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If you are in any doubt as to any aspect of this circular or as to the action to be taken, you should consult your stockbroker or other registered dealer in securities, bank manager, solicitor, professional accountant or other professional adviser.

If you have sold or transferred all your shares in Li & Fung Limited, you should at once hand this circular to the purchaser or to the bank, stockbroker or other agent through whom the sale or transfer was effected for transmission to the purchaser.

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LI & FUNG LIMITED

(Incorporated in Bermuda with limited liability)

(Stock Code: 494)

**ACQUISITION OF THE SOURCING ARM OF
KARSTADTQUELLE AG**

DISCLOSEABLE TRANSACTION



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DEFINITIONS

In this circular, unless the context requires otherwise, the following expressions have the following meanings:

“Acquisition”	the acquisition by the Purchaser of the entire shareholding of KQIS, Alka Italy and Alka Turkey subject to and upon the terms and conditions as set out in the Sale and Purchase Agreement
“Alka Italy”	Alka Italiana S.r.l., a company organized under the laws of Italy and a wholly-owned subsidiary of KQ
“Alka Turkey”	Alka İc ve Dis Ticaret Limited Sirketi, a company organized under the laws of Turkey and a subsidiary of KQIS with a small percentage of shares of Alka Turkey being held by KQ
“Company”	Li & Fung Limited, a company incorporated in Bermuda with limited liability and the issued shares of which are listed on the main board of the Stock Exchange
“Completion”	completion of the Acquisition in accordance with the Sale and Purchase Agreement
“connected person”	has the meaning ascribed thereto in the Listing Rules
“Directors”	directors of the Company
“Group”	the Company and its subsidiaries
“Hong Kong”	the Hong Kong Special Administrative Region of the People’s Republic of China
“KQ”	KarstadtQuelle AG, a stock corporation organized under German law
“KQBS”	KarstadtQuelle Business Services GMBH, a company organized under German law
“KQIS”	KarstadtQuelle International Services AG, a stock corporation organized under the laws of Switzerland and a wholly-owned subsidiary of KQBS
“Latest Practicable Date”	16 October 2006, being the latest practicable date prior to the printing of this circular for ascertaining certain information contained in this circular

DEFINITIONS

“Listing Rules”	the Rules Governing the Listing of Securities on the Stock Exchange
“Purchaser”	Cenntennial (Luxembourg) S.a.r.l., purchaser to the Sale and Purchase Agreement, a company incorporated in Luxembourg and a wholly-owned subsidiary of the Company
“Sale and Purchase Agreement”	the sale and purchase agreement dated 30 September 2006 and entered into between the Purchaser and the Sellers in relation to the Acquisition
“Sellers”	KQ and KQBS, sellers to the Sale and Purchase Agreement
“SFO”	the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong)
“Shareholders”	shareholders of the Company
“Stock Exchange”	The Stock Exchange of Hong Kong Limited
“Euro”	the lawful currency for the time being of the European Union
“HK\$”	Hong Kong dollars, the lawful currency for the time being of Hong Kong
“%”	per cent

Unless otherwise stated, all references in this circular to HK\$ are for information only and are referenced to Hong Kong Dollars based on an approximate exchange rate of Euro 1 = HK\$9.9.

LETTER FROM THE CHAIRMAN

LI & FUNG LIMITED

(Incorporated in Bermuda with limited liability)

Non-Executive Directors:

Victor Fung Kwok King (*Chairman*)
Paul Edward Selway-Swift*
Allan Wong Chi Yun*
Franklin Warren McFarlan*
Makoto Yasuda*
Lau Butt Farn

Executive Directors:

William Fung Kwok Lun
(Managing Director)
Bruce Philip Rockowitz
Henry Chan
Danny Lau Sai Wing
Annabella Leung Wai Ping

* *independent non-executive director*

Registered Office:

Canon's Court
22 Victoria Street
Hamilton HM12
Bermuda

Principal place of business:

11th Floor
LiFung Tower
888 Cheung Sha Wan Road
Kowloon
Hong Kong

23 October 2006

ACQUISITION OF THE SOURCING ARM OF KARSTADTQUELLE AG

DISCLOSEABLE TRANSACTION

To Shareholders,

Dear Sirs or Madam,

INTRODUCTION

On 30 September 2006, the Purchaser entered into a conditional Sale and Purchase Agreement with KQ and its wholly-owned subsidiary KQBS. Pursuant to the conditional Sale and Purchase Agreement, the Purchaser has agreed to purchase the entire issued share capital of each of KQIS, Alka Italy and Alka Turkey which together comprise the sourcing arm of KQ for an aggregate consideration of approximately Euro 60 million (HK\$594 million).

The Acquisition constitutes a discloseable transaction under Chapter 14 of the Listing Rules. This circular contains details of the Acquisition required to be disclosed under the Listing Rules.

LETTER FROM THE CHAIRMAN

SALE AND PURCHASE AGREEMENT

The sale and purchase agreement dated 30 September 2006 contains, *inter alia*, terms set out below:–

Parties

Purchaser : Cenntennial (Luxembourg) S.a.r.l., purchaser to the Sale and Purchase Agreement, a company incorporated in Luxembourg and a wholly-owned subsidiary of the Company

Sellers : KQ and KQBS, sellers to the Sale and Purchase Agreement

Asset to be acquired

Pursuant to the conditional Sale and Purchase Agreement, the Purchaser agreed to acquire the entire issued share capital of each of KQIS, Alka Italy and Alka Turkey.

Consideration

The consideration payable by the Purchaser under the Sale and Purchase Agreement is approximately Euro 60 million (HK\$594 million) subject to the finalization of audited completion accounts and will not exceed Euro 70 million (HK\$693 million).

The consideration represents a price earnings ratio of approximately 5.6 times Euro 10,673,000 (HK\$105,663,000) which is the unaudited combined profit after tax of KQIS, Alka Italy and Alka Turkey for the year ended 31 December 2005.

The consideration is to be financed from the Company's internal resources.

The consideration for the Acquisition was arrived at after arm's length negotiations between the parties to the conditional Sale and Purchase Agreement. The Directors, including independent non-executive directors, of the Company consider that the terms of the Acquisition are fair and reasonable and are in the interests of the Group and the shareholders of the Company as a whole.

Completion

Completion is conditional upon the approval of the German Bundeskartellamt and if necessary, the competent Turkish merger control authority and is expected to take place by 31 December 2006. The Agreement will be terminated if the Completion does not occur, at the latest, on 31 January 2007.

LETTER FROM THE CHAIRMAN

INFORMATION ON THE SELLERS

KQ, listed on the German stock exchange, is the market leader of the department store and mail order business in Germany. KQBS is a wholly-owned subsidiary of KQ. The department stores division is operated under the name of Karstadt whereas the mail order divisions, under Quelle, Neckerman and Specialty Catalogues. KQ also operates Thomas Cook.

To the best of the Directors' knowledge, information and belief having made all reasonable enquiries, the Sellers and their ultimate beneficial owners are third parties independent of and not connected with the Company and its connected persons.

INFORMATION ON KQIS, ALKA ITALY AND ALKA TURKEY

KQIS, Alka Italy, Alka Turkey and their affiliates together comprise the sourcing arm of KQ. They serve predominantly KQ and its subsidiaries although they also source for independent customers. Their combined profit before and after tax and extraordinary items for the year ended 31 December 2005 according to their audited accounts amounted to Euro 10,942,000 (HK\$108,326,000) and Euro 10,673,000 (HK\$105,663,000) respectively. The corresponding figures for the year ended 31 December 2004 were approximately Euro 15,079,000 (HK\$149,282,000) and Euro 13,609,000 (HK\$134,729,000) respectively.

