

PMI Quarterly on China Manufacturing

China Federation of Logistics & Purchasing

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PMI indicates downward pressure on manufacturing sector and economy

- Output growth moderates.
- New orders index returns to expansion.
- Backlogs of orders continue to drop.
- Stocks of finished goods and major inputs drop at faster pace.
- Manufacturers start to increase their purchases of production inputs.
- Prices of production inputs go up in September.
- Ex-factory prices index continues to drop.
- Imports index stays below critical 50-mark.
- Manufacturing employment continues to decline.
- Suppliers' delivery quickens.
- Purchasing managers become more optimistic.

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1. PMI indicates downward pressure on manufacturing sector and economy

China's manufacturing PMI dropped from 49.7 in July to 49.5 in August, and then picked up to 49.8 in September. The index has stayed below the critical 50-mark for five consecutive months, pointing to continued downward pressure on China's manufacturing sector and economy. However, the rebound in the September figure indicates that the downward pressure is easing. (See exhibit 1)

It is noteworthy to recognize the discrepancy by size of enterprises. The PMI of 'large enterprises' fluctuated above the critical 50-mark within the range of 50.4 to 50.8 throughout July to September. The readings indicate a continued expansion of 'large enterprises'. Meanwhile, the PMI of 'medium enterprises' went down from 48.7 in July to 48.2 in August, but then rebounded to 48.6 in September. The PMI of 'small enterprises' increased from 48.2 in July to 48.6 in August and further to 48.8 in September. Although the readings of both indices stayed below 50 in the quarter, the pick-up in the indices in recent months indicates that the rate of contraction of small and medium enterprises has stabilized recently. (See exhibit 2)

The headline PMI stayed below the critical 50-mark in the quarter, pointing to continued contraction of the manufacturing sector. The output index rose from 51.9 in August to 52.3 in September, indicating that output growth has accelerated recently. This was due largely to an improving domestic demand: The new orders index has returned to the expansionary zone in September. Meanwhile, the new export orders index rebounded from 46.9 in July to 48.2 in September, indicating that the new export orders have decreased at a slower pace lately.

Prices of industrial products continued to decline: The ex-factory prices index stayed below the neutral level of 50 in the quarter. Meanwhile, the input prices index rose markedly from 48.6 in August to 52.2 in September. It is noteworthy that the decline in ex-factory prices was coincident with the rise in input prices, which would in turn have adverse impact on the profitability of Chinese manufacturers.

Looking ahead, the Chinese economy is still under downward pressure with the China-US trade disputes lingering and the global economy slowing down. We expect that the central government is likely to introduce more policies to stabilize economic growth. In the short term, the central bank will continue to adopt an appropriate monetary policy to maintain reasonably sufficient liquidity. For example, the People's Bank of China (PBoC) announced on 6 September that it would lower the required reserve ratios (RRR) for all banks effective 16 September, with additional targeted cuts for qualified city commercial banks effective 15 October and 15 November. Moreover, the central government will continue with its proactive fiscal policy, such

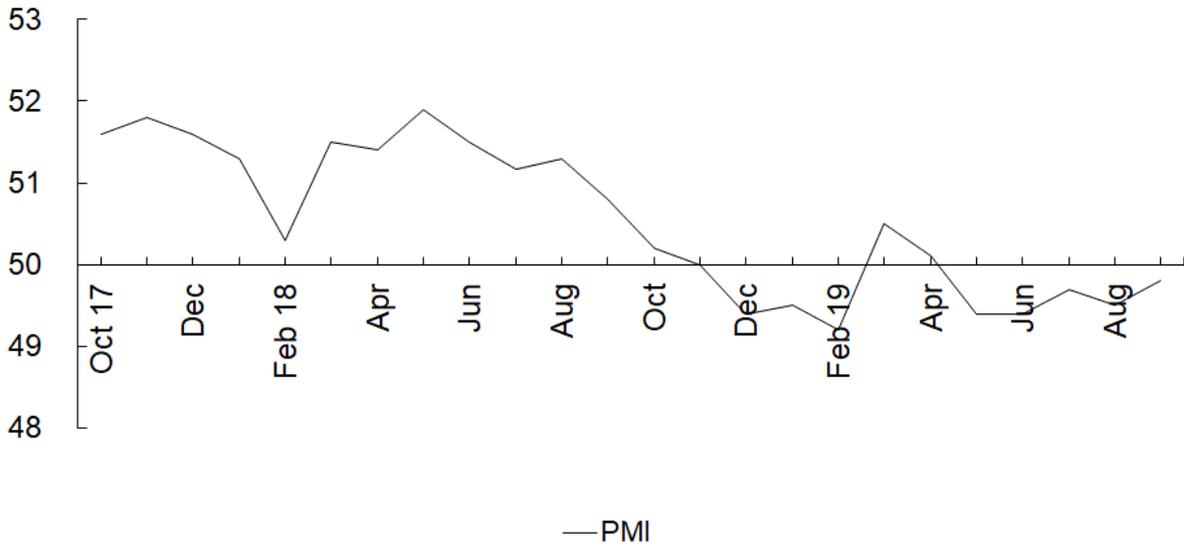
as further reducing tax and fee burdens on enterprises and speeding up special bonds issuance to encourage investment in infrastructure projects. In addition, the central government published a document on 27 August to propose a number of measures to help promote consumer spending, including liberalizing car-purchase restrictions, supporting trade-ins for household appliances, etc. We believe that these policies will help alleviate the downward pressure on the Chinese economy.

The escalation in China-US trade tensions, coupled with the slowdown in global economic growth, has put downward pressure on the Chinese economy. However, with the positive impact of China's stimulus measures starting to unfold, China's economic growth is set to stabilize in the near term. Overall, we predict that the headline PMI will fluctuate within 49 to 50.5 and the real GDP growth will be around 6.0% yoy in 4Q19. Challenges facing Chinese manufacturers include ongoing trade frictions between China and the US, strong government's determination to tackle the pollution problem, and intense competition in the international market. Overall, we expect that the industrial production (VAIO) growth will stabilize around 5.0% yoy in 4Q19.

Exhibit 3 shows the contributions of the sub-indices to the change in the headline PMI. The rise in the headline PMI in September was due largely to the increase in the output index (which weighs 25% in the computation of the headline PMI) and the new orders index (which weighs 30%). Among the 12 sub-indices (i.e. excluding the suppliers' delivery time index), only the output index and the business expectations index remained in the expansionary zone over the past three months. Meanwhile, the indices of new export orders, backlogs of orders, stocks of finished goods, imports, ex-factory prices, stocks of major inputs and employment stayed in the contractionary zone over the same period. (See exhibit 4)

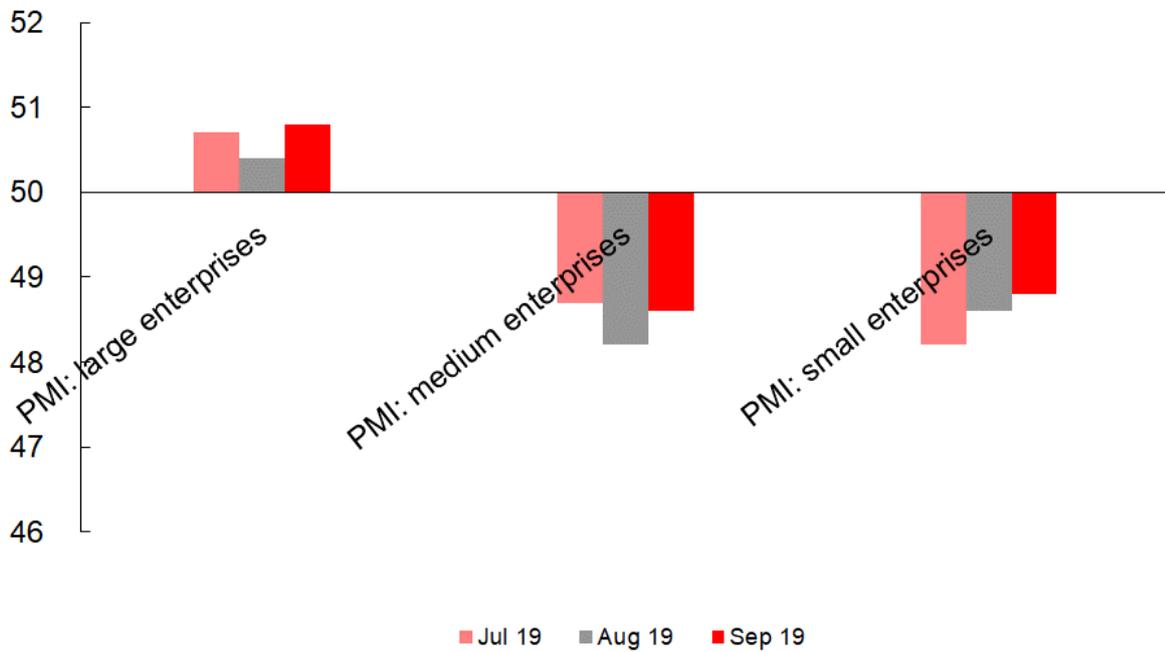
China's manufacturing PMI has so far done a satisfactory job in predicting economic growth. Exhibit 5 plots the quarterly real GDP yoy growth rates versus the monthly PMIs since October 2014. It could be seen that the PMI demonstrates a fairly good track record of forecasting the growth trend of the economy at least over the next few months. Based on this chart we project that the real GDP growth will be around 6.0% in 4Q19.

Exhibit 1: Headline PMI, October 2017 to September 2019



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

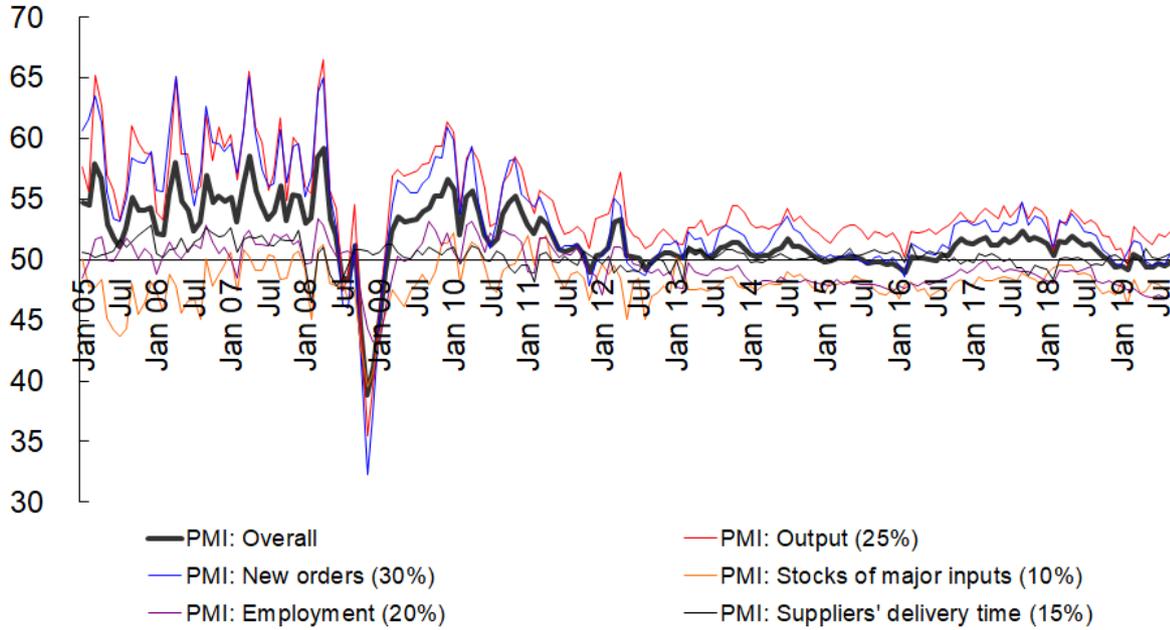
Exhibit 2: PMIs of large enterprises, medium enterprises and small enterprises, July to September 2019



