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## INDUSTRY OVERVIEW

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### SOURCES OF INFORMATION

#### General

The Company had engaged Euromonitor to conduct an independent assessment of the apparel supply chain management industry in Hong Kong and has agreed to pay a fee of approximately US\$104,320 for the Euromonitor Report. Established in 1972, Euromonitor is a global research organisation with analysts in over 80 countries worldwide engaging in strategy research for both consumer and industrial markets.

#### Research methodology

In compiling and preparing the Euromonitor Report, Euromonitor used the following methodologies to collect multiple sources, validate the data and information collected, and cross-check each respondent's information and views against those of others: (i) secondary research, which involved reviewing published sources including national statistics and official sources such as Census and Statistics Department of Hong Kong, the National Bureau of Statistics of China, the Statistics Bureau of Japan, and the National Statistical Office of Thailand, company reports including audited financial statements where available, independent research reports, and data based on Euromonitor's own research database; (ii) primary research which involved interviews with a sample of leading industry participants and industry experts for latest data and insights on future trends and to verify and cross check the consistency of data and research estimates; (iii) projected data obtained from historical data analysis plotted against macroeconomic data with reference to specific industry-related drivers; and (iv) review and cross-checks of all sources and independent analysis to build all final estimates including the size, shape, drivers and future trends of the apparel supply chain management market and prepare the final report.

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### Forecasting basis and assumptions

The Euromonitor Report is prepared by Euromonitor under the following assumptions: (i) the economy in Hong Kong, China, Japan and Thailand is expected to maintain steady growth over the forecast period from 2016 to 2020 (the “**Forecast Period**”); (ii) the social, economic, and political environment in Hong Kong, China, Japan and Thailand is expected to remain stable in the Forecast Period; (iii) there will be no external shock, such as financial crisis or raw material shortage that affects the demand and supply for apparel supply chain management services in Hong Kong, apparel manufacturing in China and Thailand, as well as apparel retail in Japan during the Forecast Period; (iv) key market drivers such as Hong Kong firms’ profound knowledge and experiences of apparel supply chain management and close relationship with trading partners are expected to boost the development of the apparel supply chain management market in Hong Kong; (v) key drivers including rising expenditure by foreign tourists on apparel in Japan and growth in online retailing are likely to drive the future growth of the apparel retail industry in Japan; (vi) key drivers including massive domestic demand, sophisticated production techniques and high level of production efficiency are likely to drive the future growth of the apparel manufacturing industry in China; and (vii) key drivers including structural change in the apparel manufacturing industry are likely to drive the future growth of the apparel manufacturing industry in Thailand.

### APPAREL RETAIL MARKET IN JAPAN

The apparel retail market in Japan is a mature one with stagnant growth in both volume and value terms over the period from 2011 to 2015 (the “**Review Period**”). Retail sales value of apparel decreased at a CAGR of 9.5% over the Review Period to reach USD62,452.9 million in 2015 while retail sales volume of apparel decreased at a CAGR of 0.5%.

The decrease in retail value sale and retail volume of apparel in Japan from 2011 to 2015 was mainly due to shrinking disposable incomes, stagnating Japanese population, and a growing ageing population which had made expansion through domestic consumption difficult. This is corroborated by declining consumer expenditure on apparel items as recorded by Statistics Bureau of Japan data. Household expenditure on clothing and footwear declined from JPY14,245.0 per month in 2000 to JPY9,832 per month in 2015.

The sustained economic downturn in Japan has caused a drop in disposable income. Apart from that, the consumption pattern in Japan apparel retail market has gradually shifted to the local and imported fast fashion brands with affordable price. In other words, consumers tended to purchase more lower-priced apparel. This further caused affordable yet trendy mass market local apparel brands and other imported fast fashion brands to increase in traction, which led to decrease in the overall retail sales value of apparel. During the Review Period when the apparel retail market in Japan witnessed shrinking retail sales value and volume, increasing inbound tourism and growing internet apparel retailing has contributed to offset part of the decrease.

