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## INDUSTRY OVERVIEW

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### SOURCE OF INFORMATION

In connection with the [REDACTED], we have commissioned Euromonitor International, an independent third party, to conduct a study of the food sourcing and processing services in Hong Kong at a fee of US\$43,500. Established in 1972, Euromonitor International is the world leader in strategy research for both consumer and industrial markets. With offices around the world and analysts in 80 countries, Euromonitor International is a leading provider of global market intelligence. Except for the Euromonitor Report, we have not commissioned any other customised research report in connection with the [REDACTED] or this document.

The objective of the research is to provide an independent assessment of the services of supplying vegetables and fruits for the food service industry in Hong Kong and to attain an objective and robust overview of the markets.

### RESEARCH METHODOLOGY

Euromonitor International’s research methodology offered a combination of primary and secondary research to build a market consensus view of size, shape and trends across each category. Primary research consists of qualitative based trade interviews with multiple organisations to augment the estimated market size, growth trend and competitive landscape, whereas secondary research began with an assessment of publicly available secondary information through various sources including but not limited to governmental statistics, reports and/or databases, specialist trade press, company financial or annual reports, independent analyst reports and Euromonitor International’s existing industry data base.

### **Euromonitor International based the Euromonitor Report on the following assumptions:**

- The Hong Kong economy is expected to maintain steady growth over the forecast period;
- The Hong Kong social, economic, and political environments are expected to remain stable during the forecast period;
- There will be no external shock, such as a financial crisis or raw material shortage that affects the demand and supply of the foodservice industry in Hong Kong during the forecast period;
- Key market drivers such as economic growth, tourism, consumer affluence and habits and government policy are expected to boost the development of the foodservice industry and the service of supplying vegetables and fruits to the foodservice industry in Hong Kong;

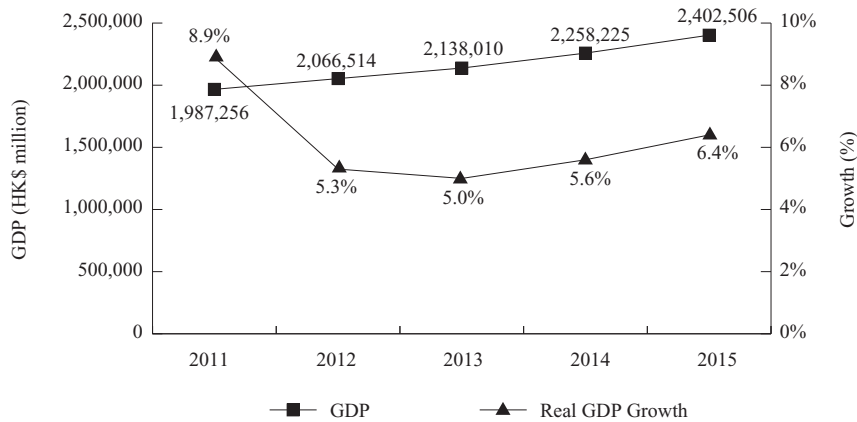
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The research results may be influenced by the accuracy of these assumptions and the choice of these parameters. The market research was completed in June 2016 and all statistics in the Euromonitor report are based on information available at the time of reporting. Euromonitor’s forecast data is derived from an analysis of the historical development of the market, the economic environment, and underlying market drivers, and it is cross-checked against established industry data and trade interviews with industry experts.

### MACRO-ECONOMIC ENVIRONMENT IN HONG KONG

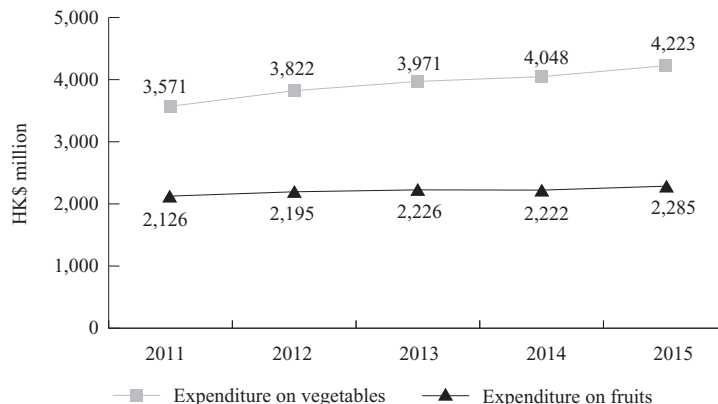
Hong Kong’s economy expanded by a CAGR of 5.6% over the 2011 through 2015 review period, recovering strongly from the global financial crisis since 2011. Gross national income has grown proportionally together with GDP growth, having expanded by a CAGR of 5.2% over the same review period to reach HK\$2,436.6 billion in 2015. GDP per capita however grew at a slower CAGR of 4.4%, largely due to the population growing by a 0.7% CAGR over the same period.

