

# PMI Quarterly on China Manufacturing

## China Federation of Logistics & Purchasing

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## PMI indicates a continuous improvement in the manufacturing sector and the economy

- Output index rises to five-year high.
- Both new orders and new export orders indices go up in September.
- Backlogs of orders index advances in September.
- Stocks of finished goods continue to drop.
- Growth in purchasing activities accelerates.
- Prices of production inputs soar.
- Ex-factory prices continue to go up.
- Imports of raw materials and parts increase at a relatively fast pace.
- Employment index stabilizes at around 49.
- Suppliers' delivery slows.
- Purchasing managers are optimistic.

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## 1. PMI indicates a continuous improvement in the manufacturing sector and the economy

China's manufacturing PMI rose from 51.4 in July to 51.7 in August. The index went up further to 52.4 in September, the highest level since May 2012. The index readings in recent months show that the manufacturing sector and the economy in China have continued to improve. (See exhibit 1)

It is noteworthy to recognize the discrepancy by size of enterprises. After dropping slightly from 52.9 in July to 52.8 in August, the PMI of 'large enterprises' rose to 53.8 in September, indicating that the growth in 'large enterprises' has accelerated recently. Meanwhile, the PMI of 'medium enterprises' improved from 49.6 in July to 51.0 in August, and further to 51.1 in September. The index has been above the critical 50-mark for two consecutive months, indicating an expansion for 'medium enterprises'. The PMI of 'small enterprises' climbed from 48.9 in July to 49.1 in August. The index then went up to 49.4 in September, but was still below 50, indicating that 'small enterprises' have contracted at a slower pace recently. (See exhibit 2)

The recent trend of the headline PMI indicates a continuous improvement in the economy. The output index rose in August and September, suggesting that growth in production activities tends to accelerate. Besides, the new orders index went up to a five-year high of 54.8 in September, reflecting the relatively fast growth in total new orders. Nevertheless, the input prices index registered 65.3 in August and 68.4 in September, well above the critical 50-mark, showing a sharp rise in the prices of production inputs in recent months. Upstream cost pressure on manufacturers has been building up. In response, manufacturers have continued to increase ex-factory prices of their products lately: the ex-factory prices index has stayed above the critical 50-mark for three consecutive months.

Looking ahead, the Chinese government will continue its efforts to ensure the stability of the economy and the financial system. We predict that China's monetary policy will remain prudent and neutral, and the central bank will maintain stable liquidity conditions. Meanwhile, the central government will continue its active fiscal policy. Particularly noteworthy is that, on 27 September, the central government announced a series of measures to encourage financial institutions to increase their support to micro- and small enterprises, which have continued to face difficulty in financing and high financing costs. For example, the current value added tax (VAT) exemptions for financial institutions' interest income derived from loans to rural households will be expanded to cover loans to micro- and small enterprises, and individual industrial and commercial households between 1 December 2017 and 31 December 2019. In addition, commercial banks will receive a reduction in their reserve requirement ratios if their

loans to micro- and small enterprises with a credit line below 5 million yuan, individual industrial and commercial households, rural households and startups reach a certain proportion; these banks will also receive support from the central bank via relending.

It is also expected that the government will continue with its supply-side structural reforms, focusing on tackling the overcapacity problem, reducing housing inventories, bringing down the financial leverage and costs of enterprises, shoring up weak areas; and will strengthen the regulation of the financial sector.

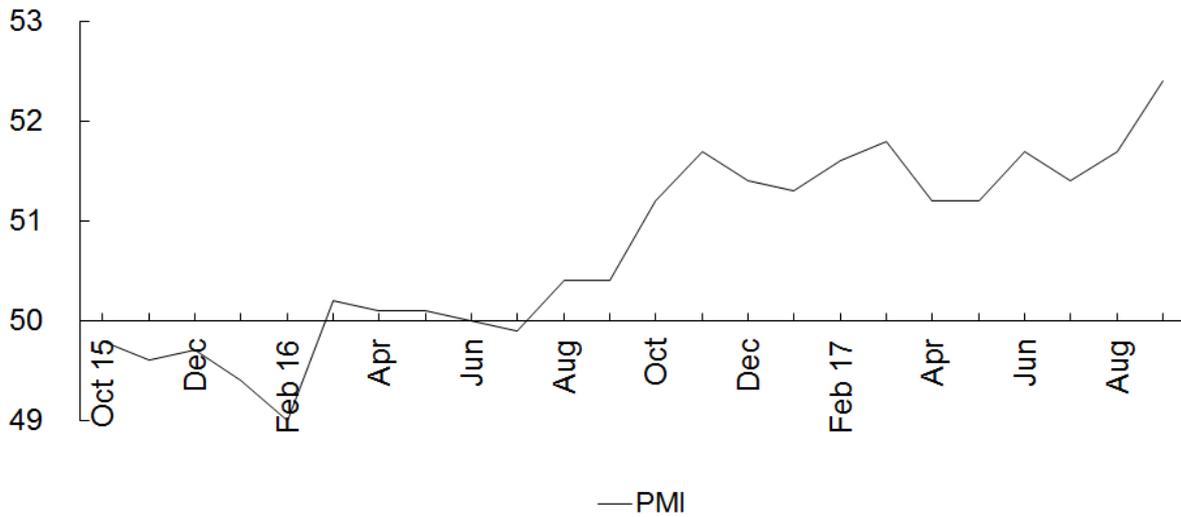
In view of the relatively strong domestic and export demand, we expect China's economy to maintain stable growth in near future. Going forward, we predict that the headline PMI will stay high at between 51.5 and 52.5 in 4Q17. We also forecast that the real GDP growth will be 6.8% in 4Q17. Challenges facing Chinese manufacturers, however, include stronger government's efforts to enforce environmental regulations, a marked increase in prices of materials, cost pressure, the greater uncertainty in the US trade policies under the Trump administration, 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 4Q17.

Exhibit 3 shows that the pick-up in the headline PMI in the past two months was largely due to the rise in the output index (which weighs 25% in the computation of the headline PMI) and the new orders index (weighs 30%). In September, 8 of the 13 sub-indices were higher than their respective levels in the previous month, while 4 sub-indices (i.e. stocks of finished goods, imports, employment and business expectations) were lower than their respective levels in the previous month. (See exhibit 4)

Among the 13 sub-indices, 8 stayed in the expansionary zone over the past three months (i.e. output, new orders, new export orders, purchases of inputs, imports, 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 stayed in the contractionary zone over the same period.

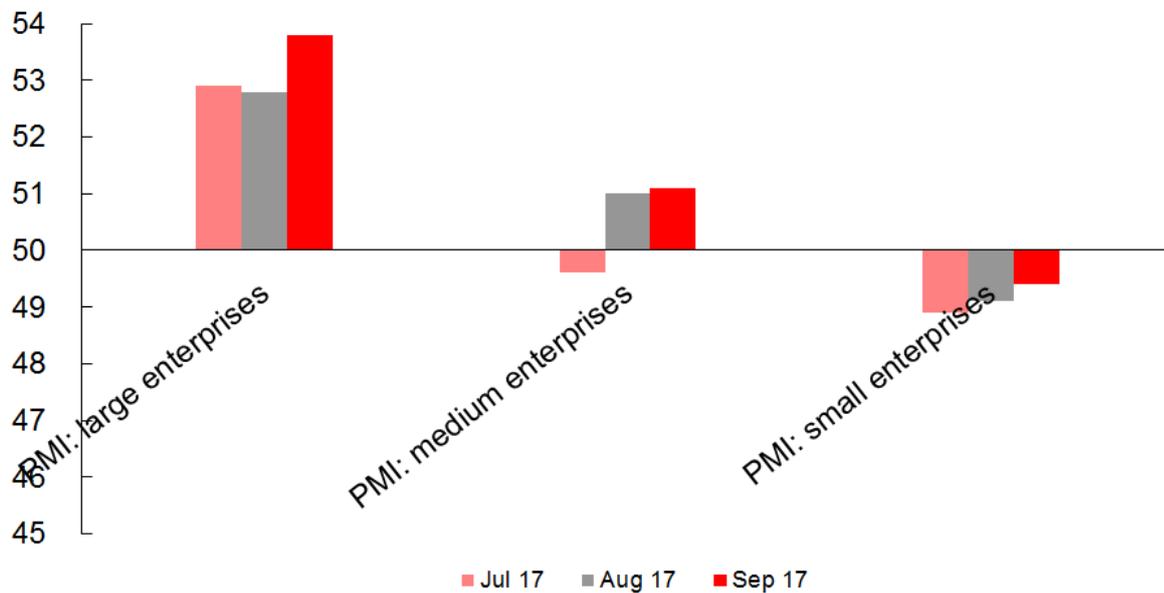
China's manufacturing PMI has so far done a satisfactory job in predicting economic growth. Exhibit 5 plots the quarterly real GDP yoy growth rates versus the monthly PMIs since its inception. It could be seen that the PMI demonstrates a fairly good track record of forecasting the growth trend of the economy at least over the next few months. Based on this chart we project that the real GDP growth will be 6.8% in 4Q17.

