

# PMI Quarterly on China Manufacturing

## China Federation of Logistics & Purchasing

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## PMI indicates relatively stable growth of production and economic activities in China

- Production activities expand at a relatively stable pace.
- New export orders index dips into contractionary zone in June.
- Backlogs of orders drop at a faster pace.
- Stocks of finished goods decrease at a relatively fast pace.
- Purchases of inputs index stays high in June.
- Input prices go up at a relatively rapid pace.
- Ex-factory prices index stays above critical 50-mark.
- Imports index falls to a four-month low.
- Employment index stays around 49.
- Suppliers' delivery time stays relatively stable.
- Purchasing managers remain optimistic.

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## 1. PMI indicates relatively stable growth of production and economic activities in China

China's manufacturing PMI rose from 51.4 in April to 51.9 in May, and then moderated to 51.5 in June. The index readings in the past three months indicate that production and economic activities in China have expanded at a relatively stable pace recently. (See exhibit 1)

It is noteworthy to recognize the discrepancy by size of enterprises. The PMI of 'large enterprises' went up from 52.0 in April to 53.1 in May. The index then dropped slightly to 52.9 in June, but was still the second highest level in six months. The readings in the past two months indicate the relatively fast expansion of 'large enterprises'. The PMI of 'medium enterprises' rose from 50.7 in April to 51.0 in May, but then went down to 49.9 in June. The index fell below the critical 50-mark for the first time in four months, indicating that 'medium enterprises' contracted again in June. Meanwhile, the PMI of 'small enterprises' dropped from 50.3 in April to 49.6 in May. The index then came in at 49.8 in June, still below the critical 50-mark, indicating the continuous contraction of 'small enterprises'. (See exhibit 2)

The small fluctuation of the headline PMI in the past three months points to a stabilizing economy. The output index fluctuated within the narrow range of 53.1 to 54.1 throughout April to June, indicating that production activities have expanded at a relatively steady pace recently. This was supported by the relatively stable growth in overall new orders. The new orders index stayed between 52.9 and 53.8 in the past three months. However, for the first time in four months, the new export orders index dipped into the contractionary zone in June, indicating a recent drop in new export orders. Meanwhile, the input prices index stayed high at 56.7 and 57.7 in May and June respectively. The figures show that prices of production inputs have gone up at a relatively fast pace recently, which will in turn put strong cost pressure on Chinese manufacturers.

Looking ahead, the Chinese policy makers will strive to maintain stable growth of the Chinese economy in near future. We predict that monetary policy in China will stay neutral and the central bank will maintain abundant liquidity in the banking system. On 5 July, the central bank made a targeted cut in the reserve requirement ratios (RRRs) of some banks in China by 50 bps, pumping funds of about 700 billion yuan into the banking system. Moreover, the central government will continue with its active fiscal policy; in particular, the government will focus on reducing taxes and fees in a bid to alleviate cost burden on enterprises. For example, on 1 May this year, the value-added tax rate on the manufacturing sector was reduced from 17% to 16%, while the value-added tax rate on the transportation, construction, telecommunication services sectors and agricultural products was decreased from 11% to 10%. In the meantime, the central government will increase its efforts to curb major risks, cut poverty and tackle pollution.

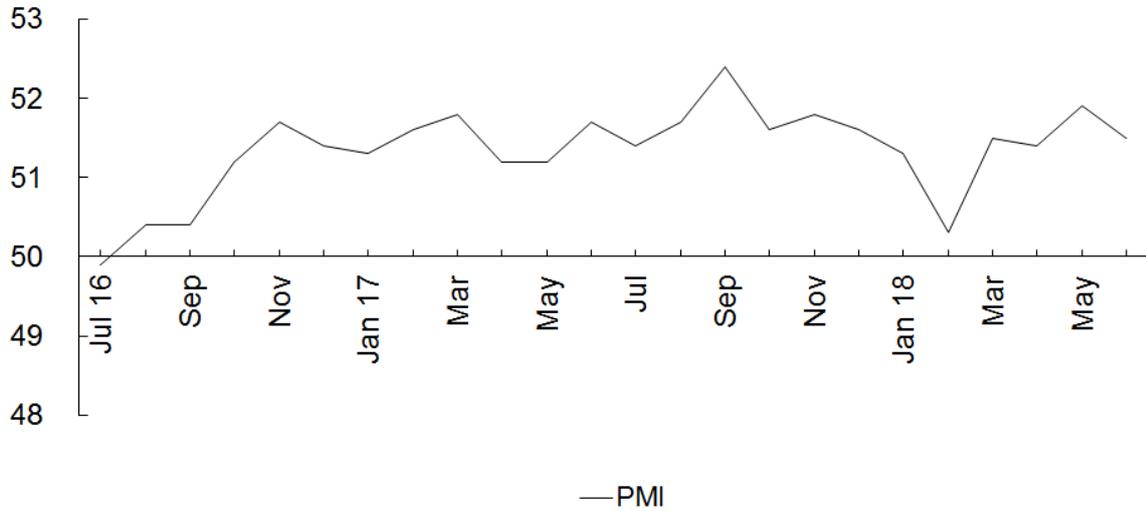
The recent trend of the new export orders index indicates a moderation in the export demand. Nevertheless, the domestic demand has continued to expand at a relatively stable pace, as indicated by the readings of the new orders index in the past three months. The Chinese economy is set to maintain stable growth in the near term. We predict that the headline PMI will hover around 51.5 and the real GDP growth will be around 6.7% in 3Q18. Challenges facing Chinese manufacturers, however, include the escalating trade tensions between China and the US, stronger government's efforts to enforce environmental regulations, a marked increase in prices of materials, intense competition in the international market, and the weak demand for luxury products. Overall, we expect that the industrial production (VAIO) growth will be around 6.5-7.0% yoy in 3Q18.

Exhibit 3 shows that the fall in the headline PMI in June was largely due to the drop in the output index (which weighs 25% in the computation of the headline PMI) and the new orders index (weighs 30%). In June, 9 of the 13 sub-indices were lower than their respective levels in the previous month. (See exhibit 4)

Among the 12 sub-indices (i.e. excluding the suppliers' delivery time index), 6 stayed in the expansionary zone over the past three months (i.e. output, new orders, purchases of inputs, input prices, ex-factory prices and business expectations). Meanwhile, the indices of backlogs of orders, stocks of finished goods, stocks of major inputs and employment remained in the contractionary zone over the same period.

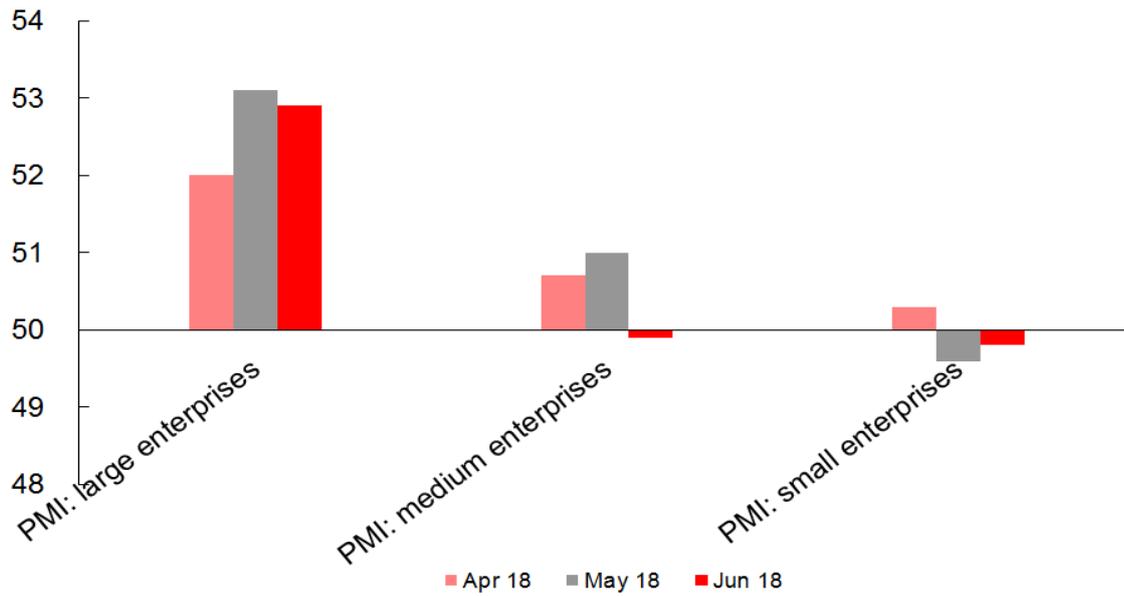
China's manufacturing PMI has so far done a satisfactory job in predicting economic growth. Exhibit 5 plots the quarterly real GDP yoy growth rates versus the monthly PMIs since its inception. It could be seen that the PMI demonstrates a fairly good track record of forecasting the growth trend of the economy at least over the next few months. Based on this chart we project that the real GDP growth will be around 6.7% in 3Q18.

Exhibit 1: Headline PMI, July 2016 to June 2018



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

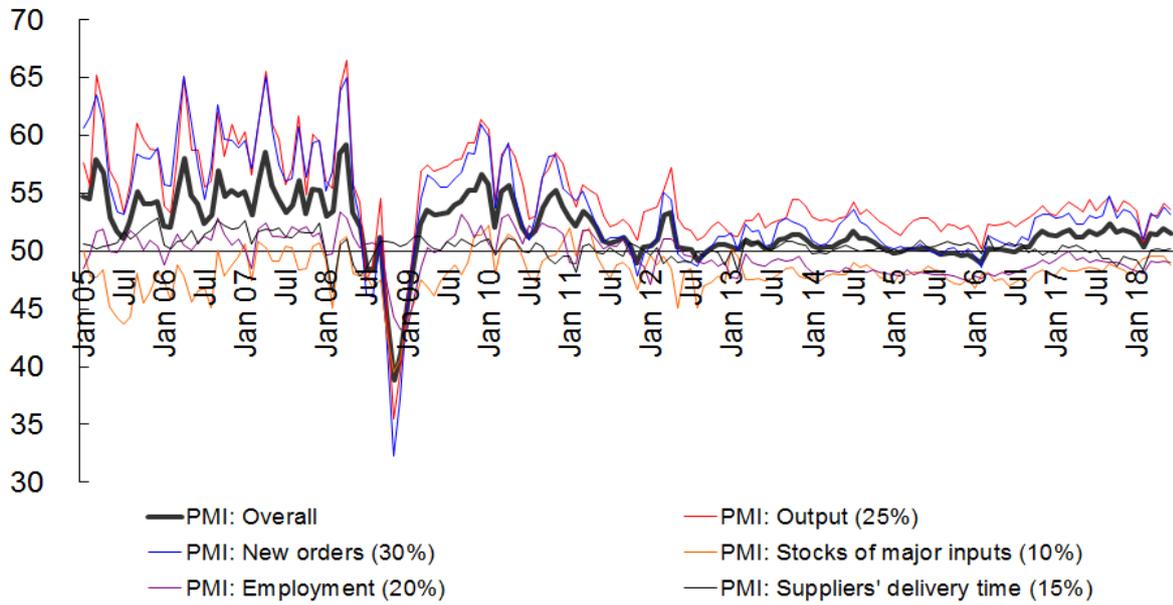
Exhibit 2: PMIs of large enterprises, medium enterprises and small enterprises, April to June 2018



