

PMI Quarterly on China Manufacturing

China Federation of Logistics & Purchasing

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PMI indicates growth deceleration of production and economic activities in China

- Output growth softens.
- New export orders decrease at a faster pace.
- Backlogs of orders index falls to seven-month low.
- Stocks of finished goods and stocks of major inputs continue to shrink.
- Growth of purchasing activities moderates.
- Input prices index rises to nine-month high.
- Ex-factory prices index stays high in September.
- Imports index hits 31-month low.
- Employment index drops to seven-month low.
- Suppliers' delivery slows slightly
- Purchasing managers remain optimistic.

IN THIS ISSUE:

Headline PMI	3
Output	7
New orders & new export orders	9
Backlogs of orders	11
Stocks of finished goods & major inputs	12
Purchases of inputs	13
Input prices	16
Ex-factory prices	19
Imports	19
Employment	22
Suppliers' delivery time	24
Business expectations	25

1. PMI indicates growth deceleration of production and economic activities in China

China's manufacturing PMI rose slightly from 51.2 in July to 51.3 in August. However, the index fell to a seven-month low of 50.8 in September, indicating that growth of production and economic activities in China has decelerated lately. (See exhibit 1)

It is noteworthy to recognize the discrepancy by size of enterprises. The PMI of 'large enterprises' fell all the way from 53.1 in May to 52.1 in August, and then remained low at 52.1 in September, indicating that the growth of 'large enterprises' has moderated lately. Meanwhile, the PMI of 'medium enterprises' rose from 49.9 in July to 50.4 in August, but then went down to 48.7 in September. The index returned to the contractionary zone in September, showing that 'medium enterprises' contracted again in the month. In contrast, the PMI of 'small enterprises' went up from 49.3 in July to 50.0 in August, and further to 50.4 in September, indicating that the situations facing 'small enterprises' have been improving. (See exhibit 2)

The headline PMI fell to a seven-month low in September, pointing to a growth moderation of the Chinese economy. The output index slid 0.3 pts in September, showing that output growth has decelerated recently amid the softening demand. The new orders index fell from 52.3 in July to 52.2 in August, and further to 52.0 in September.¹ Besides, the new export orders index dropped to a 31-month low of 48.0 in September, suggesting that the negative impact of the escalating China-US trade frictions has started to unfold.

Meanwhile, prices of industrial products have risen at a relatively fast pace: the ex-factory prices index stayed high at 54.3 in August and in September. A major reason behind the increase in product prices was that the prices of materials have gone up markedly in recent months. The input prices index climbed from 58.7 in August to 59.8 in September, well above the critical 50-mark. Also noteworthy is that the difference between the input prices index and the ex-factory prices index widened from 4.4 pts in August to 5.5 pts in September, implying that the prices of materials were still rising faster than the prices of industrial products. This would in turn have adverse impact on profitability of Chinese manufacturers.

In view of the potential impact of the escalating China-US trade frictions on the Chinese economy, China's central government has taken a series of measures to boost domestic demand. For example, to accelerate construction of infrastructure, the central government has urged local governments to speed up the issuance of 1.35 trillion yuan of special bonds and the use of

¹ The 'new orders index' covers both domestic and export orders. That is to say, the manufacturers are not asked to differentiate between domestic and export orders when filling in questionnaires.

funding obtained through the bonds. In addition, on 7 October, China's central bank announced to cut the reserve requirement ratios (RRRs) of some financial institutions in China by 100 bps, effective from 15 October. Besides, the Standing Committee of the National People's Congress passed the 'Amendments to the Individual Income Tax Law' on 31 August. The minimum threshold for individual income tax has been raised and the tax brackets of the three lowest grades have been widened. This would help reduce the tax burden on low- and middle-income earners. The implementation of these measures will help alleviate the downward pressure on the Chinese economy.

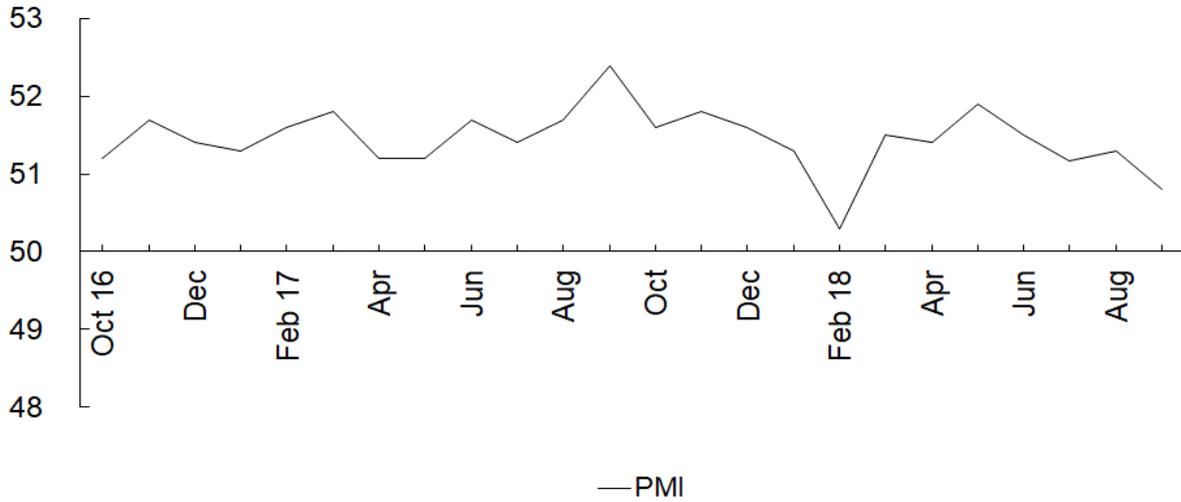
Going forward, the escalating China-US trade frictions will negatively affect China's exports; and we also expect domestic demand to soften amidst the poor consumer sentiments. Overall, China's economic growth is set to moderate in the near future. We predict that the headline PMI will fluctuate within a lower range of 50 to 51 and the real GDP growth will decelerate to 6.4% yoy in 4Q18. Besides the escalating China-US trade frictions, challenges facing Chinese manufacturers also include 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 5.5-6.0% yoy in 4Q18.

Exhibit 3 shows that the fall in the headline PMI in September was due to the drop in the employment index (which weighs 20% in the computation of the headline PMI), the stocks of major inputs index (weighs 10%), output index (weighs 25%) and the new orders index (weighs 30%). In September, 10 of the 13 sub-indices were lower than their respective levels in the previous month, while 2 sub-indices were higher 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 new export orders, backlogs of orders, stocks of finished goods, imports, stocks of major inputs and employment were in the contractionary zone over the same period.

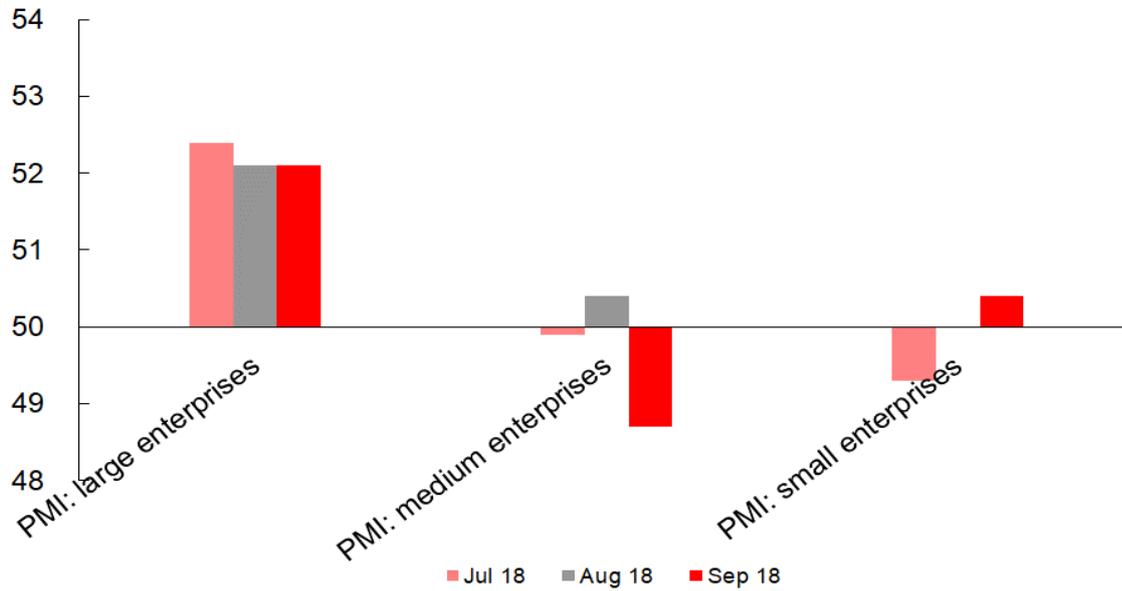
China's manufacturing PMI has so far done a satisfactory job in predicting economic growth. Exhibit 5 plots the quarterly real GDP yoy growth rates versus the monthly PMIs since its inception. It could be seen that the PMI demonstrates a fairly good track record of forecasting the growth trend of the economy at least over the next few months. Based on this chart we project that the real GDP growth will be around 6.4% in 4Q18.