Exhibit 1: Headline PMI, October 2015 to September 2017



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

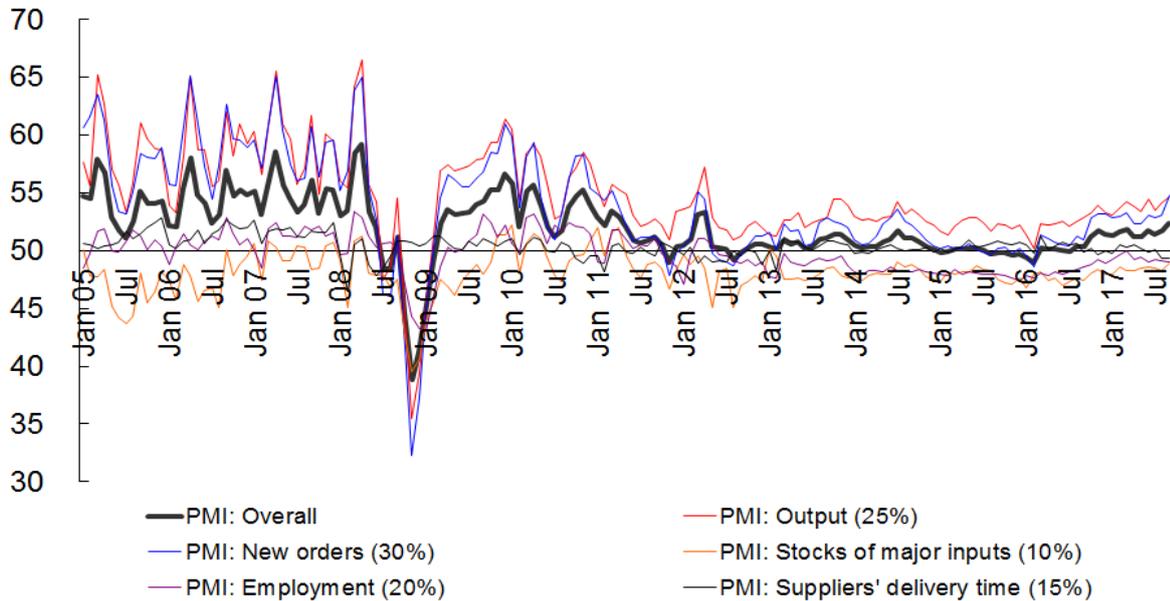
Exhibit 2: PMIs of large enterprises, medium enterprises and small enterprises, July to September 2017



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

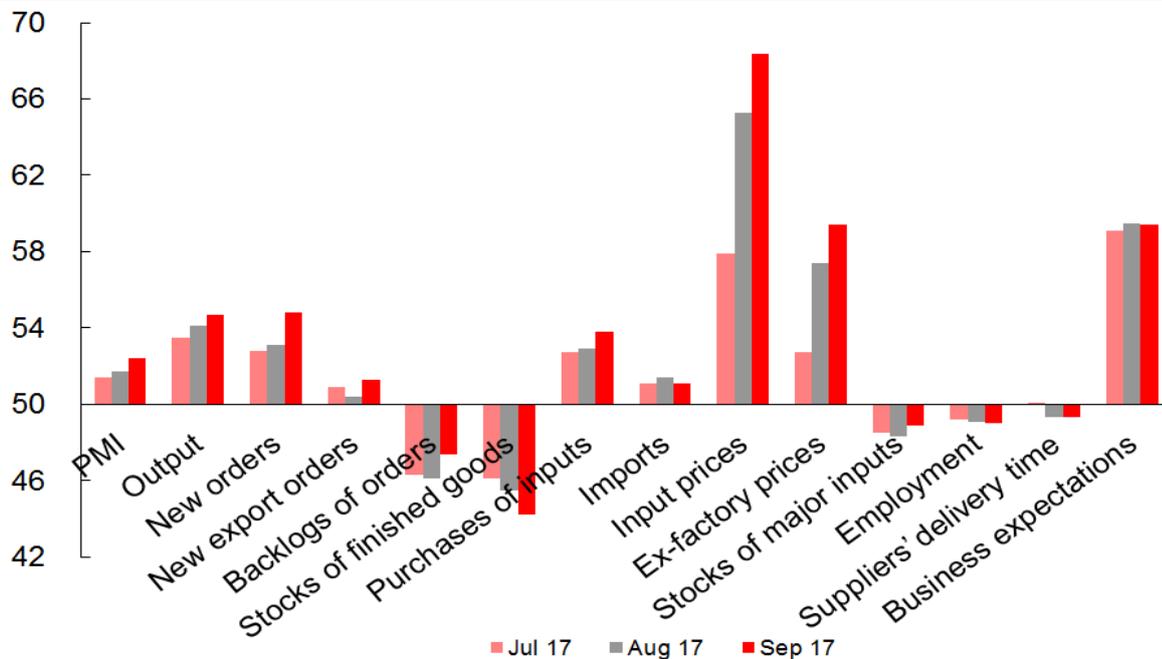
**Exhibit 3: Headline PMI and sub-indices, January 2005 to September 2017**

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



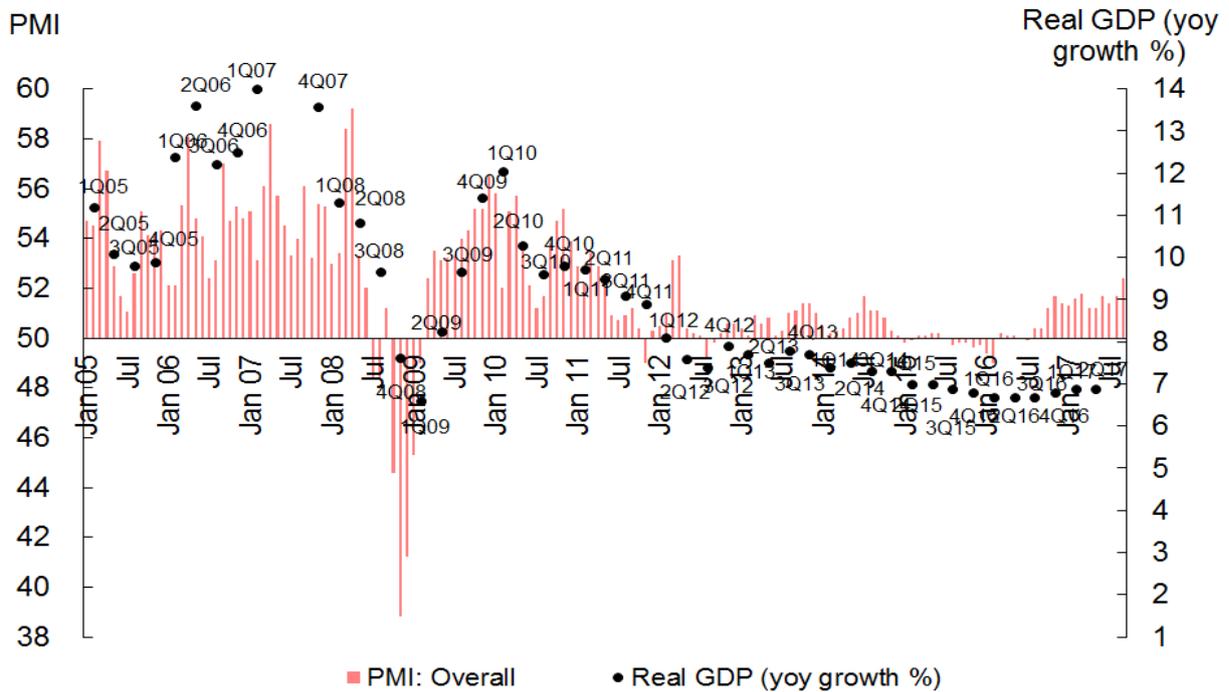
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

**Exhibit 4: Headline PMI and all sub-indices, July to September 2017**



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

Exhibit 5: Headline PMI and real GDP growth, January 2005 to September 2017



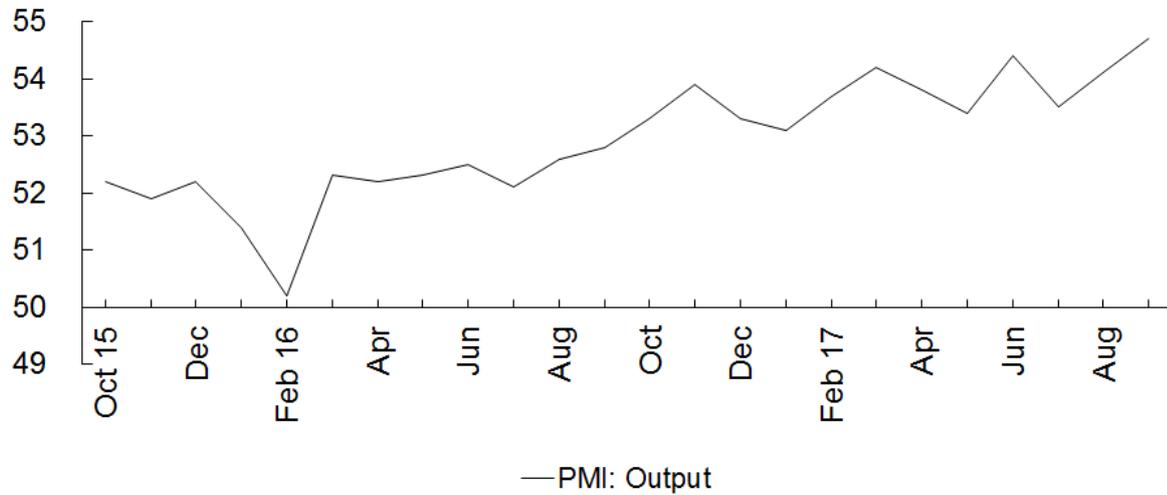
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

## 2. Output index rises to five-year high

The output index rose from 53.5 in July to 54.1 in August, and went up further to 54.7 in September, the highest level since May 2012. The uptrend indicates that growth in production activities tends to accelerate. (See exhibit 6)

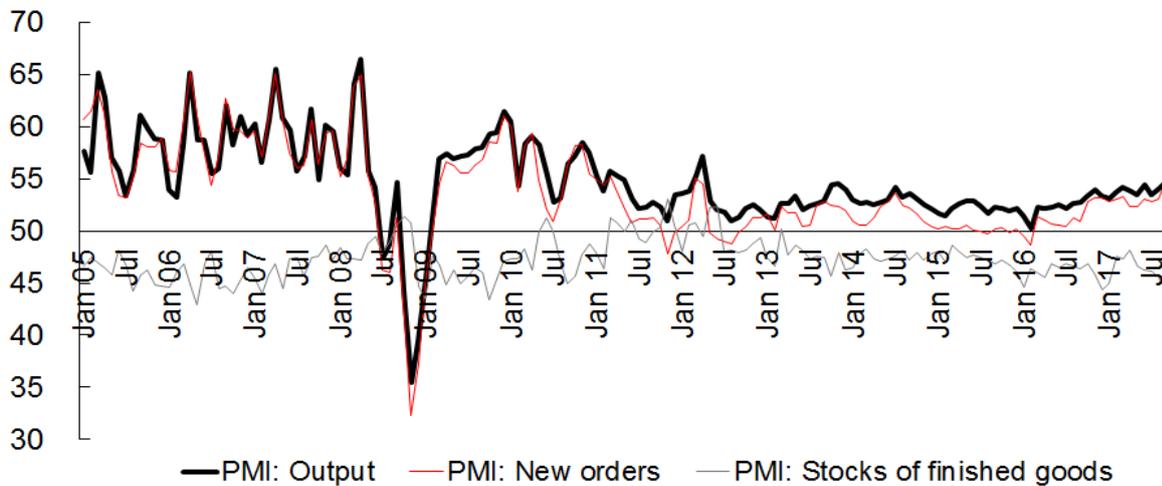
Exhibit 7 shows that the output growth was mainly fuelled by new orders growth instead of restocking activities, as the stocks of finished goods index has stayed in the contractionary zone for fifty four consecutive months. However, output may grow strongly later when manufacturers have finally run out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

