
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 fitting-out, renovation and A&A works industry in Hong Kong at a fee of US\$56,580. Established in 1972, Euromonitor International is a global research organisation with over 1,000 full-time staff and field-based analysts in 80 countries worldwide, providing trade and strategy research and detailed local market analysis, and has accumulated over 15 years of industry experience in Hong Kong. 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 fitting-out, renovation and A&A works industry in Hong Kong and to attain an objective and robust overview of the industry.

RESEARCH METHODOLOGY

In compiling and preparing the Euromonitor Report, Euromonitor International used the following methodologies to collect multiple sources, validate the data and information collected, and cross-checked each respondent's information and views against those of others:

- Secondary research involved the review of published sources, company reports including audited financial statements where available and independent research reports.
- Primary research involved interviews and surveys with a sample of leading industry participants and experts for the latest data and insights into future trends, supplemented by verification and cross-checking of data and research estimates for consistency.
- Review and cross-checks of all sources and independent analysis to build final estimates including the size, shape, drivers and future trends of the fitting out, renovation and A&A works industry in Hong Kong and prepare the final report.

Our Directors confirm that, after taking reasonable care, there is no adverse change in the market information since the date of the Euromonitor Report which may qualify, contradict or have an impact on the information in this section.

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ASSUMPTIONS

The following assumptions were based on in the Euromonitor Report:

- 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;
- Key market drivers such as Hong Kong’s moderate and steady GDP growth and the gradual expansion of Hong Kong’s construction industry are expected to boost the development of Hong Kong’s fitting-out and renovation works and A&A works markets;
- Key drivers including the Government’s pledge to increase public housing supply and regulatory requirements on building maintenance are likely to drive the future growth of Hong Kong’s fitting-out and renovation works and A&A works markets.

MACRO-ECONOMIC ENVIRONMENT IN HONG KONG

Hong Kong’s economy has performed well

Hong Kong’s economy expanded by a CAGR of 5.6% over the 2011 through 2015 period (the “**Review Period**”). Gross national income has grown proportionally together with GDP growth, having expanded by a CAGR of 5.3% over the same period to reach HK\$2,442 billion in 2015. GDP per capita however grew at a slower CAGR of 4.4%.

However, China’s economic slowdown as well as weakening global demand leads to macroeconomic conditions that are expected to persist over the short to medium term, resulting in declining exports and retail sales over the Review Period. The GDP growth of 3.1% in the first quarter of 2016 evidenced the slowdown of Hong Kong economy.

Strong growth and expansion in the construction industry fuelled by real estate boom

The construction industry had expanded significantly in recent years, registering a double digit growth year-on-year to reach HK\$99.4 billion in 2014, hitting a high of 17% in 2013 before moderating to 16% in 2014. Much of this was due to an on-going boom in the real estate market for Hong Kong over the review period, creating heightened levels of demand for the construction of new buildings overall.

The construction industry is also an important contributor to overall GDP output and growth in Hong Kong, accounting for 4.4% of total GDP in 2014 – up from only 3.4% in 2011. At the same time, this growth in the construction industry has also benefited workers in this industry, with median monthly wages growing by an impressive 7.1% CAGR over the Review Period to hit HK\$20,000 in 2015. This highlights the increasing importance of the construction industry to Hong Kong’s continued economic prosperity and GDP growth over time.

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Growth in domestic households creates growth opportunities for fitting-out and renovation works

Hong Kong’s population has expanded at a similar pace over the past decade, growing by a CAGR of 0.9% over the Review Period to reach a population of 7.3 million people by 2015. The overall fertility rate in Hong Kong remains low, as urban residents continue to delay starting their own families as they pursue career and education goals.

Growth in the number of domestic households has taken place at a slightly faster pace compared to population growth over the period, increasing by a CAGR of 1.2% over the Review Period, by which there were approximately 2.5 million households in Hong Kong, up from the nearly 2.4 million households recorded back in 2011.

That the growth in domestic households has been faster than overall population growth bodes well for the residential fitting-out and renovation works in Hong Kong. Households moving into new residences are more likely to provide new business opportunities for such service providers compared to more established households who have resided at their current residence for some period of time.