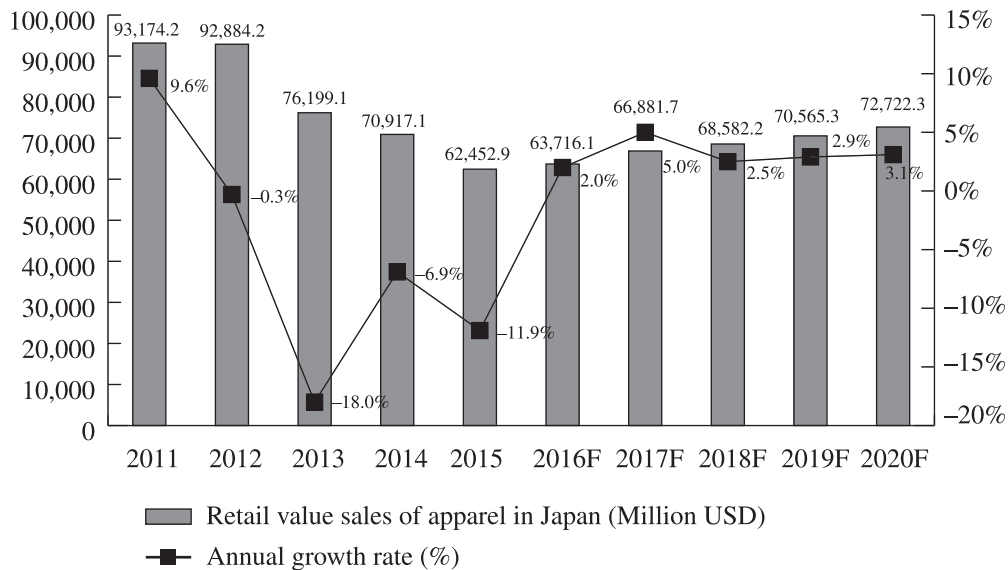
In the Forecast Period, while the growth constraints including shrinking disposable incomes, stagnating Japanese population and ageing population are likely to persist, the apparel retail market in Japan is expected to recover due to growing popularity of internet apparel retailing, increasing

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inbound tourism and changing consumer pattern. The retail sales value of apparel is projected to reach USD72,722.3 million in 2020, representing a CAGR of 3.4% over the Forecast Period. In the Forecast Period, the internet retailing is expected to continue to become increasingly prominent in consumer lifestyles in Japan, while consumers are also expected to become increasingly comfortable with shopping online. The apparel retail sales value through internet retailing grew at a CAGR of 10.5% during the Review Period. It is expected that the internet retailing within apparel retail will have a steady growth over the Forecast Period. In addition, the flood of tourists into Japan is set to grow further over the Forecast Period. Growth in the number of inbound tourists will continue to be driven both by government campaigns and by the efforts of private companies. The Japanese government has set a target of 20 million tourist arrivals annually by 2020. As part of its tourism growth strategy, the Japanese government also aims to increase the number of outlets participating in its duty-free scheme to 10,000, up from 4,000 in 2014.

However, despite the forecast growth in terms of retail sales value, the annual retail sales value in the Forecast Period will be generally lower than that in the Review Period. This is partly due to ongoing economic constraints and the increasing preference towards mass-market apparel due to shrinking disposable incomes, and partly due to the decline in population and ageing population which results in lower demand in fashion clothing and apparel for work.