**Exhibit 6: Output index, October 2015 to September 2017**



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

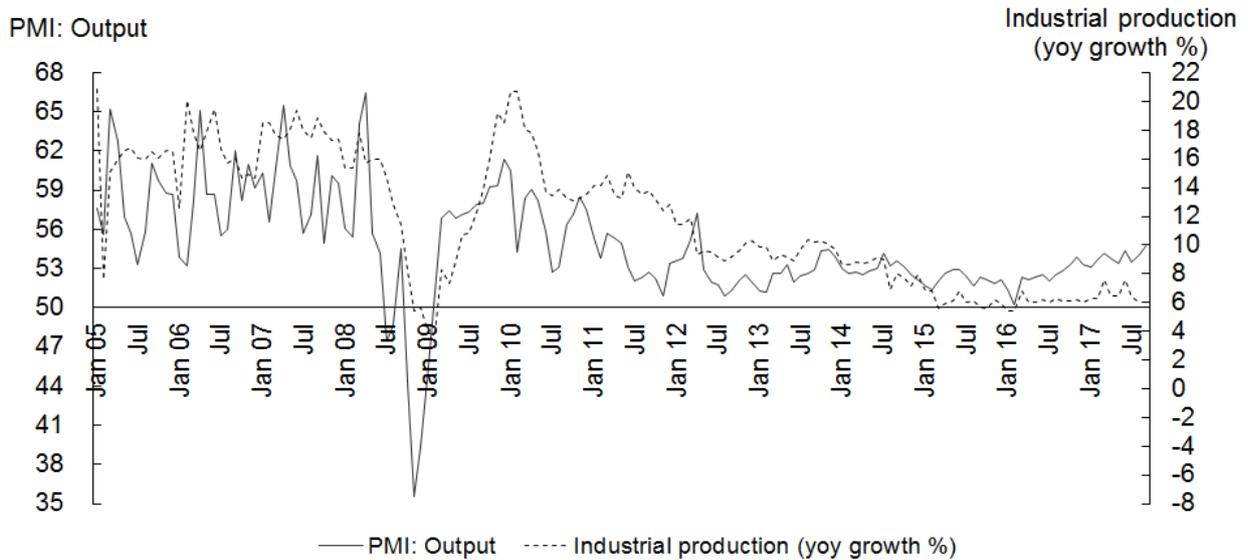
**Exhibit 7: Output, new orders and stocks of finished goods, January 2005 to September 2017**



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 4Q17. In the coming months, industrial activities will be supported by the increasing demand. Challenges facing Chinese manufacturers, however, include stronger government’s efforts to enforce environmental regulations, a marked increase in prices of materials, cost pressure, the greater uncertainty in the US trade policies under the Trump administration, intense competition in the international market, and the weak demand for luxury products.

**Exhibit 8: Output index and industrial production growth, January 2005 to September 2017**



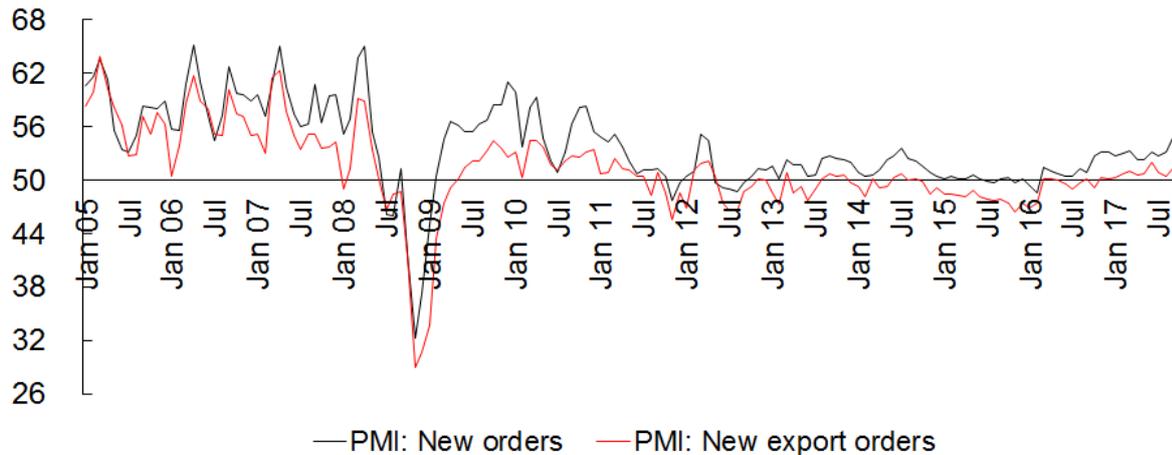
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

### 3. Both new orders and new export orders indices go up in September

The new orders index went up from 52.8 in July to 53.1 in August. Afterwards, in September, the index rose to a five-year high of 54.8, showing that the growth momentum of new orders has been relatively strong recently. Since May this year, the index has generally been on an upward trend, showing a continuous increase in the overall demand.

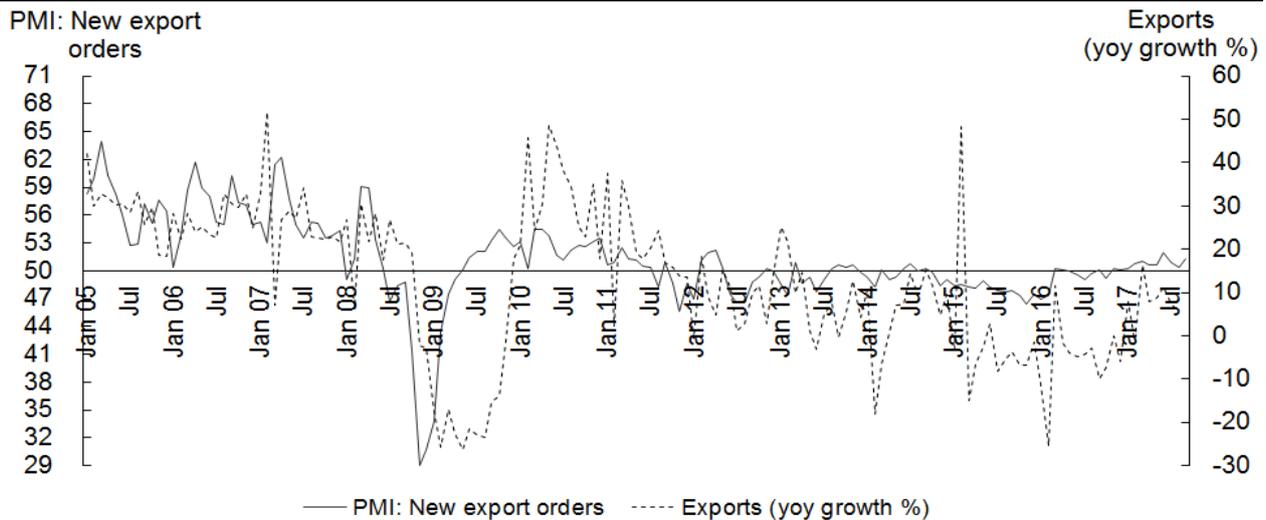
The new export orders index rebounded to 51.3 in September, after having fallen for two consecutive months. The September reading indicates a stabilization in export demand. (See exhibit 9)

**Exhibit 9: New orders index and new export orders index, January 2005 to September 2017**



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

**Exhibit 10: New export orders index and export growth, January 2005 to September 2017**



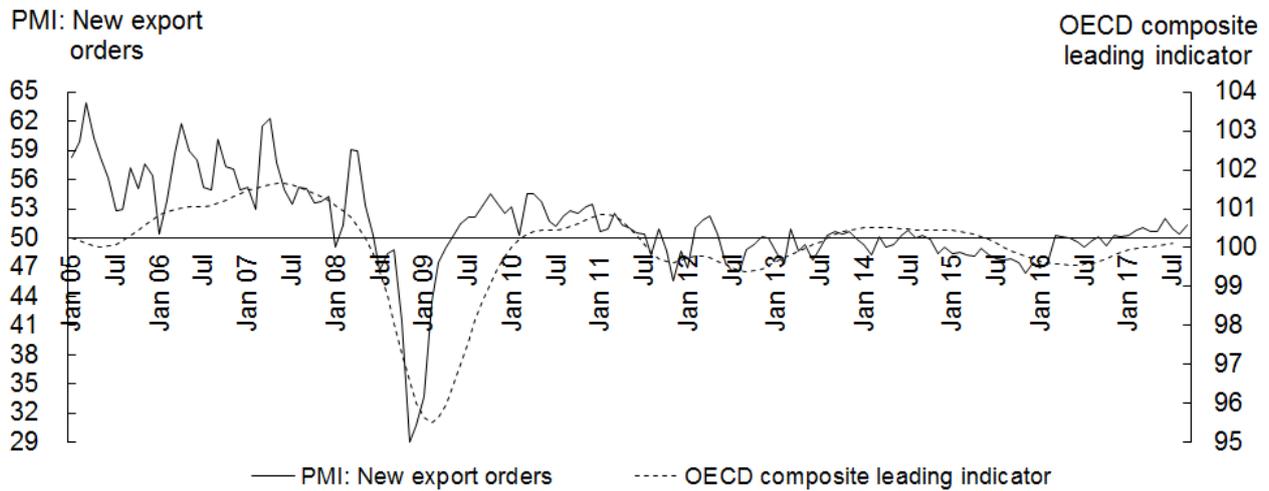
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics, China Customs

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 in September rebounded to the second highest level in sixty five months, we have been 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 an upward trend

<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.

since July last year, suggesting a continuous improvement in the global economy. All in all, we forecast that China’s exports will show high single-digit year-on-year growth in 4Q17.