Growing demand for high quality fitting-out work and renovation of retail stores

Retailing has been vibrant in Hong Kong where the city remains a popular shopping destination in the region. In view of the economic slowdown, retailers were seen to take up or combine smaller outlets for cost effectiveness instead of expanding the number of outlets. Nonetheless, retailers are placing emphasis on store quality and brand image. A combination of pleasant shopping environment and customer service can deliver advanced shopping experience. Retailers such as the luxury goods and fashion brands put strong emphasis on the quality of fitting-out and interior design of their stores in order to create premium customer service to their customers, which in turn drives the demand of high quality fitting-out and renovation work services.

Leases/Tenancy agreements maintain stable base

Demand for offices and commercial spaces witnessed growth from 2011 to 2014 as Hong Kong continued to position itself as a business hub attracting both local and global businesses to set up their offices here. The city is known to be the most expensive city in the world to rent office space in high rise buildings. Office rentals have been consistently on the rise with the rental index growing from 169.9 in 2011 to 226.6 in 2015. However, the number of deeds dipped by around 16% in 2015, as shown in the table below, which could be dampened by the global economic slowdown.

| | 2011 | 2012 | 2013 | 2014 | 2015 | CAGR (2011-2015) |
|--|-------|-------|-------|-------|-------|---------------------|
| Number of leases/ tenancy agreements | 4,999 | 4,885 | 4,823 | 5,031 | 4,231 | -4.1% |

(Source: Land Registry)

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DEVELOPMENT OF PUBLIC AND PRIVATE SPACES IN HONG KONG

Sharp fall in number of sale and purchase agreements although total consideration fared better

There was a sharp decline in the number of sale and purchase agreements registered over the Review Period, dropping by a CAGR of 9.8% from 84,462 agreements registered in 2011, to only 55,982 agreements registered in 2015. The lowest numbers of registrations were recorded in 2013, when cooling measures targeting the residential property market in Hong Kong was first introduced by the Government, pushing investors into taking a wait-and-see approach as they sought more clarity on the impact of these cooling measures.

Over the same period, the total consideration amount of domestic units registered declined at a slower pace, despite dropping from HK\$442.5 billion in 2011 to HK\$298.9 billion in 2013, before rebounding to HK\$416.5 billion by 2015. This indicated that despite a fall in the number of sale and purchase agreements for residential units, overall valuation of these transactions remained resilient. This in turn was most probably due to sustained purchasing interest in higher-end properties, which helped to cushion the negative impact of a significantly sharper decline in overall transactions.

Government cooling measures cause a slowdown in completion of private projects

Residential property prices in Hong Kong is among the most expensive in the world, and correspondingly is also one of the most active property markets globally, with high capital gains and relaxed regulations on foreign ownership of properties in Hong Kong attracting many well-heeled investors from across the world. Over time, this has led to high demand for residential properties in Hong Kong, which in turn has seen residential property prices soar to new highs.

In response to sky-high prices of residential properties and the fear of a property bubble building up in Hong Kong, the Government has introduced a series of cooling measures for the property market in 2012 to avert a hard landing, which has taken effect at a time when large numbers of residential properties were already under construction. This rising supply of residential units, rising short-term interest rates, slowing growth in Mainland China and cooling measures have all begun to take effect, with housing sales dropping to a 25-year low in February 2016, and housing prices down by 10% in the same month from the peak prices recorded back in September 2015 before picking up again in the second half of 2016. All of these point at weakness in Hong Kong’s residential property market, with both consumers and developers starting to stay away from the market for the time being.

Growing demand for private offices in Hong Kong

The completion of private offices has fluctuated significantly over the Review Period, growing by a CAGR of 1.5%, although year-on-year growth declined significantly for three consecutive years between 2012 and 2014, due to 2011 being a year where the number of completions of private offices were unusually high. In 2015, such completions soared more than 50% to reach 164,500.

Such growth in the construction of private offices has been driven by strong demand for commercial spaces and offices in Hong Kong, bolstered by strong economic growth and a sustained expansion in GDP output over the Review Period.