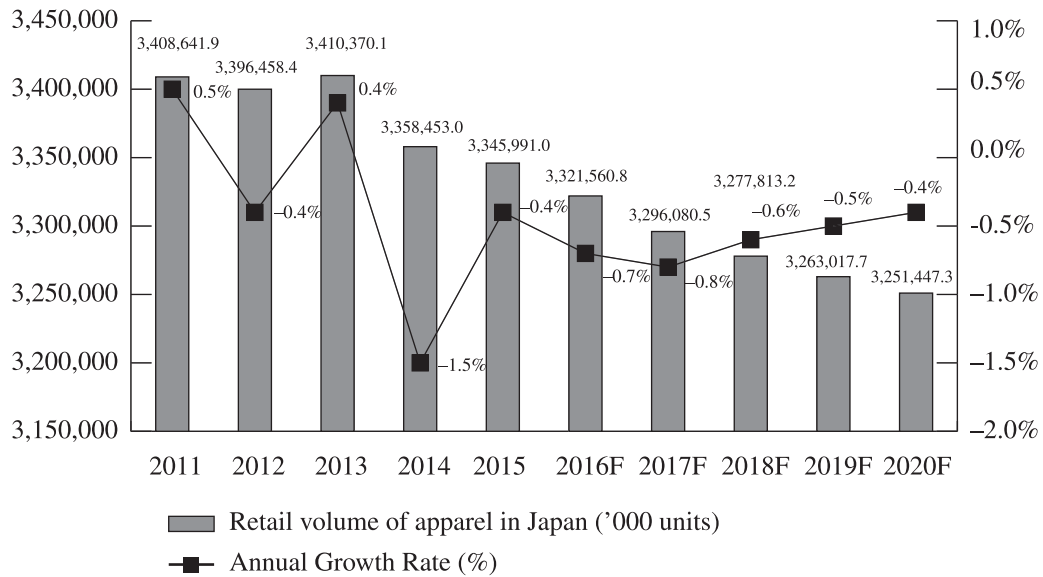
**Retail Value Sales of Apparel in Japan, 2011–2020**



Source: Passport — Apparel and Footwear 2016 edition

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### Retail Volume of Apparel in Japan, 2011–2020



Source: Passport — Apparel and Footwear 2016 edition

### Ranking of the Leading Apparel Brands in Japan, 2015

**Ranking**      **Leading apparel brands (up to 5), in terms of retail value sales, 2014 historic**

- |   |            |
|---|------------|
| 1 | Uniqlo     |
| 2 | Shimamura  |
| 3 | GU         |
| 4 | Cross Plus |
| 5 | Wacoal     |

Source: Passport Data — Apparel and Footwear 2016 edition

Note: Audited data if available is usually not industry specific and includes other products/services. Industry ranking will therefore be estimated on publicly available data and the trade opinion survey (not just the companies themselves).

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In 2015, Japan imported USD13,315.1 million of knitted or crocheted apparel and clothing accessories, representing a CAGR of –3.3% over the Review Period. The apparel import market in Japan is highly fragmented, with apparel imported from more than 100 countries worldwide, and mostly from Asian countries. China is the largest exporter to Japan, followed by Vietnam and Indonesia. These three countries accounted for 86% of Japan apparel imports in 2015. Hong Kong is the largest 35th importing country in the same year.

### The Imports of Apparel Items and Clothing Accessories in Japan, 2011–2015

Data	Unit	2011	2012	2013	2014	2015
As per HS Code 61: From the world at articles of apparel large (value at CIF) and clothing accessories knitted or crocheted	Million USD	15,223.6	15,633.4	15,683.6	14,576.5	13,315.1

*Source: The United Nations Commodity Trade Statistics Database (the “UN Comtrade”)*

\* *CIF:* includes the transaction value of the goods, the value of services performed to deliver goods to the border of the exporting country and the value of the services performed to deliver the goods from the border of the exporting country to the border of the importing country.

## KEY DRIVERS FOR THE APPAREL RETAIL INDUSTRY IN JAPAN

### Rising expenditure by foreign tourists on apparel in Japan an important growth factor

Over the Review Period, tourist arrivals into Japan increased significantly, partially due to a depreciation in the yen which has made Japan a more affordable and attractive holiday destination to the rest of the world. Furthermore, new initiatives by the government to relax entry visa requirements for tourists from China and various Southeast Asian countries have also helped to bolster the inflow of tourists from these regions. All of these have led to significant increases in expenditure by tourists in Japan, with total expenditure generated by inbound tourists exceeding JPY3.5 trillion in 2015, increased by 71.5% from 2014.

The apparel retail industry has been one of the main beneficiaries, with expenditure on apparel products being recorded as the third highest expenditure category for tourists in 2015, at JPY38,841 per person. This has helped to drive growth in an otherwise stagnant and lackluster industry in Japan, and will also be critical to any further expansion of the apparel retail market in Japan over the Forecast Period.