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

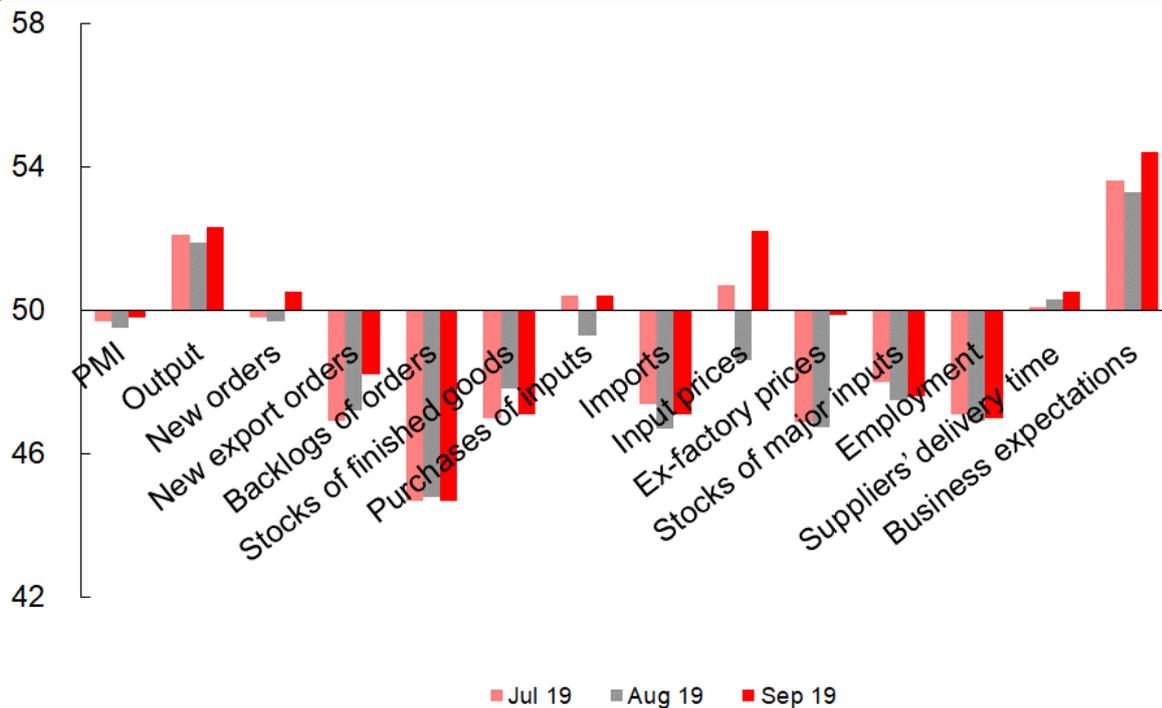
Exhibit 3: Headline PMI and sub-indices, January 2005 to September 2019

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



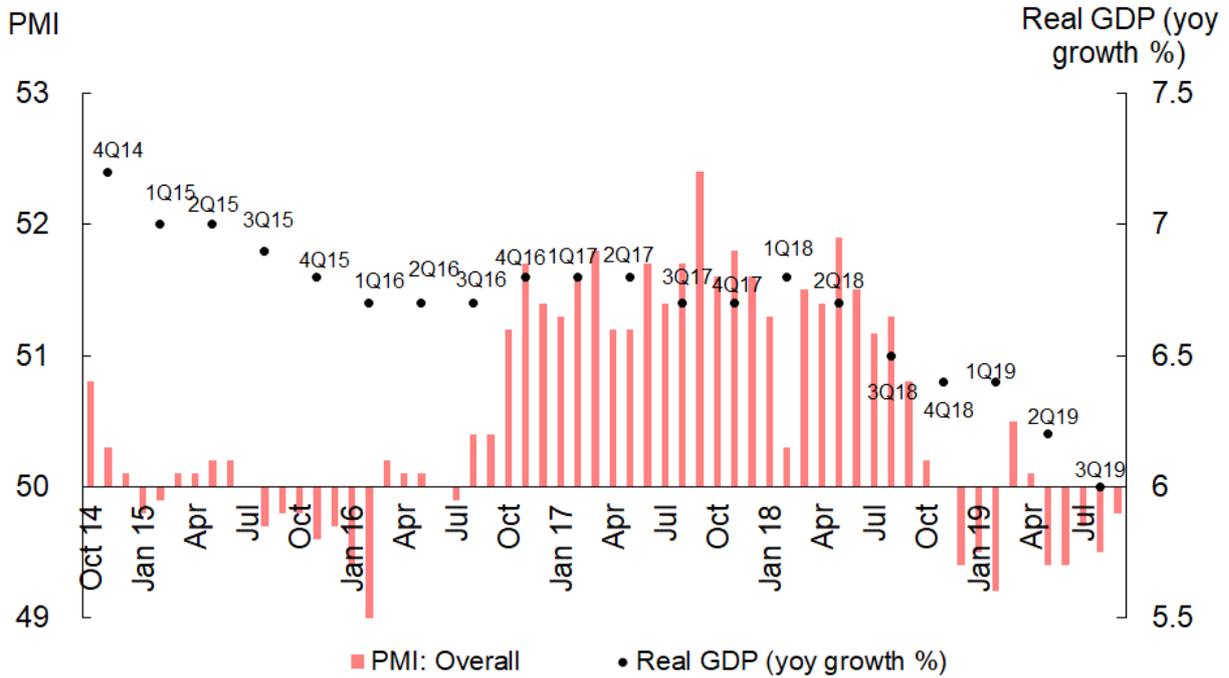
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 4: Headline PMI and all sub-indices, July to September 2019



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

Exhibit 5: Headline PMI and real GDP growth, October 2014 to September 2019



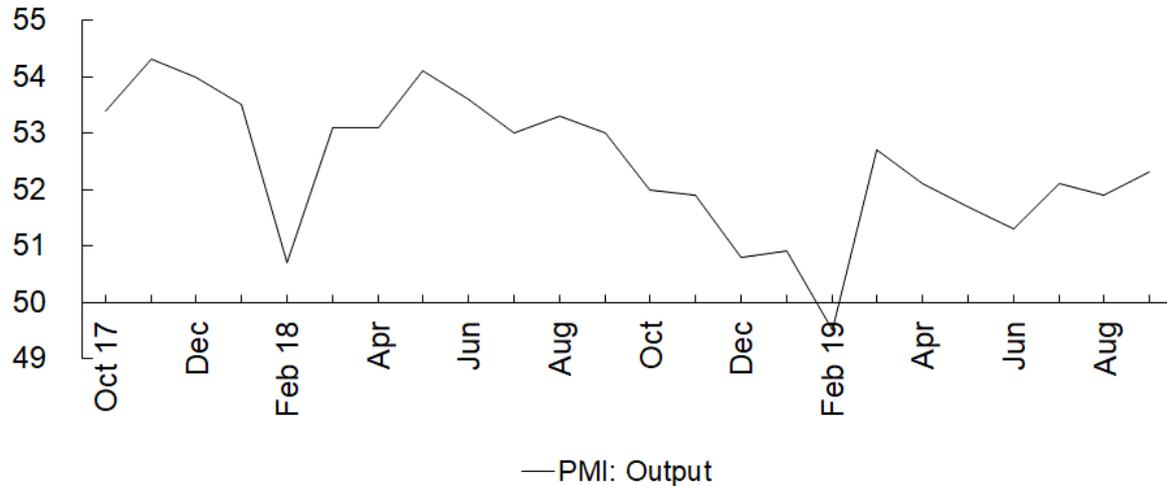
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

2. Output growth moderates

After falling from 52.1 in July to 51.9 in August, the output index went up to 52.3 in September. The latest figure indicates a recent acceleration in the output growth. (See exhibit 6)

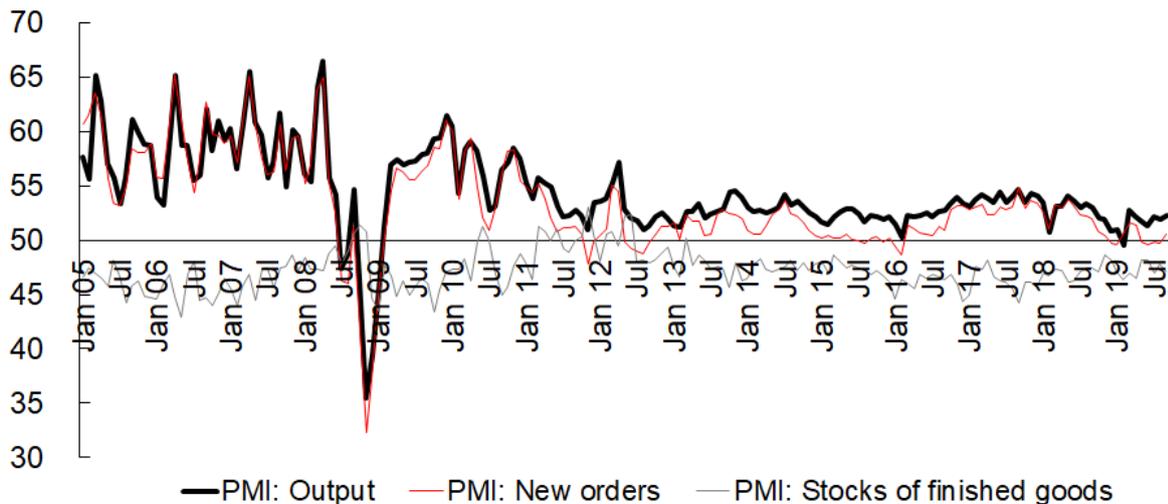
Exhibit 7 shows the contributions of new orders growth and restocking activities to output growth. Although the stocks of finished goods index has stayed in the contractionary zone for 78 consecutive months, output may grow strongly later when manufacturers finally run out of their inventory or regain confidence to restock.

