

INDUSTRY OVERVIEW

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SOURCES OF INFORMATION

Certain information provided in this section is derived from various official or publicly available sources including the following:

The Census and Statistics Department of the Government (the "C&SD") provides statistics covering various social and economic aspects of Hong Kong.

The Rating and Valuation Department of the Government provides statistics covering the completion of properties and stock of properties in Hong Kong.

Hong Kong Trade Development Council ("HKTDC") provides research in relation to building and construction industry in Hong Kong.

The EMSD provides the number of electrical contractors registered to carry out electrical work in Hong Kong.

The Fire Services Department provides the number of fire service installation contractors registered to carry out related work in Hong Kong.

The Development Bureau provides the number of specialist contractors registered to carry out air conditioning installation for public work in Hong Kong.

The Buildings Department provides the number of registered specialist contractors (sub-register of Ventilation Works Category) and registered minor works contractors (Company) in Hong Kong.

The information presented in this document from the above sources is freely accessible by the public.

INTRODUCTION

Construction works are divided into two main broad trade groups namely (i) construction works at construction sites; and (ii) construction works at locations other than the sites. Under the construction works at locations other than the sites, there are two trade groups namely general trades and special trades. General trades include decoration, repair and maintenance, and construction works at minor work

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locations such as site investigation, demolition, and structural alternation and additional works. Special trades include carpentry, electrical equipment, ventilation, gas and water fitting installation and maintenance etc.

All construction projects in Hong Kong can broadly be divided into public projects and private projects. Public projects include construction of public housing, subsidised housing, public facilities buildings or structures and other civil engineering projects that were initiated, advocated or implemented by the Hong Kong government or public bodies in Hong Kong. Private projects include construction of private residential, commercial or industrial buildings. In Hong Kong most of the public or subsidised housing projects are implemented by Housing Authority and the Hong Kong Housing Society. The market for public projects in Hong Kong is dependent on the number, size and scale of building and construction work advocated or funded by the Hong Kong government or other public bodies. These in turn, are determined by policies and the budget of the Hong Kong government and other public bodies. Private projects are initiated by numerous private property developers. The construction market for private projects is influenced by factors such as economic prospect, land supply and the general demand for properties in Hong Kong.

NUMBER OF CONTRACTORS WITH RELEVANT QUALIFICATIONS AND LICENSES IN HONG KONG

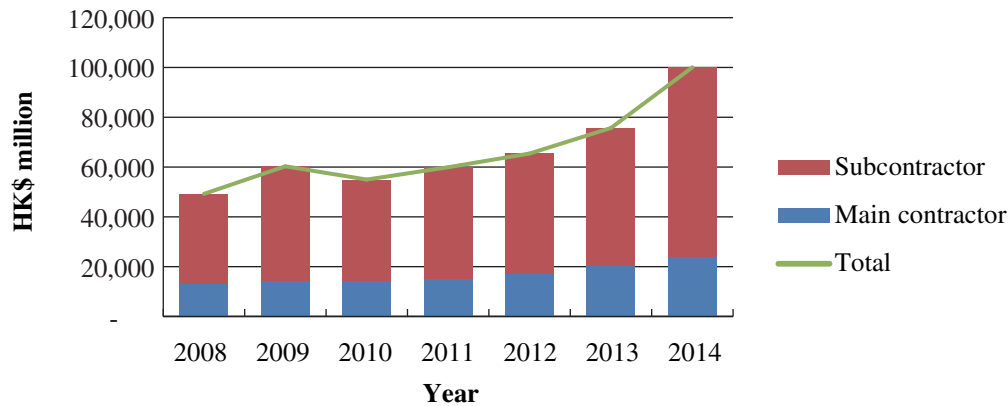
As stated in a research article titled "Buildings and construction industry in Hong Kong" published by HKTDC on 17 June 2014, Hong Kong's construction industry is characterised by a small number of large local contractors, a high level of subcontracting, presence of a large number of overseas contractors, with a substantial proportion of companies being both developers and contractors. Most of Hong Kong's construction companies are small in size and those with less than HK\$10 million (US\$1.3 million) in annual gross value of construction work account for as high as 96% of the construction industry. The majority of the small ones act as subcontractors to the large companies, which tend to be main contractors. There are quite a number of big construction companies capable of handling projects requiring sophisticated technology and strong financial background and are expanding their business across the region. Hong Kong contractors are experienced and highly skilled in building works. Because of the growing size and complexity of the projects, the current industry trend is to award large and complex building contracts as a single package to multi-disciplinary contractors. There is no formal restriction for entry to the contracting business in Hong Kong. Foreign and local contractors are treated alike, and they are allowed to tender local public sector projects.