### Growth in online retailing helping to encourage purchases of apparel products

Online retailing has been taking off in Japan over the past decade, with increasing number of Japanese consumers moving away from retail storefronts towards digital stores, being drawn by exclusive promotions and products offered through collaborations between online retailers, fashion labels and media companies. Apparel is one of the product categories benefiting from this evolution

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of online shopping in Japan, and both online retailers and traditional retailers have been devoting more resources to online storefront to drive apparel sales, capture new consumers and retain existing customers. Over the Forecast Period, growth in online retailing is expected to help boost retail sales of apparel products.

### **OPPORTUNITIES FOR THE APPAREL RETAIL INDUSTRY IN JAPAN**

#### **Two-pronged approach to growing domestic consumer base as well as tourists market to drive growth**

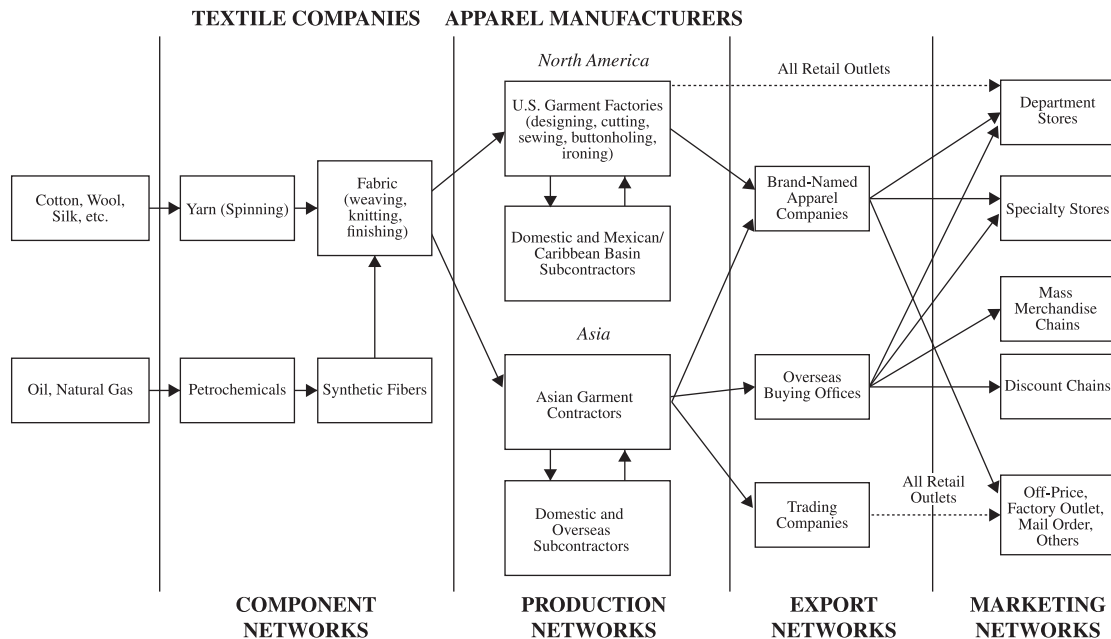
Over the Forecast Period, growth opportunities are likely to present themselves in the apparel retail industry. The increased influx of foreign tourists into Japan is one of the few bright spots for the industry, with such tourists exhibiting a strong propensity for apparel-related purchases while on vacation in Japan. Industry players should form strategic alliances with travel agencies and tourism players to further drive sales of apparel products to such tourists. Other options are to undertake advertising campaigns targeted at the most significant tourist groups likely to spend a significant amount on apparel products while in Japan, especially tourists from China.

On the domestic front, apparel retailers should continue riding on the rising popularity of online shopping by making exclusive products available only through their online platforms, as well as undertake more strategic partnerships with firms from other industries such as media and technology firms to expand the appeal of their apparel products to a wider local consumer base. For example, Chinese tourists tend to research for potential purchases in Japan before their trip via social networking service platforms, and this is an area which apparel retailers can leverage to promote their products directly to tourists before they arrive in Japan.