Exhibit 6: Output index, October 2017 to September 2019



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

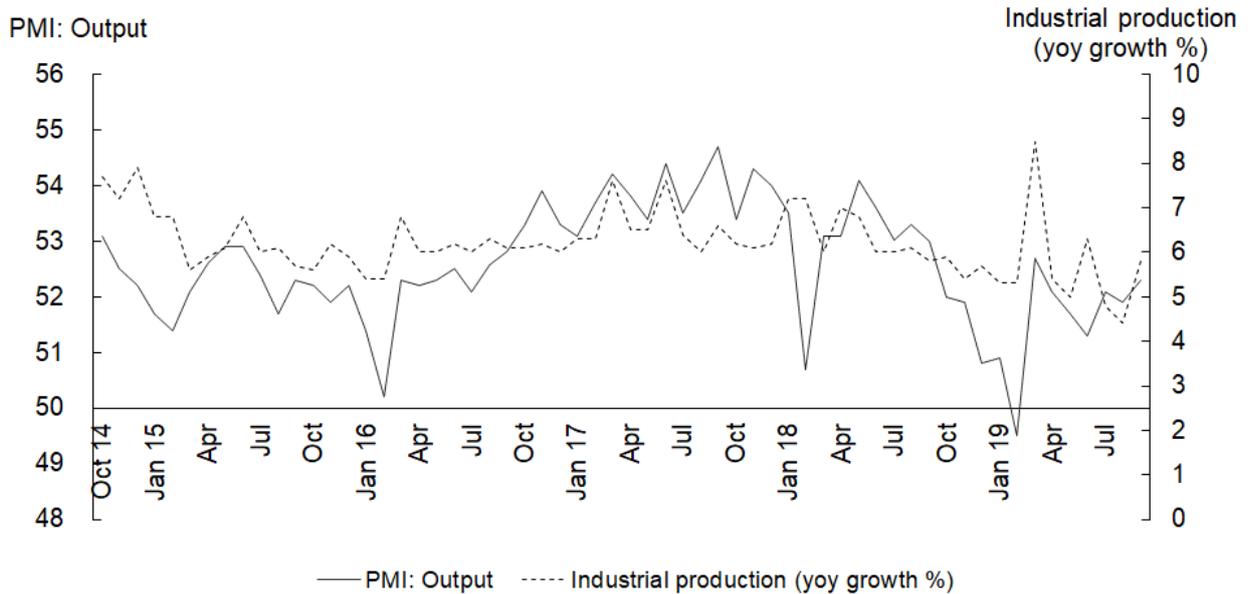
Exhibit 7: Output, new orders and stocks of finished goods, January 2005 to September 2019



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 stabilize around 5.0% yoy in 4Q19, as the government’s stimulus measures are likely to partly offset the impact of weakening export demand on industrial activities. Challenges facing Chinese manufacturers include ongoing trade frictions between China and the US, strong government’s determination to tackle pollution problem, and intense competition in the international market.

Exhibit 8: Output index and industrial production growth, October 2014 to September 2019



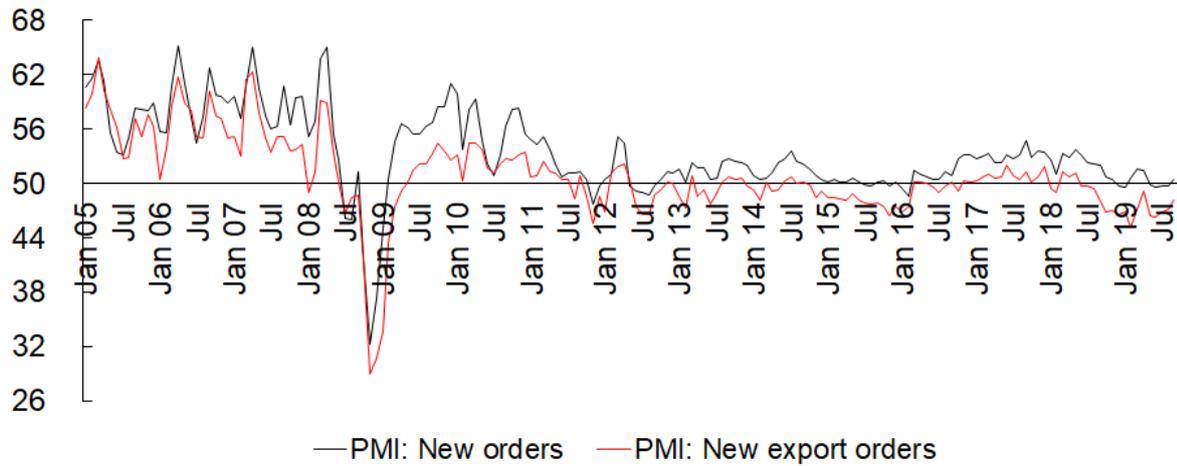
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

3. New orders index returns to expansion

The new orders index edged down from 49.8 in July to 49.7 in August, and then rose to 50.5 in September, returning to the expansionary zone for the first time in five months. This implies an improvement in the overall demand.

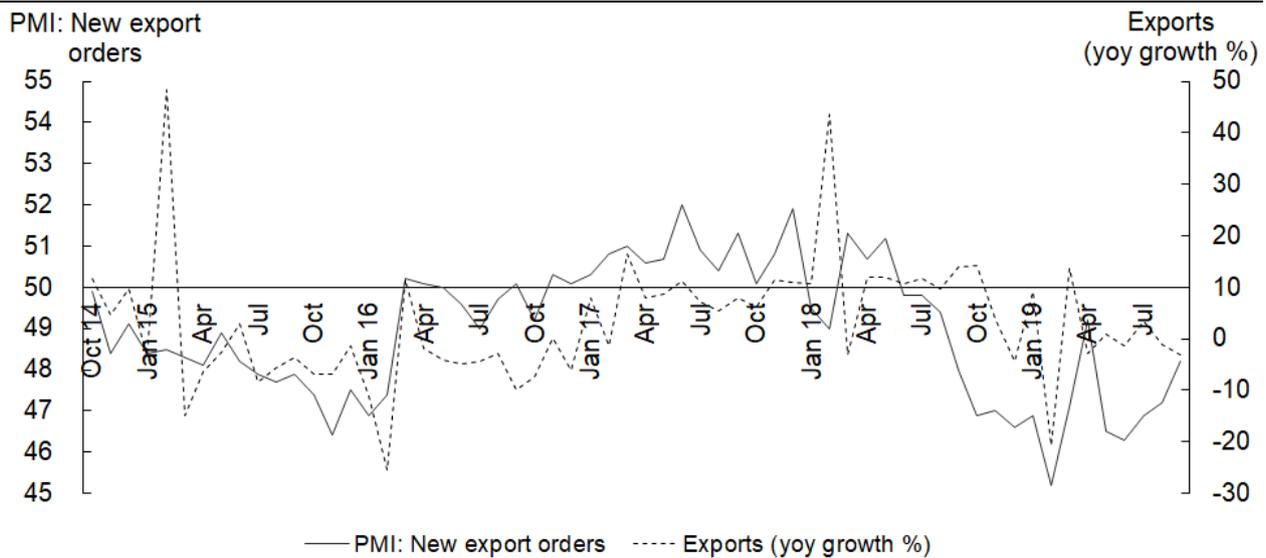
Meanwhile, the new export orders index picked up from 46.9 in July to 47.2 in August, and further to 48.2 in September. The latest figure indicates that the new export orders have decreased at a slower pace lately. Although China and the US have resumed trade negotiations, the US could still hike the additional US tariff rate on about US\$160 billion worth of Chinese goods in mid-December. Thus, the downward pressure on China’s exports is unlikely to ease in the coming months, in our view. (See exhibit 9)

Exhibit 9: New orders index and new export orders index, January 2005 to September 2019



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

Exhibit 10: New export orders index and export growth, October 2014 to September 2019



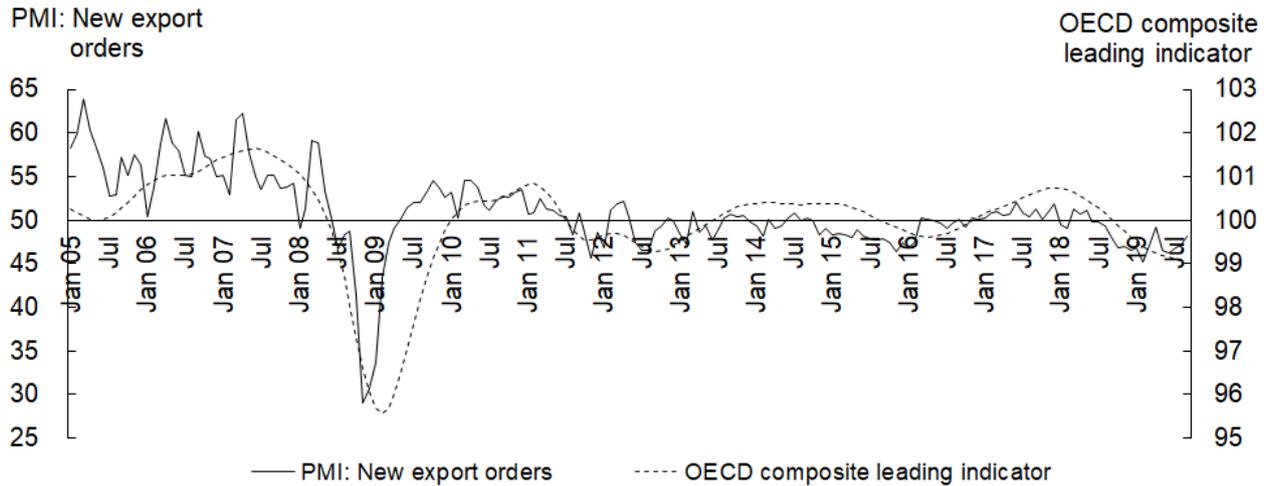
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics, China Customs

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 last year, 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 indicator¹ has continued to fall since late

¹ 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.

2017, suggesting a moderation in the growth of the global economy. All in all, we forecast that China’s exports will show negative year-on-year growth in 4Q19.