As of April 2015, there were (i) over 4,700 electrical contractor limited companies registered under the EMSD to carry out electrical work in Hong Kong; (ii) over 270 fire service installation contractors holding both Class 1 and Class 2 license under the Fire Services Department to install, maintain, repair and inspect any fire service installation or equipment (other than portable equipment) which (a) contains an electrical circuit or other apparatus for the detection and warning, by alarm or otherwise, of smoke or fire (Class 1 license) and (b) contains pipes and fittings designed or adapted to carry water or some other fire extinguishing medium or any type of electrical apparatus other than those specified in class 1 (Class 2 license); (iii) 64 approved specialist contractors registered under the Development Bureau to carry out air conditioning installation for public works in Hong Kong; (iv) 172 registered specialist contractors under the Buildings department who are qualified to perform ventilation works under the Buildings Ordinance; and (v) 1,071 registered minor works contractor (classes I, II and III) under the Buildings Department to carry out different classes, types and items of minor works.

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OVERVIEW OF BUILDING SERVICES (SPECIAL TRADES) IN HONG KONG

Gross value of special trades construction works (2008–2014)



Source: Report on the Quarterly Survey of Construction Output (2008 – 2014), C&SD

Notes:

1. Special trades include carpentry, electrical equipment, ventilation, gas and water fitting installation and maintenance etc.
2. A construction establishment is regarded as a main contractor for a particular construction contract if it secures the contract directly from the property developer or the client party of the project, and assumes full responsibilities for the satisfactory completion of the construction works. It is regarded as a subcontractor if it secures the contract from another contractor (either main contractor or subcontractor).
3. Owing to the widespread subcontracting practices in the construction industry, a construction establishment can be a main contractor for one contract and a subcontractor for another contract at the same time. For the purpose of the above chart, the gross value of construction works performed by main contractor covers only those projects in which the construction establishment takes the role of a main contractor, but not projects in which it takes only the role of a subcontractor. However, subcontractors' contribution to projects should have been included in the gross value of construction works performed by main contractor for whom they worked.
4. The above statistics are subject to the effect of double-counting as subcontractors may further subcontract their construction works. Thus such figures only serve to provide a broad indication of the extent of subcontracting in the construction industry and should be interpreted with care.
5. The gross value of special trades construction works for 2014 is provisional figure.

Gross value of special trades construction works which include services provided in building industry has increased from approximately HK\$49 billion in 2008 to approximately HK\$100 billion in 2014, representing an increase of approximately 103.3% and a CAGR of approximately 12.6%. The amount has increased by approximately 32.2% from HK\$76 billion in 2013 to HK\$100 billion in 2014. The portion of gross output value attributable to subcontractor ranges from 73% to 76% of total gross output value during the period.

COMPETITIVE LANDSCAPE AND ENTRY BARRIERS

There is a large number of contractors in Hong Kong which provide services in relation to supply, installation and maintenance of (i) air-conditioning system; (ii) electrical system; (iii) plumbing and drainage system; and (iv) fire services system and the competition in the market is intense. The Directors consider that there are entry barriers of the building service industry in Hong Kong which

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hinder new players from entering into the industry. Such entry barriers include (i) attainment of required registrations under different authorities for different types of works; (ii) credible track record built over years of high quality of projects; (iii) attracting experienced and qualified technical personnel. Potential competitors will also have to face challenges such as increasing labour costs, subcontracting charges, material costs which can be affected by economic factors such as macro-economic trend, property market, interest rate and inflation rate. All of the above factors create entry barriers for the Group's potential competitors.

Based on the gross value of construction works in nominal terms performed by the main contractors and the subcontractors of special trades of approximately HK\$100 billion in 2014 issued by C&SD and the Group's revenue of approximately HK\$135.5 million for the year ended 31 December 2014, the Group's revenue represented approximately 0.14% to the gross value of construction works in nominal terms performed by the main contractors and the subcontractors of special trades in 2014. To the best knowledge of the Directors, due to the lack of official and public statistics and information on each of the industry players in Hong Kong, it is difficult to accurately estimate the exact market position of the Group in Hong Kong.