**Gross Domestic Product in Hong Kong, Historic (2011-2015)**



Source: The Census and Statistics Department of Hong Kong

**Per Capita Consumer Expenditure on vegetables and fruits in Hong Kong, Historic (2011-2015)**



Source: The Census and Statistics Department of Hong Kong

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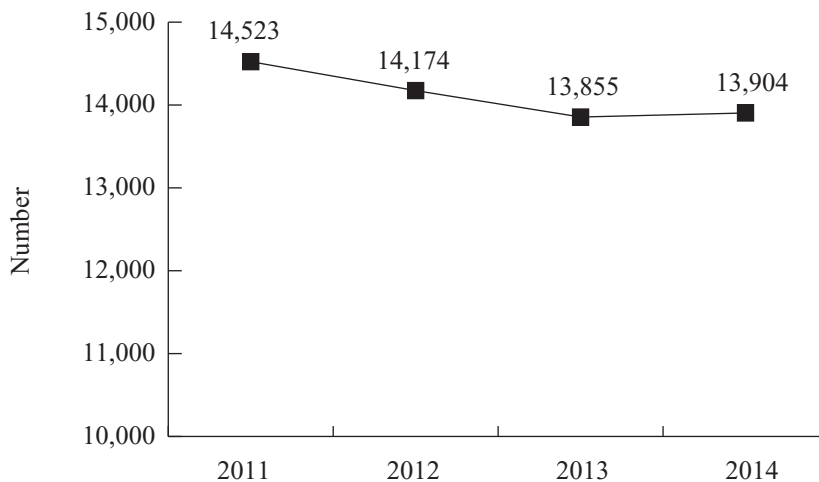
### THE FOOD SERVICE INDUSTRY IN HONG KONG

Total revenue generated by the consumer food service industry in Hong Kong has grown significantly over the 2011 through 2015 review period, expanding by a 4% CAGR to reach HK\$104,331 million in 2015 – up from HK\$89,301 million in 2011. This was despite a fall in the number of establishments within the industry, which hit a high of 14,523 establishments in 2011 before declining to 13,904 establishments in 2014, on the back of fierce competition and rising operating costs such as higher rental and wages, squeezing profit margins and forcing less popular retailers to close shop.

This has also seen a trend of the premiumisation of consumer food service in Hong Kong to meet growing demand for premium dining by both affluent locals as well as wealthy tourists, manifesting in the form of restaurants helmed by Michelin starred chefs, gourmet ice cream cafes, and gourmet cafes. Fine dining and premium dining experience where ambience and lifestyle image are at the forefront has also gained popularity with the more affluent consumer segment, as dining out becomes a lifestyle choice and expression of their affluence for such consumers. This trend has helped to lift revenue among restaurants, with receipts growing by a CAGR of 3.3% over the review period to reach HK\$77,369 million in 2015, or about three-quarters of total receipts in the food service industry.

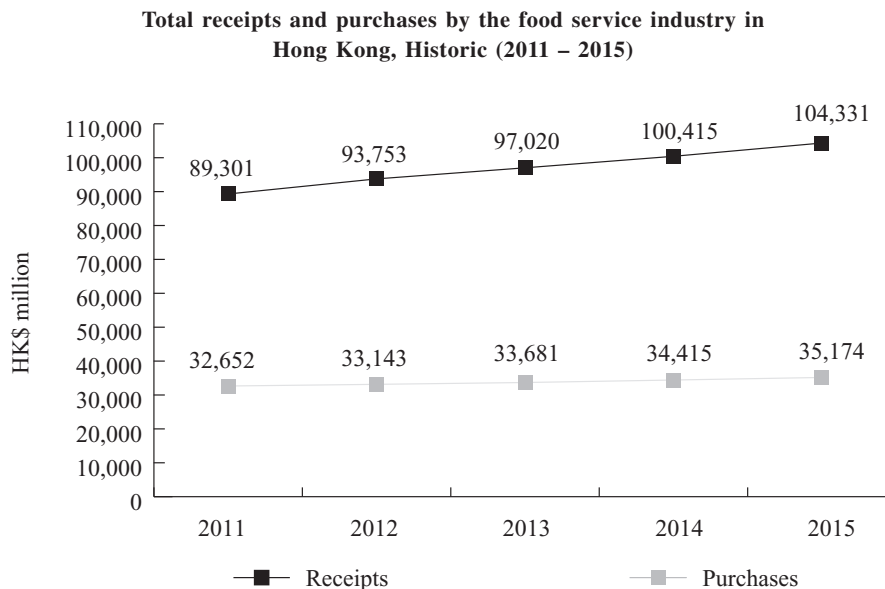
The charts below show the total number of establishments, and total receipts and purchases of the food service industry in Hong Kong:

**Total number of establishments within the food service industry in Hong Kong, Historic (2011-2014)**



Source: The Census and Statistics Department of Hong Kong

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Source: The Census and Statistics Department of Hong Kong

## SUPPLY OF VEGETABLES AND FRUITS IN HONG KONG

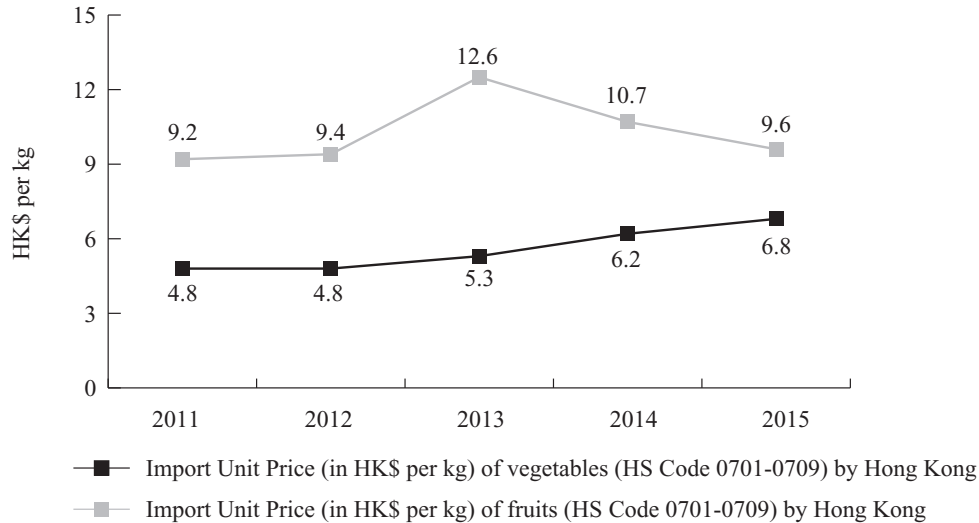
The value of imported vegetables in Hong Kong rose by 8% to reach HK\$6,949 million in 2015, even though import volumes dropped by 2% in the same year. Overall per capita consumption of vegetables remained stable after strong growth in 2011 due to an increase in the number of vegetarians in the population. Over the review period, the focus of recent health campaigns by the government has shifted away from encouraging greater consumption of vegetables, to adopting healthier cooking methods such as using less salt in daily food consumption. This has slowed down the growth of vegetable consumption in recent years.

The volume of imported fruit grew by a CAGR of over 5% over the review period. This was partially due to an increase in the shelf space made available for fruits, while more food service operators are increasingly incorporating different types of fruit, especially lemon and orange, in their menu offerings. More restaurants, especially Chinese restaurants, are also offering fruits instead of sweet desserts on their menus.

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The chart below shows the import unit price of vegetables and fruits by Hong Kong between 2011 and 2015:

### Import Unit Price of Vegetables and Fruits by Hong Kong, Historic (2011-2015)



Source: The Census and Statistics Department of Hong Kong

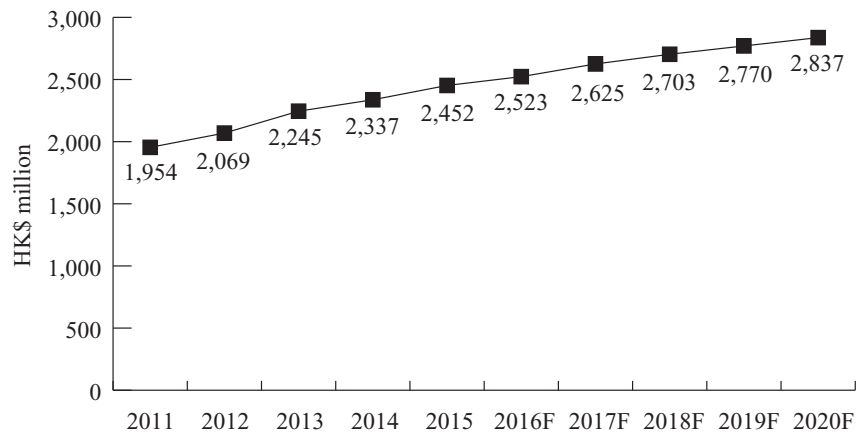
During the review period, the unit price of vegetables imported by Hong Kong increased from HK\$4.8 per kg in 2011 to HK\$6.8 per kg in 2015. This increase was primarily due to (i) the appreciation of RMB; (ii) the increase in cost of production of vegetables in China, including the rising wages of workers; (iii) the increased demand for organic and premium vegetables, which are generally of higher average prices, by the customers in Hong Kong; and (iv) the dramatic increase in the import volume and unit price of the item “Mushrooms and Truffles, dried, but not further prepared” (HS Code 5613) since 2013.