Exhibit 11: New export orders index and OECD composite leading indicator, January 2005 to September 2019



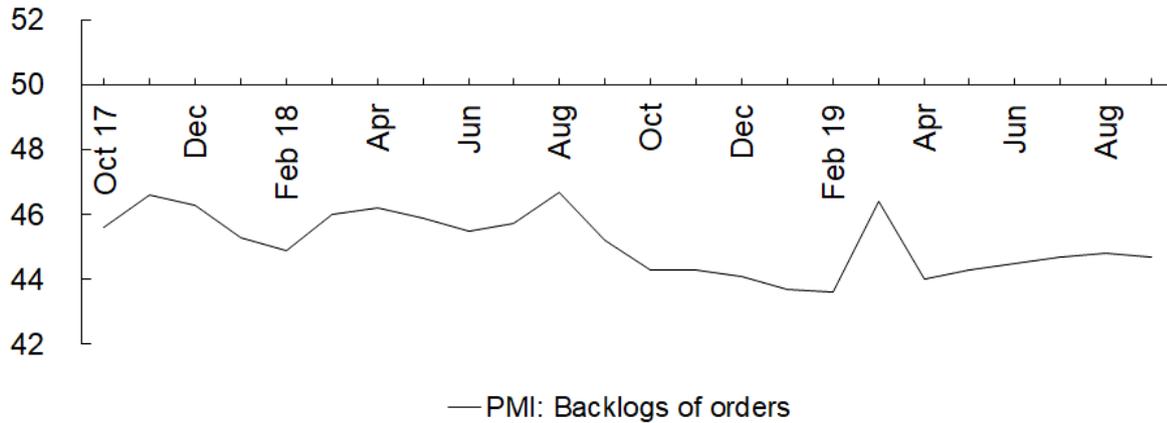
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics, Organization for Economic Cooperation and Development

4. Backlogs of orders continue to drop

The backlogs of orders index rose slightly from 44.7 in July to 44.8 in August, before dropping to 44.7 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)

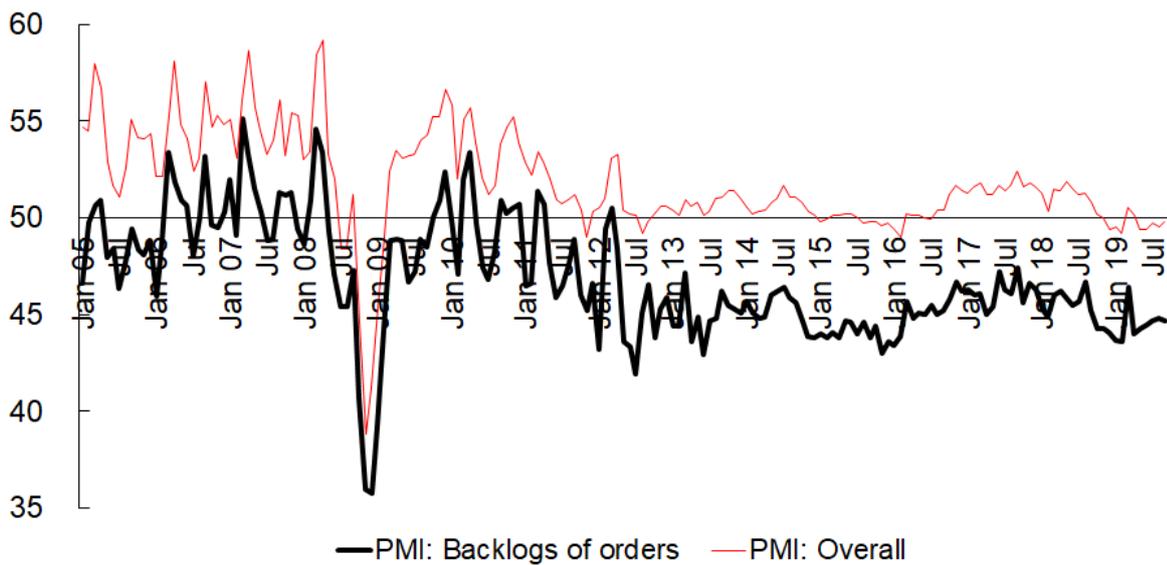
Looking ahead, we expect the index to stay low in the near term, as indicated by the apparently very high correlation between the sub-index and the headline PMI, and the recent weakness in the headline PMI. (See exhibit 13)

Exhibit 12: Backlogs of orders index, October 2017 to September 2019



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

Exhibit 13: Backlogs of orders index and headline PMI, January 2005 to September 2019



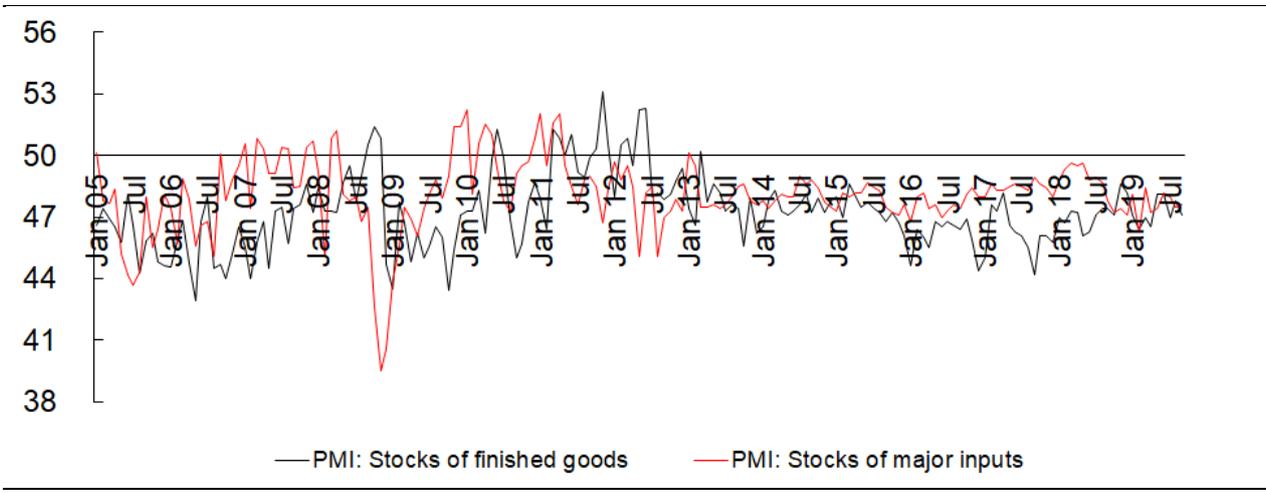
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

5. Stocks of finished goods and major inputs drop at faster pace

The stocks of finished goods index went up from 47.0 in July to 47.8 in August, and then fell to 47.1 in September. The latest figure indicates that the stocks of finished goods held by manufacturers have decreased at a faster pace lately.

Meanwhile, the stocks of major inputs index dropped from 48.0 in July to 47.5 in August and stayed low at 47.6 in September. The latest readings indicate a faster decline in the stocks of major inputs in recent months. (Exhibit 14)

Exhibit 14: Stocks of finished goods index and stocks of major inputs index, January 2005 to September 2019



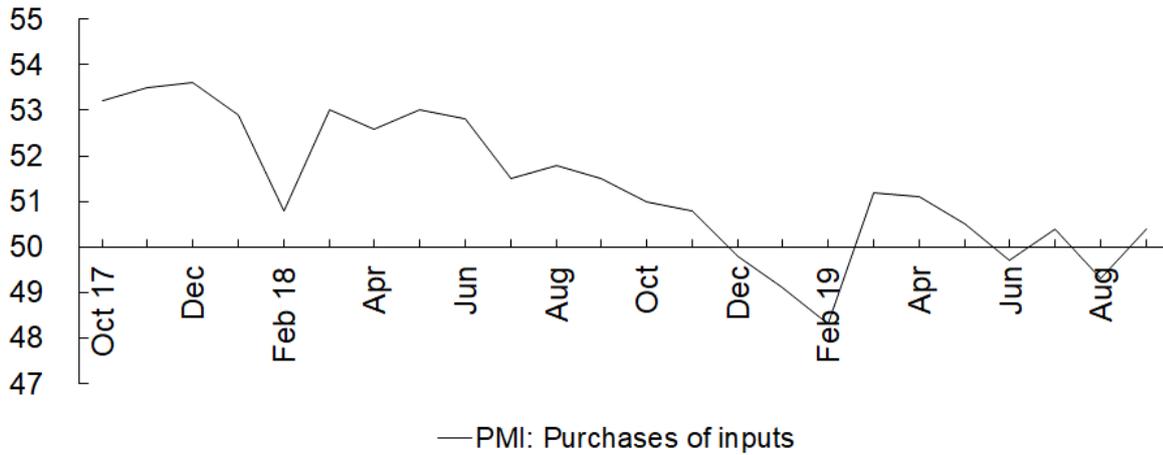
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

6. Manufacturers start to increase their purchases of production inputs

The purchases of inputs index dropped from 50.4 in July to 49.3 in August, and then went up to 50.4 in September, returning to the expansionary zone. The latest figure indicates that manufacturers have started to increase their purchases of production inputs recently. (Exhibit 15)

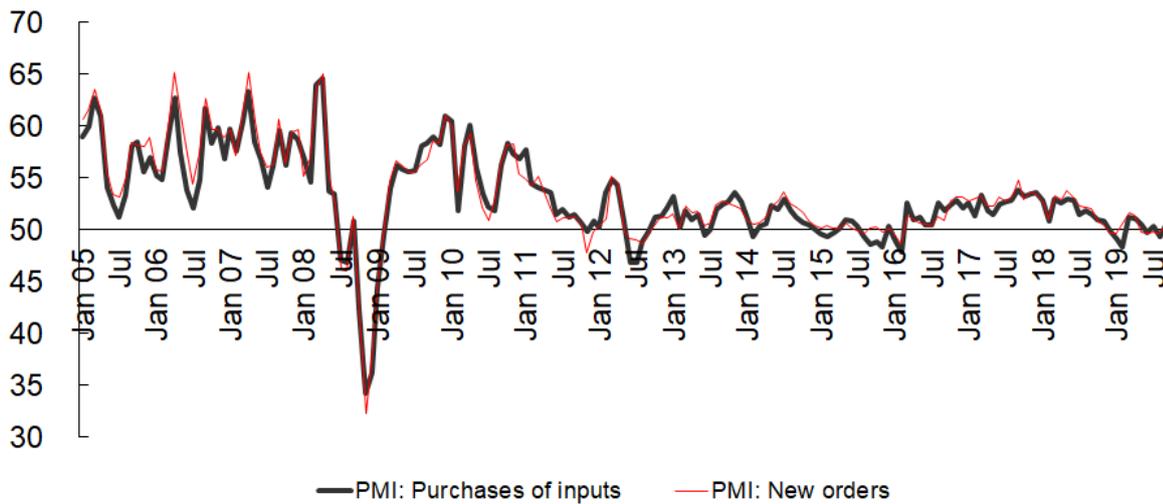
A number of factors affect the purchasing activities of manufacturers, among which the amount of new orders received by manufacturers has been the most important factor. Exhibit 16 plots the purchases of inputs index against the new orders index. The correlation between the two sub-indices is very strong. 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. 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 2017 to September 2019



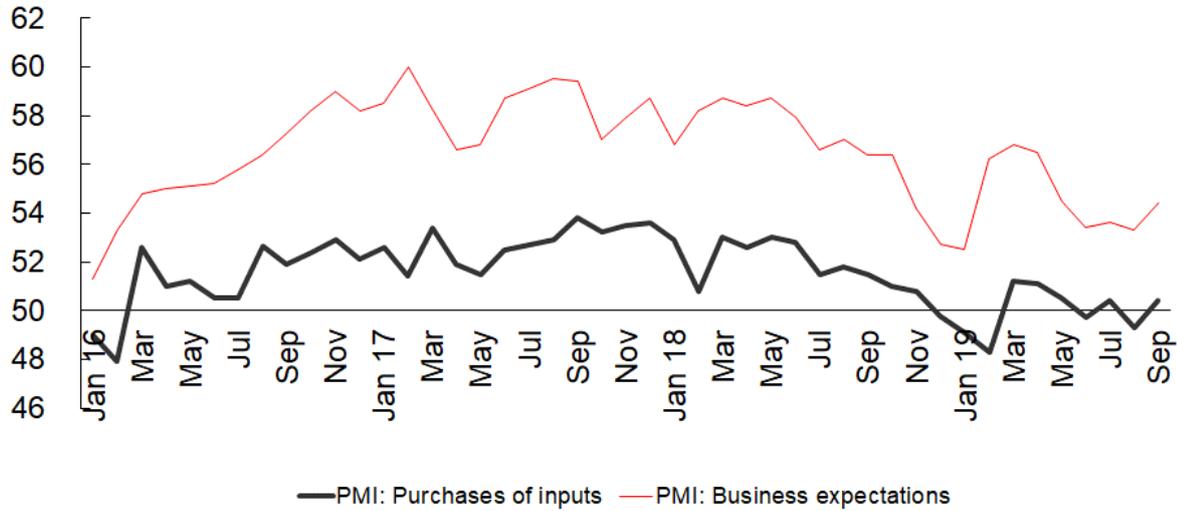
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 16: Purchases of inputs and new orders, January 2005 to September 2019