Exhibit 1: Headline PMI, October 2016 to September 2018



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

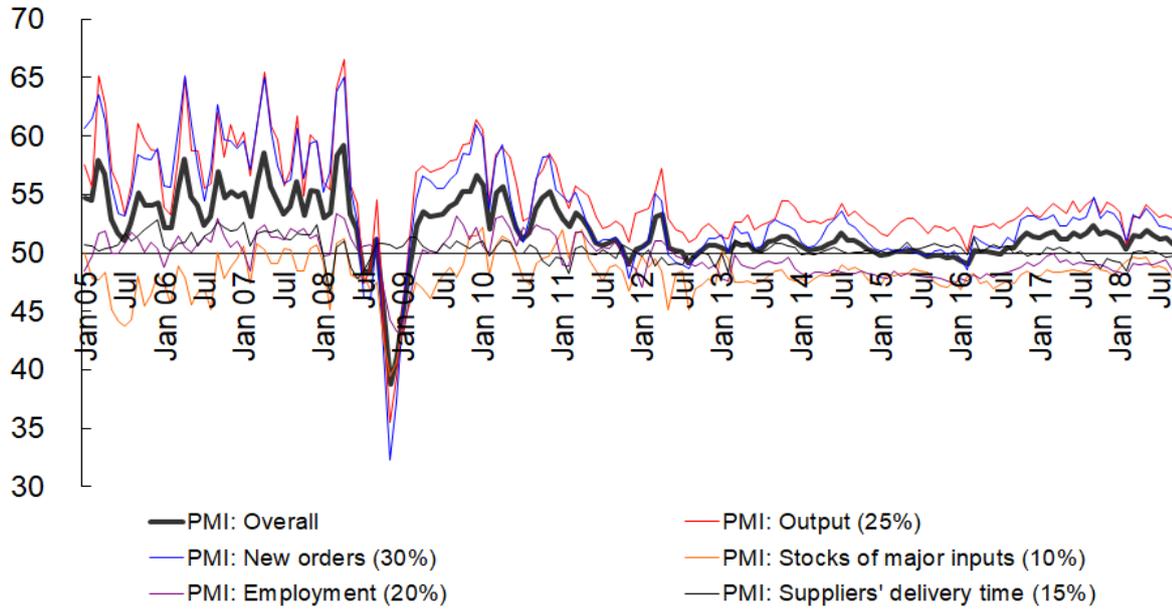
Exhibit 2: PMIs of large enterprises, medium enterprises and small enterprises, July to September 2018



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

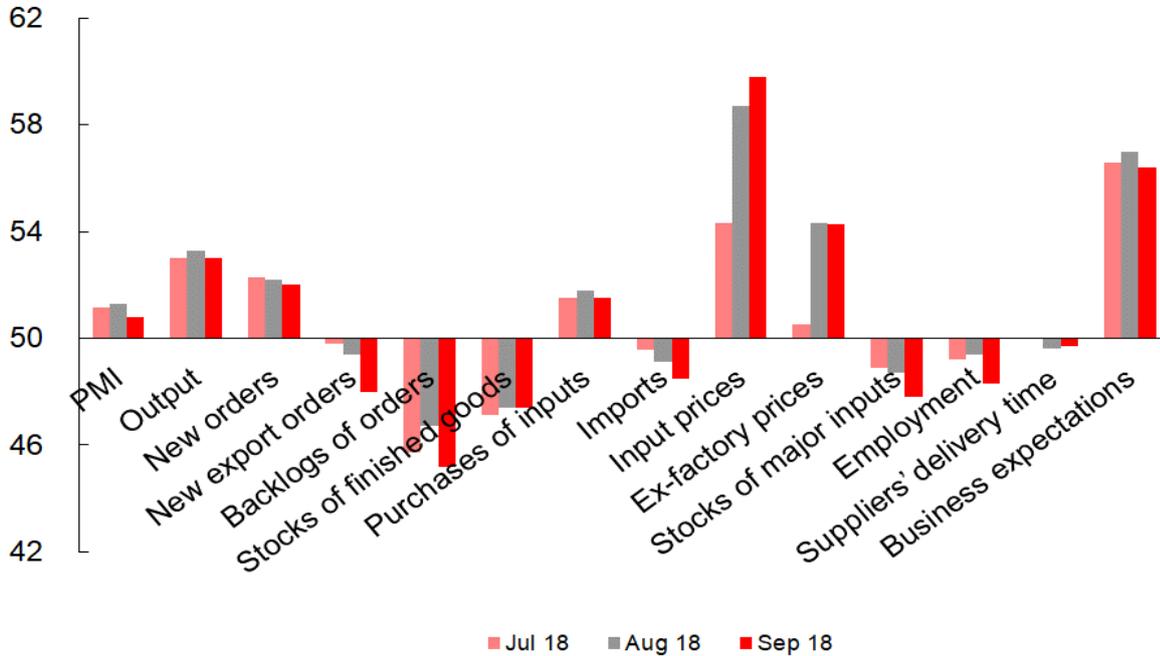
Exhibit 3: Headline PMI and sub-indices, January 2005 to September 2018

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



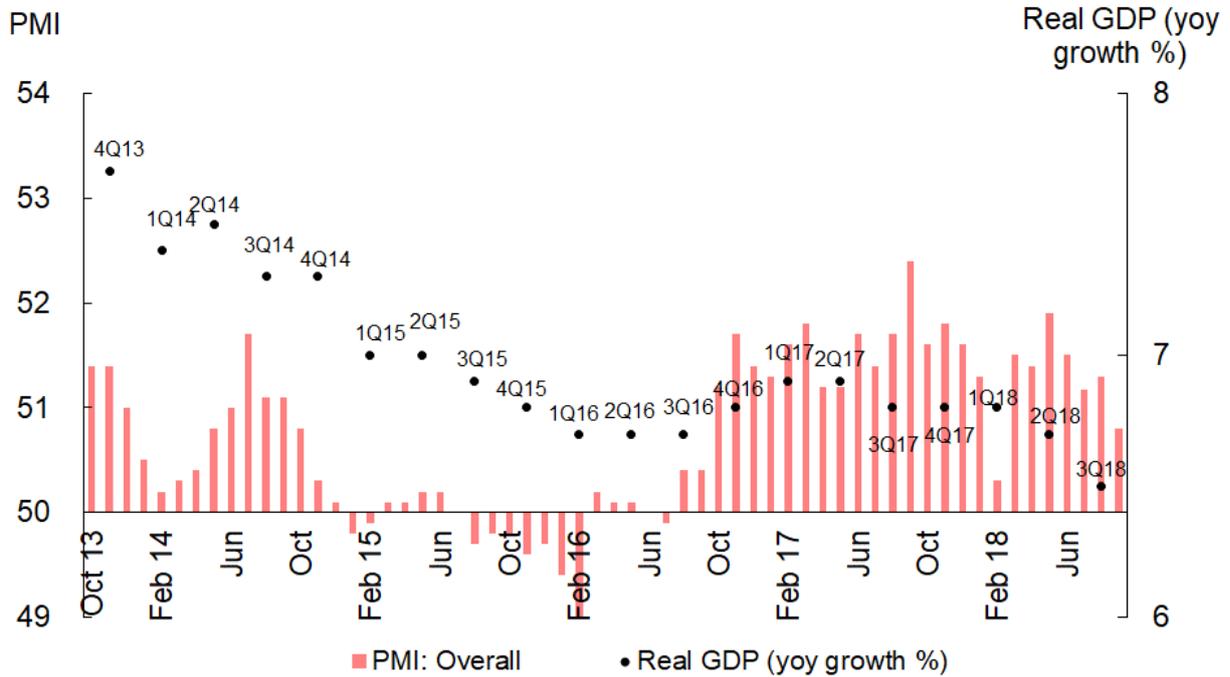
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 4: Headline PMI and all sub-indices, July to September 2018



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

Exhibit 5: Headline PMI and real GDP growth, October 2013 to September 2018



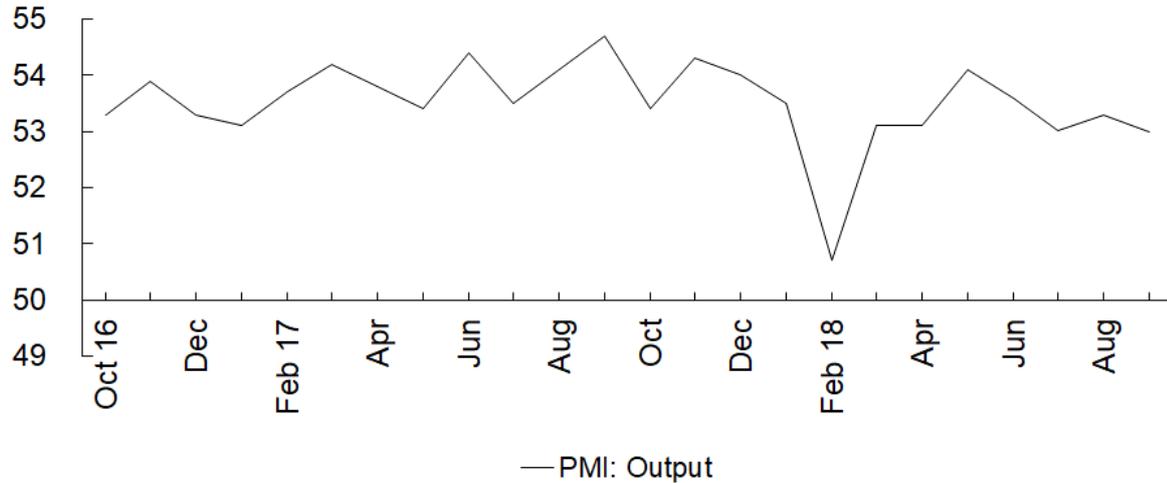
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

2. Output growth softens

After rising from 53.0 in July to 53.3 in August, the output index dropped to 53.0 in September, indicating that the output growth has softened recently. (See exhibit 6)

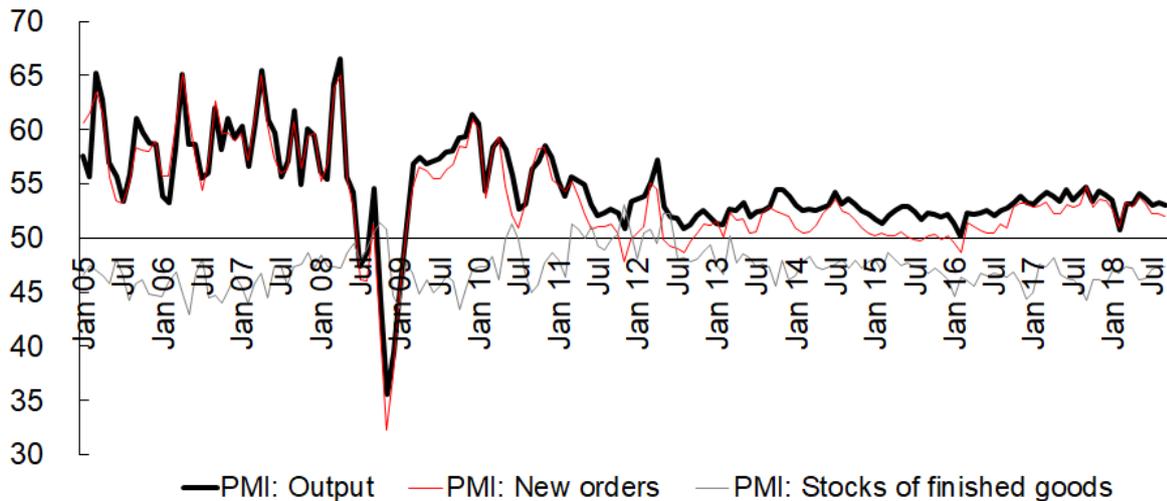
Exhibit 7 shows that the output growth was mainly fuelled by new orders growth instead of restocking activities, as the stocks of finished goods index has stayed in the contractionary zone for sixty six consecutive months. However, output may grow strongly later when manufacturers have finally run out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