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| | 2011 | 2012 | 2013 | 2014 | 2015 | CAGR (2011-2015) |
|---|------------|------------|------------|------------|------------|---------------------|
| Completion of private offices (m ²) | 155,200 | 135,700 | 122,700 | 103,600 | 164,500 | 1.5% |
| Stock of private offices (m ²) | 10,782,100 | 10,891,100 | 10,983,200 | 11,060,700 | 11,283,200 | 1.1% |

(Source: Rating and Valuation Department)

Growing demand for retail premises in Hong Kong

Completions of retail premises and other premises for commercial use (exclude purpose-built offices) picked up from 2013 and the completion increased by 77.9% to 68,300 m² in 2015. The rating and valuation department has announced that completions are likely to increase to 125,900 m² in 2016.

| | 2011 | 2012 | 2013 | 2014 | 2015 | CAGR (2011-2015) |
|--|------------|------------|------------|------------|------------|---------------------|
| Completions of retail premises and other premises for commercial use (exclude purpose-built offices, in m ²) | 42,200 | 90,100 | 38,400 | 57,100 | 68,300 | 12.8% |
| Stock of retail premises and other premises for commercial use (exclude purpose-built offices, in m ²) | 10,791,900 | 10,862,100 | 10,882,700 | 10,917,200 | 10,992,400 | 0.5% |

(Source: Rating and Valuation Department)

FITTING-OUT, RENOVATION AND A&A WORKS IN HONG KONG

Market overview

Robust growth in customer expenditure on fitting-out, renovation works from 2011 to 2015

Customer expenditure on fitting-out and renovation work registered robust growth during the Review Period, with a CAGR of 19.7%. Growth was particularly strong in 2012, when customer expenditure on fitting-out more than doubled. One of the contributing factors was an increase in the number of commercial property completions. There were also a number of mixed developments and housing projects which started construction work before 2011 and completed in 2012, boosting the number of new buildings completed and the value of fitting-out works that year. Expenditure fell in 2013, from the abnormally high base in 2012 and due to a slight slowdown in the property market causing declines in both domestic private property and commercial property completions. However, expenditure on fitting-out picked up in 2014, as the residential property market saw a revival, with prices fuelled by tight demand-supply balance and the low interest rate environment. This growth carried on in 2015, as customer expenditure on fitting-out and renovation works grew by 24%. In general, the market trends of the fitting-out industry closely mirror the developments of the building works sector in the construction industry, with some years registering significant growths as property developers launch developments in waves.

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Economic growth and Government policies contributed to growth

Customer expenditure on A&A works also grew strongly over the same period, with a CAGR of 26.7%, supported by the overall positive economic performance and strong demand from home owners, office tenants, the retail industry and the hospitality industry.

Specifically, the Government’s Mandatory Building Inspection Scheme (“**MBIS**”) and the Mandatory Window Inspection Scheme (“**MWIS**”) have given the industry a significant boost. Implemented on 30 June 2012, the MBIS and the MWIS are relevant for all commercial and residential buildings aged 30 years or above and 10 years or above, respectively, with the exception of domestic buildings not exceeding three storeys in height. The aim of MBIS and MWIS is to arrest the long-standing problem of buildings negligence in Hong Kong. Under the schemes, the Buildings Department selects 2,000 and 5,800 target buildings, on an annual basis, for the MBIS and the MWIS, respectively to conduct inspection and repairs. To help building owners comply with statutory requirements for inspection, the Government has also launched various financial assistance schemes. For instance, the Integrated Building Maintenance Assistance Scheme was integrated and enhanced in 2015 to encourage domestic property owners and owners of composite buildings to rehabilitate their buildings, through providing cash subsidies and interest-free loans to individual owners for rehabilitation to common areas of building and safety and hygiene repair works to individual units. This may also have had an impact on encouraging more tenders for such works.

Depending on the scale and nature of the works involved for fitting-out, renovation and A&A works, contract cost has a wide range from HK\$10,000 onwards.

Fitting-out and renovation works and A&A works in Hong Kong (2011-2020)

| Customer expenditure (HK\$ million) | 2011 | 2012 | 2013 | 2014 | 2015 | 2016F | 2017F | 2018F | 2019F | 2020F |
|--|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|
| On fitting-out and renovation works | 15,273.0 | 24,963.1 | 20,301.4 | 25,304.9 | 31,324.9 | 32,016.9 | 32,799.7 | 33,793.6 | 34,804.2 | 36,010.9 |
| On A & A works | 2,285.1 | 3,537.4 | 4,611.9 | 4,722.5 | 5,893.9 | 6,176.8 | 6,393.0 | 6,540.0 | 6,677.4 | 6,764.2 |

(Source: Euromonitor estimates from desk research, trade surveys and trade interviews)

BUSINESS MODEL AND OPERATIONAL COSTS

Typical business model of fitting-out, renovation works and A&A works service providers

The business model of contractors within the fitting-out and renovation works and A&A works service industry depends on the contractor’s place within the value chain. Some contractors are focused on delivering turnkey solutions and usually have a project management team to engage specialist contractors further down the value chain to deliver individual components of the fitting-out or renovation works. The project team manages the cost, time and quality of projects through the arrangement of specialist contractors and material and equipment procurement. The revenue of such contractors from a project is mainly derived from contracting fee, while main costs include subcontracting costs, staff costs of in-house project management team, cost of raw materials and other supplies required for the performance of the work.

