have always avoided over-reliance on China, or any single country, even when the environment appeared benign. We have not just focused on short-term efficiency and economic considerations by running a narrow sourcing base. Instead we have purposefully built a comprehensive network that diversifies risk and accommodates disruptions just as we are now facing.

Within our production network we have, over decades, cultivated deep relationships with factories, business communities and local governments. This diversified sourcing network gives us the ability to quickly shift production among countries for our customers, a unique competitive advantage that is difficult to replicate at our scale. This flexibility has proven extremely useful in the panic and scramble that followed the surprise tariff announcement. Our core strength will be even more apparent as tectonic shifts in the global trade landscape continue over the next number of years.

### Our commitment to ESG

Our work in transforming the supply chain to meet the demands of a dynamic retail sector importantly focuses not only on improving working conditions but also on creating a positive environmental impact. For example, under the speed model, retailers manage to maintain a leaner inventory, greatly reducing waste. End-to-end 3D virtual design reduces the creation of physical samples and their transportation, reducing both material



wastage and carbon footprint. It shows that achieving positive business results is inextricably linked to our environmental, social and governance (ESG) performance. We will continue to enhance our ESG initiatives to make our world more sustainable and create value for our various stakeholders along the supply chain.

### Year of acceleration

2019 is our year of acceleration as we speed up our transformation into a digital organization. To accelerate the business growth of our logistics business, in June we welcomed Temasek as an investor into the logistics side of the business. The changes we are making to our business and the achievements we have made are of strategic significance and we are now better-positioned than ever to help our customers thrive in the digital economy. Everyone at the Company works tirelessly in turning our vision of the Supply Chain of the Future into reality and I would like to thank all colleagues for their efforts. I am grateful to our customers and suppliers for our continued partnership. The trade war is bringing a big disruption for the supply chain and we are here to help them navigate the complexities. Finally, I would like to express my heartfelt gratitude to our shareholders for the support throughout the years. I am confident that our transformation will yield business and financial results in the future – and the future is closer than it seems.

Yours sincerely,

**William Fung Kwok Lun**  
Group Chairman