Exhibit 6: Output index, October 2016 to September 2018



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

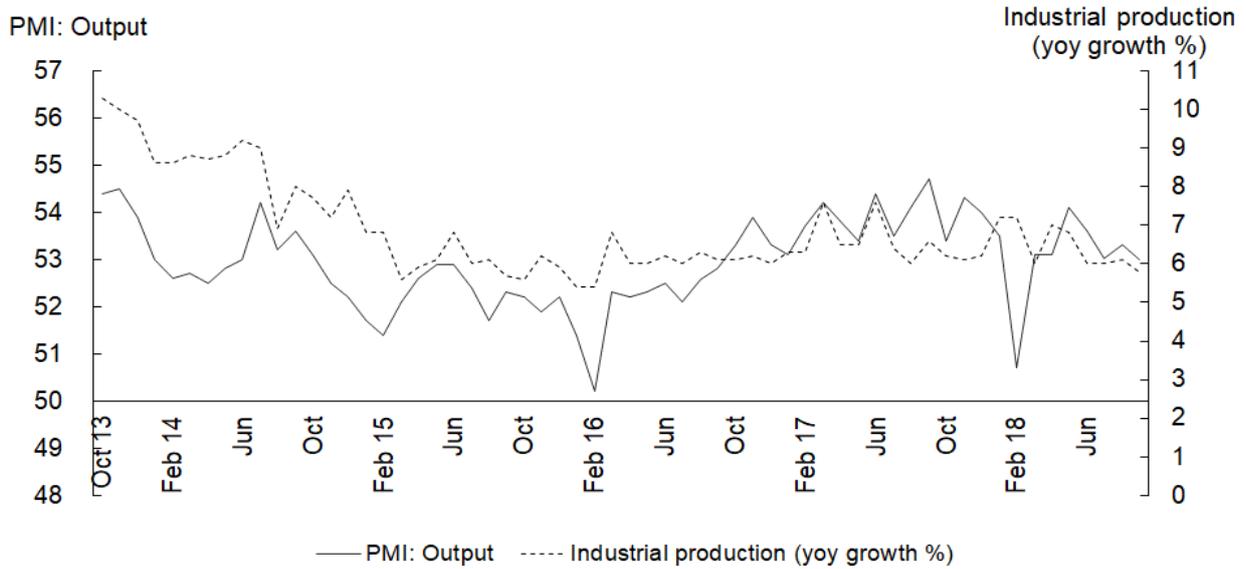
Exhibit 7: Output, new orders and stocks of finished goods, January 2005 to September 2018



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 moderate to around 5.5-6.0% yoy in 4Q18. In the coming months, industrial activities will still be supported by relatively 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, October 2013 to September 2018

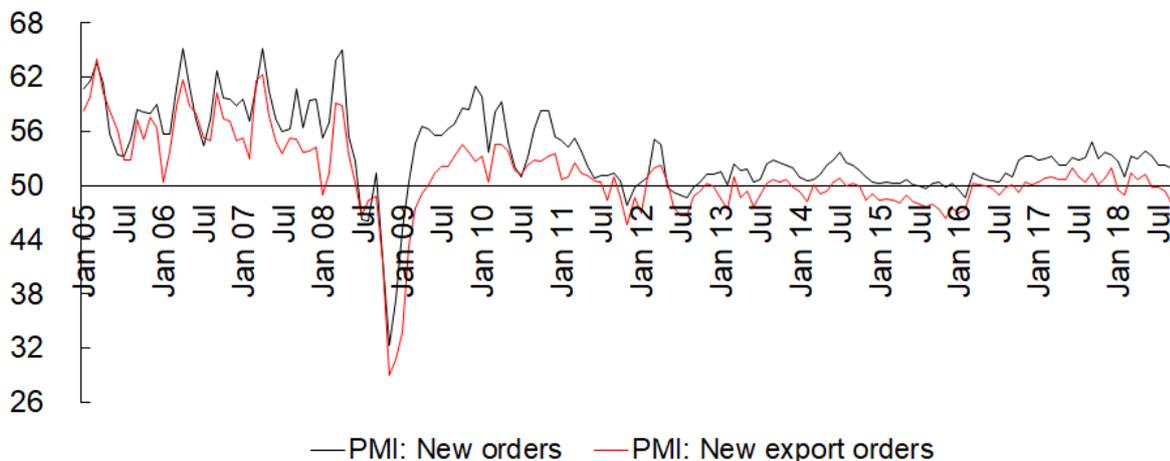


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

3. New export orders decrease at faster pace

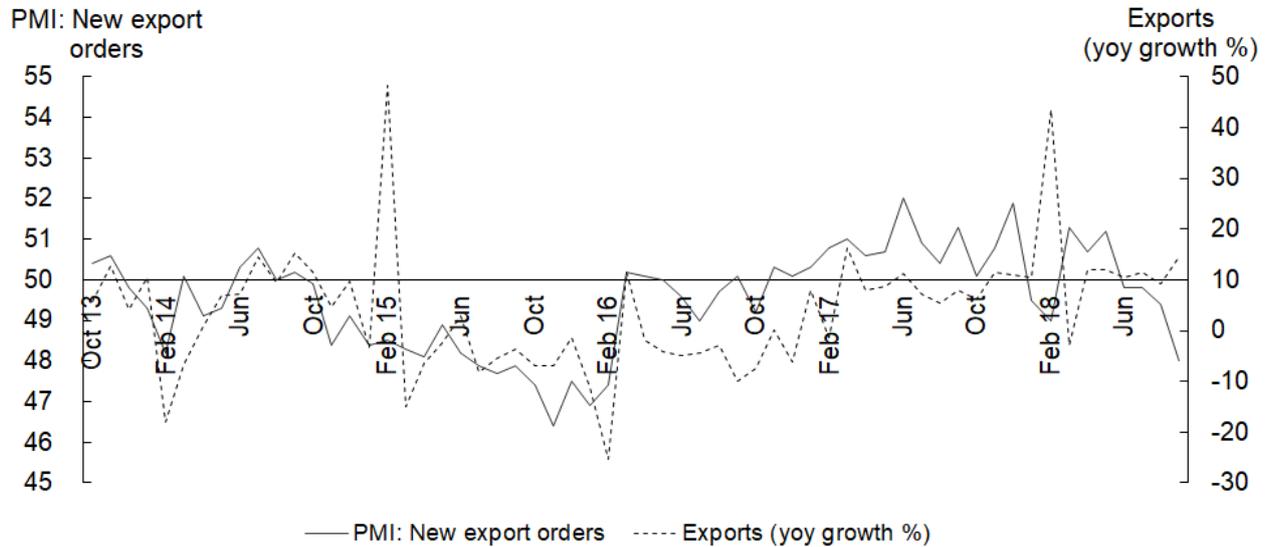
After going down slightly from 52.3 in July to 52.2 in August, the new orders index fell to 52.0 in September, showing that the growth of overall new orders has moderated lately. Meanwhile, the new export orders index dropped from 49.8 in July to 49.4 in August, before going down to 48.0 in September, the lowest level since March 2016. The low index reading in September shows that new export orders have decreased at a faster pace recently, apparently due to the escalating China-US trade frictions. (See exhibit 9)

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



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

Exhibit 10: New export orders index and export growth, October 2013 to September 2018

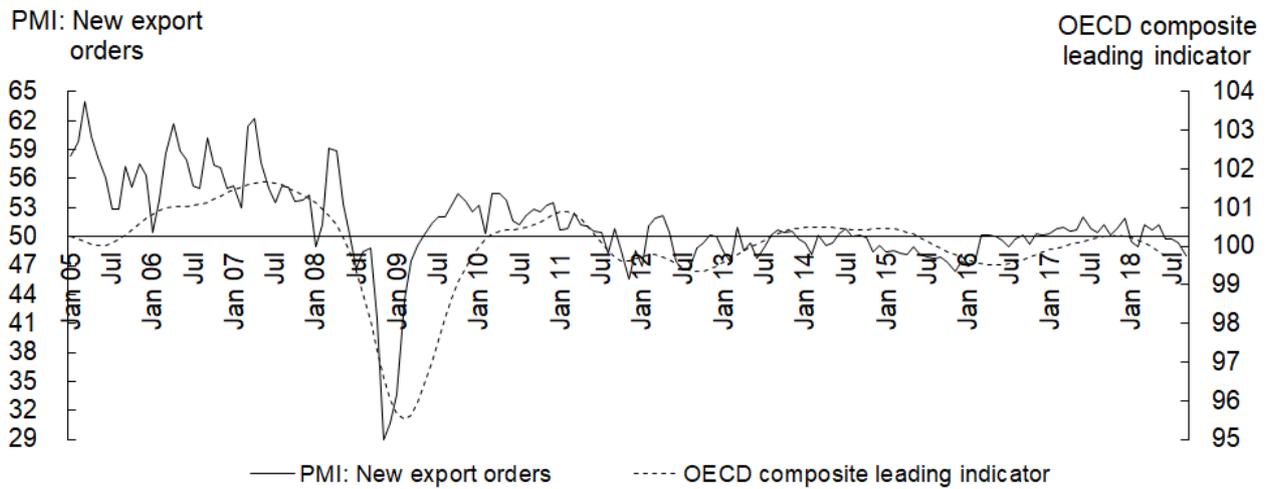


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics, China Customs

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 has been in the contractionary zone since 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 indicator² has continued to fall 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 4Q18.