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On the other hand, further down the value chain, some contractors focus on specific areas of fitting-out, renovation works and A&A works. These contractors are generally smaller in scale, in terms of both revenue and staff count and are usually subcontracted to fulfil a specialised portion of the project, such as installation of electrical systems, carpentry or plumbing works, etc.

Rising labour cost a key challenge for the industry

Labour costs rose steadily during the historic period due to tight construction manpower supply. Over the Review Period, median monthly wages for the construction industry rose by a CAGR of 7.1%. Shortage of skilled labour, coupled with strong demand for work, is another key factor for rising labour costs. The industry faces severe labour shortage due to an ageing workforce and the younger generation’s unwillingness to join the construction industry. Although the Government has implemented the Enhanced Construction Manpower Training Scheme to attract manpower through providing a training allowance, such efforts are unlikely to suffice. Hence, the Government rolled out further measures to enhance the Supplementary Labour Scheme in April 2014, which involves plans to relax the rules on importing foreign labour to keep rising manpower costs in check. However, this policy has been met with strong opposition from trade unions and construction labour activists to safeguard the interests of local workers. As a result, the problem of labour shortage and rising labour costs is unlikely to abate in the near future.

Labour cost, historic (2011-2015)

| In HK\$ | 2011 | 2012 | 2013 | 2014 | 2015 | CAGR (2011-2015) |
|--|--------|--------|--------|--------|--------|---------------------|
| Median monthly wages for the construction industry | 15,200 | 16,100 | 17,600 | 18,300 | 20,000 | 7.1% |

(Source: Census and Statistics Department of Hong Kong)

Cost of raw materials remains relatively stable

Overall cost of raw materials was relatively stable during the historic period and is expected to remain so over 2016-2020. In the fitting-out, renovation works and A&A works industry, a wide range of materials is used, including glazed ceramic wall tiles, hardwood, paint and portland cement. Trade sources have also agreed that general raw material costs did not register significant increase and the cost of some raw materials have even declined during the historic period. This is consistent with the construction materials index published by the Civil Engineering and Development Department, where materials index stood at 747.0 in January 2011 and fell to 683.1 in December 2015.

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The following table shows the trend of major raw material prices during the Review Period.

| In HK\$ | 2011 | 2012 | 2013 | 2014 | 2015 | CAGR (2011-2015) |
|--|-------|-------|-------|-------|-------|---------------------|
| Average wholesale prices of building materials | | | | | | |
| Glazed ceramic wall tiles – white tiles (HK\$/100 pieces) | 202 | 232 | 243 | 233 | 233 | 3.6% |
| Glazed ceramic wall tiles – coloured tiles (HK\$/100 pieces) | 334 | 391 | 398 | 401 | 443 | 7.3% |
| Hardwood (HK\$/cubic metre) | 5,470 | 5,654 | 5,519 | 5,707 | 5,707 | 1.1% |
| Paint – Emulsion (HK\$/litre) | 45 | 51 | 52 | 52 | 53 | 4.2% |
| Portland cement (ordinary) (HK\$/tonne) | 677 | 699 | 698 | 729 | 738 | 2.2% |

(Source: Census and Statistics Department)

MARKET OUTLOOK

Forecast customer expenditure expected to grow marginally

The growth in customer expenditure on fitting-out, renovation and A&A works is expected to slow down during the 2016 through 2020 forecast period. This is in line with the anticipated slowdown in the Hong Kong economy as investor sentiments remain dented by concerns over the uncertainties associated with the US interest rate and the uncertain global economic outlook. The falling property prices and lower demand for property investments may also lead to less building activities and subsequently, a lower expenditure.

Although businesses are likely to reduce expenditure in view of the economic uncertainties, the impact on the industry will be cushioned by the MBIS and other various renovation support schemes. The MBIS will continue to ensure that building owners of private buildings aged 30 years or above engage contractors to carry out essential renovation and maintenance works so that they may pass the Buildings Department’s inspections.