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

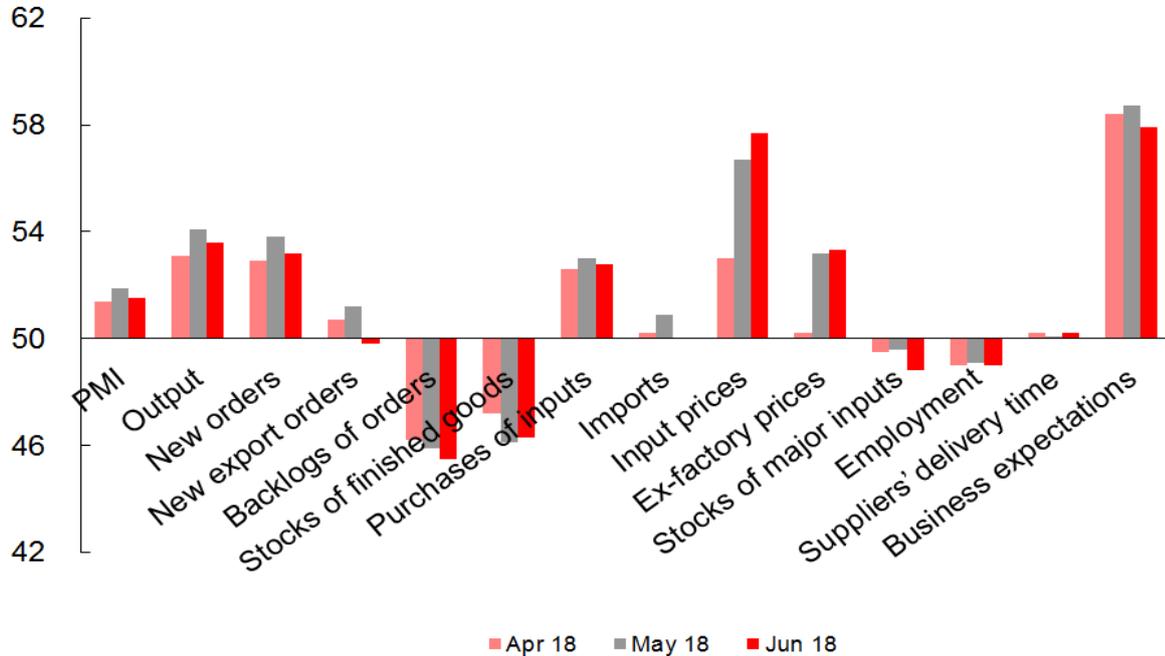
**Exhibit 3: Headline PMI and sub-indices, January 2005 to June 2018**

PMI = Output x 25% + New Orders x 30% + Stocks of Major Inputs x 10% + Employment x 20% + (100 - Suppliers' Delivery Time) x 15%



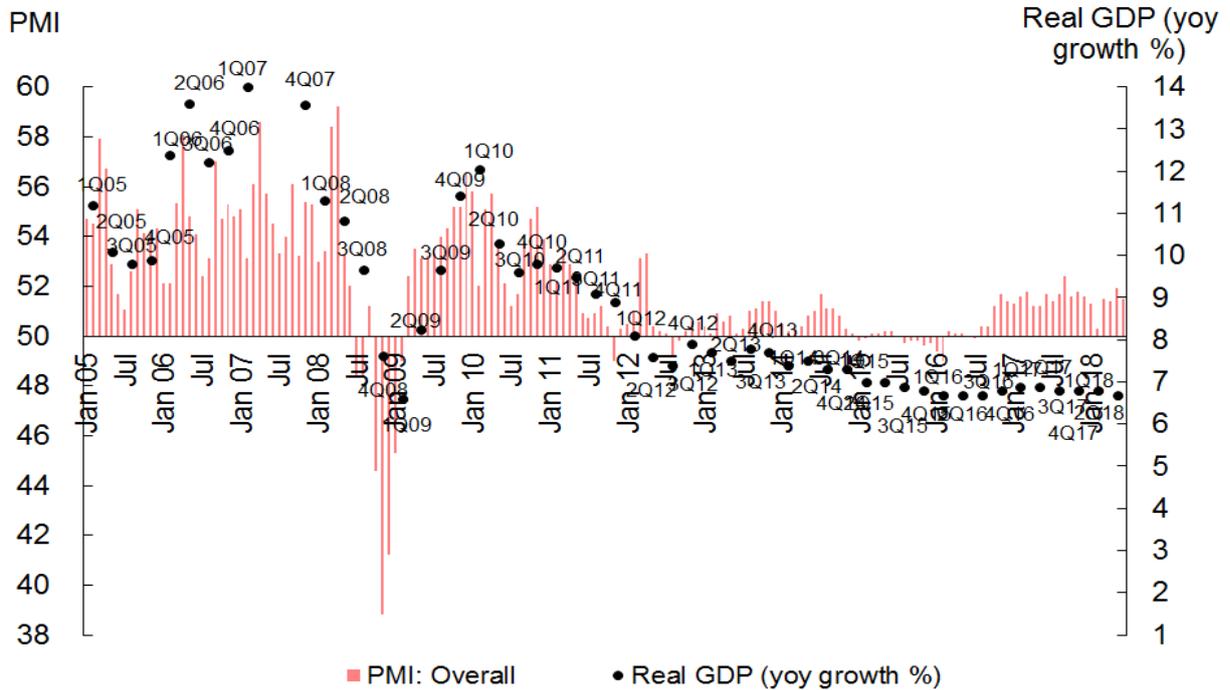
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

**Exhibit 4: Headline PMI and all sub-indices, April to June 2018**



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 5: Headline PMI and real GDP growth, January 2005 to June 2018



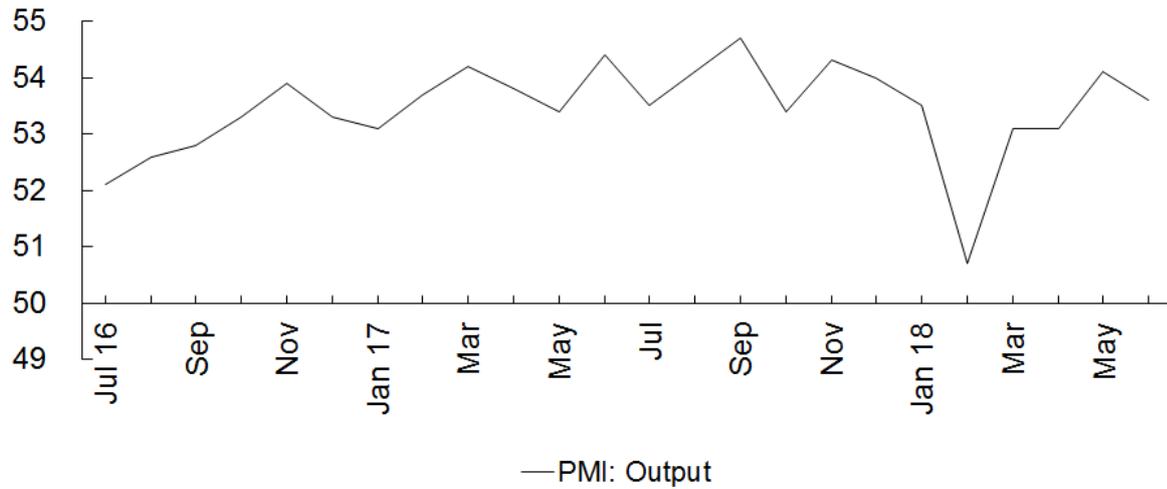
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

## 2. Production activities expand at a relatively stable pace

The output index fluctuated within the narrow range of 53.1 to 54.1 in the past three months, indicating that the production activities have expanded at a relatively stable pace recently. (See exhibit 6)

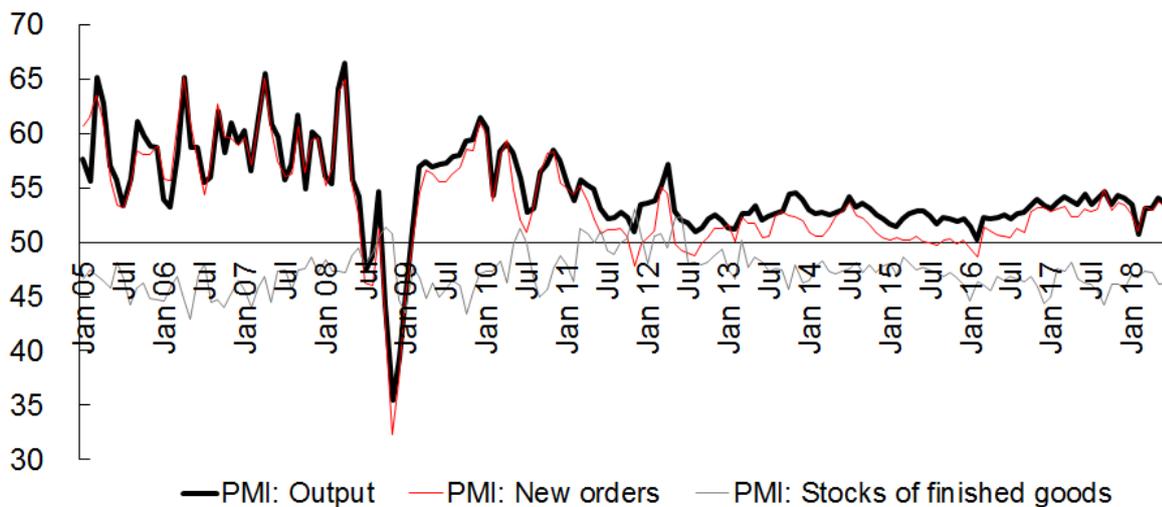
Exhibit 7 shows that the output growth was mainly fuelled by new orders growth instead of restocking activities, as the stocks of finished goods index has stayed in the contractionary zone for sixty three consecutive months. However, output may grow strongly later when manufacturers have finally run out of their inventory or regained confidence to restock.

**Exhibit 6: Output index, July 2016 to June 2018**



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

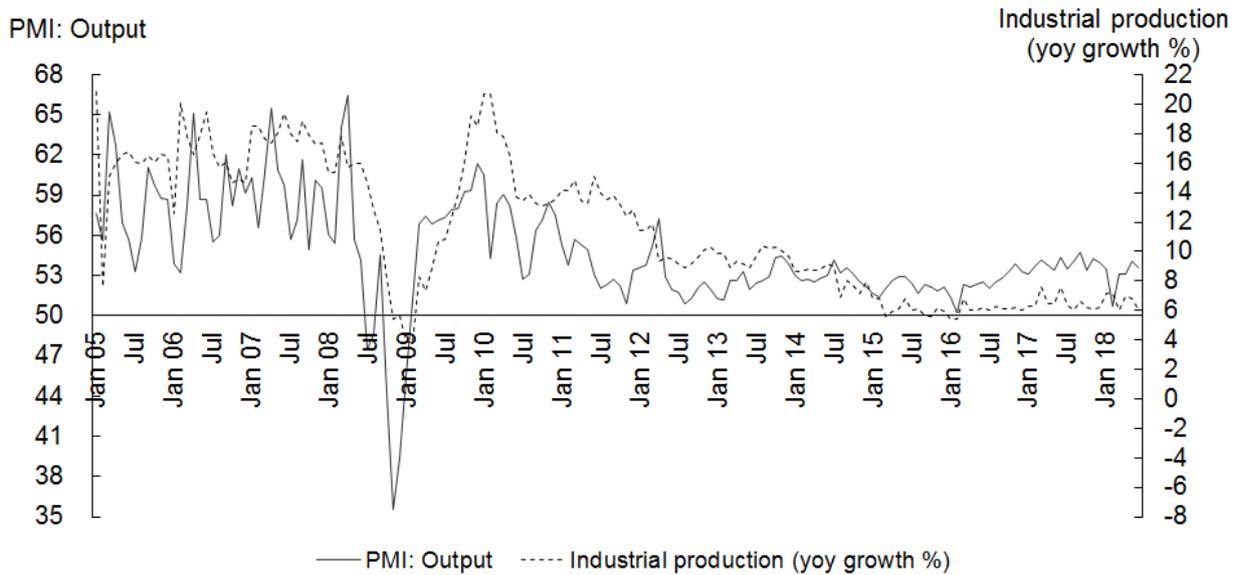
**Exhibit 7: Output, new orders and stocks of finished goods, January 2005 to June 2018**



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 8 demonstrates the correlation (with some lags) between the output index and the year-on-year growth of value-added of industrial output (VAIO). Looking ahead, we expect that the VAIO growth will be around 6.5-7.0% yoy in 3Q18. In the coming months, industrial activities will be supported by stable domestic demand. Challenges facing Chinese manufacturers, however, include escalating trade tensions between China and the US, stronger government’s efforts to enforce environmental regulations, a marked increase in prices of materials, intense competition in the international market, and the weak demand for luxury products.