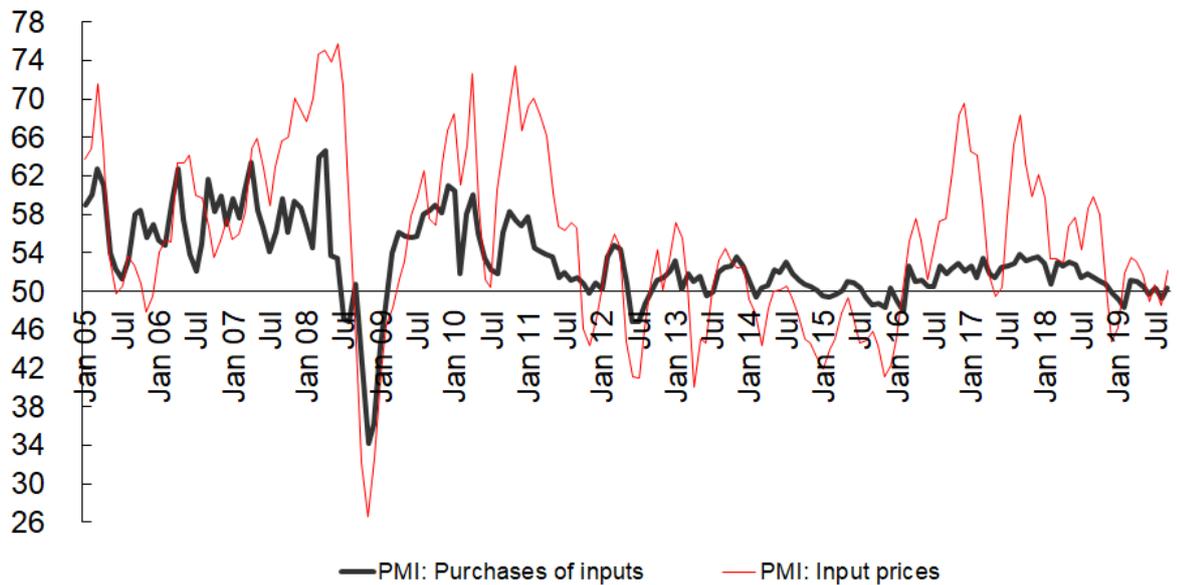
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 17: Purchases of inputs and business expectations, January 2016 to September 2019



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 2019

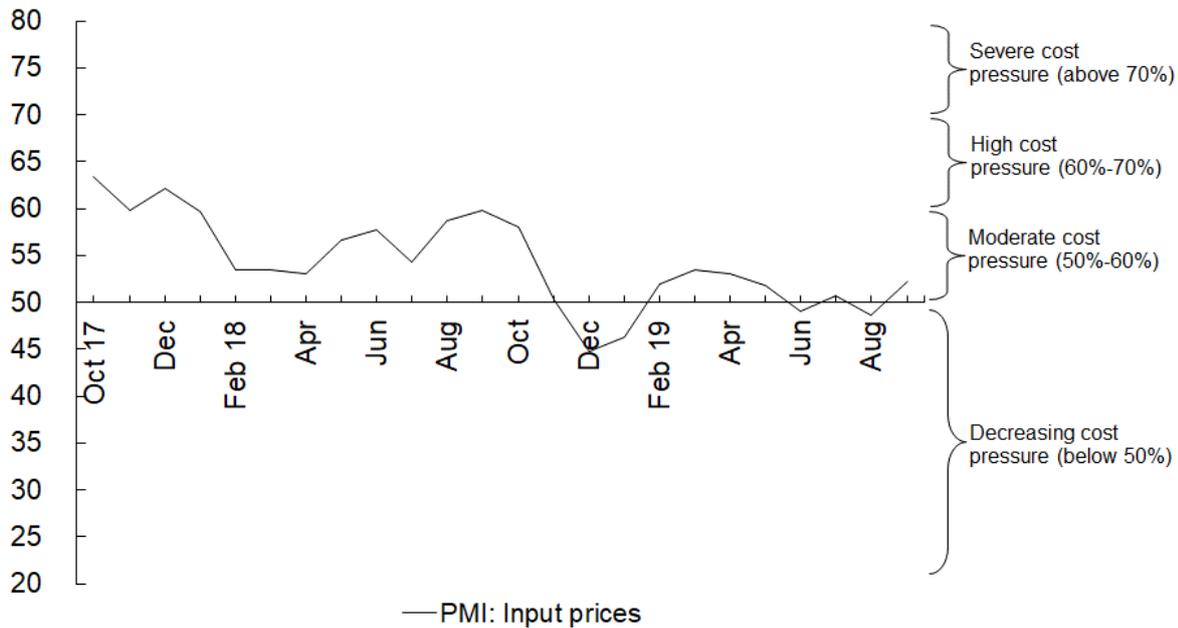


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

7. Prices of production inputs go up in September

The input prices index fell from 50.7 in July to 48.6 in August, and then went up markedly to 52.2 in September. The index rose above the critical 50-mark in September, indicating an increase in prices of production inputs. This would increase the cost pressure on Chinese manufacturers. (Exhibit 19)

Exhibit 19: Input prices index, October 2017 to September 2019



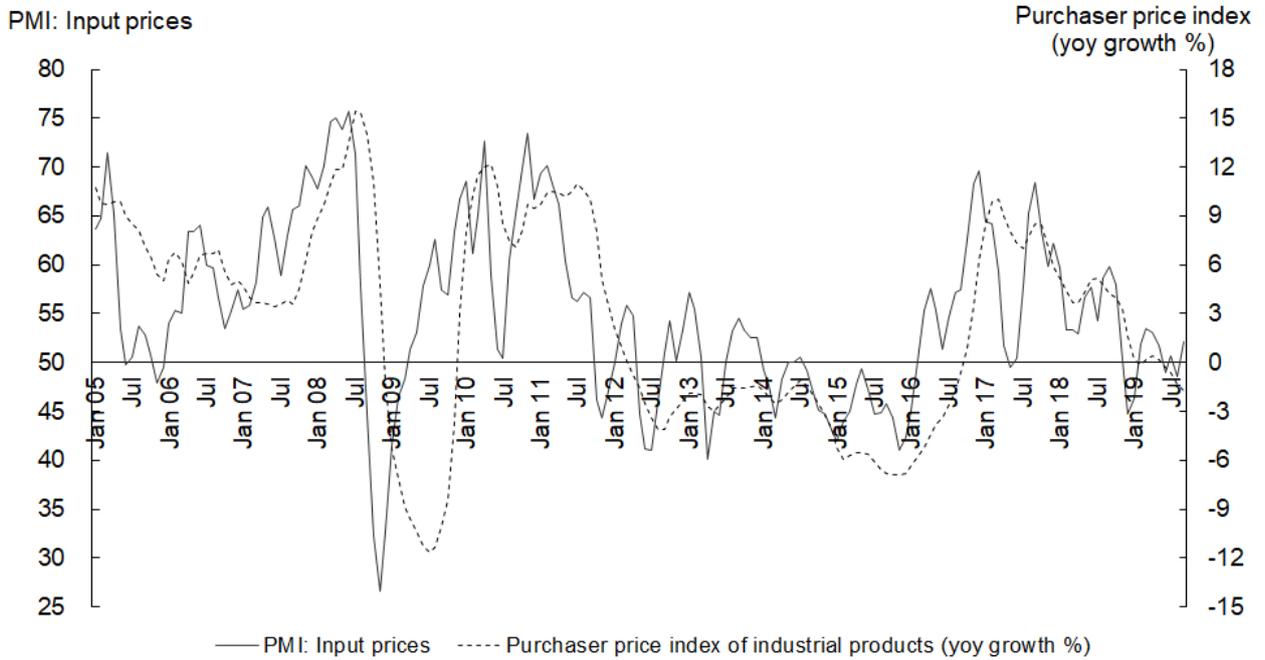
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

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)² in exhibit 21. Going forward, we expect that the month-on-month growth rates for both the purchaser price index and the PPI will stay low in the near term, and the year-on-year growth rates for both the purchaser price index and the PPI will remain negative in 4Q19. Meanwhile, we forecast that the year-on-year CPI growth will continue to go up in the coming months, due mainly to rising pork 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.³

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.

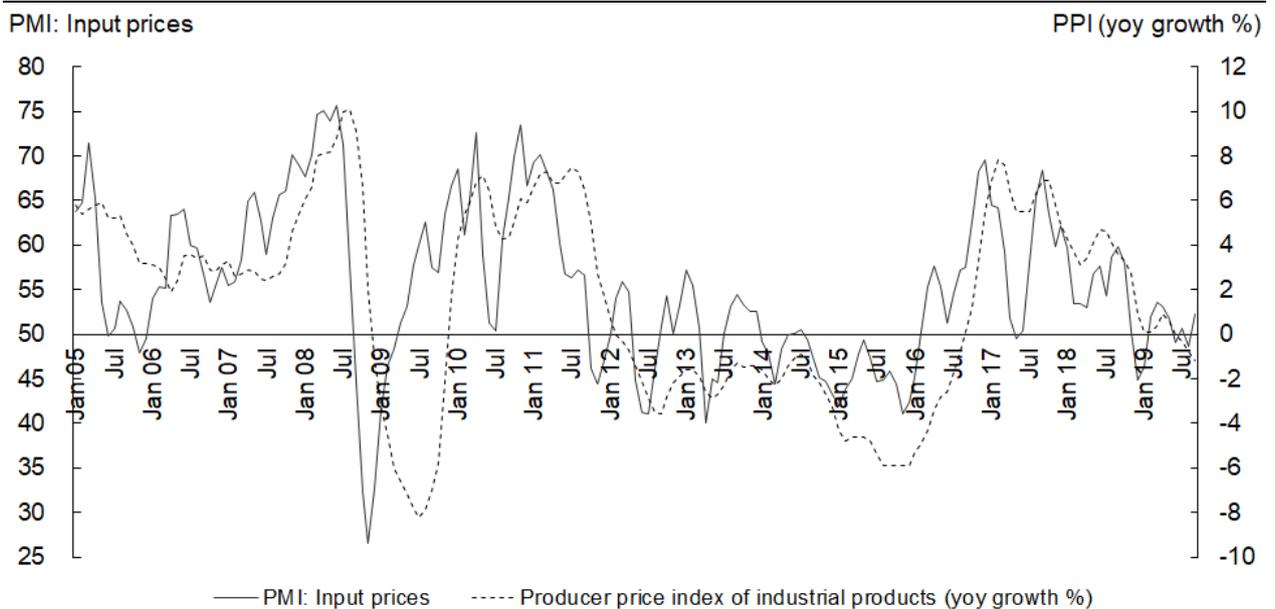
³ The Thomson Reuters/ CoreCommodity CRB Index, which comprises 19 commodities such as crude oil, aluminum, corn, cotton, gold, natural gas, soybeans, etc, has served as one of the most recognized measures of global commodities markets.