² 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 September 2018



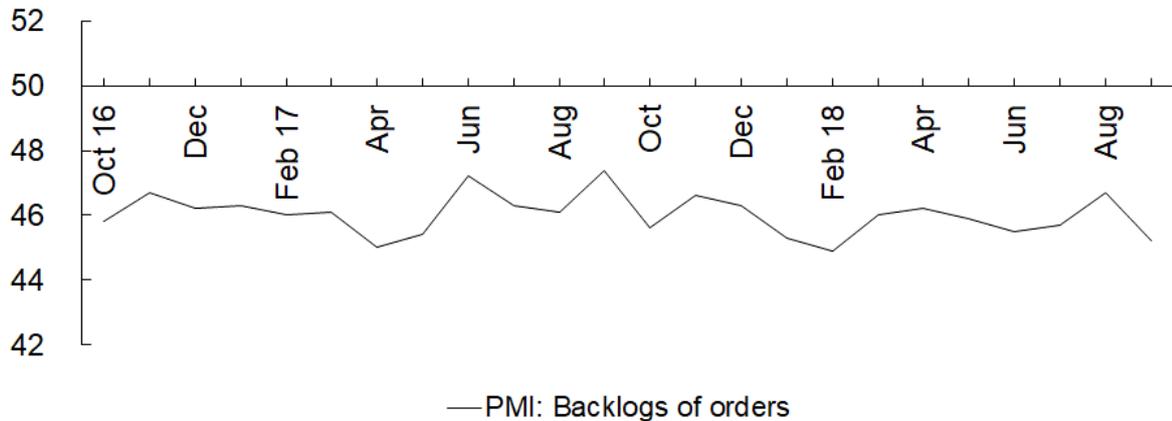
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics, Organization for Economic Cooperation and Development

4. Backlogs of orders index falls to seven-month low

The backlogs of orders index went up from 45.7 in July to 46.7 in August, but then slid to a seven-month low of 45.2 in September, indicating that backlogs of orders have decreased at a more rapid pace lately. (See exhibit 12)

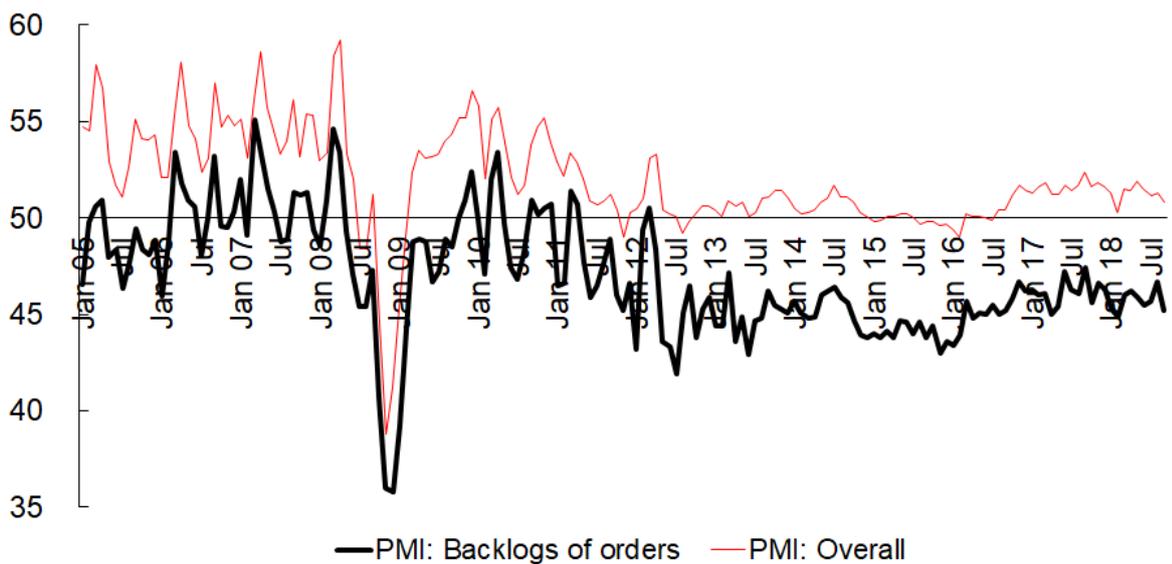
Looking ahead, we expect the index to post a slight fall in the near term, as indicated by the apparently very high correlation between the sub-index and the headline PMI, and the recent drop in the headline PMI. (See exhibit 13)

Exhibit 12: Backlogs of orders index, October 2016 to September 2018



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

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

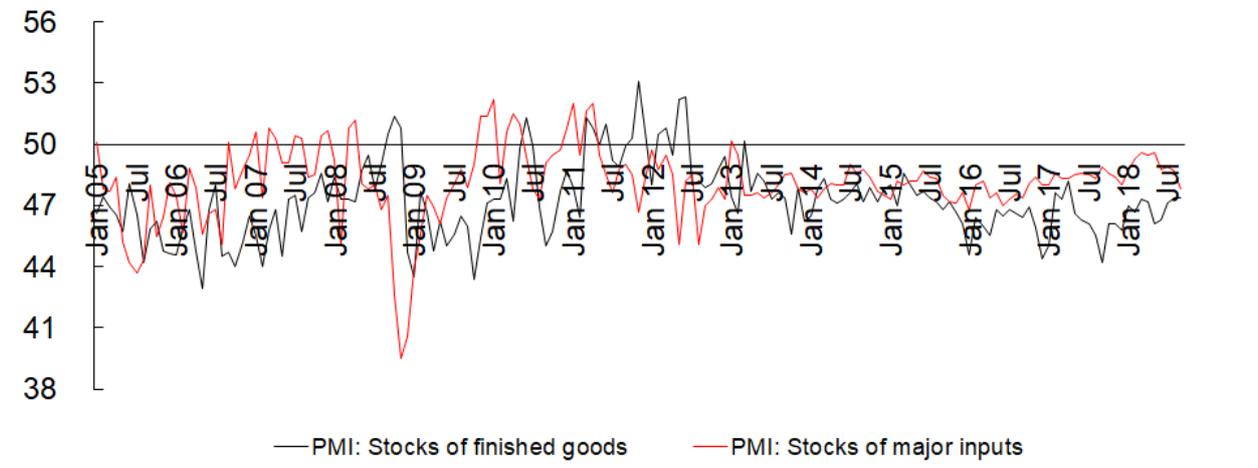


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

5. Stocks of finished goods and stocks of major inputs continue to shrink

The stocks of finished goods index rose all the way from 46.1 in May to 47.4 in August and in September. The index readings in the past two months show that the stocks of finished goods held by manufacturers have decreased at a slower pace lately. Meanwhile, the stocks of major inputs index went down slightly from 48.9 in July to 48.7 in August, before dropping to 47.8 in September, the lowest level since October 2016. The downtrend indicates that stocks of major inputs have fallen at a faster pace in recent months. (Exhibit 14)

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



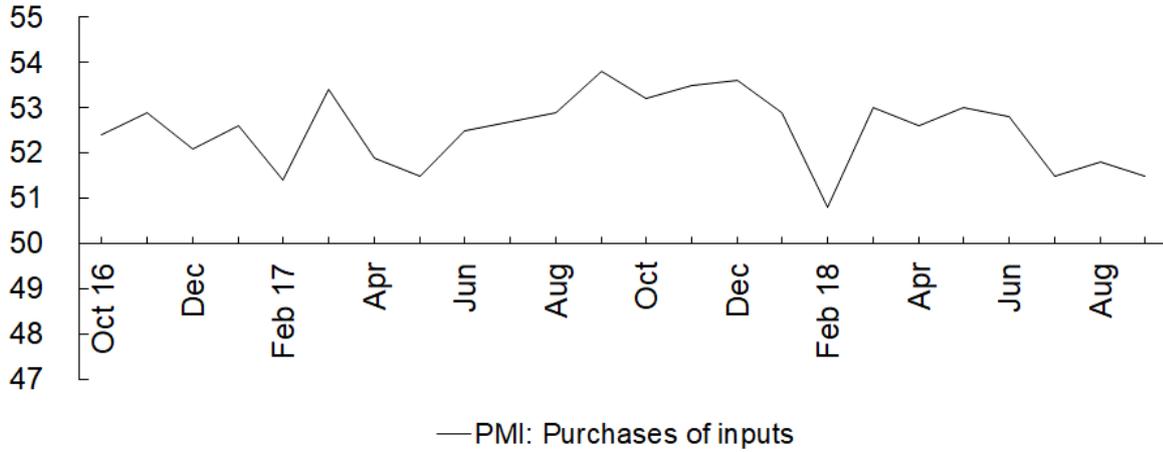
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

6. Growth of purchasing activities moderates

The purchases of inputs index rose from 51.5 in July to 51.8 in August, but then fell to 51.5 in September, indicating that the growth of purchasing activities has moderated lately. (Exhibit 15)

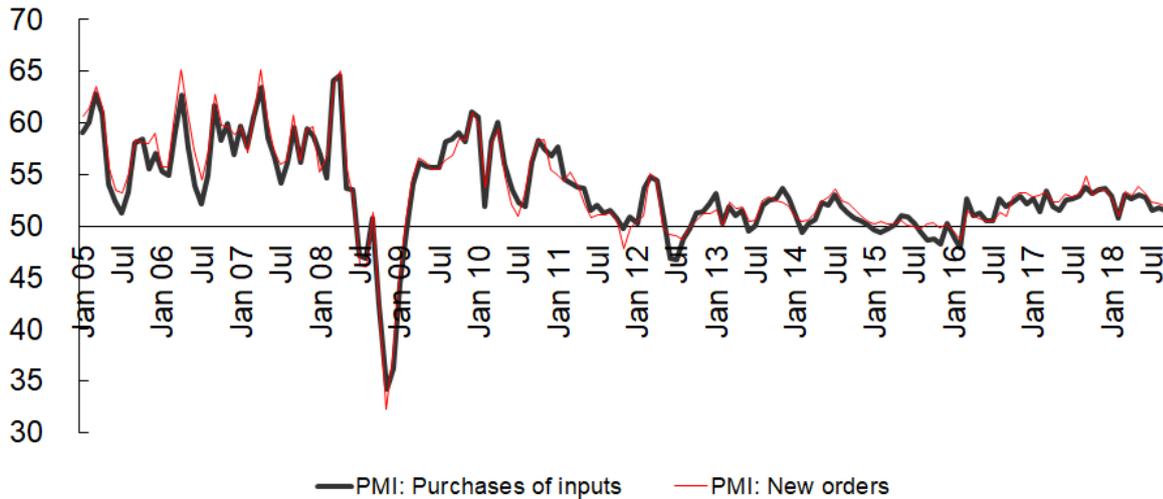
A number of factors affect the purchasing activities of manufacturers, among which the amount of new orders received by manufacturers has been the most important factor. Exhibit 16 plots the purchases of inputs index against the new orders index. The correlation between the two sub-indices is very strong. 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, October 2016 to September 2018