**Exhibit 8: Output index and industrial production growth, January 2005 to June 2018**

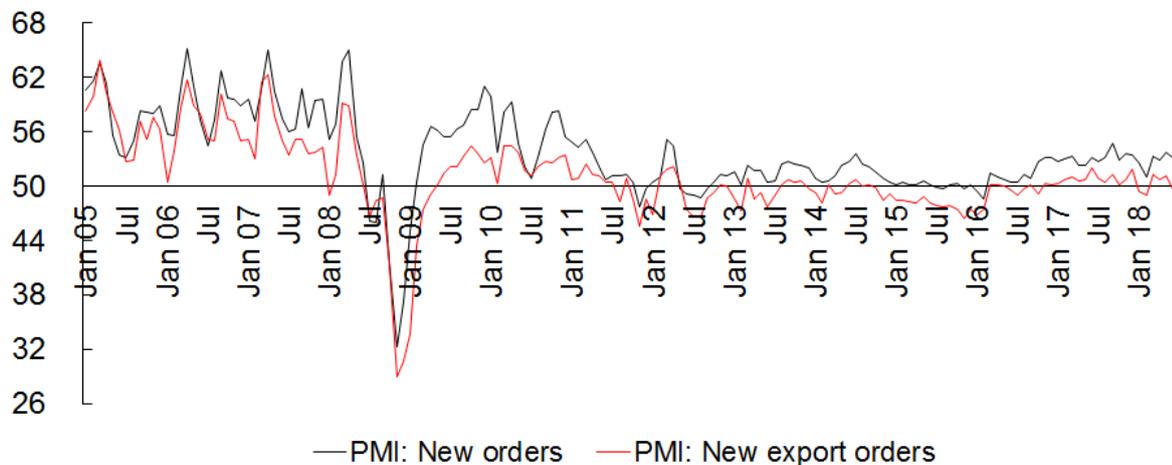


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

### 3. New export orders index dips into contractionary zone in June

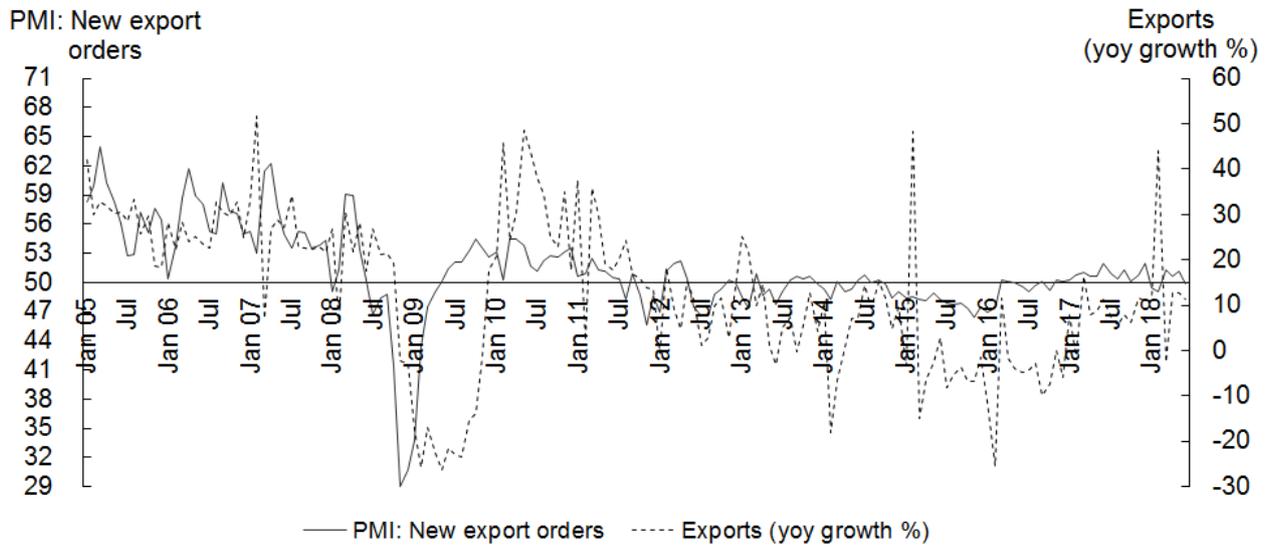
The new orders index went up from 52.9 in April to 53.8 in May, and then moderated to 53.2 in June. The index readings in the past two months indicate the relatively stable growth of new orders. Meanwhile, after having stayed above the critical 50-mark for three consecutive months, the new export orders index fell to 49.8 in June, dipping to the contractionary zone in the month. The June reading indicates a recent drop in new export orders. (See exhibit 9)

**Exhibit 9: New orders index and new export orders index, January 2005 to June 2018**



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 10: New export orders index and export growth, January 2005 to June 2018

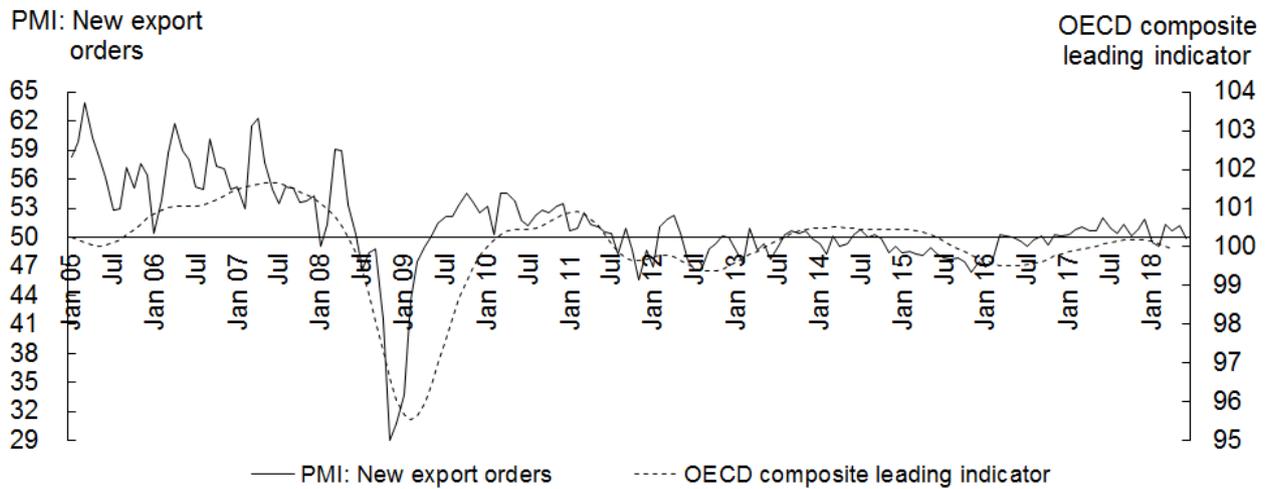


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics, China Customs

Exhibit 10 plots the new export orders index against the year-on-year growth rates of China’s exports. The correlation between the two indices is fairly high. As the new export orders index dipped into the contractionary zone in June, we have become less optimistic about the near-term prospects of China’s exports. Moreover, from exhibit 11 we can see that the new export orders index has been strongly correlated to the external economies, especially the developed economies. The OECD composite leading indicator<sup>1</sup> has been on a downward trend since December last year, suggesting a moderation in the growth of the global economy. All in all, we forecast that China’s exports will only show single-digit year-on-year growth in 3Q18.

<sup>1</sup> The OECD composite leading indicator, compiled by the Organization for Economic Cooperation and Development, is designed to provide early signals of turning points (peaks and troughs) between expansions and slowdowns of economic activity, and covers Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, United Kingdom and United States.

**Exhibit 11: New export orders index and OECD composite leading indicator, January 2005 to June 2018**



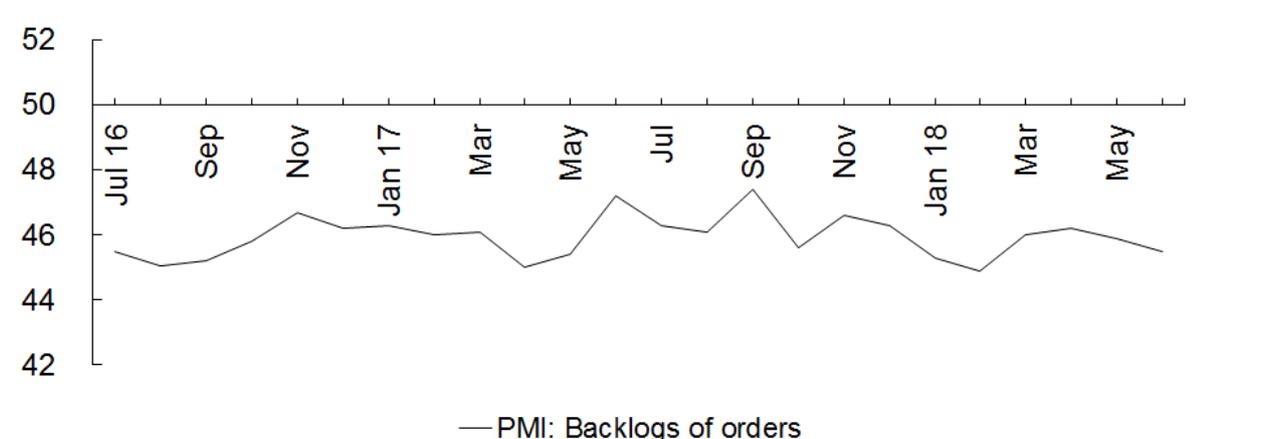
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics, Organization for Economic Cooperation and Development

#### 4. Backlogs of orders drop at a faster pace

The backlogs of orders index went down from 46.2 in April to 45.9 in May, and further to 45.5 in June, indicating that backlogs of orders have fallen at a faster pace lately. (See exhibit 12)