Exhibit 20: Input prices index and purchaser price index of industrial products, January 2005 to September 2019



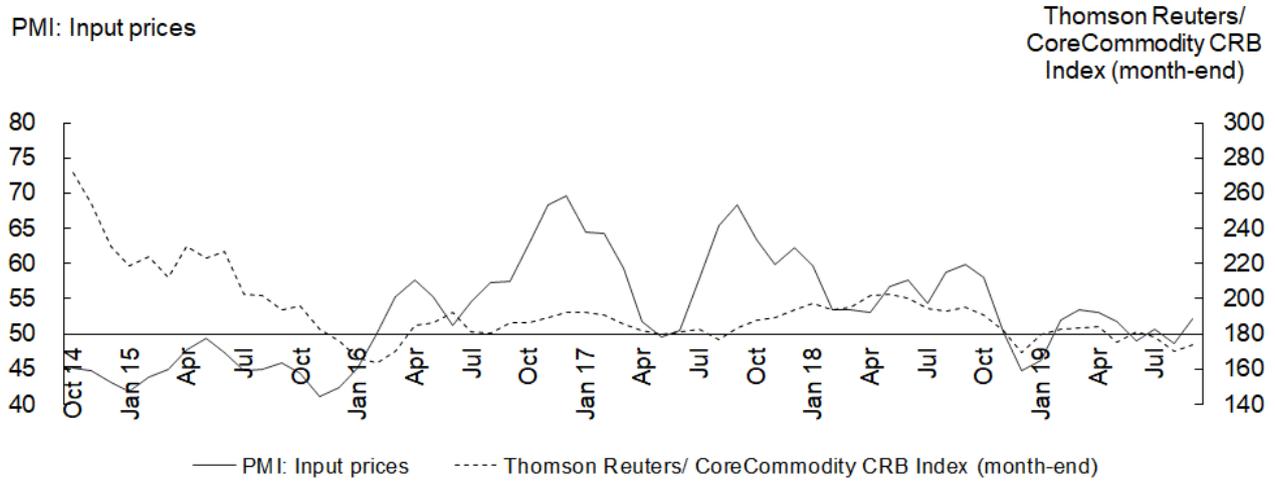
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 21: Input prices index and producer price index, January 2005 to September 2019



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

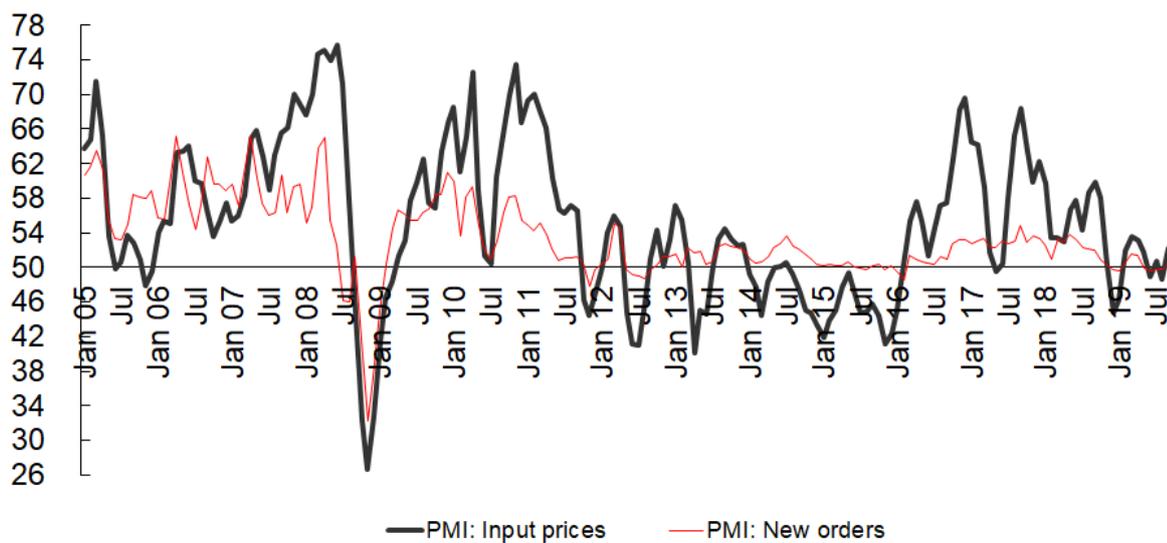
Exhibit 22: Input prices index and Thomson Reuters/ CoreCommodity CRB Index, October 2014 to September 2019



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. Input prices have risen faster than new orders recently, and this may imply a deterioration in manufacturers’ profit margins in the coming future.

Exhibit 23: Input prices and new orders, January 2005 to September 2019

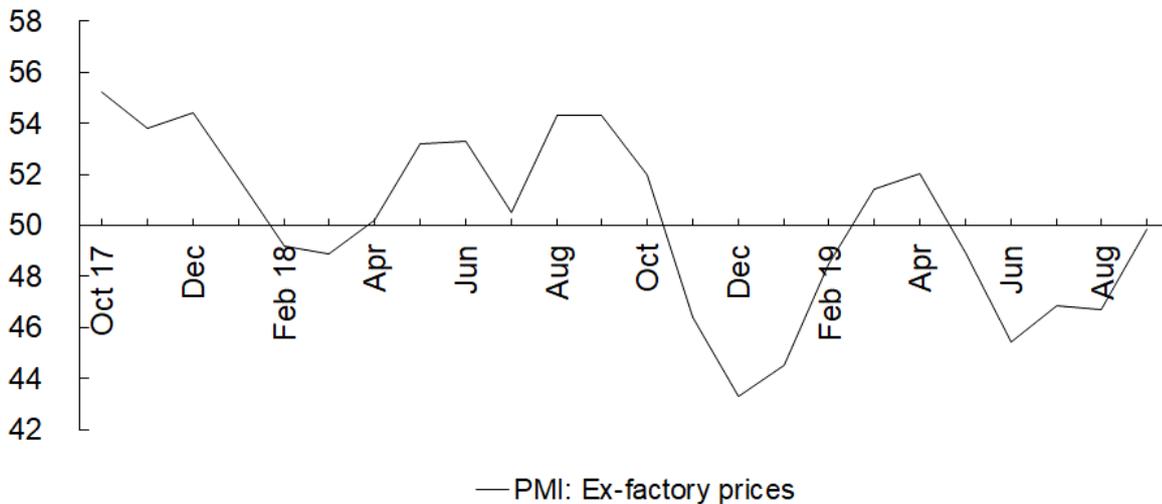


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

8. Ex-factory prices index continues to drop

After falling from 46.9 in July to 46.7 in August, the ex-factory prices index rebounded strongly to 49.9 in September. The index has stayed below the critical 50-mark for five consecutive months, indicating that Chinese manufacturers have been reducing the ex-factory prices of their finished products amid challenging sales environment. However, the rebound of the index in September signals easing price-cut pressure on enterprises.⁴ (Exhibit 24)

Exhibit 24: Ex-factory prices index, October 2017 to September 2019



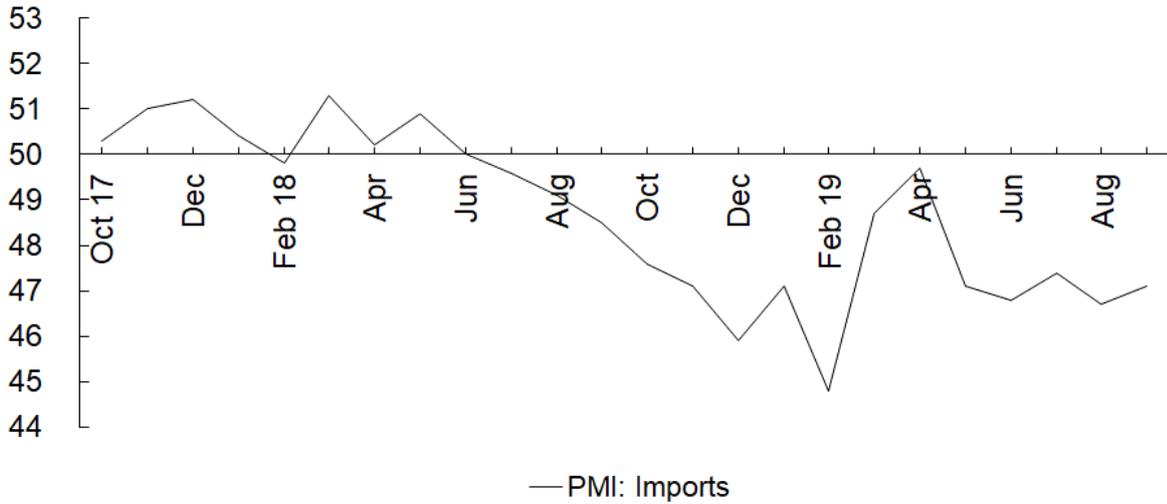
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

9. Imports index stays below critical 50-mark

The imports index went down from 47.4 in July to 46.7 in August, and then picked up to 47.1 in September. The below-50 readings in the past few months show that the domestic demand for raw materials and parts has been weak lately. (Exhibit 25)

⁴ The ex-factory prices index has been published since January 2017.