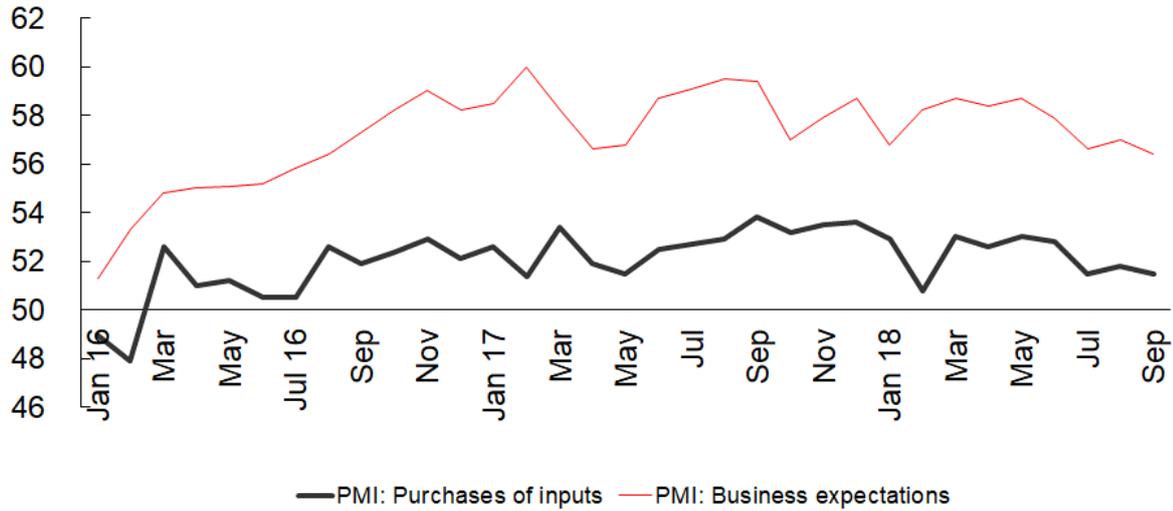
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

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



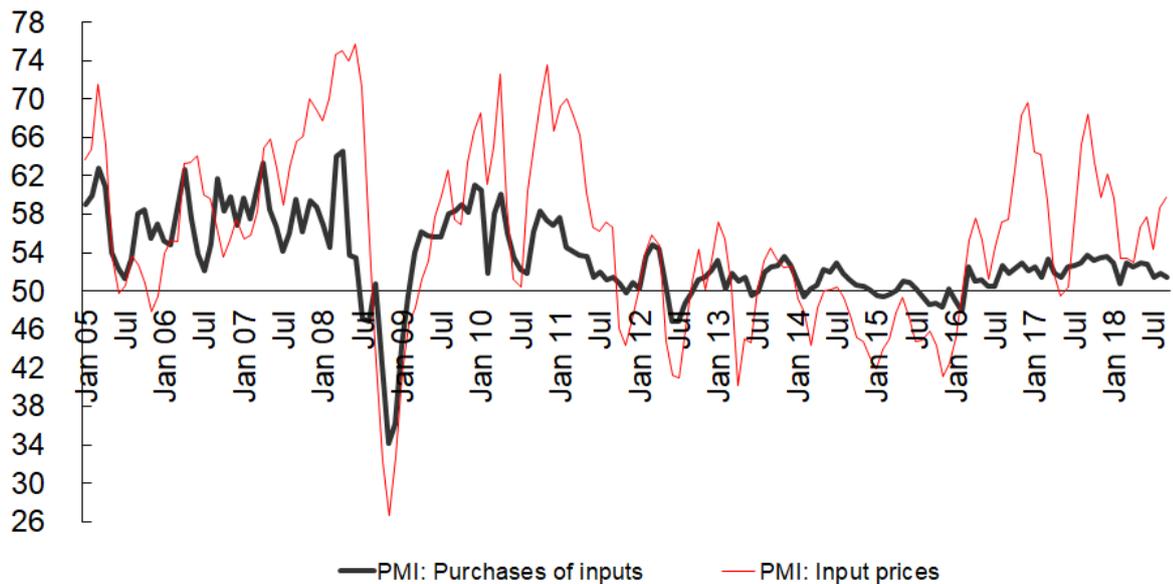
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

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

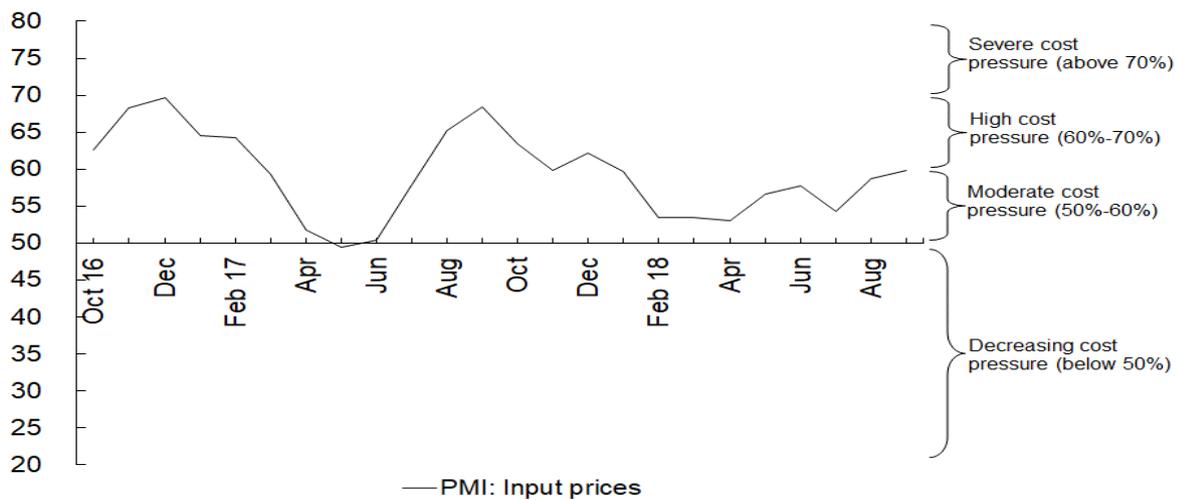


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

7. Input prices index rises to nine-month high

The input prices index went up from 54.3 in July to 58.7 in August, and rose further to 59.8 in September, the highest level in nine months. The latest reading shows that prices of production inputs have gone up markedly, which would in turn put strong cost pressure on Chinese manufacturers. (Exhibit 19)

Exhibit 19: Input prices index, October 2016 to September 2018



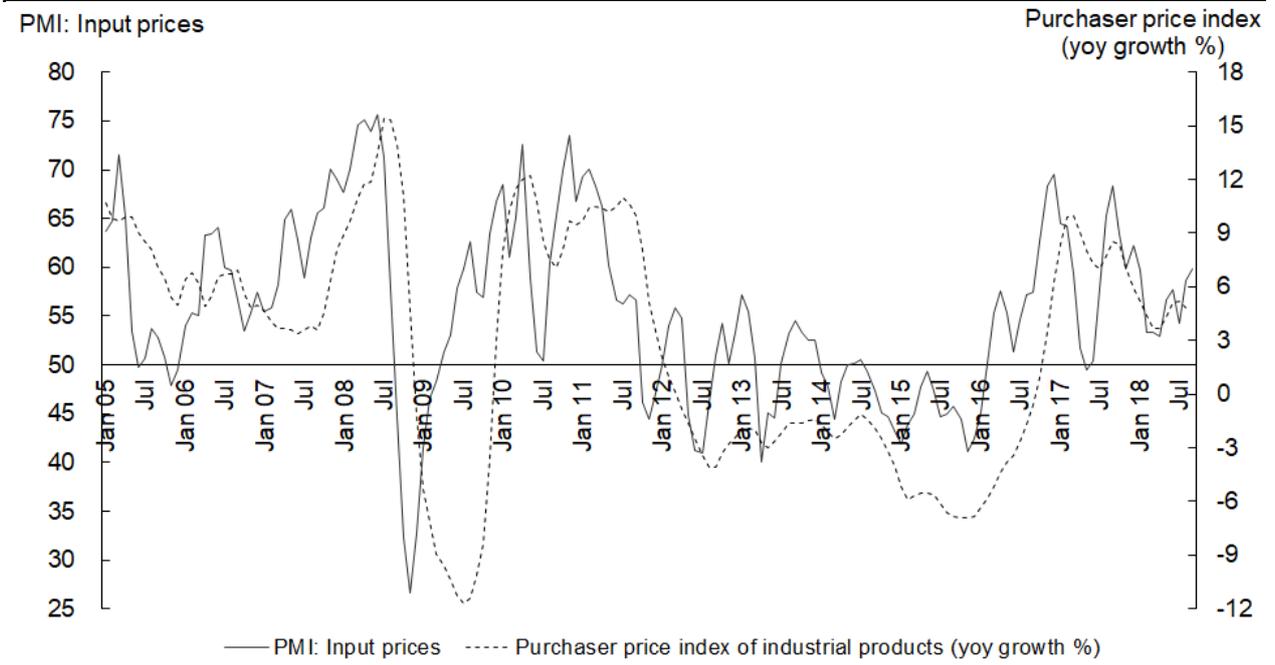
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

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)³ in exhibit 21. Going forward, we expect that the purchaser price index and the producer price index (PPI) will go up in coming months, resulting in an acceleration in the month-on-month growth for both indices. Nevertheless, due to the high comparison base in the same period last year, the year-on-year growth rates for both the purchaser price index and the PPI will fall in the rest of the year. Meanwhile, we forecast that the year-on-year CPI growth will rise further 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.⁴

³ 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.

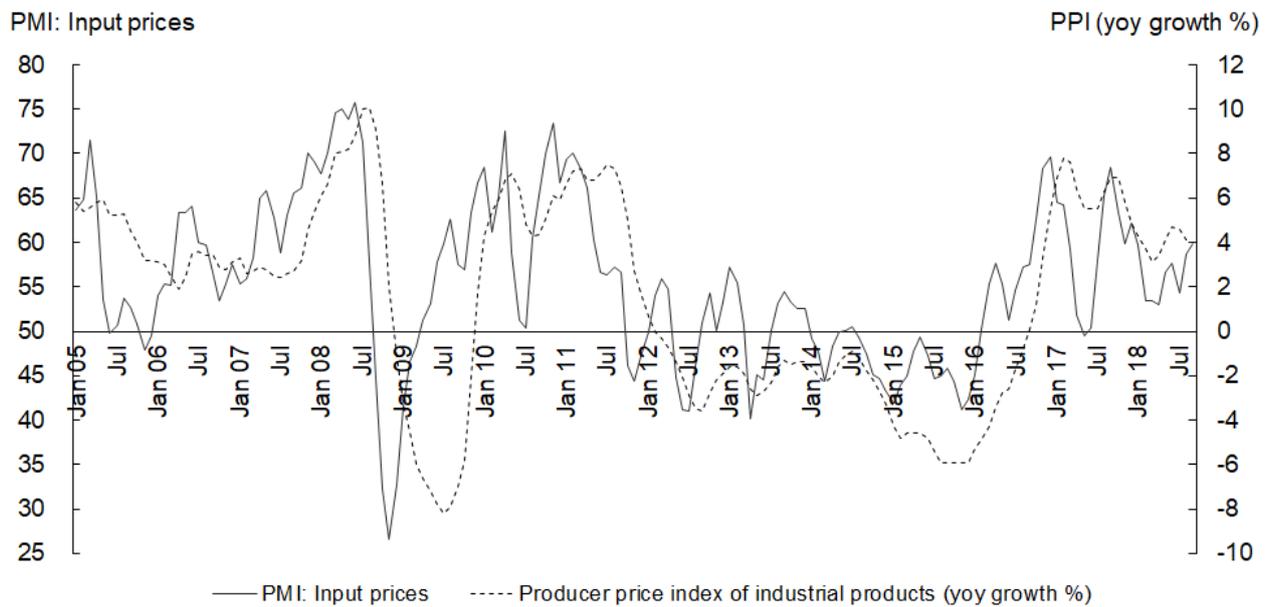
⁴ The Thomson Reuters/ CoreCommodity CRB Index, which comprises 19 commodities such as crude oil, aluminum, corn, cotton, gold, natural gas, soybeans, etc, has served as one of the most recognized measures of global commodities markets.