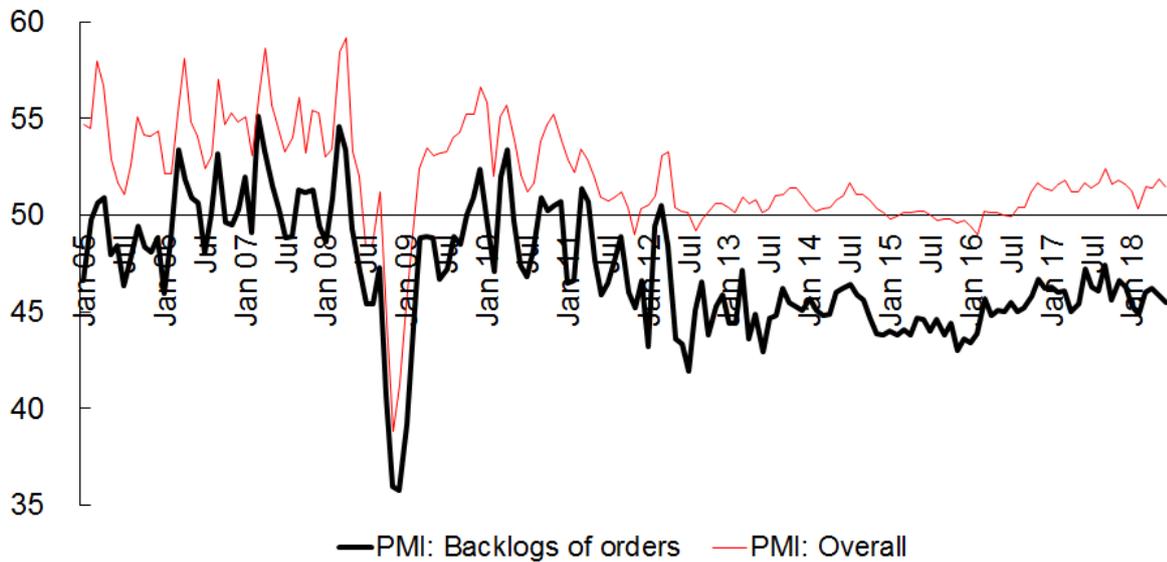
Looking ahead, we expect the index to post a slight drop in the near term, as indicated by the apparently very high correlation between the sub-index and the headline PMI, and the recent fall in the headline PMI. (See exhibit 13)

**Exhibit 12: Backlogs of orders index, July 2016 to June 2018**



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 13: Backlogs of orders index and headline PMI, January 2005 to June 2018

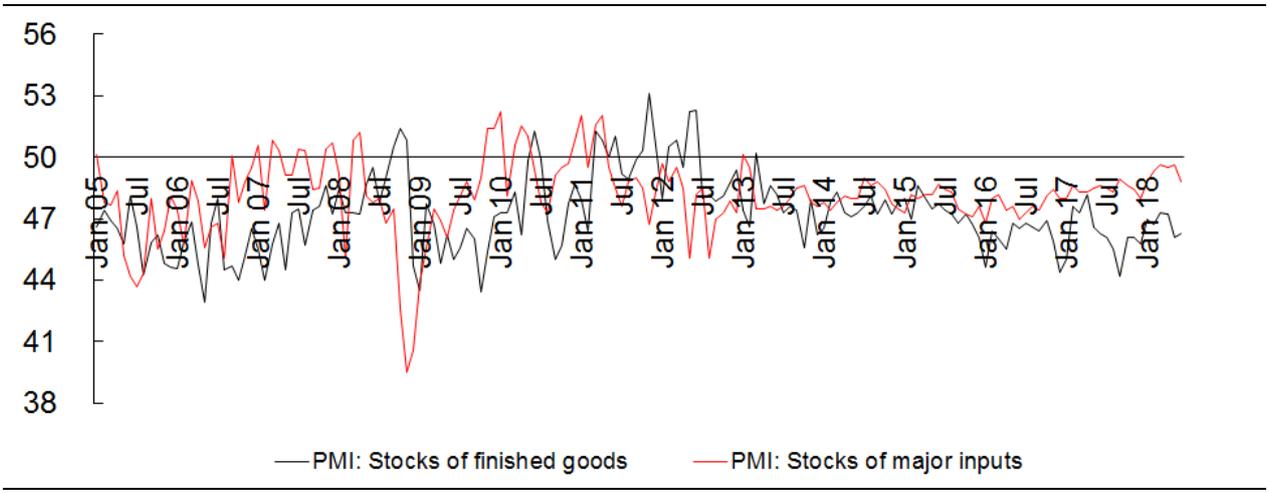


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

### 5. Stocks of finished goods decrease at a relatively fast pace

After dropping from 47.2 in April to a five-month low of 46.1 in May, the stocks of finished goods index stayed low at 46.3 in June. The index readings in May and June show that stocks of finished goods held by manufacturers have decreased at a relatively fast pace lately. Meanwhile, the stocks of major inputs index rose slightly from 49.5 in April to 49.6 in May, but then went down to 48.8 in June, the lowest in five months. (Exhibit 14) The latest reading indicates a faster decrease in the stocks of major inputs in June.

**Exhibit 14: Stocks of finished goods index and stocks of major inputs index, January 2005 to June 2018**



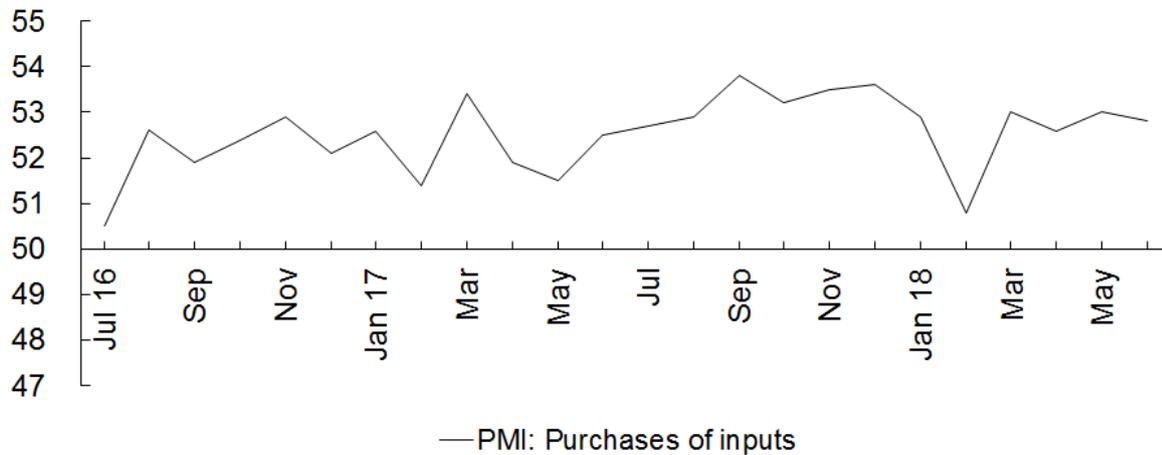
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

## 6. Purchases of inputs index stays high in June

The purchases of inputs index rose from 52.6 in April to 53.0 in May, and then stayed high at 52.8 in June, indicating a relatively fast growth of purchasing activities in recent months. (Exhibit 15)

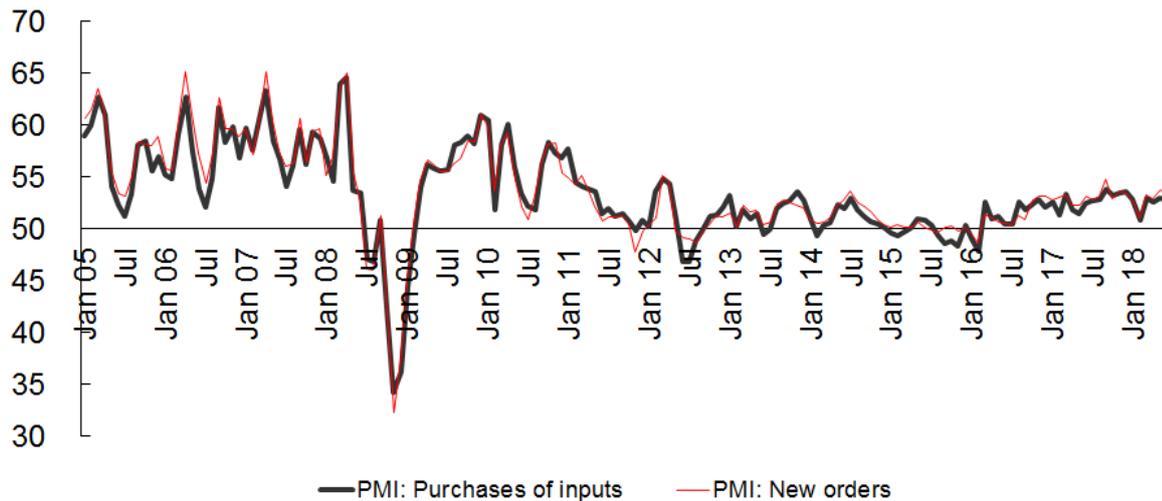
A number of factors affect the purchasing activities of manufacturers, among which the amount of new orders received by manufacturers has been the most important factor. Exhibit 16 plots the purchases of inputs index against the new orders index. The correlation between the two sub-indices is very strong. This is intuitively easy to explain – as manufacturers usually need to purchase extra inputs to cope with new orders. We expect to see a continuous increase in purchases if the rise in new orders persists. The purchasing activities also reflect business confidence. Exhibit 17 shows the association between the purchases of inputs index and the business expectations index. Credit conditions could be another factor. Finally, exhibit 18 shows that input prices, as well as the expected trend of input prices, are also important considerations when making purchasing decisions.

**Exhibit 15: Purchases of inputs index, July 2016 to June 2018**



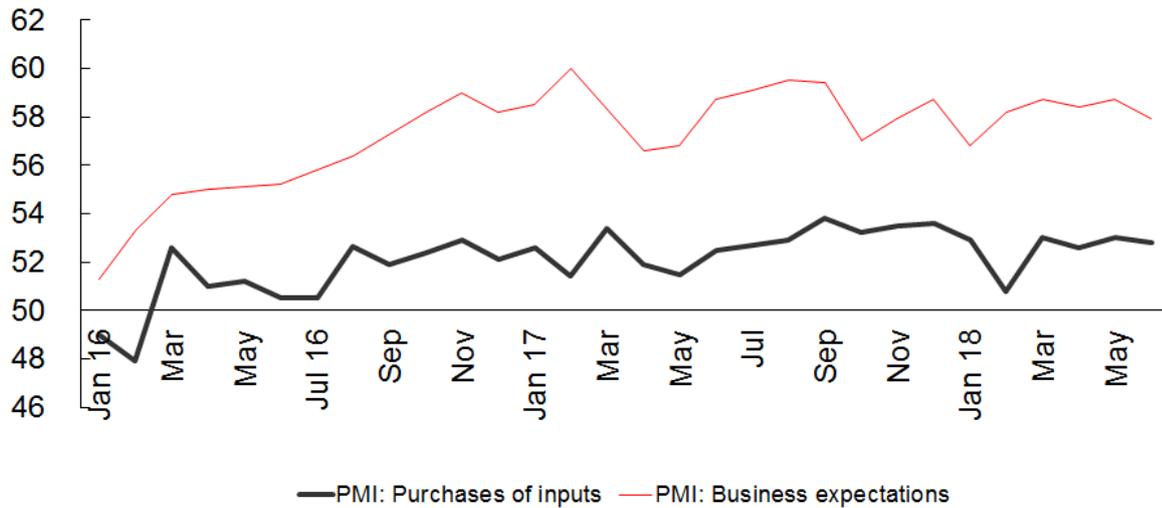
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