FUTURE OPPORTUNITIES AND CHALLENGES

The Directors consider that the future opportunities and challenges which the Group faces will be affected by the development of the property markets in Hong Kong as well as factors affecting the labour costs and material costs. The Directors are of the view that the number of properties to be built and maintained in Hong Kong is the key driver for the growth of the Hong Kong building service industry. With the Group's experienced management team and reputation in the market, the Directors consider that the Group is well-positioned to compete against its competitors under such future challenges that are commonly faced by all competitors. Set out below is an analysis of the opportunities and challenges faced by the industry.

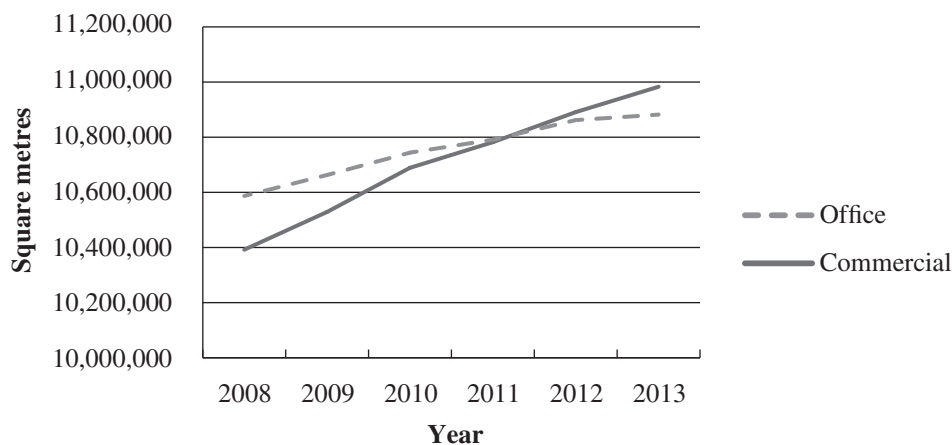
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I. Property market

Completion of properties and stock of properties in Hong Kong from 2008 to 2013

According to the statistics published by the Rating and Valuation Department, yearly completion of non-residential properties in Hong Kong recorded a significant drop from approximately 390,400 square metres in 2008 to approximately 161,100 square metres in 2013. From 2012 to 2013, this figure has decreased by 64,700 square metres, representing a decrease of approximately 28.7% in 1 year. Private offices represent a major portion of the newly completed non-residential properties in 2013, contributing 76.2% of new completions for the year. Completion of private residential properties has decreased from 10,149 units in year 2012 to 8,254 units in year 2013, representing a drop of approximately 18.7%.

Stock of non-residential properties

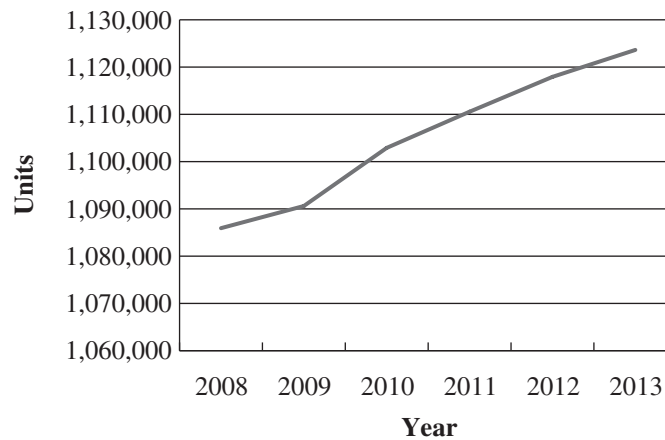


Source: Property Market Statistics — Rating and Valuation Department, HKSAR

Stock of office premises has increased from 10,392,300 square metres in 2008 to 10,983,200 square metres in 2013, representing a growth of approximately 5.7%. Stock of commercial premises has increased from 10,587,800 square metres in 2008 to 10,882,700 square metres in 2013, representing a growth of approximately 2.8%. Total stock of non-residential properties has increased by approximately 0.5%, from 21,753,200 square metres in 2012 to 21,865,900 square metres in 2013. While more office and commercial premises are established in Hong Kong, the potential demand for building service engineering in office and commercial premises is expected to increase accordingly.