The value of the net assets attributable to KQIS, Alka Italy and Alka Turkey and to be delivered at 30 September 2006 is approximately Euro 23,900,000 (HK\$236,610,000).

REASONS FOR AND EFFECTS OF THE ACQUISITION

The Group is the world's leading buying agency for consumer goods, managing the supply chain for retailers and brands worldwide.

In the views of the Directors, it is anticipated that the Acquisition will bring to the Group substantial additional sourcing volume together with an extensive sourcing network of 22 offices including several in the Eastern European countries. In view of the fact that the Acquisition will take up a new organisation with a staff of close to 1,000 who possess the know-how in dealing with retail and mail order business in Germany, it is anticipated that the Acquisition will offer a wider and deeper penetration into the European market.

On 30 September 2006, KQ and a wholly-owned subsidiary of the Company, also entered into a conditional buying agency agreement which is an exclusive agency agreement and allows the Group to carry out all of KQ and its affiliates' direct FOB purchases other than merchandise purchased via importers on a landed basis and branded business. The terms of the buying agency agreement are based on the current arrangement between KQ on the one hand and KQIS, Alka Italy and Alka Turkey on the other; the terms are also comparable to those entered into by the Group with its other customers.

LETTER FROM THE CHAIRMAN

Upon Completion, KQIS, Alka Italy and Alka Turkey will become indirect wholly-owned subsidiaries of the Company. Their results will be consolidated into the financial statements of the Company. It is expected that there will be an increase on the earnings, assets and liabilities of the Group.

GENERAL

Applying the relevant percentage ratios resulting from the calculations set out in Listing Rule 14.07, the Acquisition constitutes a discloseable transaction for the Company under the Listing Rules.

Your attention is drawn to the additional information regarding the Group which is required to be included in this circular under the Listing Rules as set out in the Appendix of this circular.

Yours faithfully,
Victor Fung Kwok King
Chairman

1. RESPONSIBILITY STATEMENT

This circular includes particulars given in compliance with the Listing Rules for the purpose of giving information with regard to the Group. The Directors collectively and individually accept full responsibility for the accuracy of the information contained in this circular and confirm, having made all reasonable enquiries, that to the best of their knowledge and belief, there are no other facts the omission of which would make any statement contained in this circular misleading.

2. DISCLOSURE OF INTERESTS

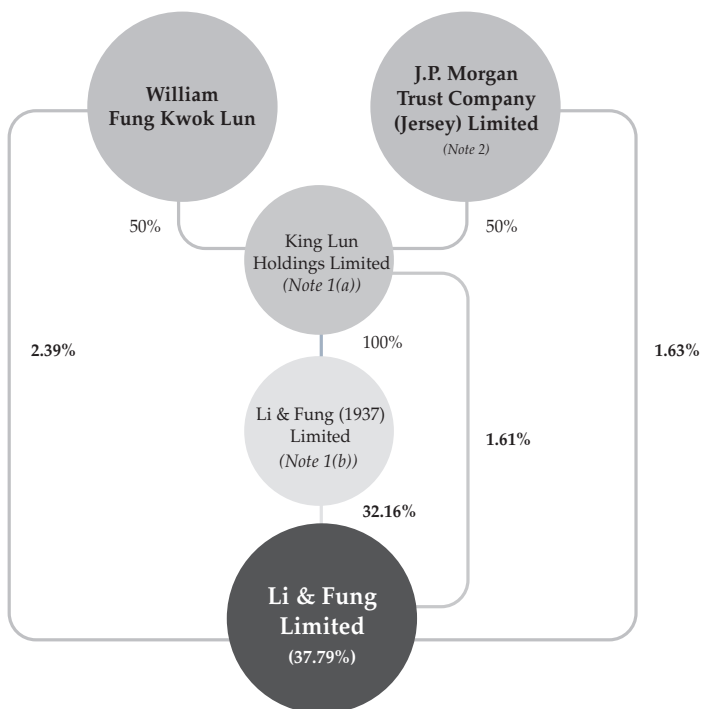
(I) Interests of Directors and the Chief Executive