**Exhibit 16: Purchases of inputs and new orders, January 2005 to June 2018**



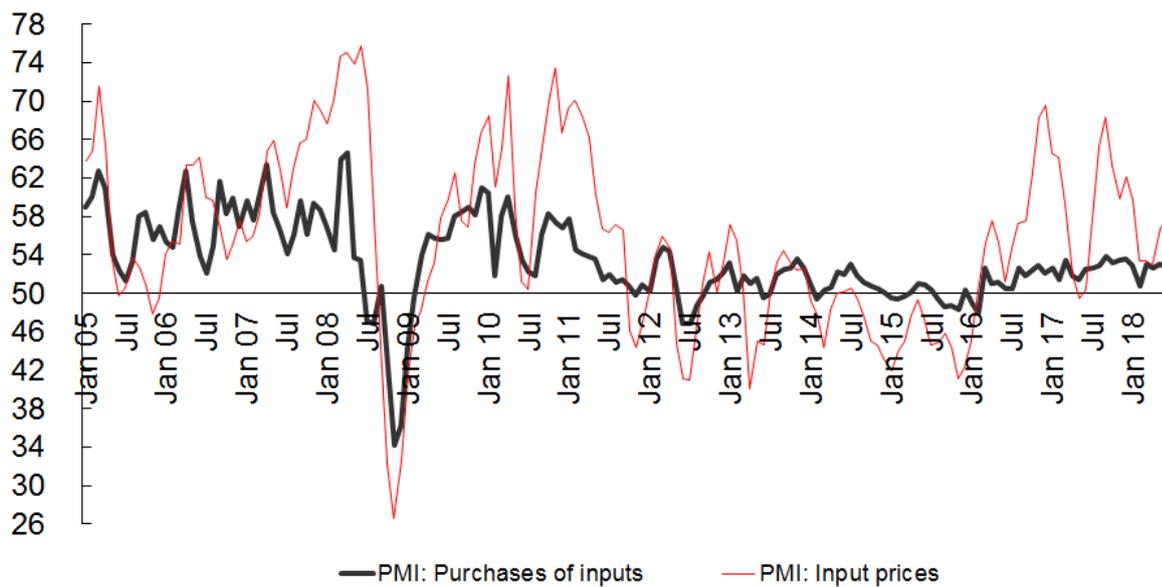
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

**Exhibit 17: Purchases of inputs and business expectations, January 2016 to June 2018**



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

**Exhibit 18: Purchases of inputs and prices of major inputs, January 2005 to June 2018**

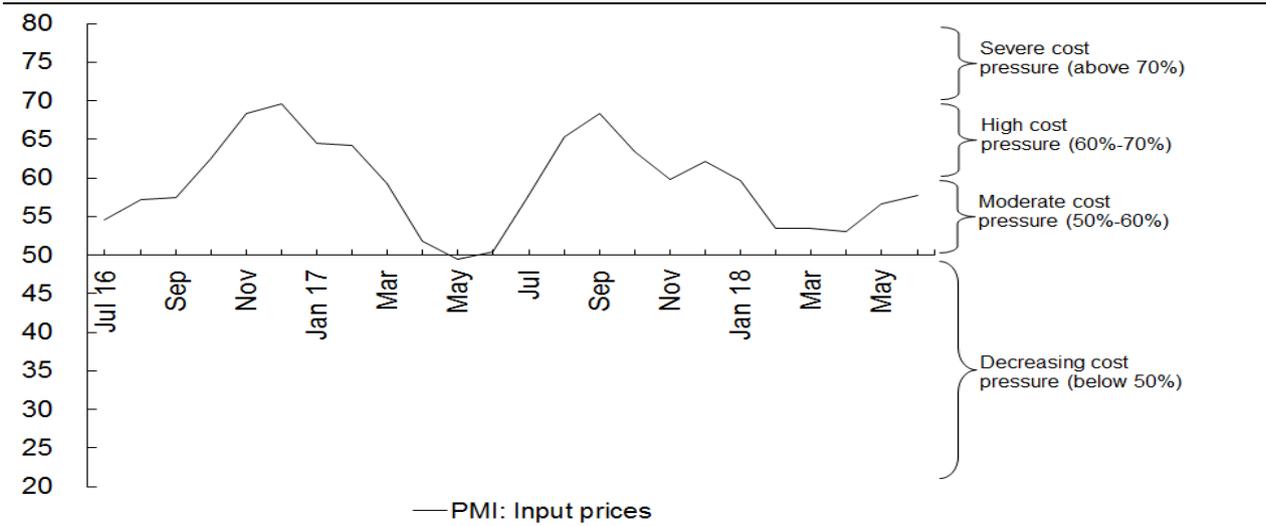


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

7. Input prices go up at a relatively rapid pace

The input prices index picked up from 53.0 in April to 56.7 in May, and rose further to 57.7 in June, the second highest level this year. The latest reading shows that prices of production inputs have gone up at a relatively fast pace recently, which will in turn put strong cost pressure on Chinese manufacturers. (Exhibit 19)

Exhibit 19: Input prices index, July 2016 to June 2018



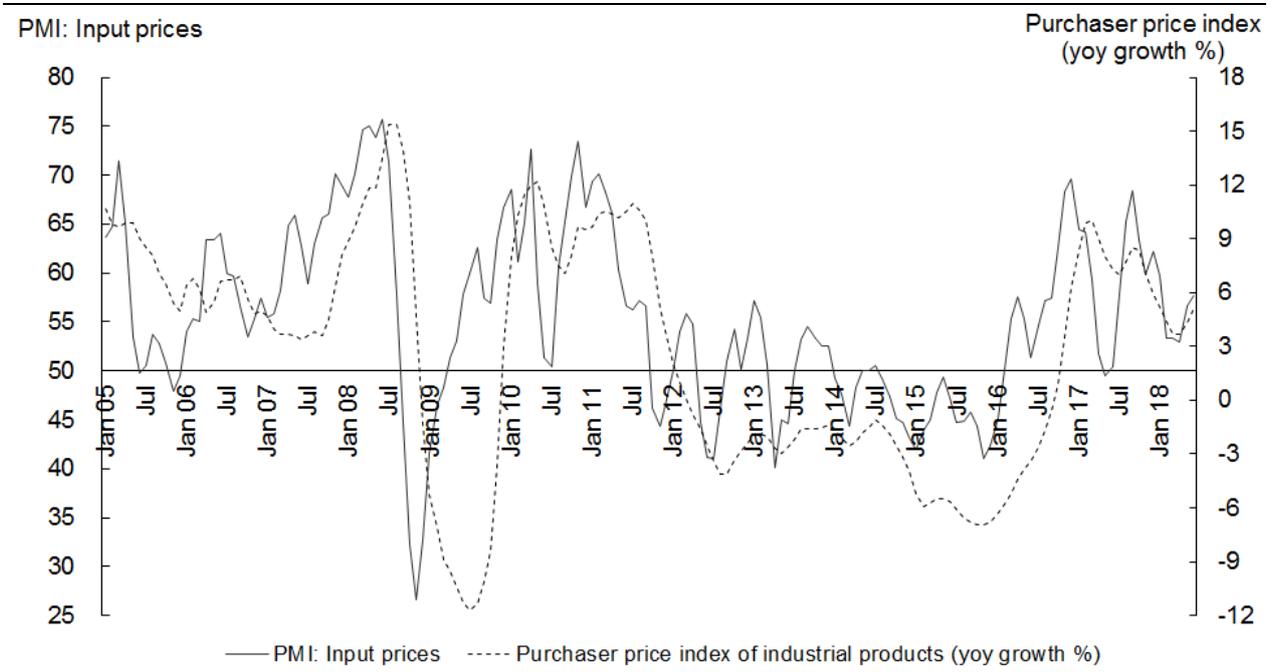
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 20 shows that the input prices index is useful as a leading indicator of upstream prices. To show the association between the input prices index and ‘midstream’ prices, we plot the input prices index against the year-on-year growth of the producer price index (PPI)<sup>2</sup> in exhibit 21. Going forward, we expect that the year-on-year growth rates for the producer price index (PPI) and purchaser price index will rise further in near future. Meanwhile, we forecast that the year-on-year CPI growth will hover around 2% in the coming months. Finally, to see the extent to which input costs of Chinese manufacturers are affected by global commodity prices, exhibit 22 puts together the input prices index and the Thomson Reuters/ CoreCommodity CRB index.<sup>3</sup>

2 The producer price index of industrial goods (PPI), compiled by China National Bureau of Statistics, measures the prices of industrial products when they are sold for the first time after production.

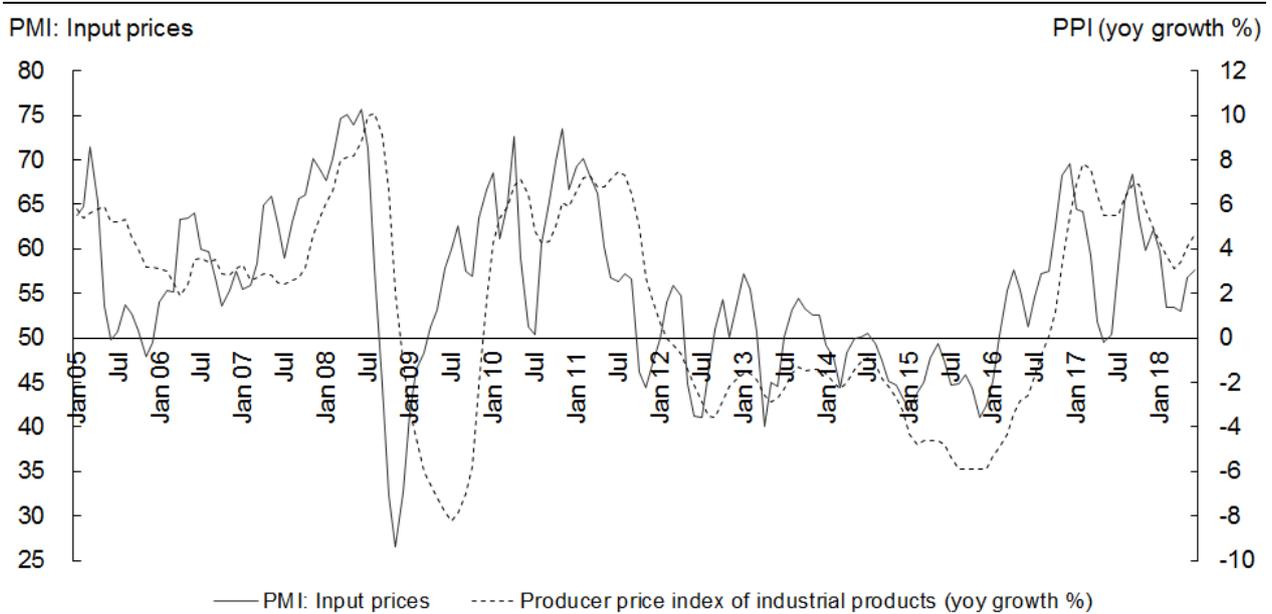
3 The Thomson Reuters/ CoreCommodity CRB Index, which comprises 19 commodities such as crude oil, aluminum, corn, cotton, gold, natural gas, soybeans, etc, has served as one of the most recognized measures of global commodities markets.