**Exhibit 11: New export orders index and OECD composite leading indicator, January 2005 to September 2017**



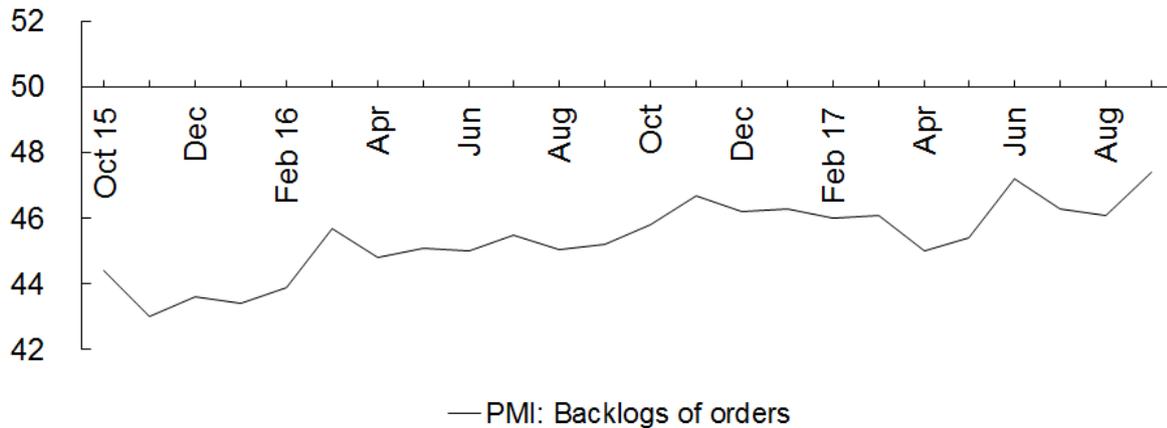
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics, Organization for Economic Cooperation and Development

**4. Backlogs of orders index advances in September**

The backlogs of orders index went down from 46.3 in July to 46.1 in August, before advancing to 47.4 in September. The index has been in the contractionary zone since April 2012, indicating that backlogs of orders have continued to drop. (See exhibit 12)

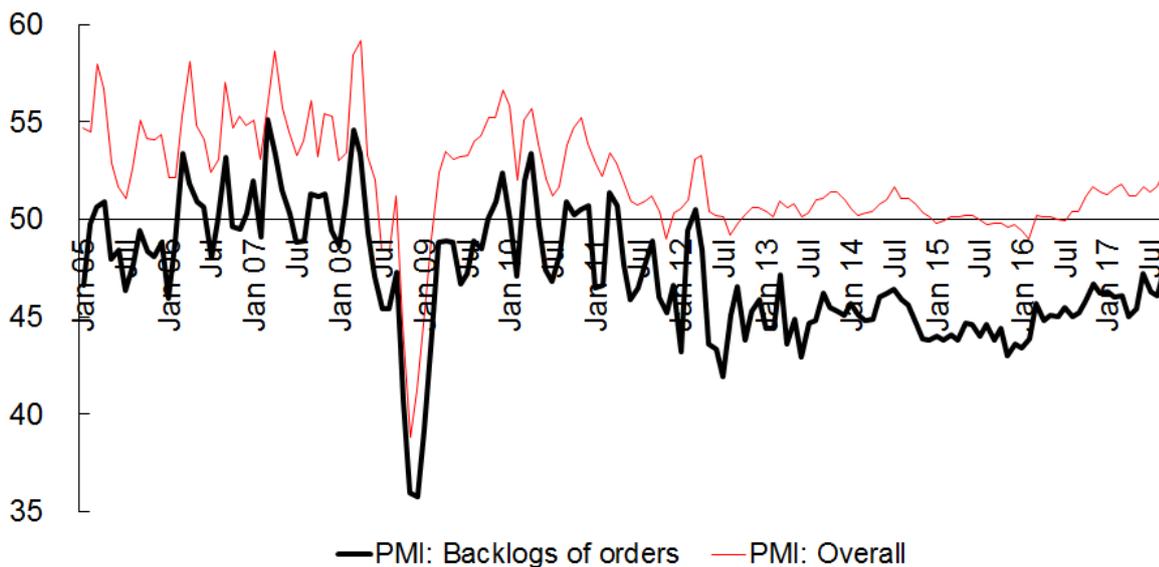
Looking ahead, we expect the index to go up in the near term, as indicated by the apparently very high correlation between the sub-index and the headline PMI, and the recent rise in the headline PMI. (See exhibit 13)

**Exhibit 12: Backlogs of orders index, October 2015 to September 2017**



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

**Exhibit 13: Backlogs of orders index and headline PMI, January 2005 to September 2017**



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

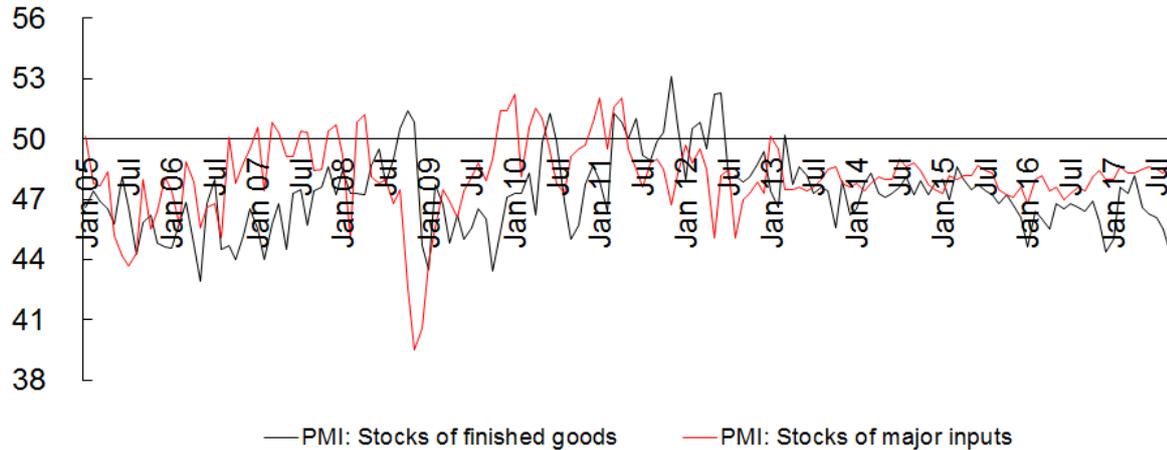
### 5. Stocks of finished goods continue to drop

The stocks of finished goods index fell from 46.1 in July to 45.5 in August, and then went down to 44.2 in September. The index stayed in the contractionary zone in the past three months, indicating that the stocks of finished goods held by manufacturers continued to drop during the period.

The stocks of major inputs index fluctuated within the range of 48.3 to 48.9 throughout July to

September. (Exhibit 14) The index remained below the critical 50-mark in the past three months, indicating a continuous fall in the stocks of major inputs.

**Exhibit 14: Stocks of finished goods index and stocks of major inputs index, January 2005 to September 2017**



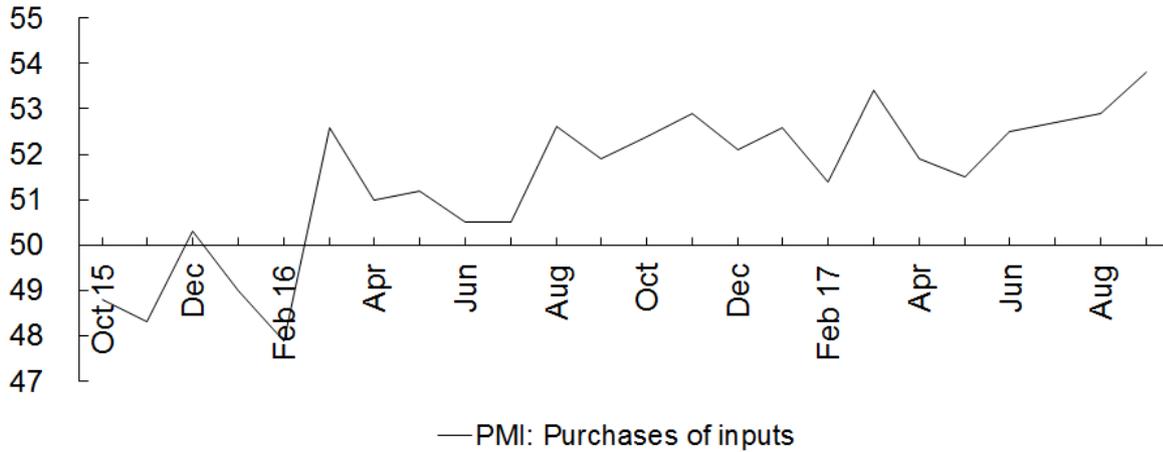
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

## 6. Growth in purchasing activities accelerates

The purchases of inputs index rose slightly from 52.7 in July to 52.9 in August, and then advanced to 53.8 in September, indicating an acceleration in the growth in purchasing activities. (Exhibit 15)

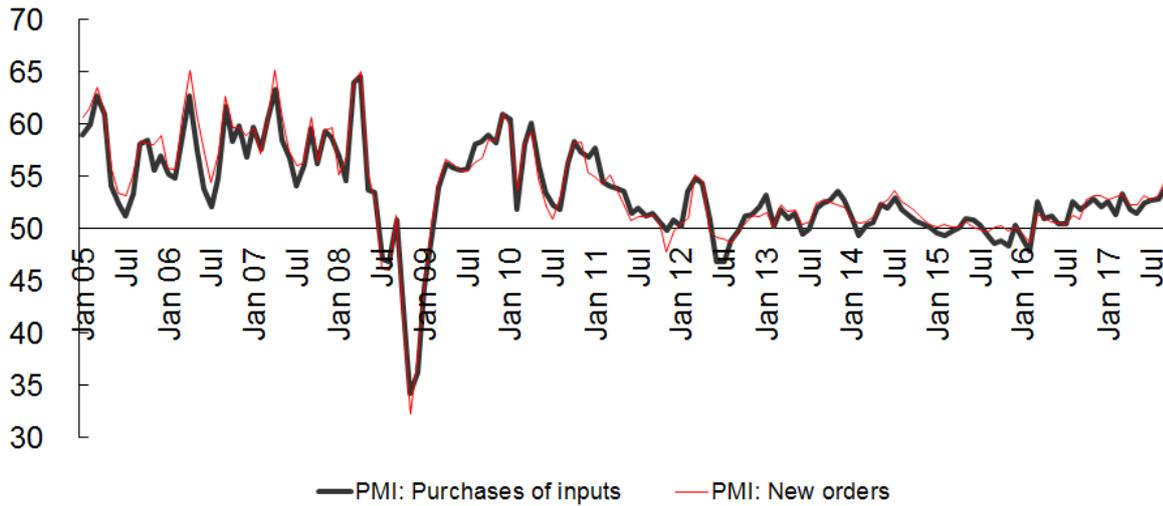
A number of factors affect the purchasing activities of manufacturers, among which the amount of new orders received by manufacturers has been the most important factor. Exhibit 16 plots the purchases of inputs index against the new orders index. The correlation between the two sub-indices is very strong. 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 increase 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, October 2015 to September 2017**