As at the Latest Practicable Date, the directors and chief executives of the Company had the following interests in the Shares and underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they are taken or deemed to have under such provisions of the SFO), the Model Code for Securities Transactions by Directors of Listed Companies of Listed Companies and which are required to be entered in the register required to be kept under section 352 of the SFO:–

(A) Long Position in Shares and underlying shares of the Company

	Number of Shares					Equity derivatives (share options)	Total	Percentage of issued share capital
	Personal interest	Corporate interest	Family interest	Trust/ similar interest				
Victor Fung Kwok King	-	1,150,545,880 ¹	-	55,825,000 ²	-	1,206,370,880	35.40%	
William Fung Kwok Lun	79,048,530	1,150,545,880 ¹	4,400	-	2,640,000 ³	1,232,238,810	36.16%	
Bruce Philip Rockowitz	712,800	-	-	22,411,510 ⁴	57,145,880 ⁵	80,270,190	2.35%	
Henry Chan	4,766,000	-	-	-	1,760,000 ³	6,526,000	0.19%	
Danny Lau Sai Wing	8,268,000	-	-	-	1,760,000 ³	10,028,000	0.29%	
Annabella Leung Wai Ping	4,928,000	-	-	-	1,760,000 ³	6,688,000	0.19%	
Lau Butt Farn	2,420,000	-	-	-	-	2,420,000	0.07%	
Franklin Warren McFarlan	-	-	-	57,200 ⁶	-	57,200	0.00%	

The interests of Dr Victor Fung Kwok King and Dr William Fung Kwok Lun in the Shares are summarized in the following chart:-



Notes:

- (1) As at the Latest Practicable Date,
- (a) King Lun Holdings Limited (“King Lun”), a private company incorporated in the British Virgin Islands, held 54,945,880 Shares.
- (b) King Lun through its wholly-owned Hong Kong incorporated subsidiary, Li & Fung (1937) Limited, held 1,095,600,000 Shares.

Dr Victor Fung Kwok King and Dr William Fung Kwok Lun are deemed to have interests in the 1,150,545,880 Shares, i.e. the total number of Shares mentioned in notes (1)(a) and (b) above, through their personal or other interests in King Lun as set out below:-

- (i) 1,332,840 shares in King Lun, representing 50% of its issued share capital, are owned by J.P. Morgan Trust Company (Jersey) Limited, the trustee of a trust established for the benefit of the family of Dr Victor Fung Kwok King.
- (ii) 1,332,840 shares in King Lun, representing 50% of its issued share capital, are owned by Dr William Fung Kwok Lun.
- (2) 55,825,000 Shares are held by J.P. Morgan Trust Company (Jersey) Limited, the trustee of a trust established for the benefit of the family of Dr Victor Fung Kwok King.
- (3) These interests represent the interests in underlying shares in respect of share options granted by the Company to these directors as beneficial owners, the details of which are set out in the Interest in Share Options section stated below.
- (4) 22,411,510 Shares are held by Hurricane Millennium Holdings Limited (“HMHL”), a company beneficially owned by a trust which has been set up for the benefit of family members of Mr Bruce Philip Rockowitz.

- (5) These interests represent:-
- (a) the beneficial interest of Mr Bruce Philip Rockowitz in 2,200,000 underlying shares in respect of share options granted by the Company to Mr Bruce Philip Rockowitz; and
 - (b) the deemed interest of Mr Bruce Philip Rockowitz in 54,945,880 underlying shares in the Company in respect of options granted by King Lun to HMHL to purchase such shares in the Company in ten tranches during the period from 25 December 2004 to 24 December 2019 with each tranche having an exercisable period of six years pursuant to an agreement made between King Lun and HMHL.
- (6) 57,200 Shares in the Company are held by a trust established for the benefit of Professor Franklin Warren McFarlan.