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Stock of private residential properties (2008–2013)



Source: Property Market Statistics — Rating and Valuation Department, HKSAR

Moreover, stock of private residential properties is also on an upward trend as shown above. The stock of private residential properties increased from 1,085,922 units in 2008 to 1,123,633 units in 2013, representing a growth of approximately 3.5%. The stock also increased by approximately 0.5% from 1,117,932 units in 2012 to 1,123,633 units in 2013. While more private residential properties are established in Hong Kong, the potential demand for building service engineering in private residential properties is expected to increase accordingly.

Hong Kong population and Long Term Housing Strategy

According to the provisional figure published by the C&SD, Hong Kong population has reached approximately 7.26 million by the end of 2014 as compared with approximately 6.96 million in 2008. With the continuous growth in population, it is expected that demand for residential properties would increase.

With reference to the Long Term Housing Strategy promulgated by the HKSAR Government on 16 December 2014, one of the major strategies is to stabilize the residential property market through steady land supply and the Government adopts a total housing supply target of 480,000 units for the ten-year period from 2015/16 to 2024/25, with a public-private split of 60:40. Accordingly, the private housing supply target will be approximately 190,000 units in the coming ten years.

Driven by the expected increase in residential properties supply in the future, potential demand for building services would increase accordingly. In this regard, the prospect building services industry is positive.

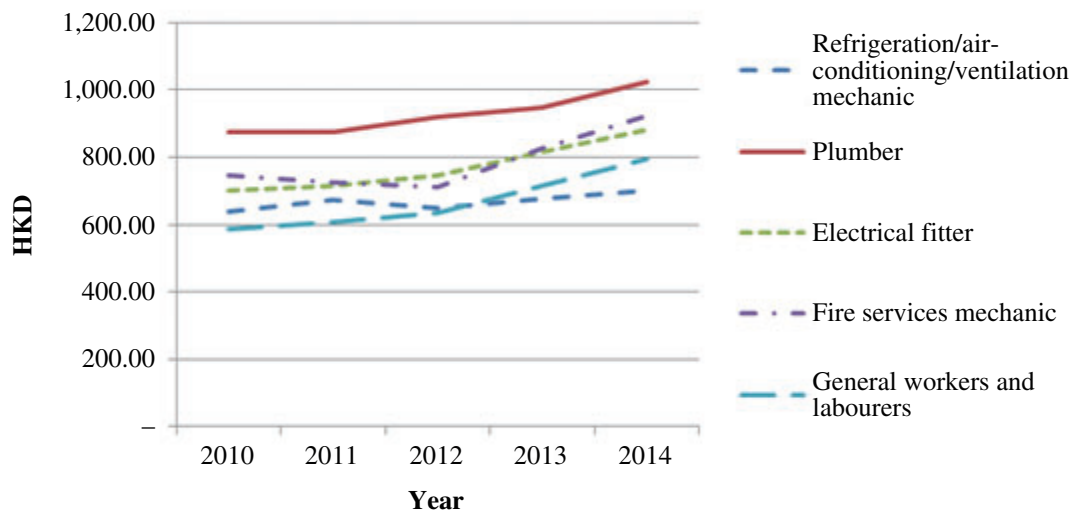
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II. Labour

Labour cost trend

The construction work carried out by the Group needs various kinds of workers including but not limited to plumber, electrical fitter (i.e. electrician), refrigeration/air conditioning/ventilation mechanic, fire services mechanic and general workers and labourers. Below is the chart showing the average daily wages movement of such workers from January 2010 to December 2014:

Average daily wages of different type of workers



Source: Average Daily Wages of Workers Engaged in Public Sector Construction Projects as Reported by Main Contractors (January 2010 – December 2014), C&SD

According to the statistics published by C&SD, the average daily wages of refrigeration/air conditioning/ventilation mechanic are trending upward as shown in the graph above. The average daily wages in 2014 is approximately HK\$700 as compared with HK\$676 in 2013, which represents an increase of approximately 3.5%.

Average daily wages of plumber is also increasing during the period. The amount increases from around HK\$948 per day in 2013 to HK\$1,024 per day in 2014, representing an increase of approximately 8.0% within one year. Average daily wages of electrical fitter also increase by approximately 8.4%, from around HK\$814 per day in 2013 to HK\$882 per day in 2014.