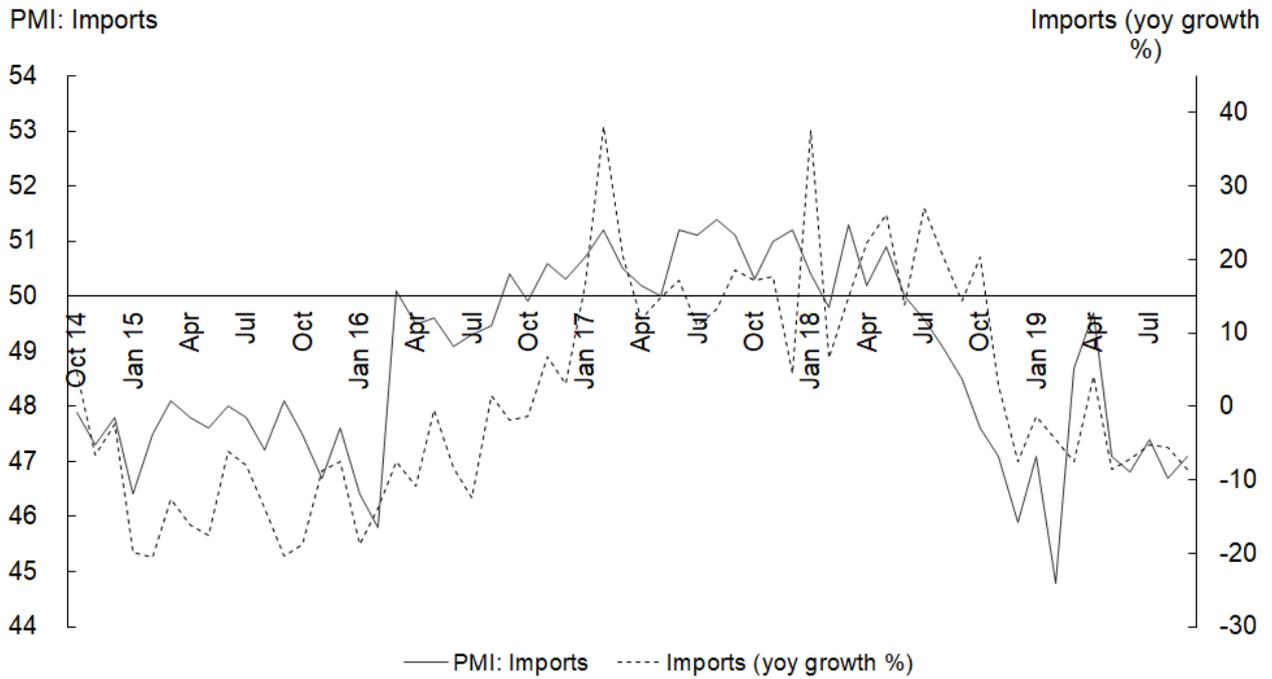
Exhibit 25: Imports index, October 2017 to September 2019



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

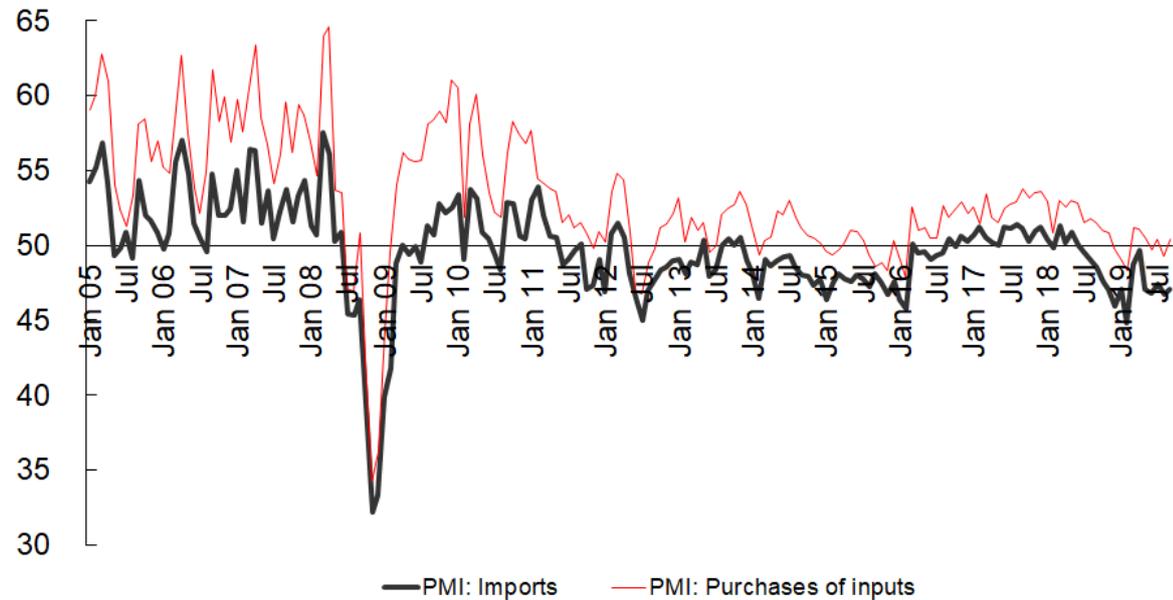
Exhibit 26 shows that the imports index is highly correlated (with some lags) to the year-on-year growth rate in imports. We expect imports to show negative year-on-year growth in 4Q19. Exhibit 27 illustrates the strong association between the imports index and the purchases of inputs index – as Chinese 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 2014 to September 2019



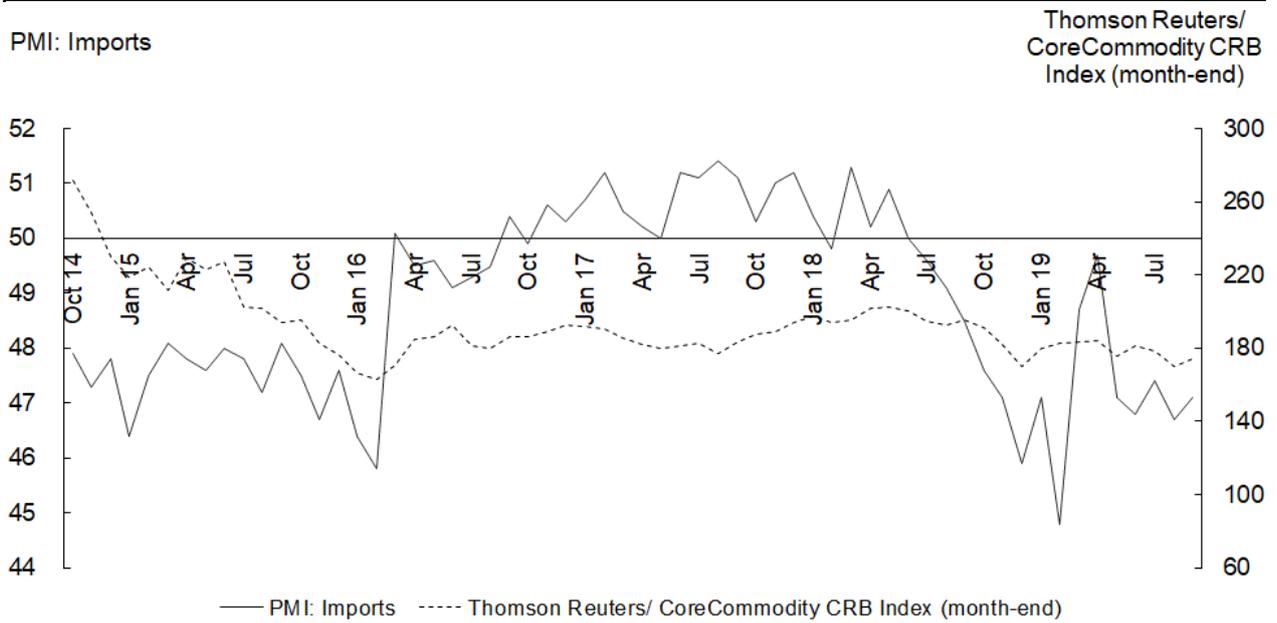
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics, China Customs

Exhibit 27: Imports and purchases of inputs, January 2005 to September 2019



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

Exhibit 28: Imports index and Thomson Reuters/ CoreCommodity CRB Index, October 2014 to September 2019

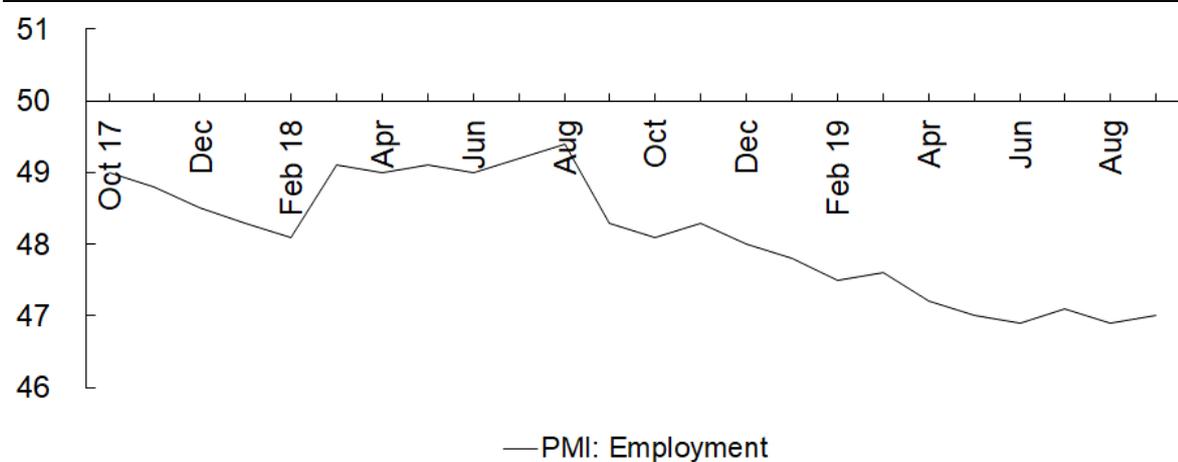


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics, Thomson Reuters

10. Manufacturing employment continues to decline

The employment index fluctuated within a narrow range, hovering between 46.9 and 47.1 during July to September. These figures show a continuous drop in manufacturing employment. (Exhibit 29)

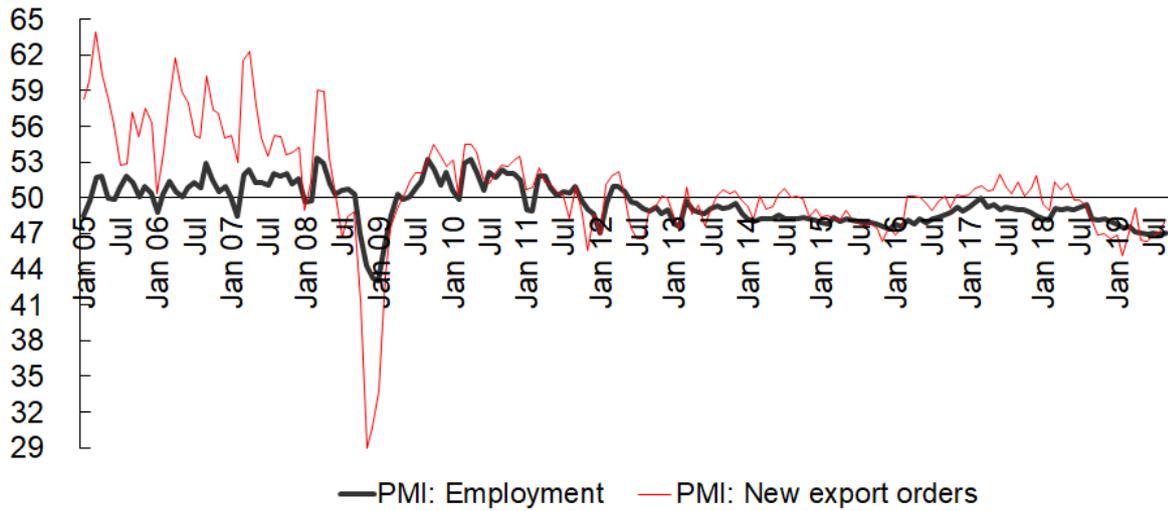
Exhibit 29: Employment index, October 2017 to September 2019