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### APPAREL SUPPLY CHAIN MANAGEMENT INDUSTRY IN HONG KONG

The apparel industry has a buyer-driven value chain and global buyers determine what will be produced at what price. Typically, lead firms outsource manufacturing to a global network of contract manufacturers in developing countries with the most competitive rates. Lead firms include retailers and brand owners that are normally based in developed markets like the US and Japan. These firms typically handle the most valuable activities in the apparel value chain, such as design, marketing, and sales. Typical value-added services provided by apparel supply chain management companies include: (i) research & development; (ii) design; (iii) purchasing/sourcing; (iv) production/assembly/cut, make, trim (CMT); (v) distribution; (vi) marketing and sales; and (vii) services. Some retailers and brand owners have started to use B2B e-commerce platforms to approach manufacturers directly. This threatens the business of the apparel supply chain management companies. However, currently the e-commerce model is suitable only for orders with small production volume or simple product design.



*Source: The Global Apparel Value Chain: What Prospects for Upgrading for Developing Countries*

Hong Kong is the most important entrepot for China. According to the Hong Kong government statistics, 61.0% of re-exports were of China origin in 2015. In terms of apparel items, the re-export value has experienced setbacks during the Review Period due to the sluggish global demand. Japan is Hong Kong's second largest re-export destination for knitted or crocheted apparel items, accounting for 9.2% of the total re-export value, second only to the US. In 2015, the re-export value of knitted or crocheted apparel items from Hong Kong to Japan reached USD840.2 million, with a negative CAGR of -7.7% over the Review Period.

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### The Re-export of Apparel Items and Clothing Accessories from Hong Kong, 2011–2015

Data	Unit	2011	2012	2013	2014	2015
As per HS Code 61: To Japan (value at articles of apparel and clothing accessories knitted or crocheted	To Japan (value at FOB) Million USD	1,155.3	1,056.1	1,192.1	1,001.4	840.2

*Source: The UN Comtrade*

\* *FOB:* type values include the transaction value of the goods and the value of services performed to deliver goods to the border of the exporting country.

### An overview of the Group's operations

Given the highly fragmented nature of the market, the Group held a market share of 0.4% in terms of apparel exports to Japan by FOB in 2015.

### The Group's Market Share in Terms of Apparel Exports to Japan, 2015

Data	The Group's market share, by FOB, based on its apparel exports to Japan, 2015 historic
The Group	0.4%
Other companies (collectively)	99.6%
Total	100%

*Source: Euromonitor estimates from desk research and trade interviews with leading manufacturers/distributors of apparel items and clothing accessories as well as the relevant trade associations in China.*

*Note:* It is assumed that the Group's data for the financial year should correspond with that for the calendar year.

## THE MANUFACTURING OF APPAREL ITEMS AND CLOTHING ACCESSORIES IN CHINA

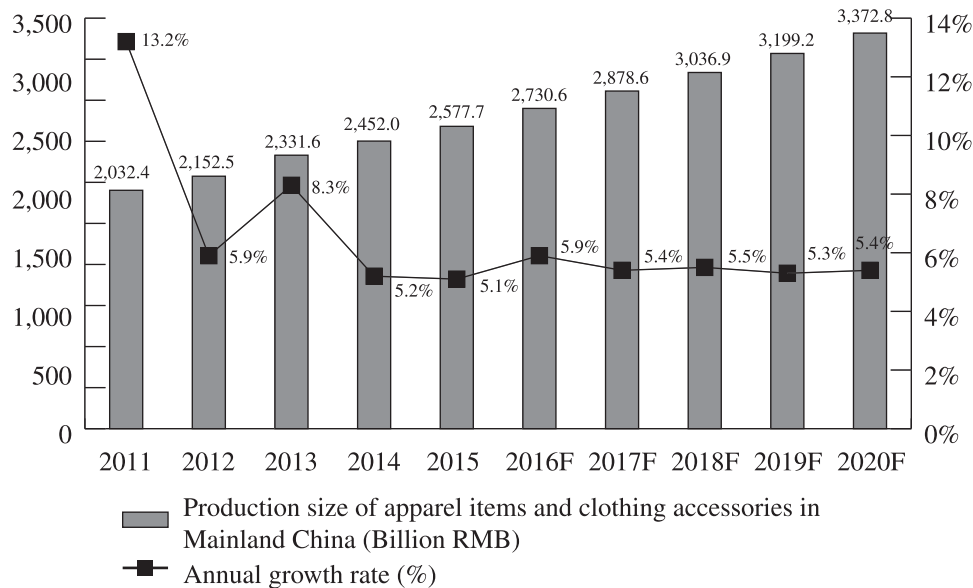
The production size of apparel items and clothing accessories in China grew steadily during the Review Period. In 2015, total production size by manufacturers' selling price reached RMB2,577.7 billion, representing a CAGR of 6.1% from 2011 to 2015.