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



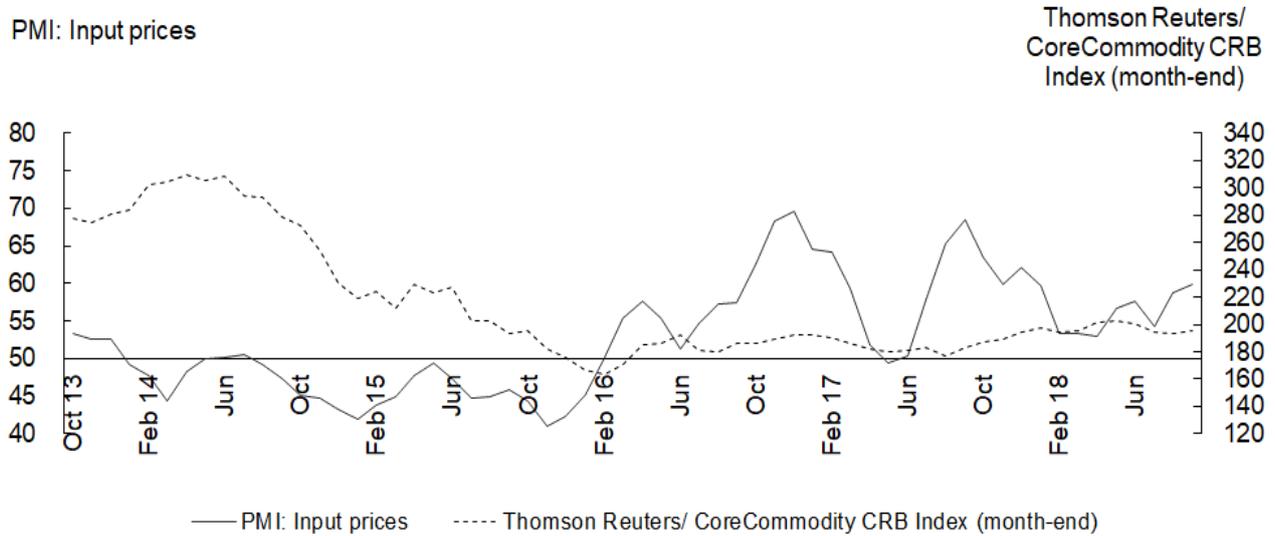
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

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



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

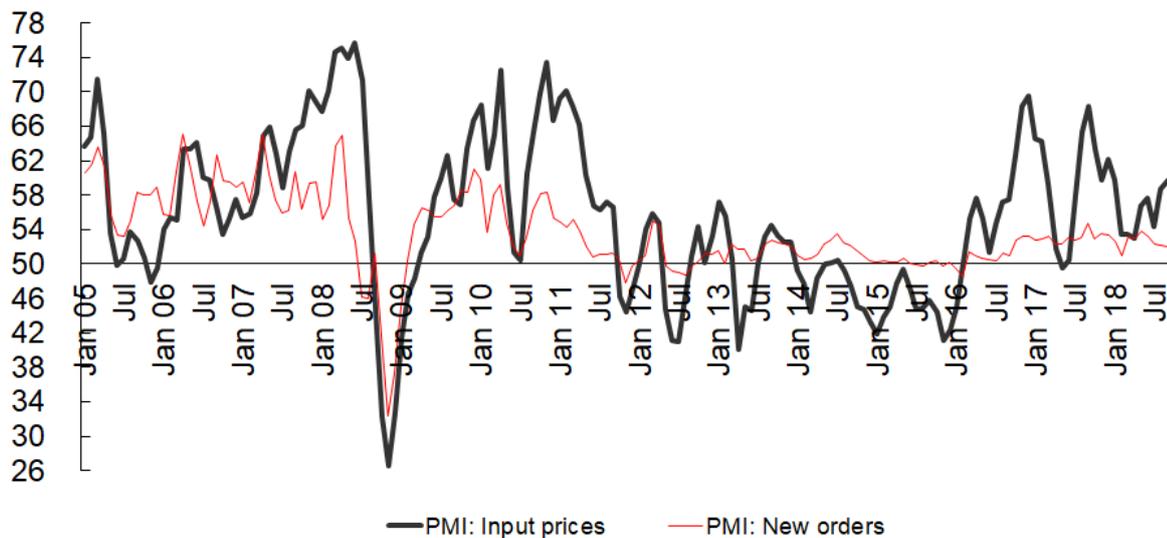
Exhibit 22: Input prices index and Thomson Reuters/ CoreCommodity CRB Index, October 2013 to September 2018



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 coming future.

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

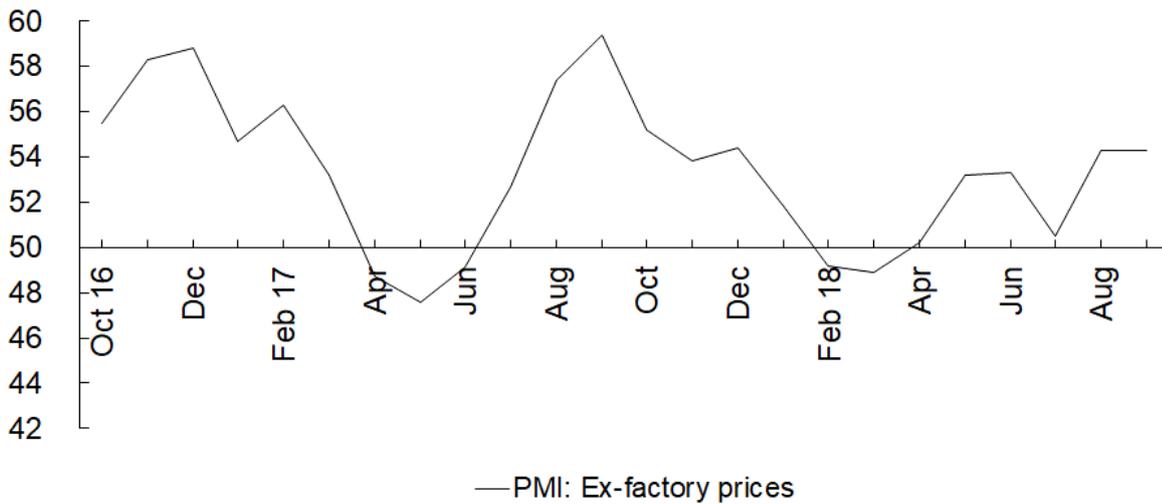


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

8. Ex-factory prices index stays high in September

The ex-factory prices index rose to an eight-month high of 54.3 in August, and then stayed high at 54.3 in September, showing a relatively fast rise in the ex-factory prices of industrial products in the past two months. The index has been above the critical 50-mark for six consecutive months, suggesting that Chinese manufacturers have continued to increase the ex-factory prices of finished goods amid rising prices of production inputs.⁵ (Exhibit 24)

Exhibit 24: Ex-factory prices index, October 2016 to September 2018



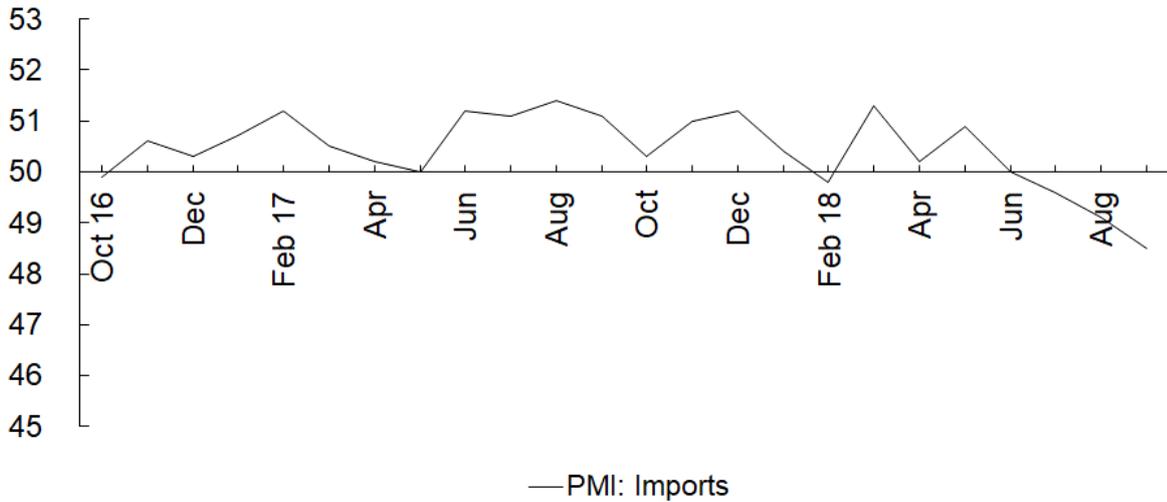
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

9. Imports index hits 31-month low

The imports index went down from 49.6 in July to 49.1 in August, and fell further to 48.5 in September, the lowest level since March 2016. The index readings in the past three months indicate a weakening import demand for raw materials and parts used by the manufacturing sector. (Exhibit 25)

⁵ The ex-factory prices index has been published since January 2017.