Among all types of workers as illustrated in the above diagram, the average daily wages of fire services mechanic, and general workers and labourers show the greatest percentage increase in 2014 as compared with 2013, calculated as approximately 11.9% and 10.8% respectively. The wages of fire services mechanic increase from around HK\$826 per day in 2013 to HK\$924 per day in 2014 while that of general workers and labourers increase from around HK\$716 per day in 2013 to HK\$793 per day in 2014.

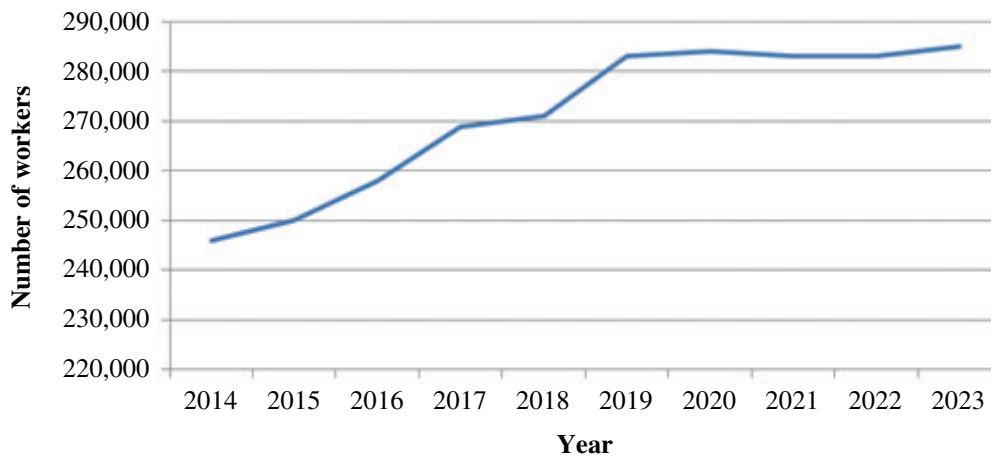
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In accordance with the Report of CIC Manpower Forecasting Model 2014 published by the Construction Industry Council (“CIC”), overall demand for construction workers in Hong Kong is increasing. Forecast shows that the construction industry would take up around 258,000 workers in 2016 and this figure is expected to reach around 285,000 by 2023, representing an increase of approximately 10.45% in 7 years. CIC expected that certain type of workers would be in consistent shortage.

Since labour cost is one of the major costs in building services industry, increase in labour cost would be a challenge to the industry.

Demand of labour in future

Demand for construction workers forecast (2014–2023)



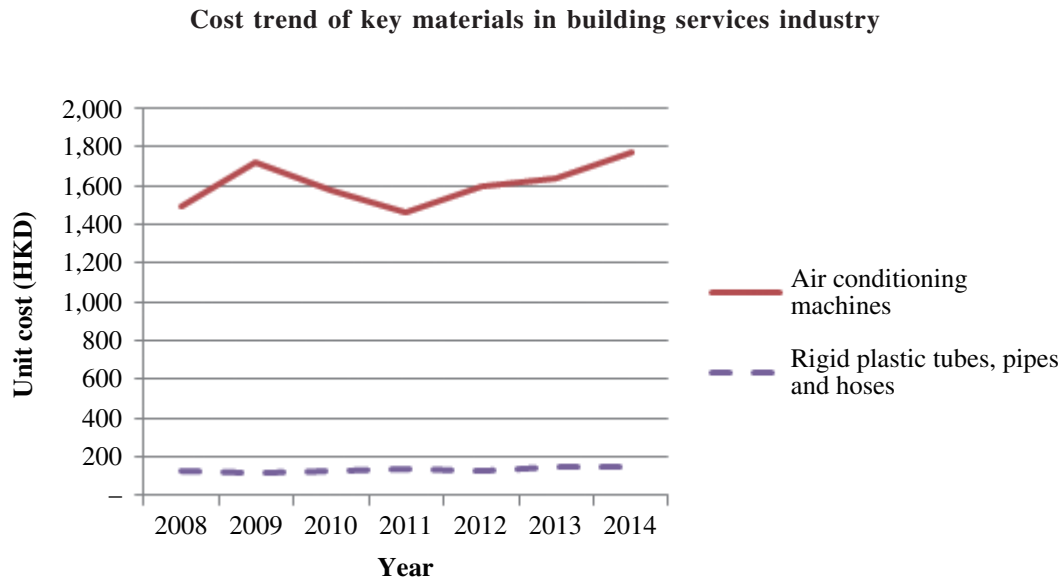
Source: Report of CIC Manpower Forecasting Model 2014 (Workers), CIC