The growth is expected to slow down during the Forecast Period due to weaker demand caused by a less favourable global and domestic economic environment as well as the outflow of apparel manufacturing to other countries with lower labour costs. In 2020, the total production size by manufacturers' selling price is estimated to reach RMB3,372.8 billion, with a CAGR of 5.4% during the Forecast Period.



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### Production of Apparel Items and Clothing Accessories in China (By Manufacturer's Selling Price), 2011–2020



*Source: Euromonitor estimates from desk research and trade interviews with leading manufacturers/distributors of apparel items and clothing accessories as well as the relevant trade associations in China.*

China has been a favoured apparel manufacturing base for decades because of advanced techniques, high level of efficiency and product quality as well as low operation cost. According to the UN Comtrade, China registered a total apparel export value of USD162.3 billion in 2015, with a CAGR of 3.2% from 2011 to 2015. The European Union (the “EU”), the USA, Japan, the UK and Hong Kong are the key export destinations of apparel items, accounting for more than 50% of total export value of apparel from China in 2015.

In 2015, the export value of apparel decreased 6.4% from 2014 due to the sluggish economic recovery in developed economies especially Europe and Japan. However, value of apparel export to the US, one of the largest apparel export destinations of China, continued to grow in 2015, with a year-on-year growth rate of 6.9%. Value of apparel export to emerging markets such as the Middle East and Africa also experienced increase in 2015.

The rising labour costs and labour shortage, especially in coastal provinces, have led to the outflow of apparel manufacturing to Southeast Asian countries such as Bangladesh, Vietnam, India and Cambodia, where the labour costs are lower. However, it is mainly the low-end apparel items or the ones requiring relatively simple techniques that are moved from China to Southeast Asia, due to China’s more sophisticated manufacturing capability.

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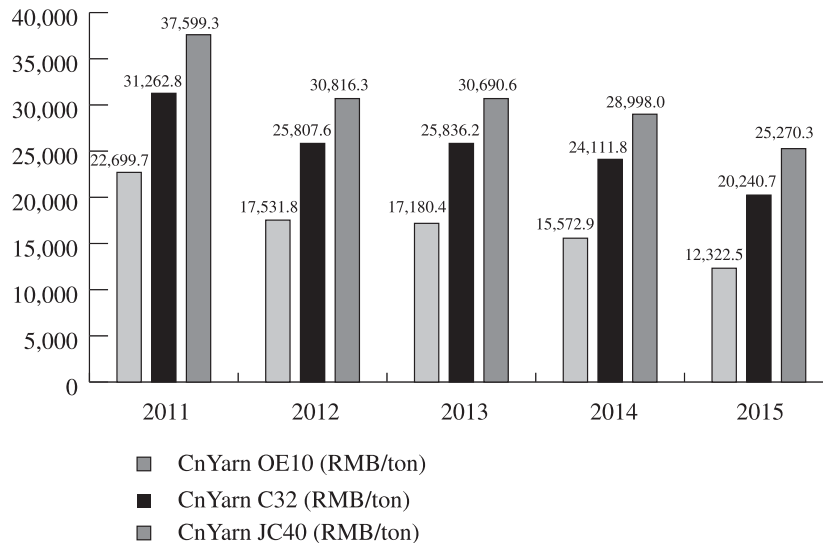
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### Raw material prices

The key raw materials used in apparel manufacturing are yarns. During the Review Period, prices of yarn were generally falling, mainly due to the weak demand in both domestic and international markets. For example, according to the Pricing Index of Yarn of China (the “**CnYarn Index**”), price of OE10 (100% Cotton Open End 10/1) fell from RMB22,699.7 per ton in 2011 to RMB12,322.5 per ton in 2015, with a negative CAGR of  $-14.2\%$ .