**Exhibit 20: Input prices index and purchaser price index of industrial products, January 2005 to June 2018**



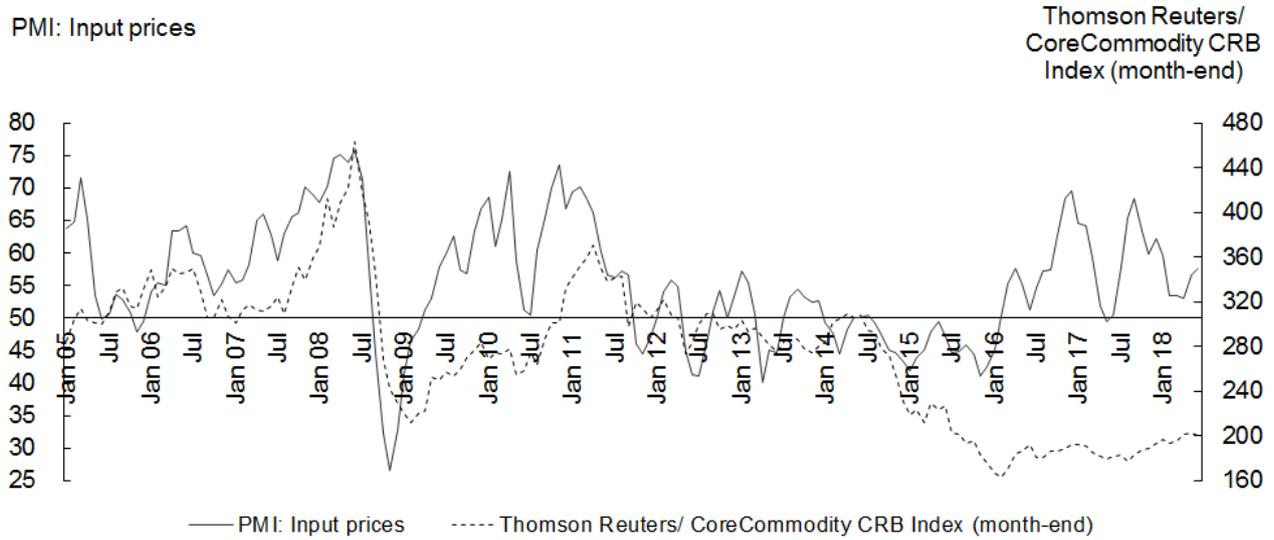
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

**Exhibit 21: Input prices index and producer price index, January 2005 to June 2018**



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

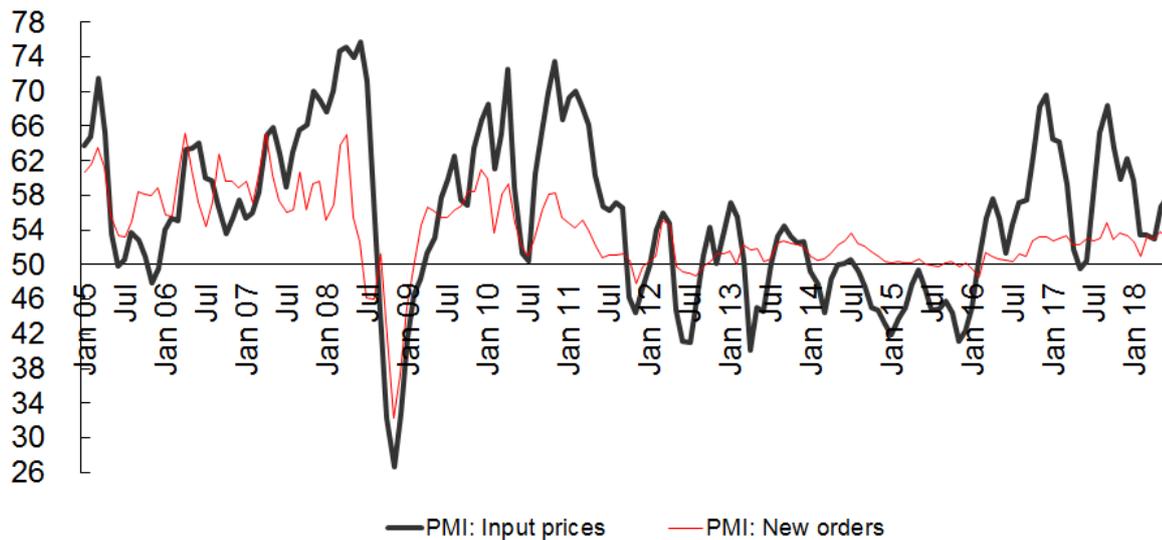
**Exhibit 22: Input prices index and Thomson Reuters/ CoreCommodity CRB Index, January 2005 to June 2018**



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics, Thomson Reuters

Exhibit 23 tries to give a convenient way of assessing and analyzing the profitability of Chinese manufacturers – since new orders represent source of new revenue and input prices represent production cost. If the former rises faster than the latter, profitability tends to improve, and vice versa. In recent months, input prices have continued to rise faster than new orders. This may imply a decrease in manufacturers’ profit margins in the near future.

**Exhibit 23: Input prices and new orders, January 2005 to June 2018**

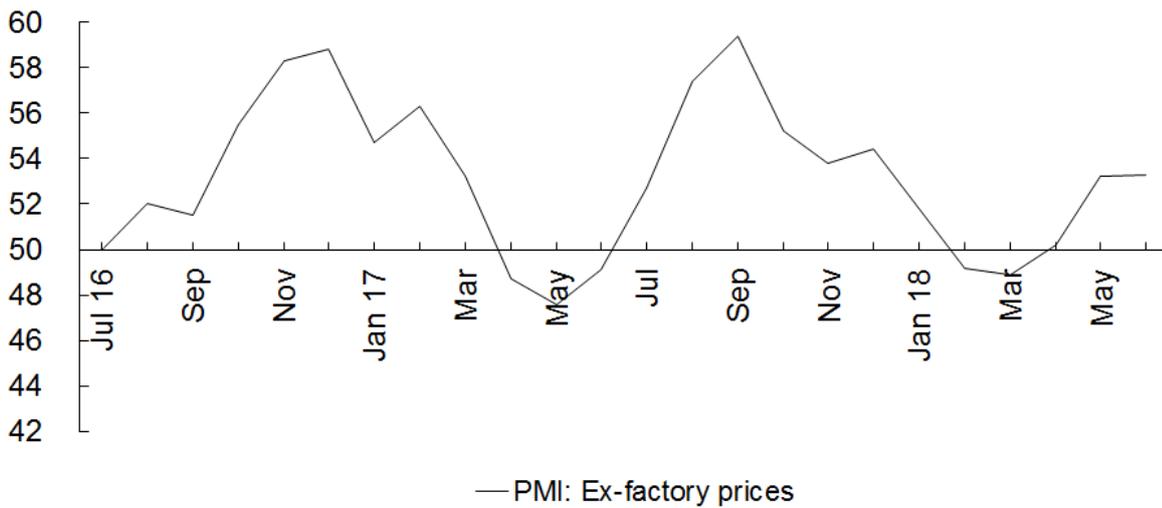


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

**8. Ex-factory prices index stays above critical 50-mark**

The ex-factory prices index advanced from 50.2 in April to 53.2 in May, and further to 53.3 in June. The index has been above the critical 50-mark since April this year, showing that Chinese manufacturers have recently increased the ex-factory prices of finished goods amid a rise in prices of production inputs.<sup>4</sup> (Exhibit 24)

**Exhibit 24: Ex-factory prices index, July 2016 to June 2018**



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

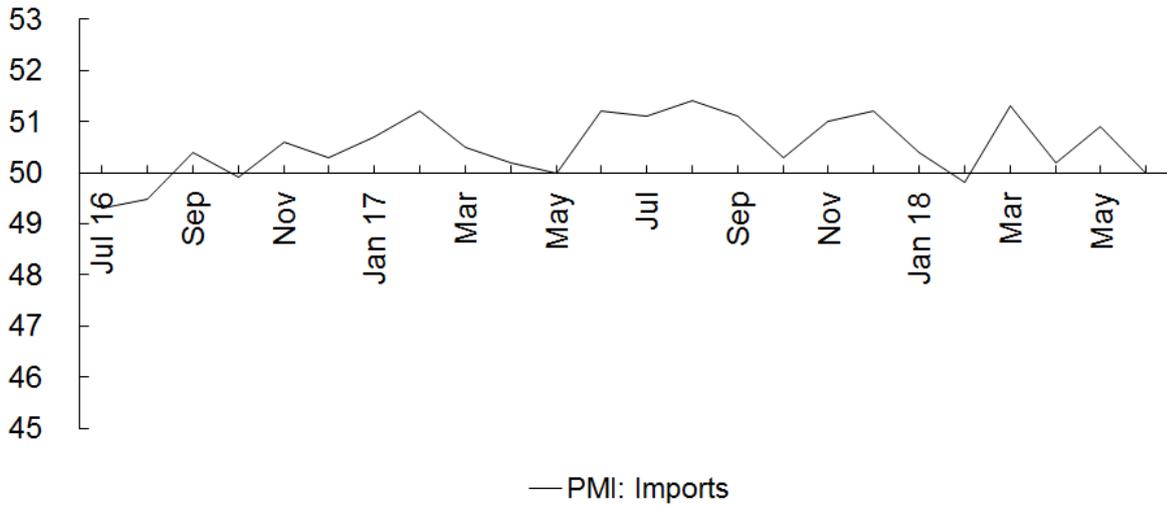
**9. Imports index falls to a four-month low**

After going up from 50.2 in April to 50.9 in May, the imports index went down to a four-month low of 50.0 in June. The latest reading shows a moderation in the import demand for raw materials and parts used in manufacturing in June. (Exhibit 25)

Exhibit 26 shows that the imports index is highly correlated (with some lags) to the year-on-year growth rate in imports. We expect import growth to decelerate in 3Q18. Exhibit 27 illustrates the strong association between the imports index and the purchases of inputs index – as Chinese manufacturers purchase a large amount of production inputs and parts from overseas. Besides, China is a major importer of oil, iron ore and other raw materials. To see how heavily China’s imports of inputs are affected by world commodity prices, we plot the imports index against the Thomson Reuters/ CoreCommodity CRB index. It is found that the imports index has been positively related to global commodity prices. (Exhibit 28)

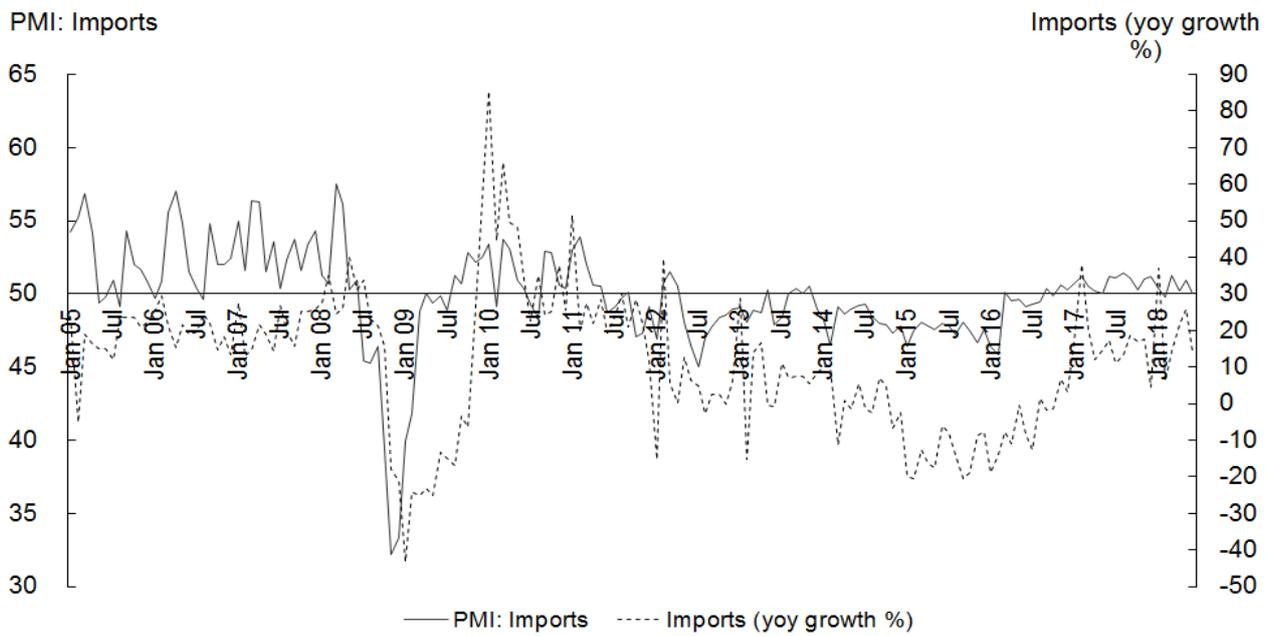
<sup>4</sup> The ex-factory prices index has been published since January 2017.