### Food service operators a key driving factor in the demand for vegetables and fruits

Purchases of vegetables and fruits by food service operators grew by a CAGR of 6% over the review period, from HK\$1,954 million in 2011 to HK\$2,452 million in 2015. After the recession that began in 2008, the economy in Hong Kong grew strongly from 2010 to 2015, with consumers becoming more affluent and enjoying an increase in disposable incomes. In addition, there has been an influx of tourists visiting Hong Kong, particularly from China ever since cross-border restrictions were eased. These factors have helped to boost growth in the food service industry, which saw many new outlets open across the territory over the review period, as demand for food services increased in Hong Kong.

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### Food service operators’ value spend on vegetables and fruits in Hong Kong, (2011-2020)



*Source:* Euromonitor estimates from desk research and trade interviews with leading vegetables and fruits suppliers, major food service operators and the relevant trade associations in Hong Kong

According to the Euromonitor’s Report, growth in the purchases of vegetables and fruits by food service operators in Hong Kong is expected to slow to a CAGR of 3% in value terms over the forecast period. This is due to the persistent slowdown in global economic growth and the resulting repercussions in Hong Kong’s highly interconnected economy, with GDP growth dipping below 1% in the first quarter of 2016. The economic slowdown will likely result in a cutback in consumer spending on restaurant meals, leading to a corresponding reduction in the spending on imported food products by food service operators. Various uncertainties in fiscal policies worldwide, as well as the dampening in the growth of China’s economy are expected to exacerbate this slowdown in growth. As a result, demand growth for imported vegetables and fruits from food service operators in Hong Kong is projected to decline over the forecast period.

Furthermore, according to trade respondents, demand from the food service industry, which has benefited from the influx of tourists into Hong Kong via day-trippers from China, has been negatively affected by a decline in the numbers of such tourists from China. This in turn was largely due to various anti-Beijing demonstrations being carried out and anti-Mainland Chinese sentiment among the local populace, which has seen the number of Mainland Chinese tourists fall by more than 10% in the first quarter of 2016.

## MARKET DRIVERS

### Tourism to stimulate the demand for consumer food services

Strong economic growth since Hong Kong’s economy rebounded from the financial crisis in 2008 has led to robust growth in demand for restaurant meals and in turn for vegetables and fruits by food service operators. There has also been an influx of tourists into Hong Kong, many of whom originate from Mainland China. These factors have stimulated a boom in demand for consumer food services, especially among large fast food chains and Chinese style restaurants, which in turn has helped to boost demand for vegetables and fruits.

### Health and wellness trends and lifestyle choices of consumers

Consumers in Hong Kong are increasingly becoming more health-conscious and cognizant of what they consume in part due to the government’s efforts to highlight the importance of a balanced diet and eating well in general. Consequently, consumers are looking to incorporate more vegetables and fruits into their meals for a healthier and

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better-balanced diet. In response to this growth in demand for healthy eating, food service operators have been launching healthier menus, such as vegetarian meals, or increasing the amount of vegetables and fruits to their menu offerings, helping to boost overall demand for vegetables and fruits both over the review period and the forecast period.

### **Operational decisions of food service industry players**

Food service operators such as fast food chains and Hong Kong style restaurants are increasingly demanding processing services from suppliers for the vegetables and fruits they purchase, such as cleaning, slicing and dicing. A key incentive behind this move is to reduce operating costs by outsourcing these processes, thereby cutting down on the usage of labour as rising wages make manpower more expensive and limited. This trend of food service operators increasingly outsourcing the basic processing of vegetables and fruits is expected to further contribute to the growth of the vegetables and fruits supply services industry.