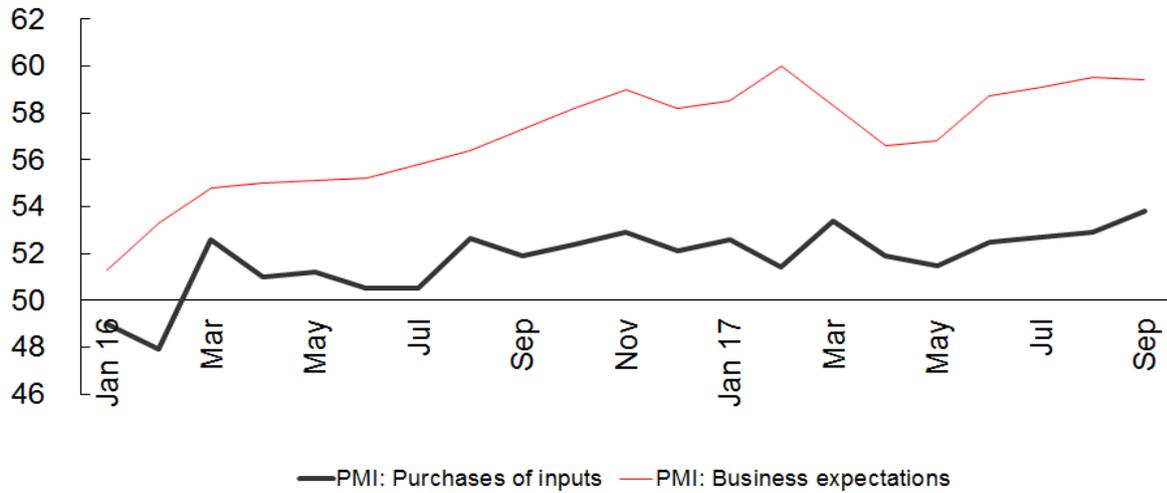
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

**Exhibit 16: Purchases of inputs and new orders, January 2005 to September 2017**



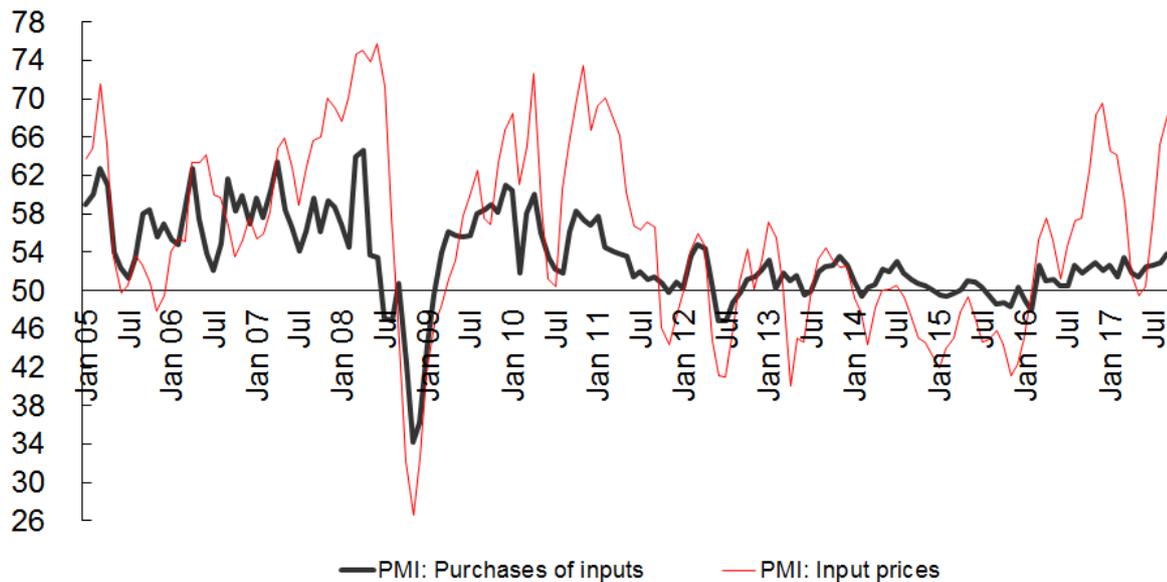
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

**Exhibit 17: Purchases of inputs and business expectations, January 2016 to September 2017**



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

**Exhibit 18: Purchases of inputs and prices of major inputs, January 2005 to September 2017**

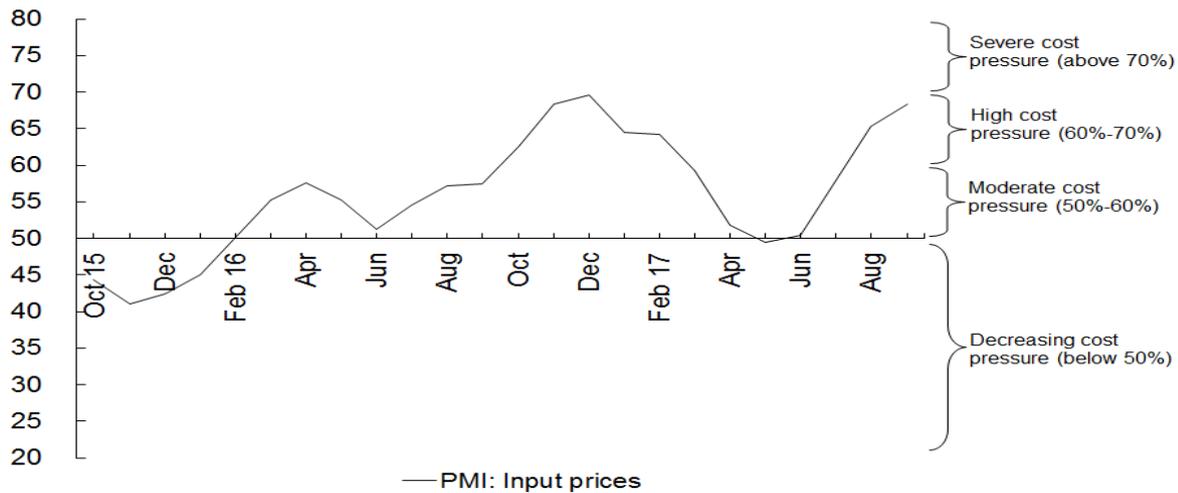


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

7. Prices of production inputs soar

The input prices index jumped from 57.9 in July to 65.3 in August. Then, in September, the index rose to 68.4, well above the critical 50-mark, showing a sharp rise in the prices of production inputs in the month. (Exhibit 19)

Exhibit 19: Input prices index, October 2015 to September 2017

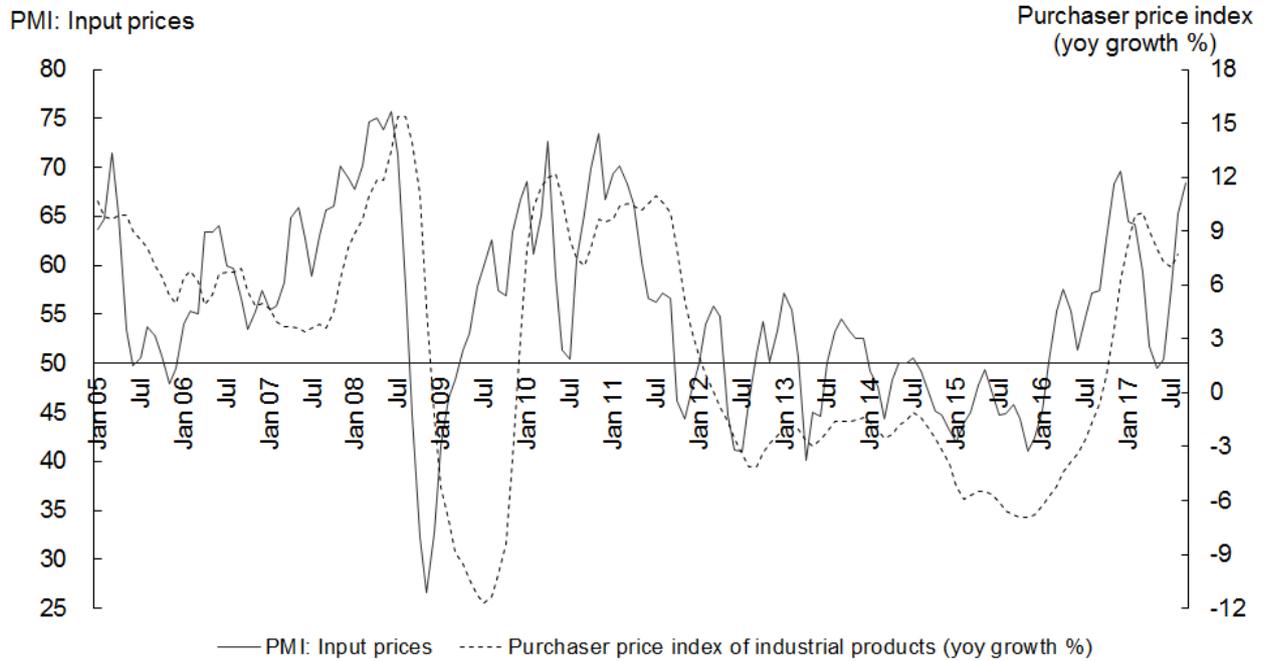


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

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. However, we forecast that the CPI growth will fall a bit and then stay low in 4Q17, due to a higher comparison base in the fourth quarter last year and the continued deflation in food prices. 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>

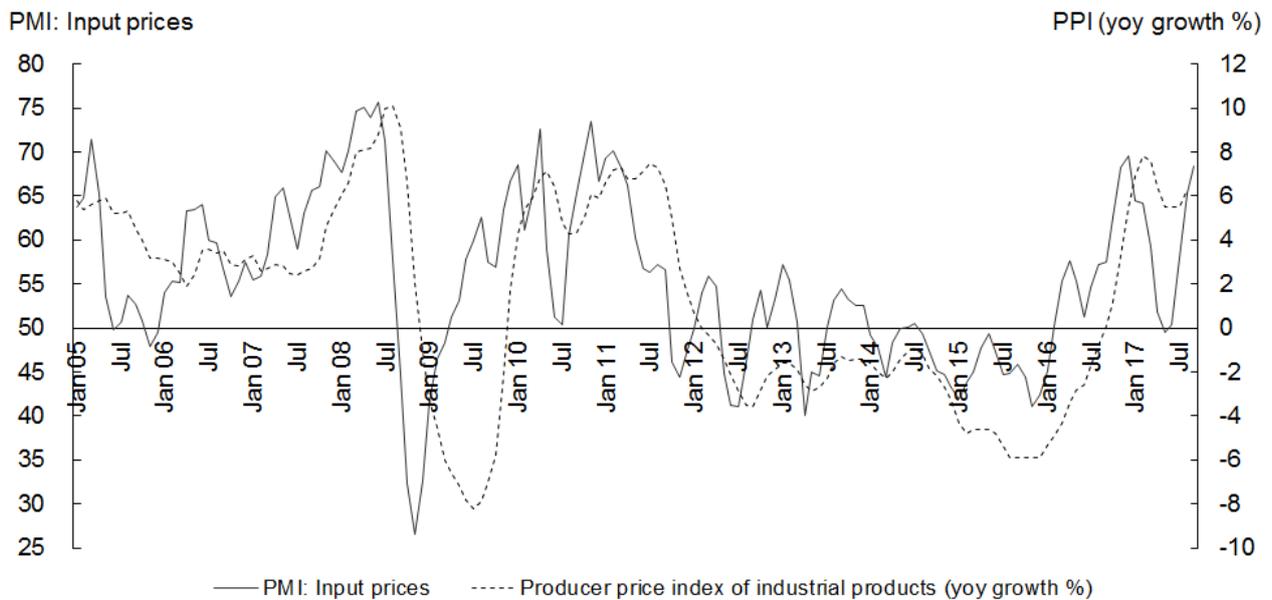
2 The producer price index of industrial goods (PPI), compiled by China National Bureau of Statistics, measures the prices of industrial products when they are sold for the first time after production.  
 3 The Thomson Reuters/ CoreCommodity CRB Index, which comprises 19 commodities such as crude oil, 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 September 2017**