Multiple challenges and opportunities ahead in the medium term

In the medium term, there are also expected to be a number of challenges and opportunities for the fitting-out, renovation and A&A works industry. Shortage of skilled labour will remain a key challenge for industry players, in light of the sustained and keen demand for construction activities and the ageing workforce. Companies will likely incur higher labour costs as construction workers demand higher wages. A shortage of workers may also limit contractors’ ability to take on more projects. Another potential challenge for companies would be the changing regulatory environment. In particular, there may be more onerous regulations governing the conduct of renovation works, as industry groups have been calling for a regulatory authority to be set up to oversee overall business practices.

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On the other hand, the main opportunities for the fitting-out, renovation and A&A works industry will stem from the planned increase in public housing projects, renovation opportunities for buildings above 30 years old and the upside potential of economic growth resulting in more renovation demand from the growth of businesses leasing commercial properties.

Government to increase the supply of public and private housing

As the number of households is growing at a faster rate than that of the population, the Government is seen placing more efforts to increase land supply for housing. In 2016, the Government pledged to build 97,100 public housing units in the next five years, 20,000 more units than her previous estimate.

The supply of private housing units is also expected to increase as the Government announced an estimated 87,000 private housing units will be built in the next three to four years. The Rating and Valuation Department has forecasted that over 18,200 private housing units will be completed by the end of 2016. This represents an increase of 61.3% from 2015 where 11,280 units were built.

The Government’s stronger commitment to tackle the housing supply-demand imbalance is likely to benefit the demand of fitting -out and renovation works in the coming years.

COMPETITIVE LANDSCAPE

Fragmented industry characterised by many contractors specialising in different areas

Contractors are required to register with the Building Authority before they are allowed to carry out building works and street works. There are three contractors’ registers kept by the Building Authority – General Building Contractors’ register, the Specialist Contractors’ register and the Minor Works Contractors’ register. In general, registered general building contractors are able to perform a wider variety of works including that of the minor works contractors and some of the specialist contractors.

The industry is fragmented with a large number of players. According to Buildings Department Registry, there are 703 Registered General Building Contractors and approximately 10,000 Registered Minor Contractors for A&A works under Type A minor works, which includes support structure for air-conditioner, removal of architectural projections, canopies, drying racks and protective barriers and a range of other, in Hong Kong, as of December 2016.

On the other hand, the market share of players within the renovation and A&A works industry is more evenly distributed among mid-sized to small players. Furthermore, as the fitting-out, renovation and A&A works industry covers a wide range of work requiring different skills, most of the players tend to offer only services in a specialised area. For example, some contractors focus on just fitting-out toilets, fire prevention systems, glass and windows or pipes. Such players are usually relatively smaller in terms of revenue and headcount and constitute the bulk of the industry.

The industry is highly competitive with the players typically competing on price. The quality of work is another factor that is important, especially for high-end developments, such as the fitting-out of luxury apartments or offices for leading international brands. On the other hand, for large-scale construction projects, the range of services that the contractor

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is able to provide is a key consideration. Customers may prefer contractors who are able to coordinate the full range of construction services, eliminating the need to negotiate and deal with multiple subcontractors and possibly shortening the project timeframe.

Low barriers to entry in the fitting-out, renovation and A&A works industry, but harder for high value projects

Barriers to entry in the industry are low because new players can enter the industry without much experience, capital or industry specific qualifications and licenses; since any work requiring specific licenses, such as A&A works, can be subcontracted to contractors holding the required licenses. Smaller companies tend to take on lower-value, less complicated or specialised projects or work on small-scale renovation projects for domestic property units.

For higher value fitting-out, renovation and A&A works projects, including fitting-out, and renovation for retail premises of luxury goods and high-end fashion, industry reputation and relationship with property developers and main contractors are potential barriers to entry. For such projects, a proven track record is important because customers want to ensure the quality of work and work safety. Contractors which have established positive relationships with major developers are more likely to win contracts from them, as they are more likely to be invited to submit a tender or provide a quotation, while new entrants have to rely on public information to source for projects. In some instances, property developers may also have a list of pre-qualified contractors from which they choose from. As a result, new players may find it hard to win high value contracts initially due to the lack of a proven track record and relationship with developers.

OUR GROUP

Based on data provided by our Group and Euromonitor International’s market estimates, our Group had 0.3% market share in fitting-out and renovation works and 0.7% market share in A&A market in Hong Kong in 2015. Due to the lack of sufficient publicly accessible information, the ranking and respective market share of key market players in the fitting-out, renovation and A&A works industry were not available in the Euromonitor Report.