(B) *Short positions in Shares and underlying shares of the Company*

By virtue of the SFO, each of Dr Victor Fung Kwok King and Dr William Fung Kwok Lun was taken as at the Latest Practicable Date to have short position through King Lun, in which both of them are deemed to have interests as disclosed above, in respect of an aggregate of 54,945,880 underlying shares in the Company, representing 1.61 percent of the total issued share capital of the Company. Such interest constitutes, for the purposes of the SFO, a short position of King Lun under unlisted physically settled equity derivative which arise under an agreement made between King Lun and HMHL pursuant to which options were granted by King Lun to HMHL to purchase such shares in the Company in ten tranches during the period from 25 December 2004 to 24 December 2019, with each tranche having an exercisable period of six years.

(C) *Interest in Share Options*

Share options granted under the share option scheme adopted on 12 May 2003 and remain outstanding:–

	Number of Share Options Outstanding	Exercise Price HK\$	Grant Date	Exercisable Period
William Fung Kwok Lun	880,000	13.45	20/6/2005	20/6/2007 – 19/6/2010
	880,000	13.45	20/6/2005	20/6/2008 – 19/6/2011
	880,000	13.45	20/6/2005	20/6/2009 – 19/6/2012
Bruce Philip Rockowitz	440,000	8.36	23/5/2003	23/5/2005 – 22/5/2008
	440,000	8.36	23/5/2003	23/5/2006 – 22/5/2009
	440,000	13.45	20/6/2005	20/6/2007 – 19/6/2010
	440,000	13.45	20/6/2005	20/6/2008 – 19/6/2011
	440,000	13.45	20/6/2005	20/6/2009 – 19/6/2012
Henry Chan	440,000	8.36	23/5/2003	23/5/2006 – 22/5/2009
	440,000	13.45	20/6/2005	20/6/2007 – 19/6/2010
	440,000	13.45	20/6/2005	20/6/2008 – 19/6/2011
	440,000	13.45	20/6/2005	20/6/2009 – 19/6/2012
Danny Lau Sai Wing	440,000	8.36	23/5/2003	23/5/2006 – 22/5/2009
	440,000	13.45	20/6/2005	20/6/2007 – 19/6/2010
	440,000	13.45	20/6/2005	20/6/2008 – 19/6/2011
	440,000	13.45	20/6/2005	20/6/2009 – 19/6/2012
Annabella Leung Wai Ping	440,000	8.36	23/5/2003	23/5/2006 – 22/5/2009
	440,000	13.45	20/6/2005	20/6/2007 – 19/6/2010
	440,000	13.45	20/6/2005	20/6/2008 – 19/6/2011
	440,000	13.45	20/6/2005	20/6/2009 – 19/6/2012

(II) Interests of Shareholders Discloseable Pursuant to the SFO

Save as disclosed below, the Directors are not aware of any other person (other than a Director or chief executive of the Company or his/her respective associate(s)) who, as at the Latest Practicable Date, had an interest or short position in the Shares or underlying shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO:–

Name of Shareholder	Capacity	Number of Shares	Percentage of issued share capital
Long Positions			
King Lun Holdings Limited	Beneficial owner (54,945,880) Interest of controlled corporation (1,095,600,000) ¹	1,150,545,880 ²	33.77%
J.P. Morgan Trust Company (Jersey) Limited	Trustee (55,825,000) Interest of controlled corporation (1,150,545,880) ²	1,206,370,880 ³	35.40%
Short Positions			
King Lun Holdings Limited	Beneficial owner	54,945,880 ⁴	1.61%
J.P. Morgan Trust Company (Jersey) Limited	Interest of controlled corporation	54,945,880 ⁵	1.61%
Lending Pool			
State Street Corporation	Interest of controlled corporation	270,290,070	7.93%

Notes:

- (1) 1,095,600,000 Shares are held by Li & Fung (1937) Limited which is a wholly owned subsidiary of King Lun.
- (2) (a) 50% of issued share capital of King Lun is owned by J.P. Morgan Trust Company (Jersey) Limited and its interests in 1,150,545,880 Shares is duplicated in the interests of J.P. Morgan Trust Company (Jersey) Limited.
(b) By virtue of the SFO, each of Dr Victor Fung Kwok King and Dr William Fung Kwok Lun is deemed to be interested in 1,150,545,880 Shares held by King Lun as described in Note (1) under the above section of Interests of Directors and the Chief Executive.
- (3) By virtue of the SFO, Dr Victor Fung Kwok King is deemed to be interested in 1,206,370,880 Shares held by J.P. Morgan Trust Company (Jersey) Limited, the trustee of a trust established for the benefit of the family of Dr Victor Fung Kwok King.

- (4) This short position represents King Lun's short position in 54,945,880 underlying shares which constitutes unlisted physically settled equity derivatives pursuant to arrangement as described in the above section of Interests of Directors and the Chief Executive.
- (5) J.P. Morgan Trust Company (Jersey) Limited is taken to have short position in the same underlying shares held by its controlled corporation, King Lun.

(III) Substantial Shareholders in Other Members of the Group

Save as disclosed below, the Directors are not aware of any other person (other than a Director or chief executive of the Company, or his/her respective associates(s)) who, as at the Latest Practicable Date, was directly or indirectly interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any other member of the Group:-

Name of Company	Name of Shareholder	%
Dodwell (Mauritius) Limited	Rogers & Co. Ltd.	40
LF Capital (II) Limited	Consolidated Resources Limited Anglo South Africa (Proprietary) Limited	21.6 18.9
Li & Fung (Mauritius) Limited	Rogers & Co. Ltd.	40
Luma Trading Limited	Wael Wagdy Olama	40
Perfect Trading Inc.	Wael Wagdy Olama	36

3. SERVICE CONTRACTS

Under a service contract dated 2 June 1992 between the Company and Dr William Fung Kwok Lun and a service contract dated 2 June 1992 between Li & Fung (B.V.I.) Limited and Dr William Fung Kwok Lun, Dr William Fung Kwok Lun has been appointed to act as Managing Director of the Company, Li & Fung (Trading) Limited, Li & Fung (Properties) Limited and Li & Fung (B.V.I.) Limited, in each case for an initial period of five years from 1 April 1992 and thereafter unless terminated by not less than 12 calendar months' notice in writing expiring at the end of such initial period or any subsequent month.

Save as disclosed above, there is no existing or proposed service contract between any of the Directors or proposed Directors and the Company or any of its subsidiaries, which is not determinable within one year without payment of compensation other than by statutory compensation.

4. COMPETING INTERESTS

As at the Latest Practicable Date, none of the Directors and their respective associates had any interest in a business which compete or may compete with the business of the Group.

5. LITIGATION

As at the Latest Practicable Date, neither the Company nor any of its subsidiaries is engaged in any litigation or arbitration of material importance and, so far as the Directors are aware, no litigation or claim of material importance is pending or threatened against the Company or any of its subsidiaries.

6. GENERAL

- (a) The secretary of the Company is Ms Terry Wan Mei Chow, a fellow member of both The Institute of Chartered Secretaries and Administrators and The Hong Kong Institute of Chartered Secretaries.
- (b) The qualified accountant of the Company is Mr Edward Yim Kam Chuen, an associate member of the Hong Kong Institute of Certified Public Accountants.
- (c) The principal share registrar of the Company is The Bank of Bermuda Limited at 6 Front Street, Hamilton HM11, Bermuda and its branch share registrar is Abacus Share Registrars Limited at 26th Floor, Tesbury Centre, 28 Queen's Road East, Wanchai, Hong Kong.
- (d) The English text of this circular shall prevail over the Chinese text.