Exhibit 25: Imports index, July 2016 to June 2018



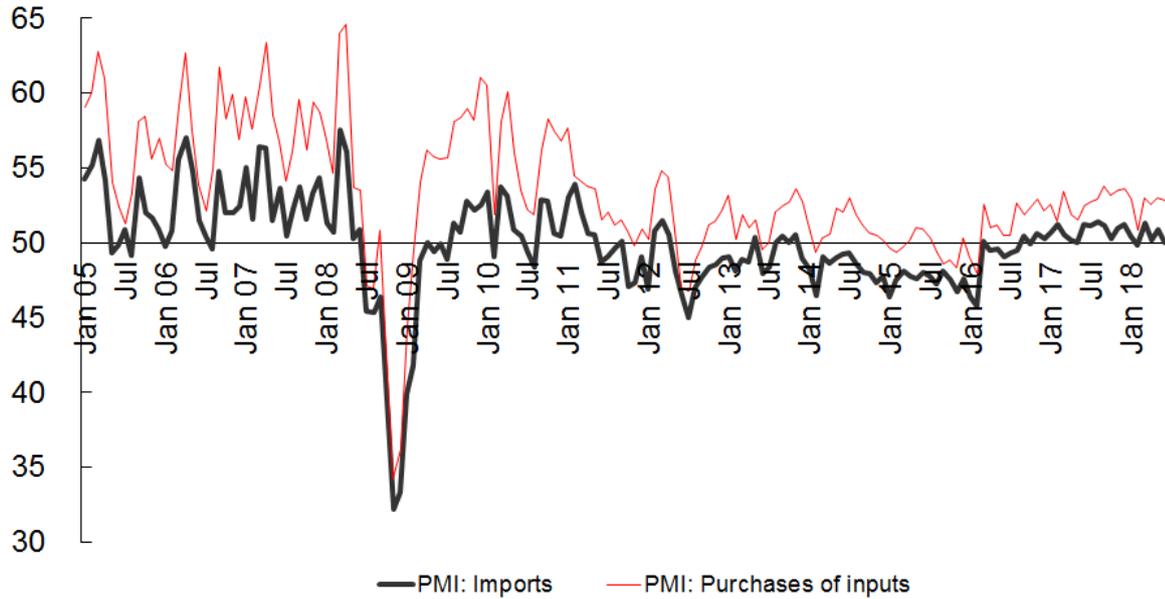
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 26: Imports index and import growth, January 2005 to June 2018



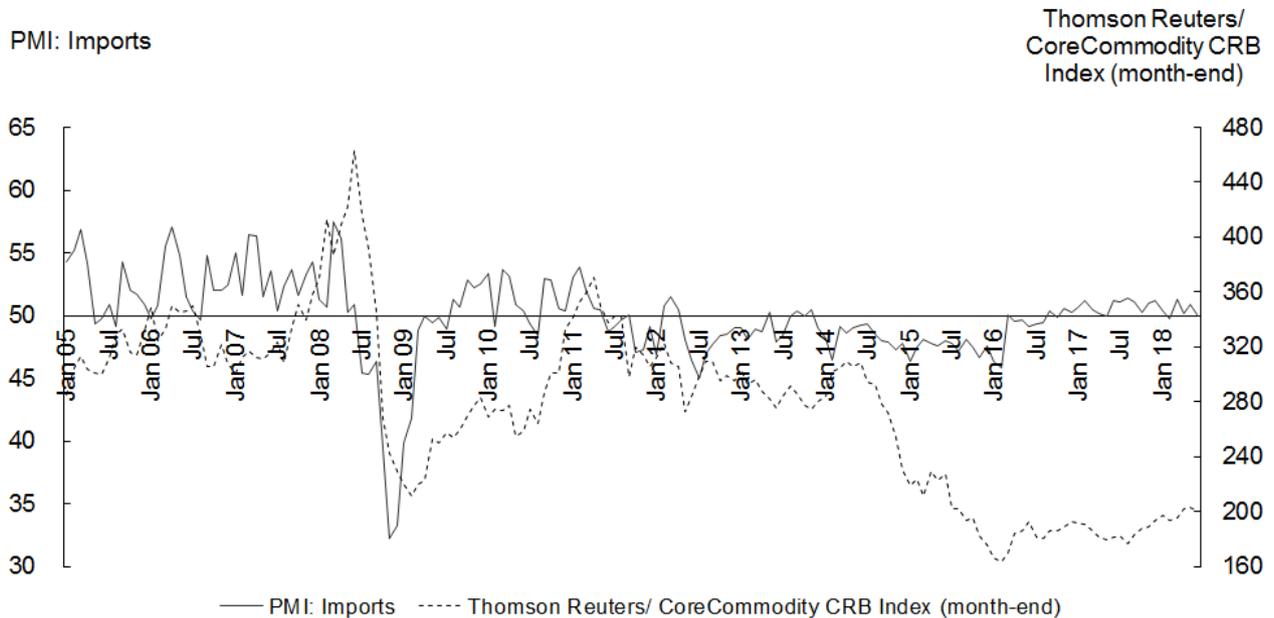
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics, China Customs

**Exhibit 27: Imports and purchases of inputs, January 2005 to June 2018**



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

**Exhibit 28: Imports index and Thomson Reuters/ CoreCommodity CRB Index, January 2005 to June 2018**

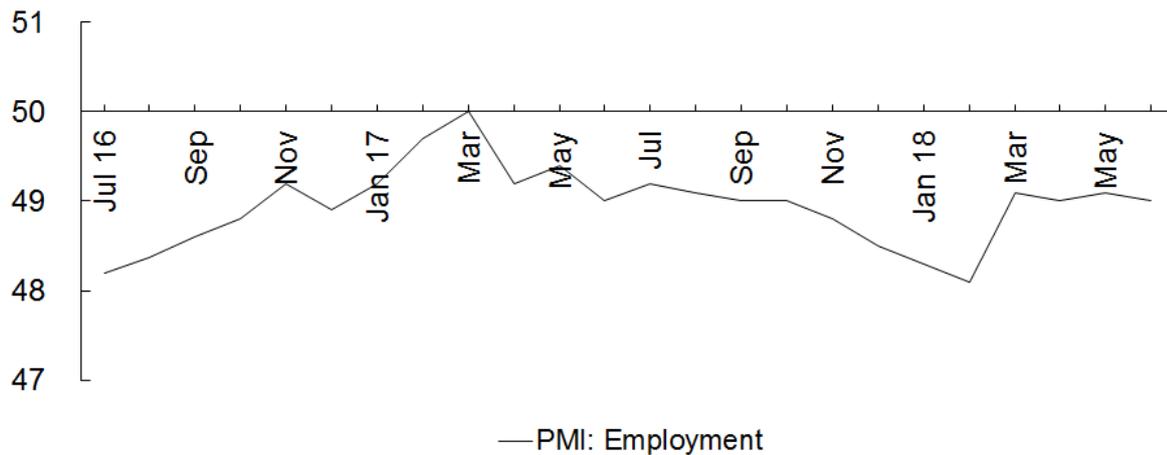


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics, Thomson Reuters

10. Employment index stays around 49

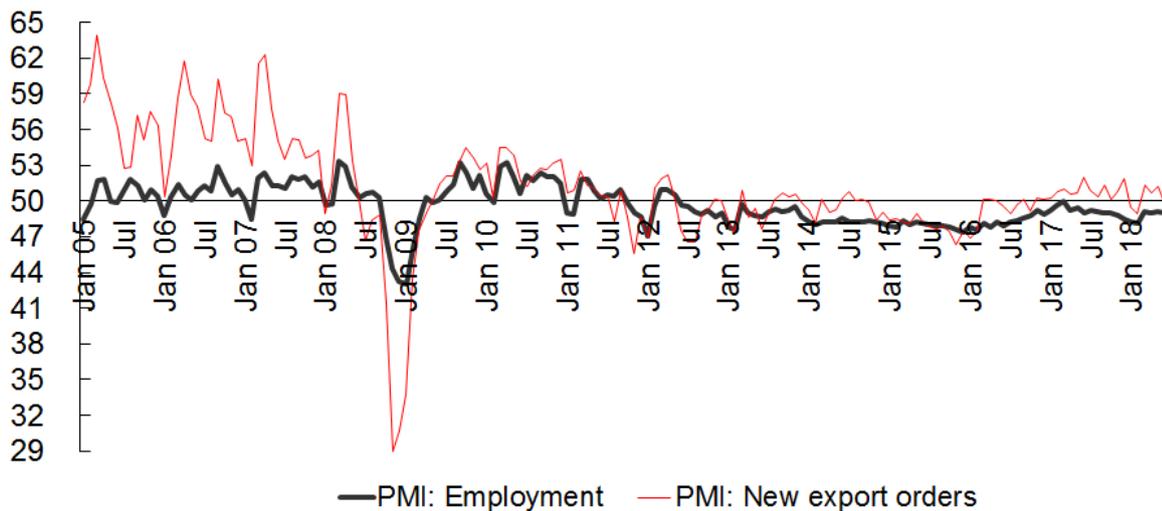
The employment index fluctuated within the narrow range of 49.0 to 49.1 throughout April to June. (Exhibit 29) The index has been slightly below 50 since April 2017, indicating that manufacturing employment has been falling in a slow and gradual manner. This was attributable to an improvement in production efficiency of factories in China, in our view.

Exhibit 29: Employment index, July 2016 to June 2018



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 30: Employment and new export orders, January 2005 to June 2018

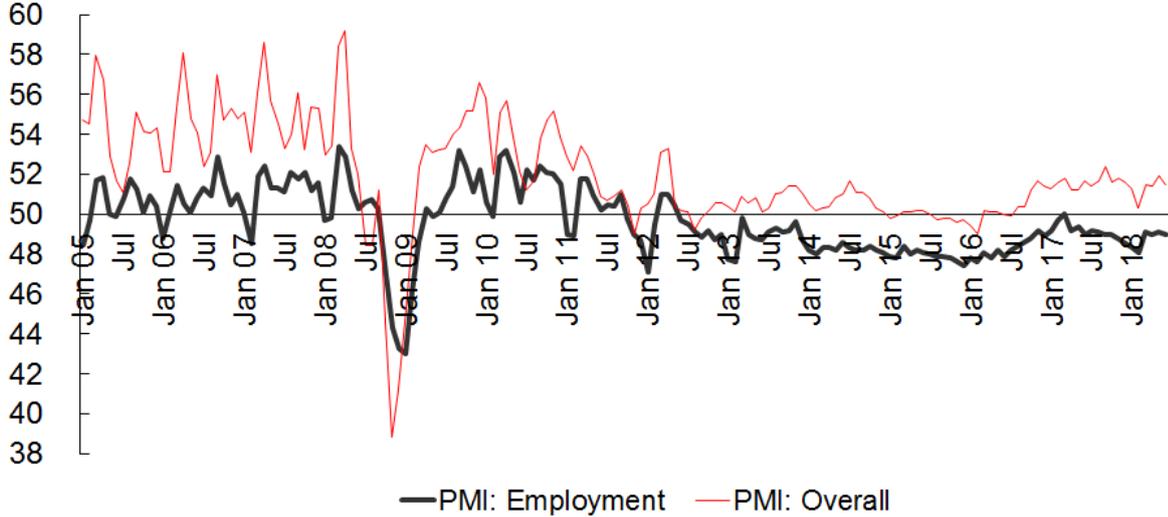


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 30 proves that the employment in China’s manufacturing sector has relied heavily on the export sector. Exhibit 31 and 32 give our readers some ideas about the extent to which the employment situation improves or deteriorates with the manufacturing sector and the overall