### **MARKET CONSTRAINTS**

#### **Transportation costs sources of operating cost pressures**

Transportation costs including the cost of diesel fuel and transport sector wages have typically accounted for a significant cost centre in the business of supplying vegetables and fruits, as such suppliers find it necessary to make frequent deliveries to their clients due to the highly perishable nature of their goods. Despite a fall in crude oil prices, the average wholesale price of diesel did not see a significant dip corresponding in timing or magnitude due to dynamics in the diesel market within Hong Kong, where transaction prices are often set well in advance and lag behind recent trading prices. The average wholesale price for diesel fuel in Hong Kong hovered between HK\$5.61 and HK\$6.24 per liter from 2011 to 2014. As such, suppliers of vegetables and fruits continued to face high and significant transportation costs over the review period. This cost pressure is however expected to have eased in 2015 as average diesel prices finally dipped below HK\$4 per liter, reflecting the anticipated time lag factor.

#### **Average rental prices for flatted factories continues to rise**

Rent poses as another major operating cost for the vegetables and fruits supply services industry. The rental prices for factories saw an increase of more than 40% over the 2011-2015 period, as the strong influx of capital from Mainland China into Hong Kong's property market and the shortage of factory space have acted together to drive up rental rates and prices for flatted factories.

#### **Rise in wages squeeze profit margins of vegetable and fruit suppliers**

In 2015, the Hong Kong Government revised the country's minimum wage upwards from HK\$30 per hour to HK\$32.5 per hour after adjusting from HK\$28 to HK\$30 in 2013. With this regulation, vegetable and fruit suppliers may have to absorb the wage hike adding to their operational costs in a price competitive industry. Moreover, based on statistics release by the Census and Statistics Department of Hong Kong, over the review period, wages of general works observed a CAGR of 4.8% from 2011-2015. Nevertheless, of some reprieve is the fact that the year on year rate of increment sustained a contractionary trend from 7.8% in 2011/2012 to a moderate and more manageable 1.8% in 2014/2015.

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### KEY MARKET ENTRY BARRIERS

#### Supplier-client relationships present key barrier to entry

Although the market still has significant potential for further expansion and growth, barriers of entry remain high as new entrants find it difficult to break the entrenched network of relationships which dominates the supplier-client relationship that is critical in the vegetables and fruits supply services industry, and gives incumbents a significant advantage in stifling new competition.

On the other hand, competition between suppliers of vegetables and fruits remains high, with larger companies attempting to establish a competitive advantage by improving efficiency levels through better logistical planning and execution, as well as actively attempting to poach high-profile clients such as five star hotels and popular restaurants away from competitors.

#### Trading in commodities in a fragmented market inhibit product differentiation

Whilst entering the market from an operational stand point is not entirely restrictive, nevertheless, the survival rate of new vegetable and fruit suppliers entering the market could potentially be relatively low as many inexperienced owners grapple with intense competition posed by their more experienced counterparts of whom would already have established their commercial networks or “guan xi” on both the supply (vegetable and fruit producers) and demand (food service operators) sides.

Unless new entrants are able to quickly carve out a differentiated service offering that would appeal to both their suppliers and customers, the inherent barrier to entry in competing in the fragmented commodities trade where products sold are generally homogeneous, is the intensity of competitive rivalry which is in favour of the buyers’ market.

#### Shortage of manpower poses operational barriers

Despite plentiful business opportunities in the vegetable and fruit supply services industry, new entrants would likely face a shortage of manpower alongside their more experienced counterparts. This would be especially so in transportation and warehouse logistics, with the number of workers willing to work in transportation on a long-term downward trend. Among the main reasons for this decline and the resulting shortage will be the common sentiment shared by Hong Kong residents that a job in transportation is unappealing and brings with it a lack of bright career prospects.

Notwithstanding, new players wrestling for the same limited pool of resources from their more experienced counterparts would pose a challenge to operations. With potentially fewer transactions expected to be closed in the initial stages of business commencement, wages offered may not be as competitive as that offered by existing players with stronger financial muscle. This may result in the inability for such new entrants to retain their staff in the long run.