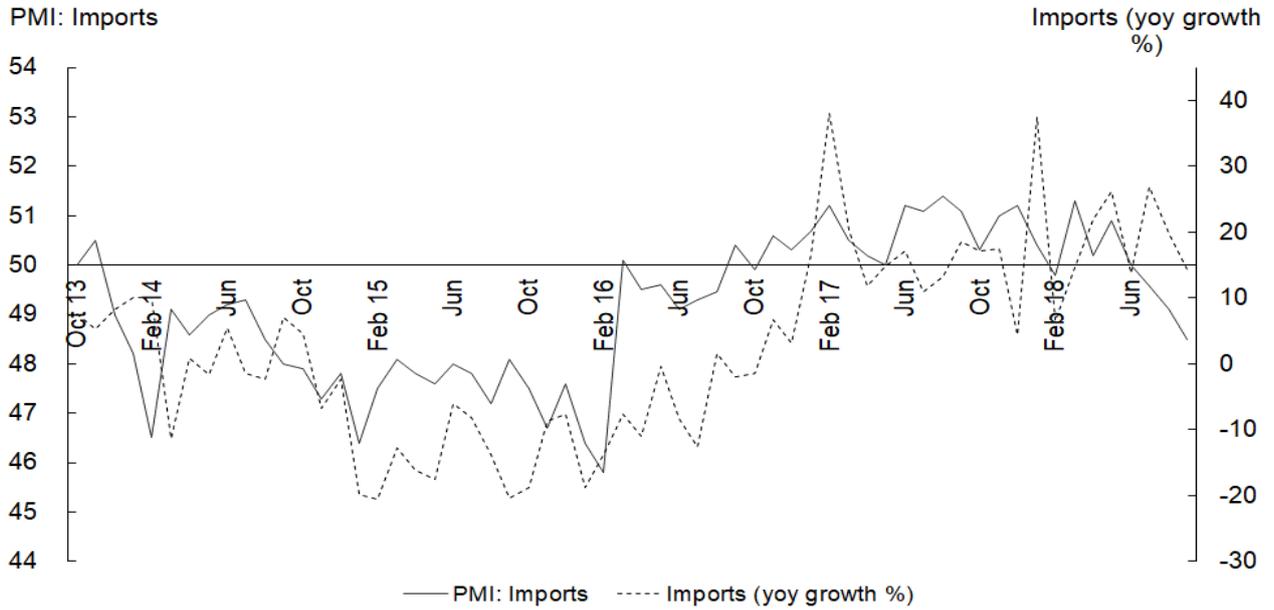
Exhibit 25: Imports index, October 2016 to September 2018



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

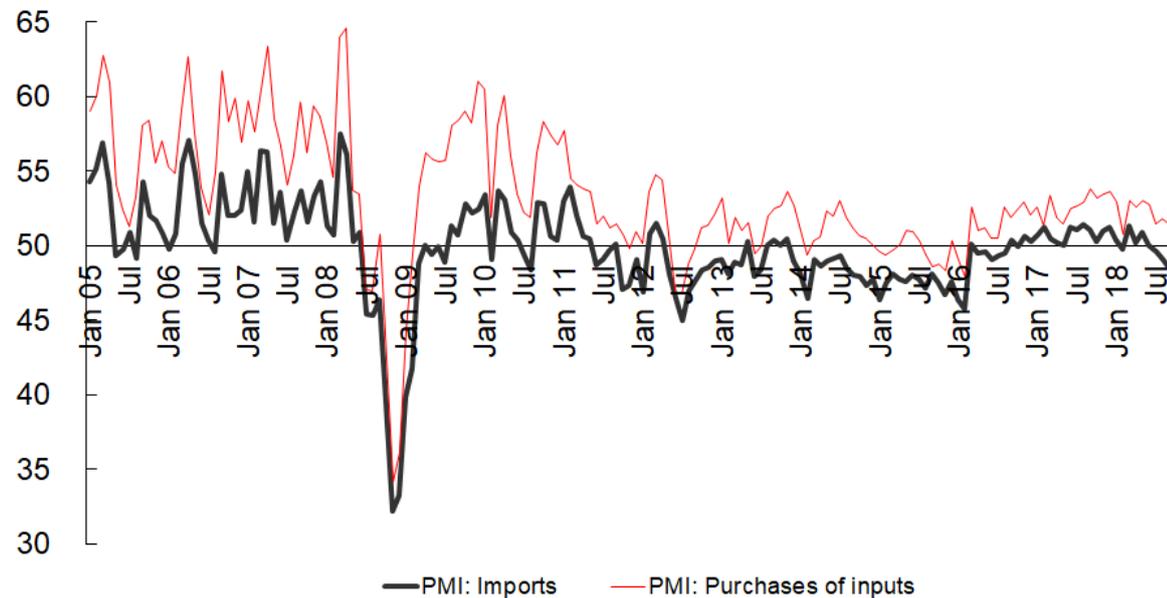
Exhibit 26 shows that the imports index is highly correlated (with some lags) to the year-on-year growth rate in imports. We expect import growth to decelerate in 4Q18. Exhibit 27 illustrates the strong association between the imports index and the purchases of inputs index – as Chinese manufacturers 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)

Exhibit 26: Imports index and import growth, October 2013 to September 2018



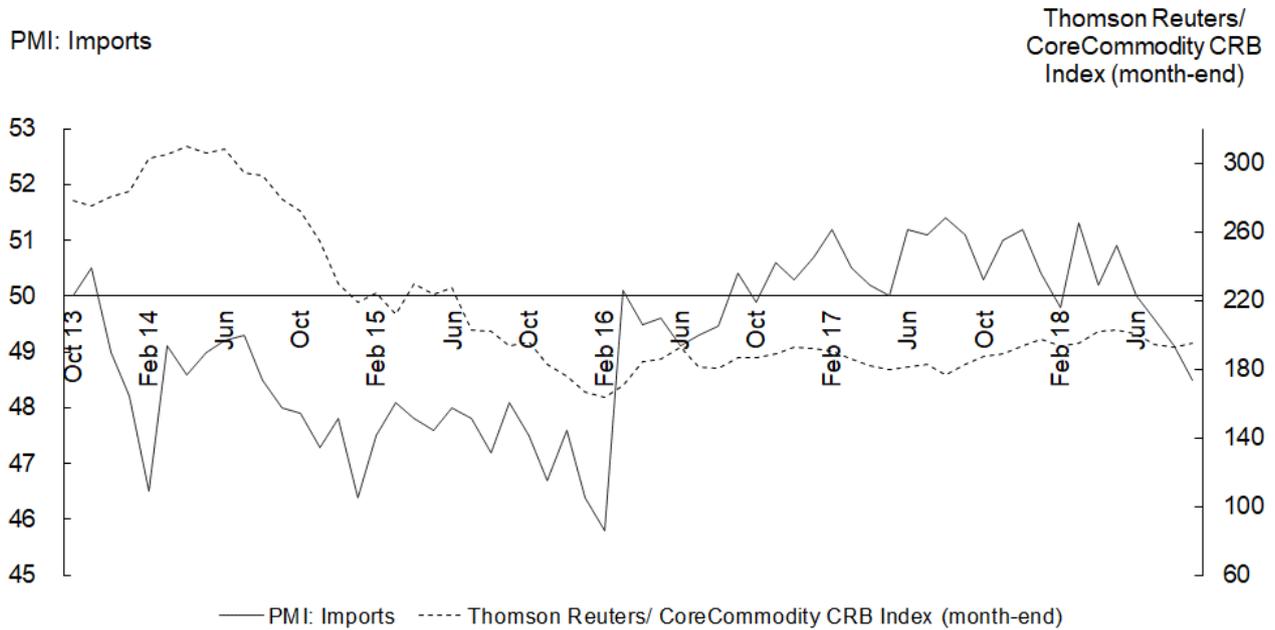
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics, China Customs

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



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

Exhibit 28: Imports index and Thomson Reuters/ CoreCommodity CRB Index, October 2013 to September 2018

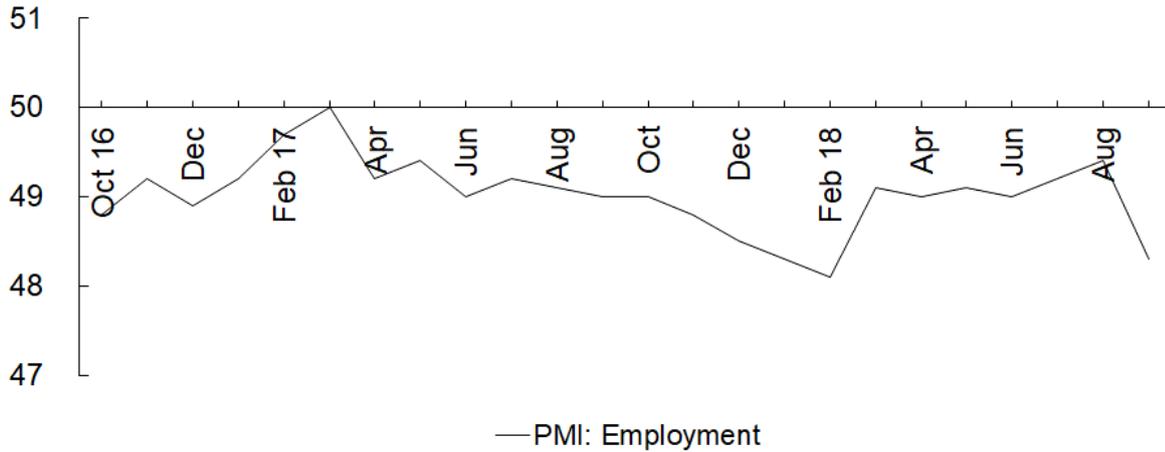


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics, Thomson Reuters

10. Employment index drops to seven-month low

The employment index rose slightly from 49.2 in July to 49.4 in August. However, the index fell to a seven-month low of 48.3 in September. (Exhibit 29) The latest index reading shows a faster drop in manufacturing employment in September. We believe that the negative impact of the escalating China-US trade frictions on businesses of export enterprises has started to unfold and, consequently, enterprises are employing fewer workers.