With reference to the report of manpower forecast for general construction workers published by CIC in 2014, the overall demand for construction workers is in an upward trend from 2014 to 2023. It is expected that demand for construction workers would grow at a CAGR of approximately 2.8% till 2019 and would be flattened thereafter. The report stated that aging, job mismatch, limitations in training, increasing manpower demand etc, are the possible factors causing the critical manpower situation in the coming years.

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III. Key material cost

The following graph set out the cost trend of key materials used in building services industry during the period from 2008 to 2014:



Source: Hong Kong Merchandise Trade Statistics — Import (2008 – 2014), C&SD

Air conditioning machines is one of the important materials used in the building services industry. According to the C&SD, price of air conditioning machines rises gradually from approximately HK\$1,462 per unit in 2008 to approximately HK\$1,768 per unit in 2014, at a rate of approximately 20.9%. The unit price has increased by approximately 7.8% from HK\$1,641 in 2013 to HK\$1,768 in 2014. A majority of air conditioning machines are imported from The People’s Republic of China, representing around 58% of the total import value of air conditioning machines in Hong Kong in 2014.

Unit price of rigid plastic tubes, pipes and hoses remain stable during the period from 2008 to 2014. The price has slightly increased by approximately 5.5% from HK\$145 per 10kg in 2013 to HK\$153 per 10kg in 2014.

IV. 2015 Policy Address about construction industry

The Government has been working with the Construction Industry Council (CIC) and members of the sector to promote the healthy development of the construction industry. Following amendment of the Construction Workers Registration Ordinance in 2014, the requirements of “designated workers for designated trades” will be implemented under the construction workers registration scheme in 2017. Skilled construction workers will then be required to register according to their respective skills. This will help further raise the quality of construction works as well as the professional image of construction workers, and attract more people to join the industry. All along, the CIC has mainly provided training for workers to bring them to semi-skilled level. In this regard, the Government will provide \$100 million for the CIC to strengthen their work to train skilled workers for the industry. The Government will make continuous efforts to enhance the professional development of construction workers and provide them with more progression pathways.

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The construction industry is facing the problem of a severe shortage and ageing of skilled workers. Although the Government and CIC have made strenuous efforts in recent years to train local skilled workers and enhance the industry's professional image, and have attracted many new entrants to the industry, the keen demand has yet to be met. If the shortage of skilled workers cannot be properly dealt with, it will seriously affect the implementation of public housing, hospital, school and public transportation projects, and will also indirectly lead to the escalation of construction costs. To this end, the Government, the construction industry and the community must work together in a pragmatic manner and stay united to embrace the challenges ahead. The Government will take the most appropriate measures to tackle the problem of acute manpower shortage comprehensively and effectively. On the overriding premise of giving priority to the employment of local skilled workers, safeguarding their income levels as well as promoting training to the construction workforce in a continuous manner, the construction industry needs to import skilled workers in a timely and effective manner to meet the demand.

The Government rolled out measures to enhance the Supplementary Labour Scheme in April 2014 specifically for the construction industry in relation to public sector works projects. Nonetheless, the relevant measures have yet to fully address the keen demand of the industry for skilled workers. The Government needs to launch further enhancement measures having regard to the unique characteristics of the construction industry. For example, since construction works are carried out in sequential order and may be affected by factors such as supply of materials, progress of upstream work processes and so on, allowing imported skilled workers to work across various public sector works projects can enhance the flexibility of deployment, maximise the productivity of skilled workers and control costs more effectively. The Government will liaise closely with the construction industry and the labour sector on the detailed arrangements of the relevant measures and review their effectiveness in a timely manner. If these measures still cannot effectively resolve the acute shortage problem of skilled workers, the Government will explore with the construction industry and labour sector the introduction of other more effective and appropriate measures to reduce the adverse effects on Hong Kong's economic and social development. To give priority to local workers in employment, the Government will set up a dedicated Construction Industry Recruitment Centre. The centre will provide career counselling services, conduct on-the-spot job interviews and organise job fairs for local construction workers, and assist contractors in according priority to employing qualified local skilled workers.