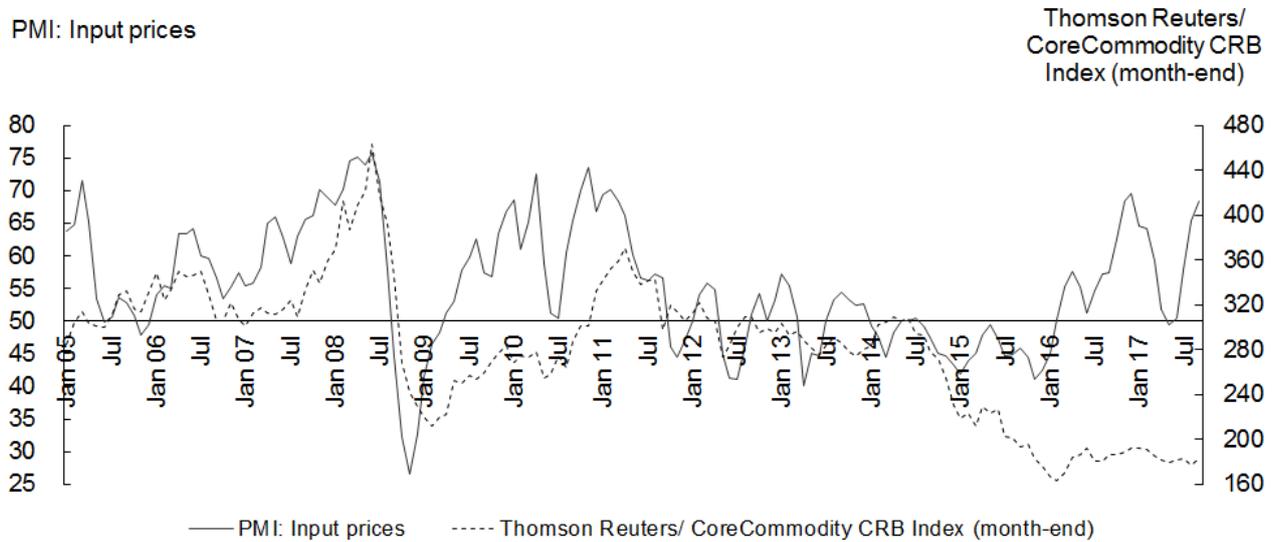
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

**Exhibit 21: Input prices index and producer price index, January 2005 to September 2017**



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

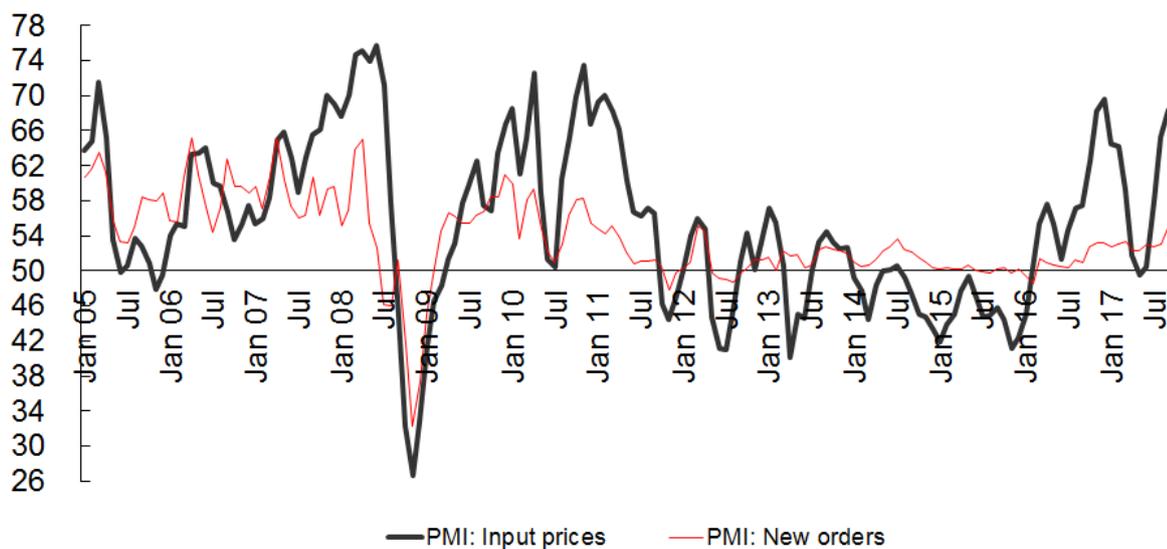
**Exhibit 22: Input prices index and Thomson Reuters/ CoreCommodity CRB Index, January 2005 to September 2017**



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 risen 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 September 2017**

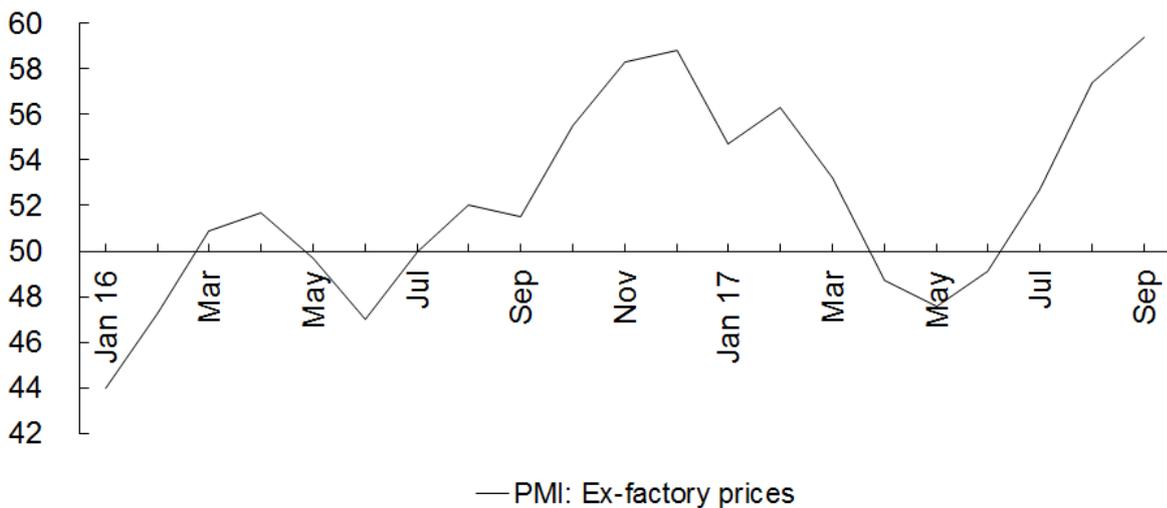


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

**8. Ex-factory prices continue to go up**

The ex-factory prices index rose sharply from 52.7 in July to 57.4 in August and further to 59.4 in September. The index has stayed above the critical 50-mark for three consecutive months, indicating that manufacturers have continued to increase the ex-factory prices for their products in recent months.<sup>4</sup> (Exhibit 24)

**Exhibit 24: Ex-factory prices index, January 2016 to September 2017**



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

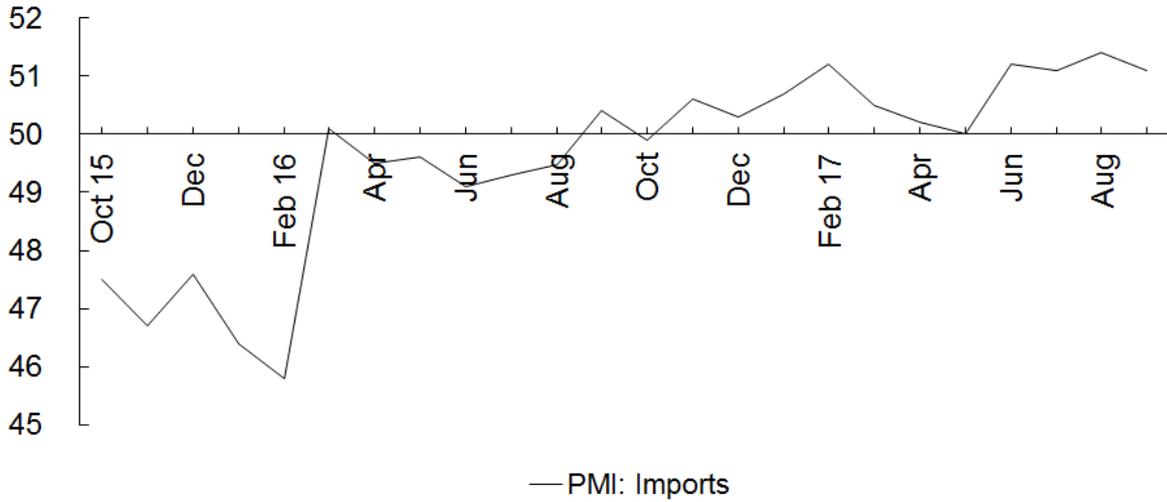
**9. Imports of raw materials and parts increase at a relatively fast pace**

The imports index stayed high at between 51.1 and 51.4 throughout July to September, indicating that imports of raw materials and parts used in manufacturing increased at a relatively fast pace during the period. (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 imports to maintain double-digit growth in 4Q17. 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)