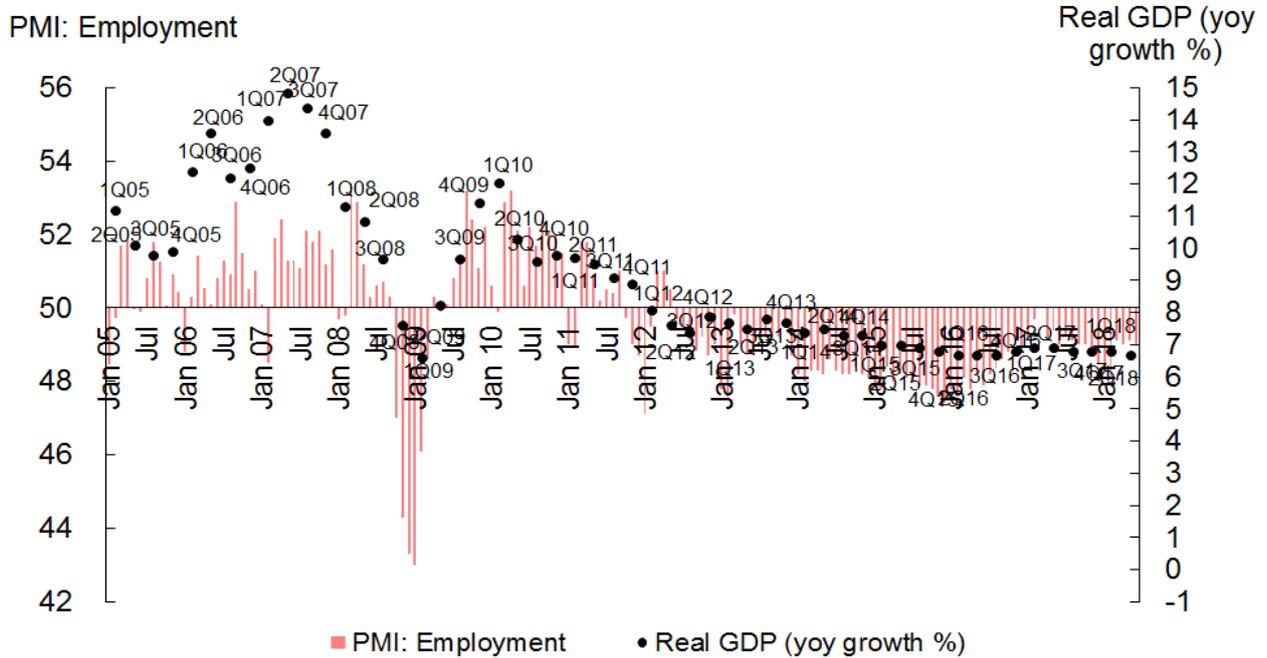
economy.

**Exhibit 31: Employment index and headline PMI, January 2005 to June 2018**



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

**Exhibit 32: Employment index and real GDP growth, January 2005 to June 2018**

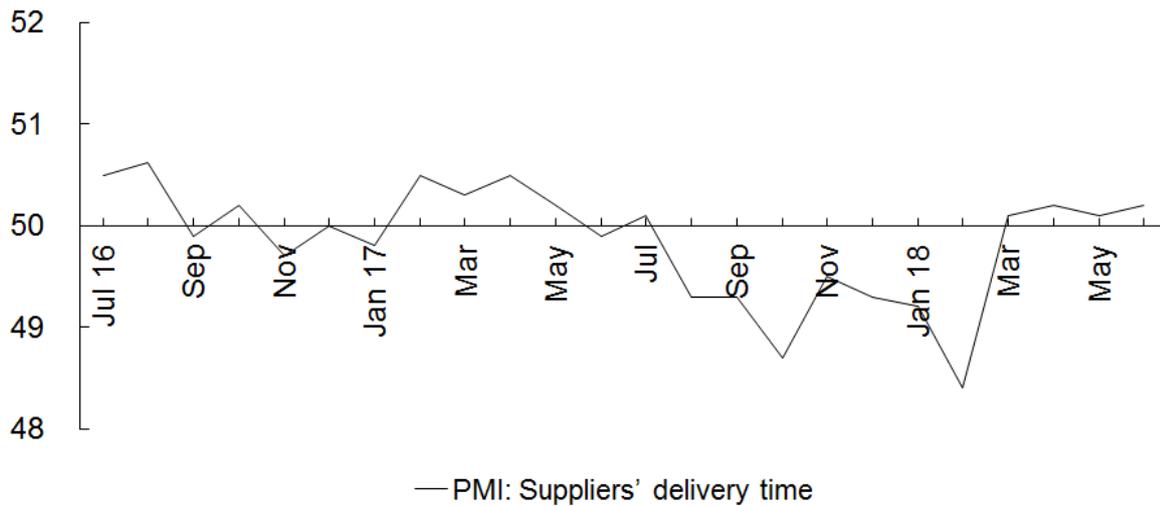


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

**11. Suppliers’ delivery time stays relatively stable**

The suppliers’ delivery time index stayed between 50.1 and 50.2 throughout April to June. The index readings in the past three months were close to the critical 50-mark, indicating that suppliers’ delivery time has stayed relatively stable recently. (Exhibit 33)

**Exhibit 33: Suppliers’ delivery time index, July 2016 to June 2018**



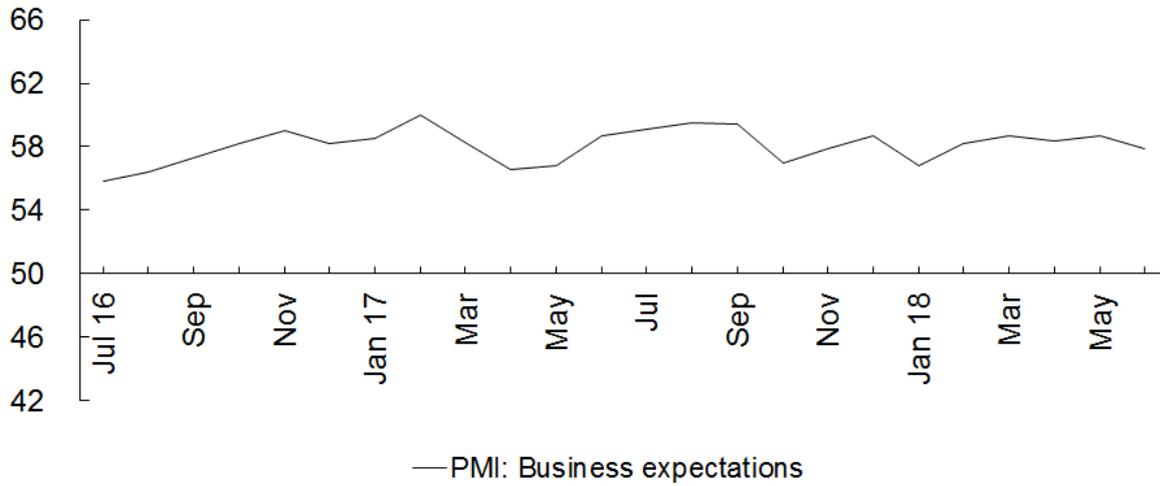
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

**12. Purchasing managers remain optimistic**

The business expectations index rose from 58.4 in April to 58.7 in May, before falling to 57.9 in June. The latest reading was still well above the critical 50-mark, indicating that purchasing managers have remained optimistic recently.<sup>5</sup> (See exhibit 34)

<sup>5</sup> Since January 2017, a new method of seasonal adjustment to the business expectations index has been adopted; and accordingly, the historical readings of the index have been revised.

Exhibit 34: Business expectations index, July 2016 to June 2018



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

**About China Manufacturing PMI:**

China Manufacturing Purchasing Managers' Index (PMI) provides an early indication each month of economic activities in the Chinese manufacturing sector. It is jointly published by China Federation of Logistics & Purchasing (CFLP) and the National Bureau of Statistics (NBS). Fung Business Intelligence is responsible for drafting and disseminating the English PMI report.

Every month questionnaires are sent to 3,000 manufacturing enterprises all over China. The data presented herein is compiled from the enterprises' responses about their purchasing activities and supply situations. CFLP makes no representation regarding the data collection procedures, nor does it disclose any data of individual enterprises. The PMI should be compared to other economic data sources when used in decision-making.

3,000 manufacturing enterprises in 31 industries from Eastern, Northeastern, Central and Western China are surveyed. The sampling of the enterprises involves the use of Probability Proportional to Size Sampling (PPS), which means the selection of enterprises surveyed is largely based on each industry's contribution to GDP, and the representation of each geographical region.

There are 13 sub-indicators in the survey: Output, New Orders, New Export Orders, Backlogs of Orders, Stocks of Finished Goods, Purchases of Inputs, Imports, Input Prices, Stocks of Major Inputs, Ex-factory Prices, Employment, Suppliers' Delivery Time and Business Expectations. An index reading above 50 indicates an overall positive change in a sub-indicator; below 50, an overall negative change.

The PMI is a composite index based on the seasonally adjusted indices for five of the sub-indicators with varying weights: New Orders—30%; Output—25%; Employment—20%; Suppliers' Delivery Time—15%; and Stocks of Major Inputs—10%. A PMI reading above 50 indicates an overall expansion in the manufacturing sector; below 50, an overall contraction.

Currently there are more than twenty countries and regions conducting the PMI survey and compilation, based on an internationally standardized methodology.

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## About the Organisations:

### China Federation of Logistics & Purchasing

China Federation of Logistics & Purchasing (CFLP) is the logistics and purchasing industry association approved by the State Council. CFLP's mission is to push forward the development of the logistics industry and the procurement businesses of both government and enterprises, as well as the circulation of factors of production in China. The government authorizes the CFLP to produce industry statistics and set industry standards. CFLP is also China's representative in the Asian-Pacific Logistics Federation (APLF) and the International Federation of Purchasing and Supply Management (IFPSM).

### Fung Business Intelligence

Fung Business Intelligence collects, analyses and interprets market data on global sourcing, supply chains, distribution, retail and technology.

Headquartered in Hong Kong, it leverages unique relationships and information networks to track and report on these issues with a particular focus on business trends and developments in China and other Asian countries. Fung Business Intelligence makes its data, impartial analysis and specialist knowledge available to businesses, scholars and governments around the world through regular research reports and business publications.

As the knowledge bank and think tank for the Fung Group, a Hong Kong-based multinational corporation, Fung Business Intelligence also provides expertise, advice and consultancy services to the Group and its business partners on issues related to doing business in China, ranging from market entry and company structure, to tax, licensing and other regulatory matters.

Fung Business Intelligence was established in the year 2000.

### Fung Group

The Fung Group is a privately held multinational group of companies headquartered in Hong Kong whose core businesses are trading, logistics, distribution and retailing. The Fung Group employs over 39,900 people across 40 economies worldwide, generating total revenue of over US\$22.5 billion in 2016. Fung Holdings (1937) Limited, a privately held business entity headquartered in Hong Kong, is the major shareholder of the Fung group of companies.

Please visit [www.funggroup.com](http://www.funggroup.com) for more about the Fung Group.



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