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

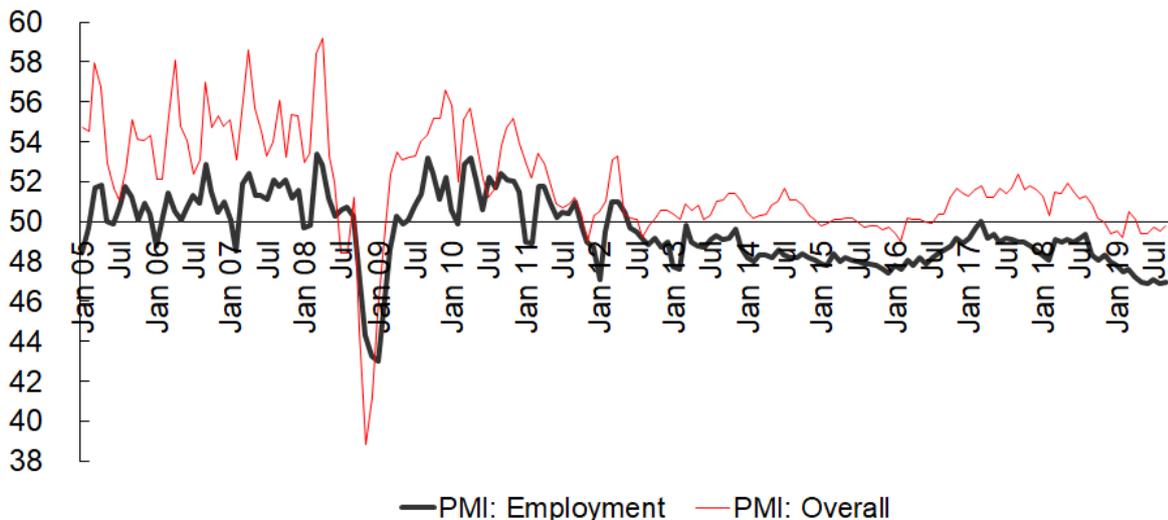
Exhibit 30 proves that the employment in China’s manufacturing sector has relied heavily on the export sector. Exhibit 31 and 32 give our readers some ideas about the extent to which the employment situation improves or deteriorates with the manufacturing sector and the overall economy.

Exhibit 30: Employment and new export orders, January 2005 to September 2019



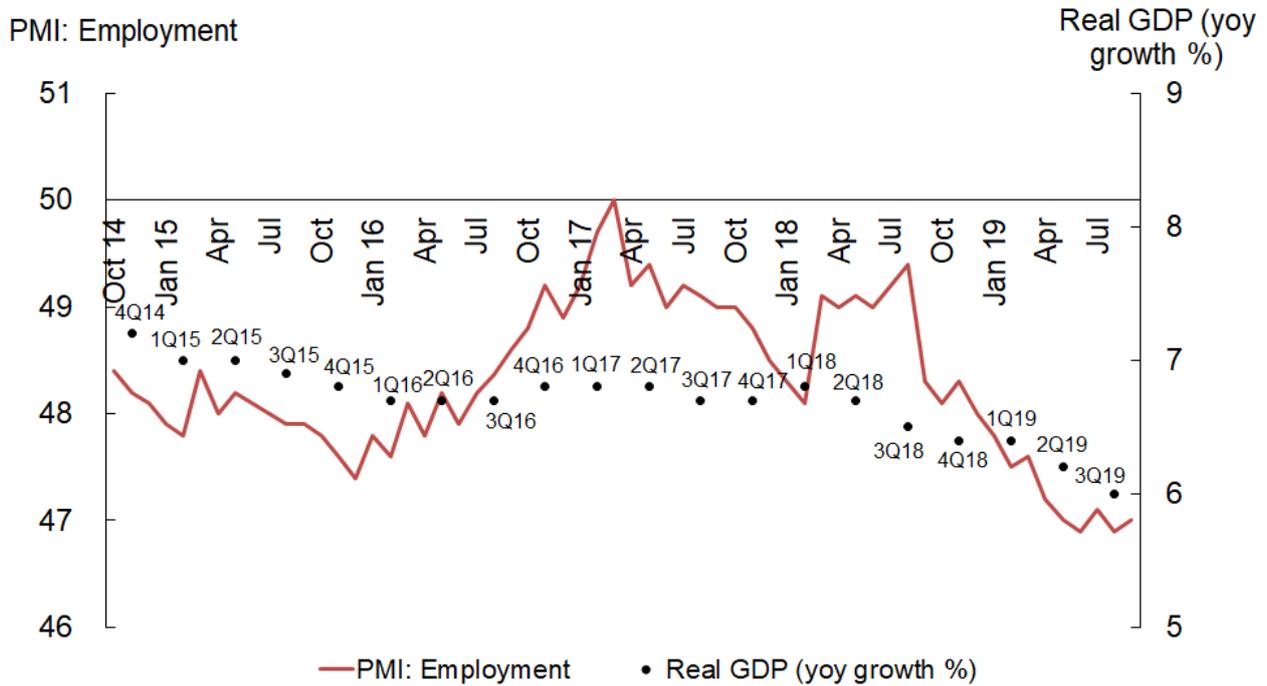
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 31: Employment index and headline PMI, January 2005 to September 2019



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

Exhibit 32: Employment index and real GDP growth, October 2014 to September 2019

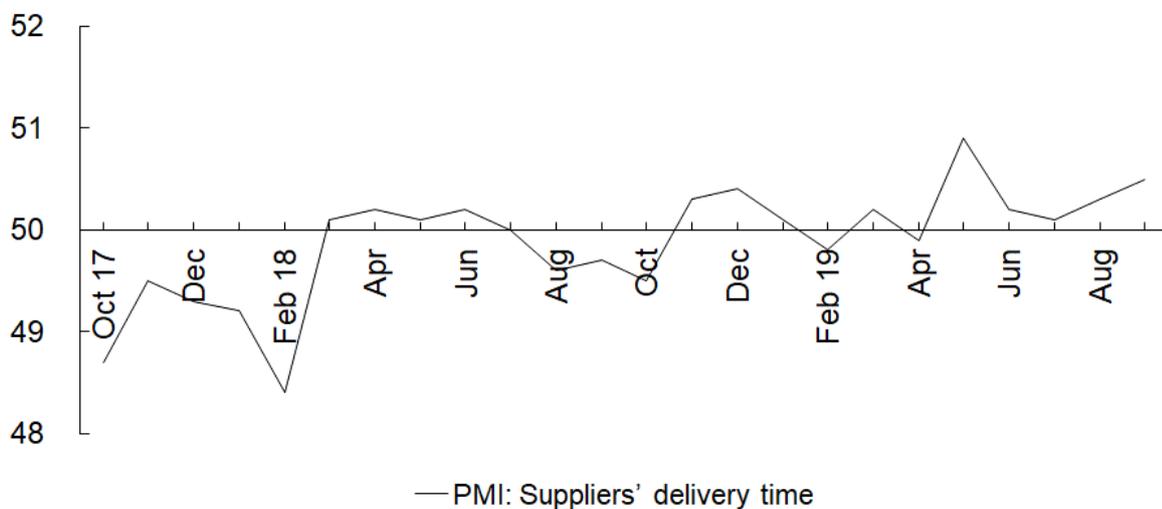


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

11. Suppliers' delivery quickens

The suppliers' delivery time index went up from 50.1 in July to 50.3 in August and further to 50.5 in September. The index readings in the past few months were above the critical 50-mark, indicating that suppliers' delivery has quickened recently. (Exhibit 33)

Exhibit 33: Suppliers' delivery time index, October 2017 to September 2019

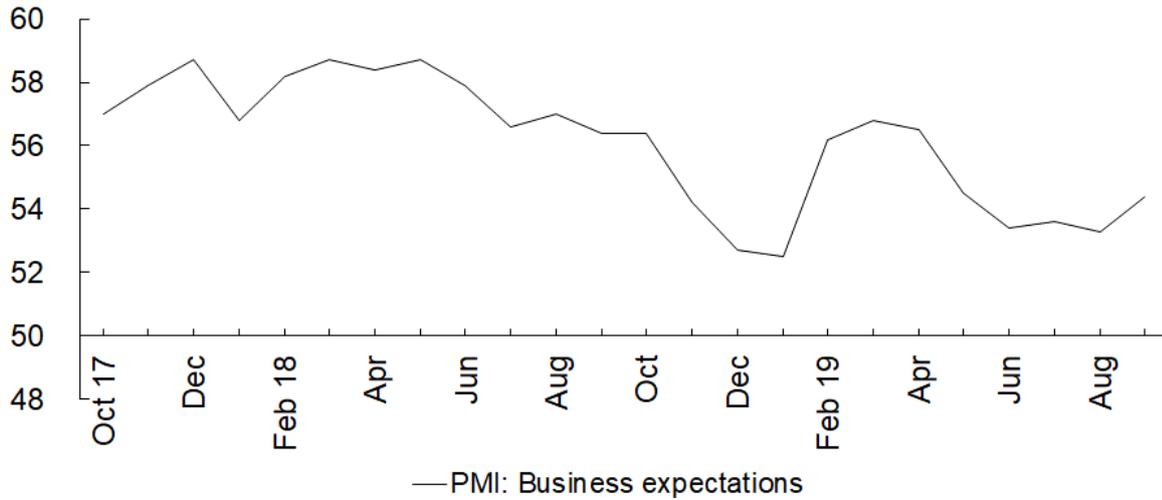


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

12. Purchasing managers become more optimistic

The business expectations index went down from 53.6 in July to 53.3 in August, and then rose to 54.4 in September. The latest uptrend indicates that purchasing managers have become more optimistic recently.⁵ (See exhibit 34)

Exhibit 34: Business expectations index, October 2017 to September 2019



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

⁵ 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 global market data on sourcing, supply chains, distribution, retail and technology.

Headquartered in Hong Kong, it leverages unique relationships and information networks to monitor, research and report on these global issues with a particular focus on business trends and developments in China. Fung Business Intelligence makes its data, impartial analysis and specialist knowledge available to businesses, scholars and governments 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 consulting 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

Fung Holdings (1937) Limited, a privately-held business entity headquartered in Hong Kong, is the major shareholder of the Fung Group of companies, whose core businesses operate across the entire global supply chain for consumer goods including trading, logistics, distribution and retail. The Fung Group comprises 42,000 people working in more than 40 economies worldwide. We have a rich history and heritage in export trading and global supply chain management that dates back to 1906 and traces the story of how Hong Kong and the Pearl River Delta emerged as one of the world's foremost manufacturing and trading regions. We are focused on both creating the Supply Chain of the Future to help brands and retailers navigate the digital economy as well as creating new opportunities, product categories and market expansion for brands on a global scale.

Listed entities of the Group include Li & Fung Limited (SEHK: 00494), Global Brands Group Holding Limited (SEHK: 00787) and Convenience Retail Asia Limited (SEHK: 00831). Privately-held entities include LH Pegasus, Branded Lifestyle Holdings Limited, Fung Kids (Holdings) Limited, Toys "R" Us (Asia) and Suhyang Networks.

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