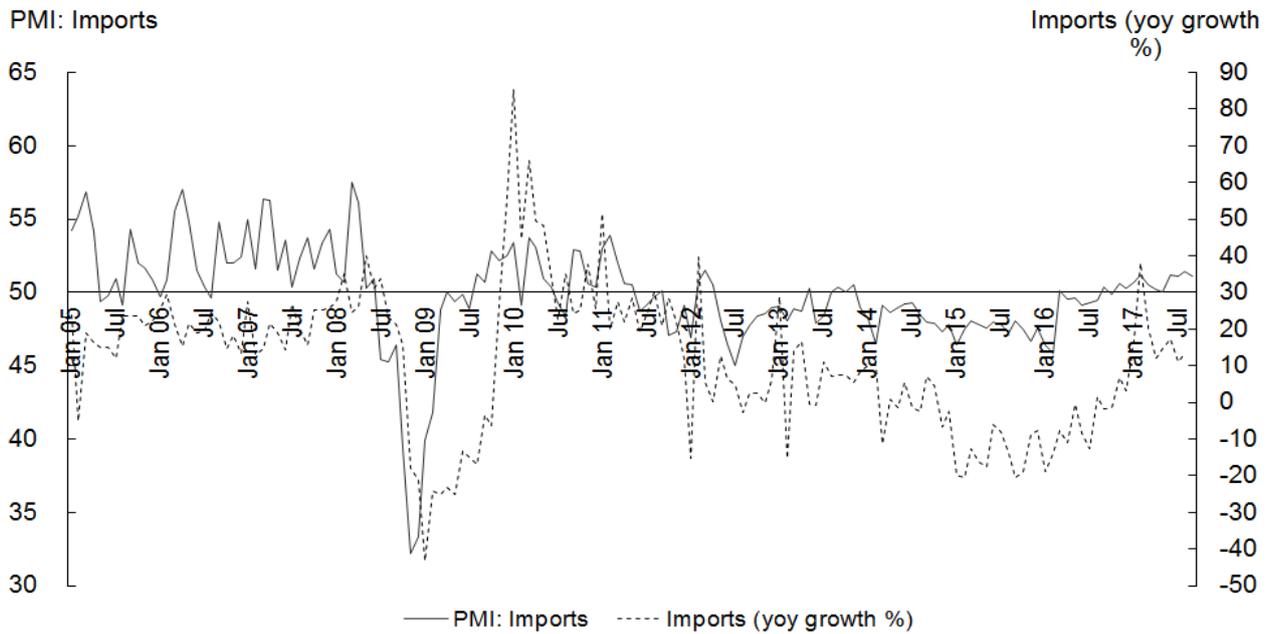
<sup>4</sup> The ex-factory prices index has been published since January 2017.

Exhibit 25: Imports index, October 2015 to September 2017



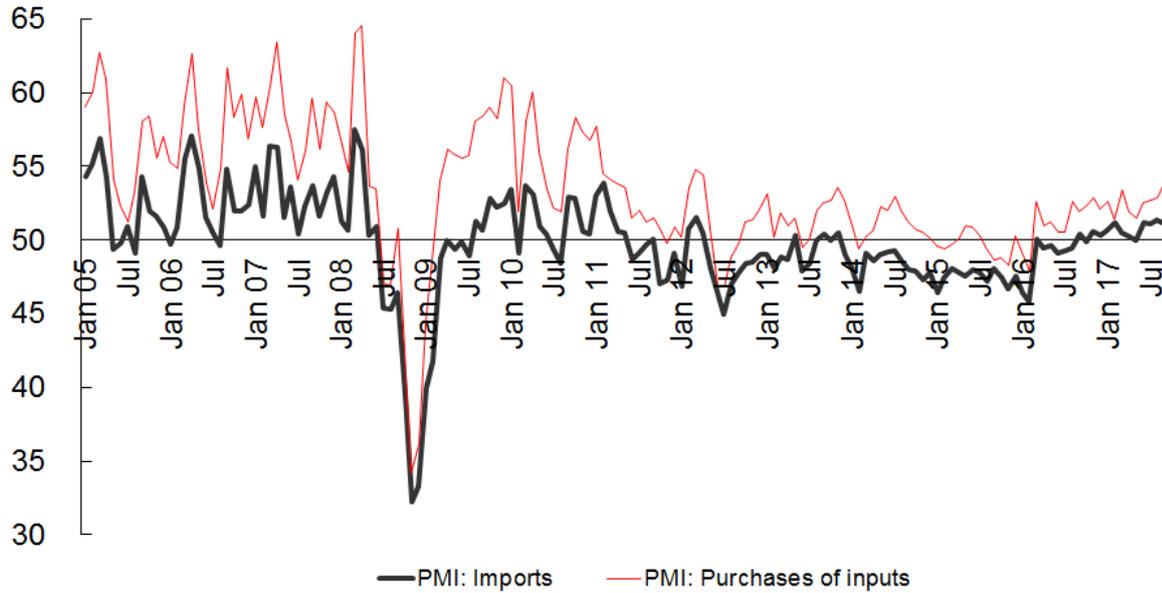
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 26: Imports index and import growth, January 2005 to September 2017



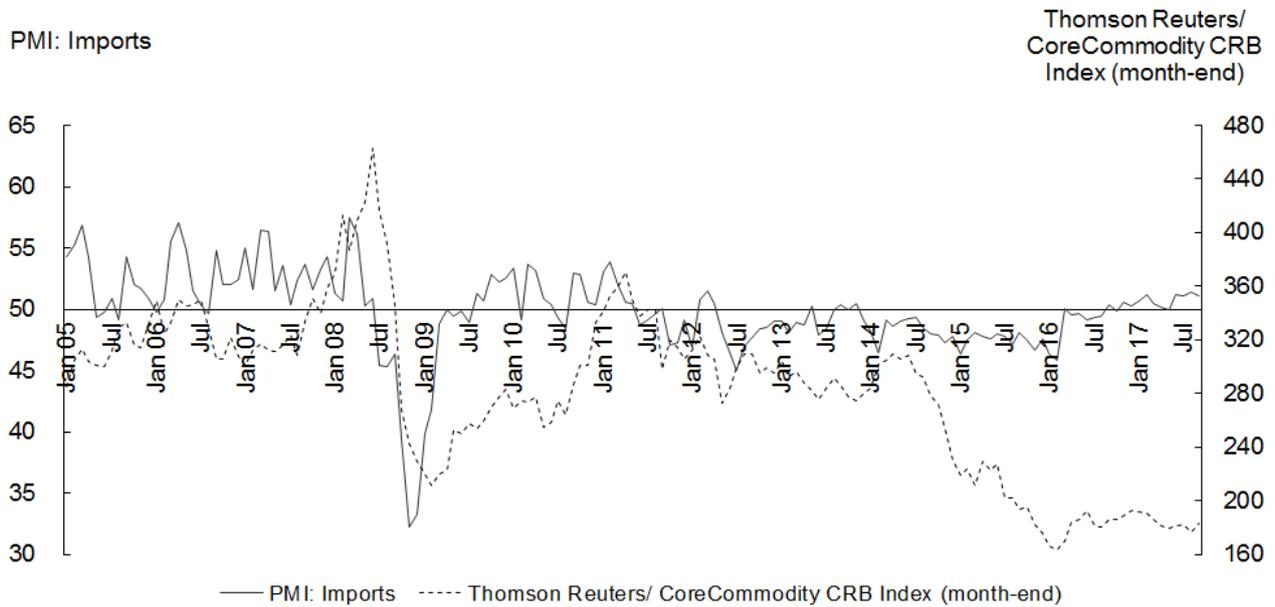
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics, China Customs

Exhibit 27: Imports and purchases of inputs, January 2005 to September 2017



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

Exhibit 28: Imports index and Thomson Reuters/ CoreCommodity CRB Index, January 2005 to September 2017

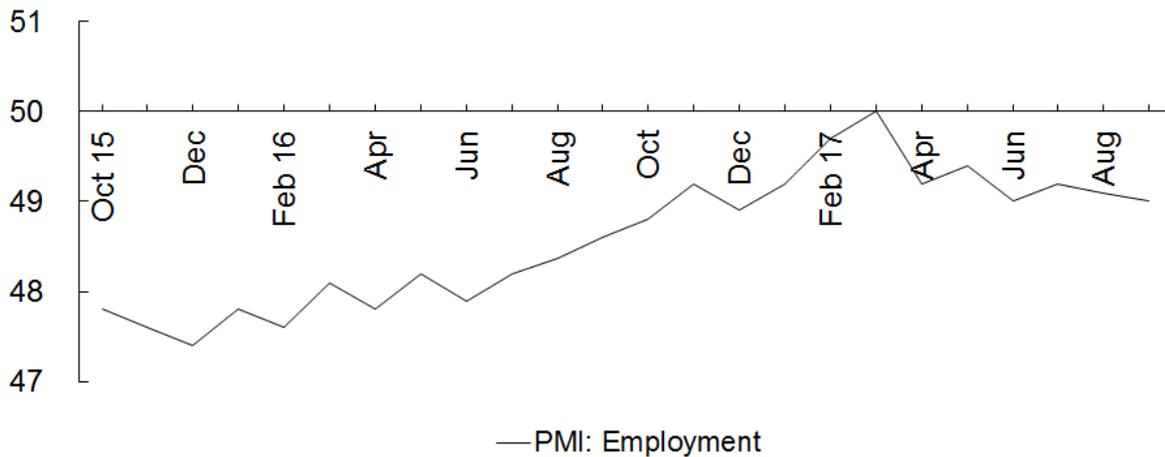


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics, Thomson Reuters

**10. Employment index stabilizes at around 49**

The employment index registered 49.2, 49.1 and 49.0 in July, August and September respectively. The index has stabilized at around 49 since April, indicating the relatively steady employment situations in the manufacturing sector in the past six months. (Exhibit 29)