### COMPETITIVE LANDSCAPE FOR THE VEGETABLE AND FRUIT SUPPLY SERVICES INDUSTRY IN HONG KONG

#### Mature industry with stagnant growth in number of suppliers

The total number of establishments supplying fresh vegetable and fruits in Hong Kong has not changed significantly over the review period, with the overall market being a mature and stagnant industry in Hong Kong. Most of these establishments are smaller companies with fewer than 10 employees, with some being family-owned companies with low staff



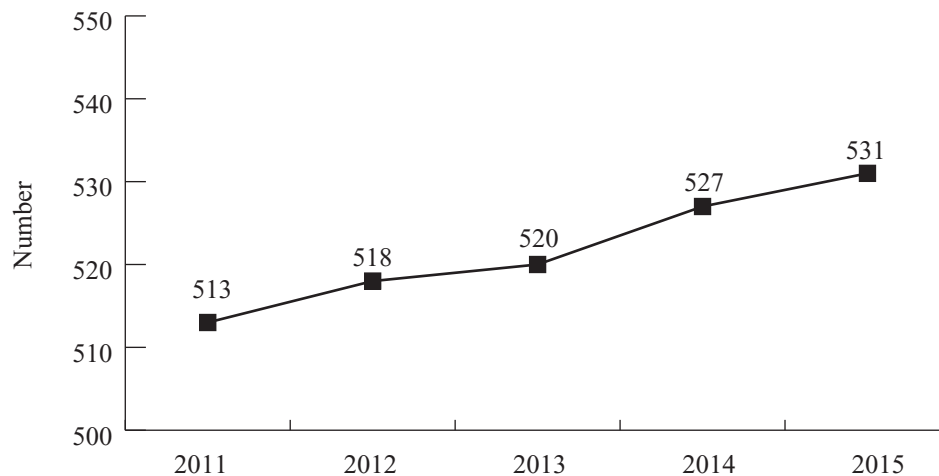
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turnover. Such companies have good control on their overall operating costs through good management on their business processes, helping them to withstand adverse economic situations.

### Number of establishments within the supply of fresh fruits and vegetables sector in Hong Kong, (2011-2015)



Source: The Census and Statistics Department of Hong Kong

### Resourceful suppliers with strong networks enjoy competitive advantage in a highly mature and fragmented market

The vegetables and fruits supply services industry is especially fragmented in Hong Kong, with an estimated more than 530 companies involved in the vegetables and fruits supply services industry in 2015. More than 90% of these suppliers are small companies operating with fewer than 10 employees. Suppliers of vegetables and fruits often represent a key component of a wider network involving food service operators as well as vegetables and fruits retailers. According to trade respondents, small-scale suppliers with fewer than 10 employees accounted for around 70% of market value and are a dominant force in the industry. Given that working relationships between suppliers and clients are typically long-term, with many partnerships stretching over decades, barriers to entry remain high for prospective market entrants. As a result, the competitive landscape is expected to remain relatively stable over the forecast period, with no major merger and acquisition activities or market disruption by new entrants expected.

According to trade sources, given the highly fragmented nature of the industry, it is estimated that the top five companies in the vegetables and fruits supply services industry would hold a combined 10% to 15% value share of the market. Based on Euromonitor’s market estimate, our group occupied an estimated 5% of the market in terms of revenue in 2015. Generally, these companies would tend to target larger chained and independent food service operators with good consumer reach within the food service industry. The existing prominent players in the supply of vegetables and fruits possess an edge over their smaller rivals, including economies of scale, greater availability of resources for expanding operations as well as more advanced technologies in food processing and logistics, such as being able to engage in e-commerce activities. In addition, these players would tend to have a well-established supply-side network for their vegetables and fruits typically from China, along with them being recognised as these market leaders also tend to be the primary suppliers of choice to leading food service operators, thereby benefitting directly from the strong growth witnessed by these companies. Due to the lack of sufficient publicly accessible information, the market share and individual description of the top five players in the vegetables and fruits supply services industry in Hong Kong was not provided in the Euromonitor Report.

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### **Suppliers of vegetables and fruits compete by providing value-added services**

In addition to the supply of products to food service operators, vegetables and fruit suppliers often offer various processing and packaging services such as washing, cutting and packaging to their customers. Larger suppliers often employ their own delivery fleet so as to secure a stable supply line for their clients. Furthermore, with wages becoming an increasingly heavy burden to food service operators, the large amount of manpower required to clean and process raw vegetables would be prohibitively costly, making the purchase of washed and clean vegetables a cost effective choice for food service operators.

Suppliers often compete in service quality via aspects such as providing products in a quick turnaround time and maintaining product quality and freshness throughout. Larger players employ refrigerated vehicles to keep vegetables and fruits at optimum freshness during delivery, with this being an important competitive advantage for overseas vegetables and fruit distributors, as long delivery times in non-chilled vehicles would greatly affect the quality of vegetables and fruits being delivered.