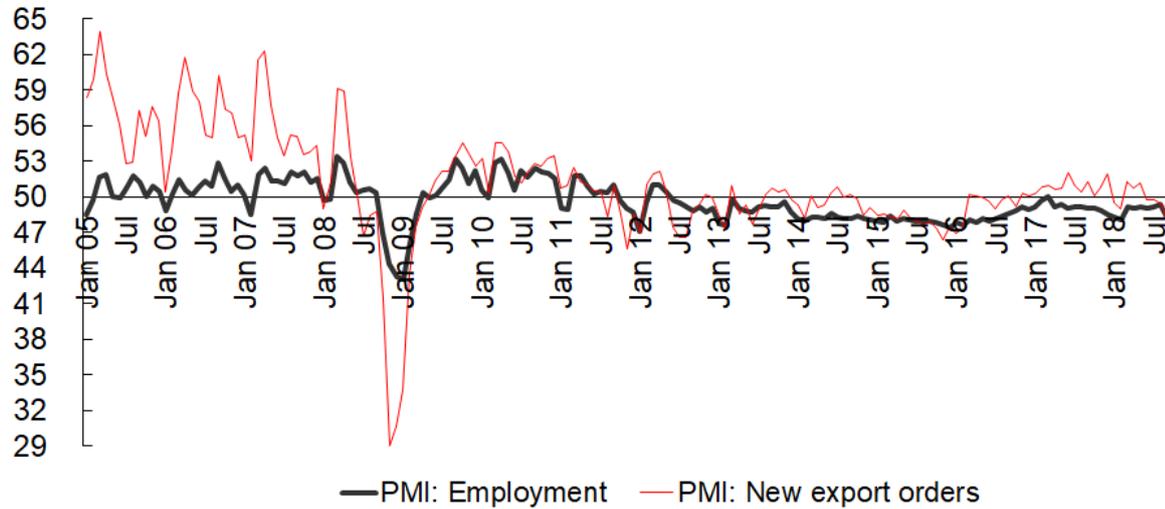
Exhibit 29: Employment index, October 2016 to September 2018



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

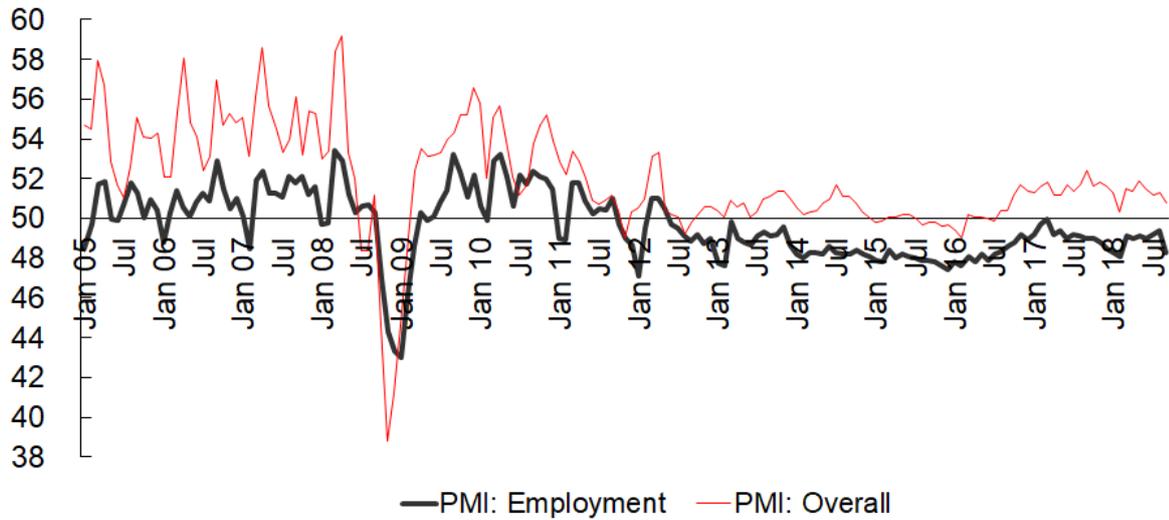
Exhibit 30 proves that the employment in China’s manufacturing sector has relied heavily on the export sector. Exhibit 31 and 32 give our readers some ideas about the extent to which the employment situation improves or deteriorates with the manufacturing sector and the overall economy.

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



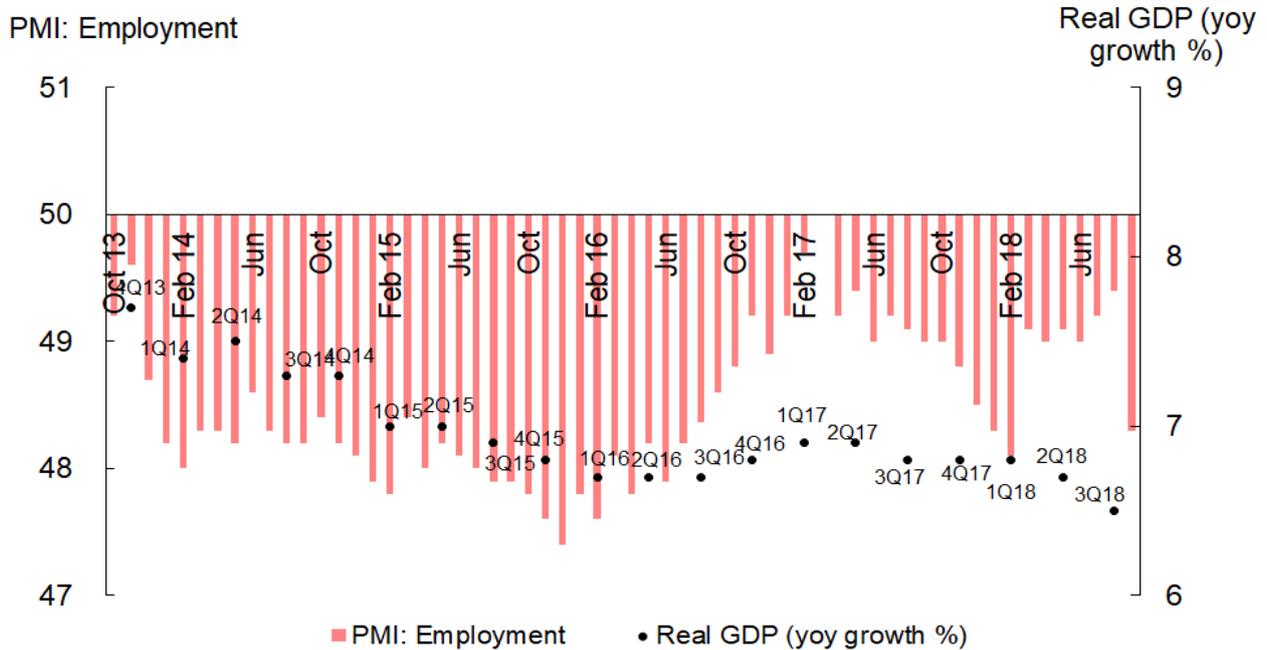
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

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



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

Exhibit 32: Employment index and real GDP growth, October 2013 to September 2018

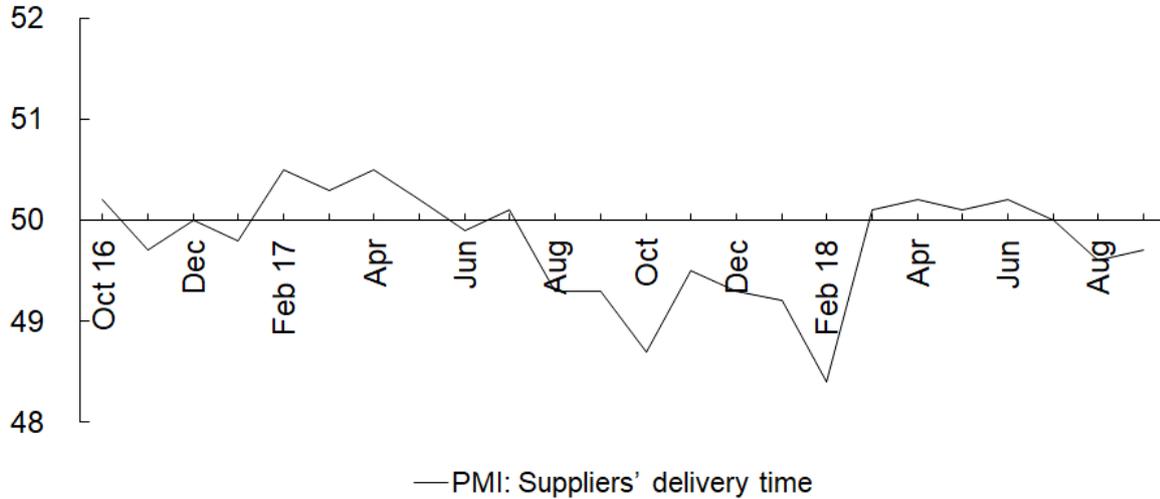


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

11. Suppliers' delivery slows slightly

The suppliers' delivery time index fell from 50.0 in July to 49.6 in August, and then rose slightly to 49.7 in September. The index readings in the past two months were slightly below the critical 50-mark, indicating that suppliers' delivery has slightly slowed recently. (Exhibit 33)

Exhibit 33: Suppliers' delivery time index, October 2016 to September 2018

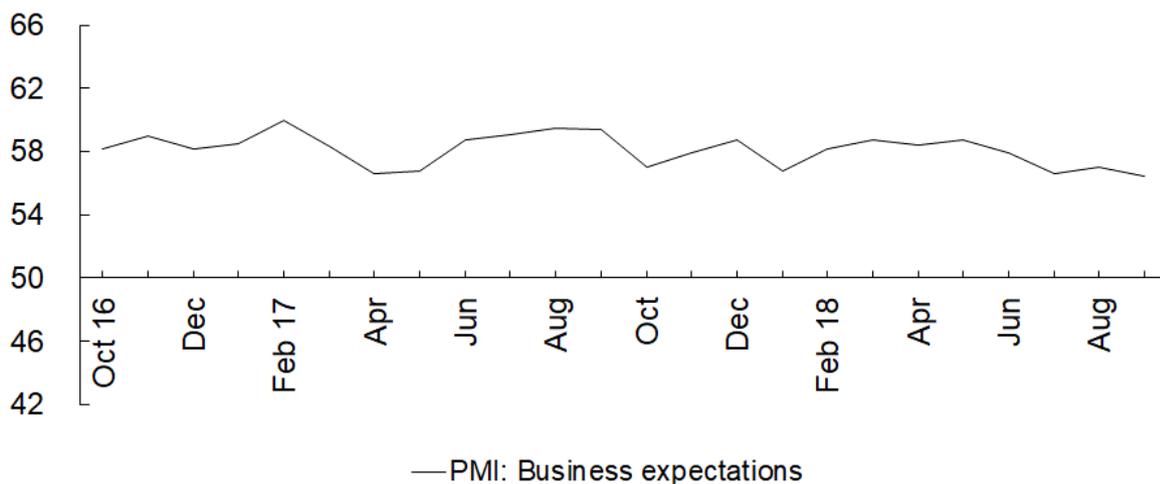


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

12. Purchasing managers remain optimistic

The business expectations index rose from 56.6 in July to 57.0 in August, and then fell to 56.4 in September. The index readings in the past three months were still above the critical 50-mark, indicating that purchasing managers have remained optimistic recently.⁶ (See exhibit 34)

Exhibit 34: Business expectations index, October 2016 to September 2018



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

⁶ 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.

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.

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.

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