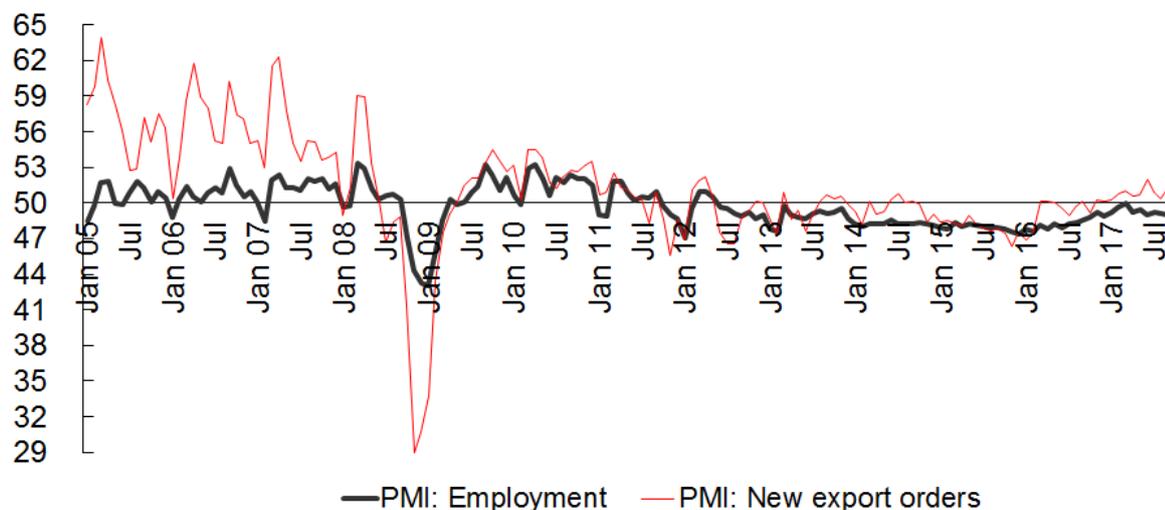
**Exhibit 29: Employment index, October 2015 to September 2017**



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

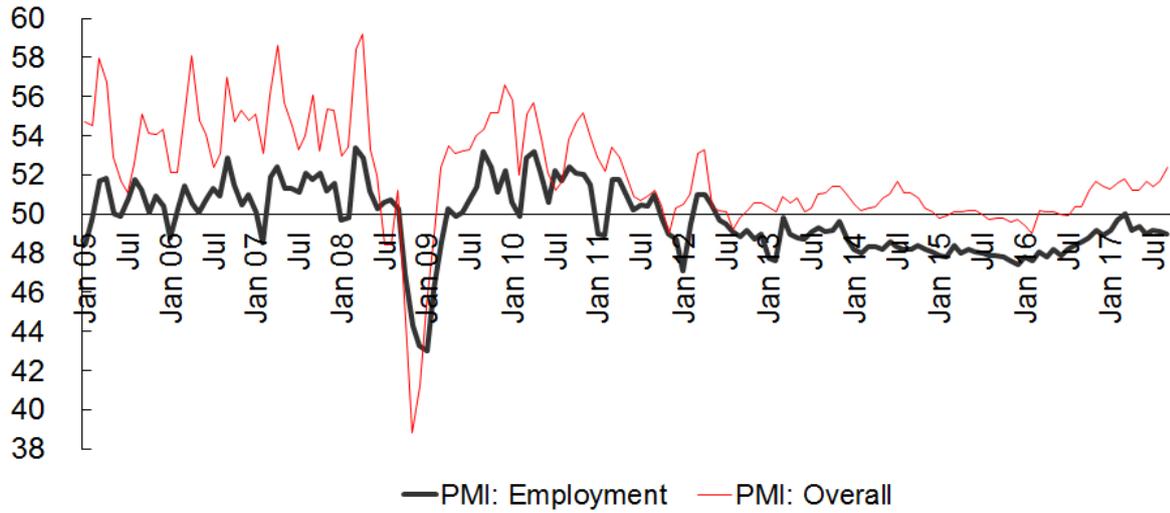
Exhibit 30 proves that the employment in China’s manufacturing sector has relied heavily on the export sector. Exhibit 31 and 32 give our readers some ideas about the extent to which the employment situation improves or deteriorates with the manufacturing sector and the overall economy.

**Exhibit 30: Employment and new export orders, January 2005 to September 2017**



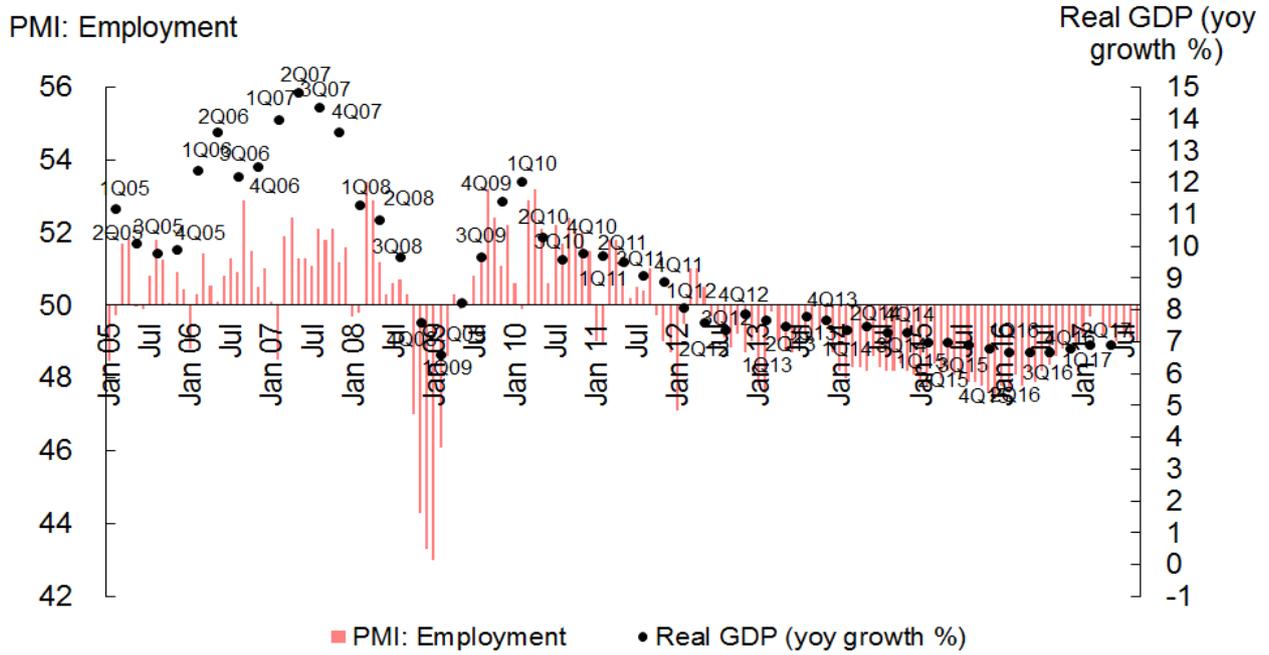
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

**Exhibit 31: Employment index and headline PMI, January 2005 to September 2017**



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

**Exhibit 32: Employment index and real GDP growth, January 2005 to September 2017**

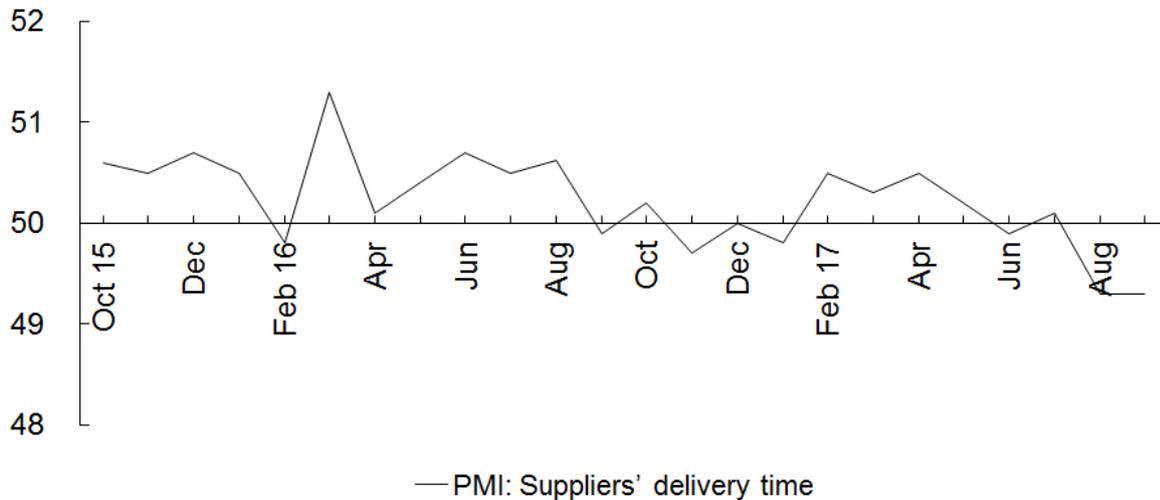


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

### 11. Suppliers' delivery slows

The suppliers' delivery time index dropped from 50.1 in July to 49.3 in August and September. The index was below 50 in August and September, indicating that suppliers' delivery slowed during the period. (Exhibit 33)

**Exhibit 33: Suppliers' delivery time index, October 2015 to September 2017**



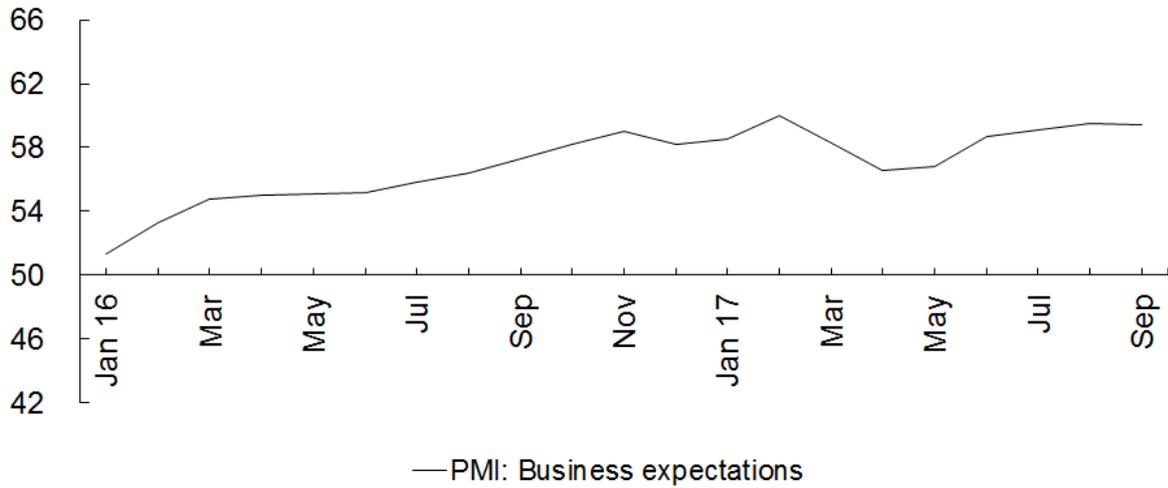
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

### 12. Purchasing managers are optimistic

The business expectations index went up slightly from 59.1 in July to 59.5 in August, and then remained high at 59.4 in September.<sup>5</sup> The index has been well above the critical 50-mark in recent months, indicating that purchasing managers in China have been optimistic about the near term outlook for their respective industries. (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, January 2016 to September 2017



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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