**The Pricing Index of Yarn from China, 2011–2015**



Source: Wind Info

Note: The CnYarn Index is released by China Cotton Textile Website in collaboration with China Cotton Textile Association and China Yarn Dyed Weaving Association.

### Labour costs

Labour cost plays a fundamental role in manufacturer’s operational costs, as apparel manufacturing is a labour intensive industry. According to the National Bureau of Statistics of China, the average wage of employed persons in the manufacturing sector located in urban areas of China reached RMB55,324 in 2015, representing a CAGR of  $10.8\%$  from 2011 to 2015. The rising labour cost increases the operating expenses of manufacturers based in China.

## THE MANUFACTURING OF APPAREL ITEMS AND CLOTHING ACCESSORIES IN THAILAND

The various companies in Thailand involved in the textile and apparel related activities range in size from large scale multinational corporations, small to medium enterprises, and even micro enterprises handcrafting textile and apparel products. These companies operate as both original equipment manufacturers (“**OEM**”) and original design manufacturers (“**ODM**”) for a wide range of apparel brands and retailers across the globe, ranging from fast fashion to designer labels, large department stores to independent retailers, etc.

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Manufacturing of apparel items is a substantial division out of the overall manufacturing industry in Thailand by size of establishment which ranked second only behind the manufacturing of food. Latest available data from the 2012 Business and Industrial Census issued by the National Statistical Office of Thailand shows that there were a total of 72,538 apparel manufacturing establishments in Thailand in 2011. Export of knitted or crocheted apparel and clothing accessories from Thailand to Japan increased in the Review Period at a CAGR of 3.0% from USD242.7 million in 2011 to USD273.4 million in 2015.

### **The Export of Apparel Items and Clothing Accessories from Thailand, 2011–2015**

<u>Data</u>		<u>Unit</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
As per HS Code 61: articles of apparel and clothing accessories knitted or crocheted	To Japan (measured at FOB)	Million USD	242.7	280.0	284.6	287.1	273.4

*Source: The UN Comtrade*

## **KEY DRIVERS FOR THE APPAREL SUPPLY CHAIN MANAGEMENT INDUSTRY IN HONG KONG**

### ***Hong Kong firms' profound knowledge of and experience in apparel supply chain management***

The apparel supply chain management companies in Hong Kong enjoy a strong reputation in the global apparel industry because of their extensive knowledge and experience in the entire apparel supply chain from design to delivery of end products. The apparel supply chain management companies in Hong Kong are able to deliver high quality end products and meet tight timelines, making them ideal and efficient partners for international apparel brand owners. In addition, the full professional proficiency of English adds to Hong Kong's advantage as a favourable partner for global clients.

### ***Hong Kong's close relationship with its trading partners***

The geographical and cultural affinity between China and Hong Kong has been one of the main drivers of the apparel supply chain management industry in Hong Kong. Because of Hong Kong's cultural knowledge of China, it is able to navigate any business and language issues efficiently. As such, Hong Kong companies are able to find quality suppliers in China. In addition, Hong Kong can take advantage of its leading position in sales, marketing, and other professional services when handling the more premium portions of the value chain. Moreover, it is also in the perfect position to assist overseas buyers in their exploration of China.

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### *Industrialisation of other Asian economies accelerates Hong Kong's shift to an apparel supply chain management model*

Over the past decade, Southeast Asian economies such as Vietnam, Myanmar, and Cambodia, as well as South Asian economies like India and Bangladesh have undergone significant modernisation and industrialisation. Consequently, these countries have developed a large manufacturing base for a wide variety of products including apparel, with these countries offering a large pool of cheap labour and low operating costs. As a result, an increasing number of apparel and clothing manufacturers based in Hong Kong have moved their manufacturing facilities to these countries to keep costs low and stay competitive in an increasingly cost-sensitive global marketplace. This has accelerated Hong Kong's shift to a supply chain management company model, which is at a higher end of the entire value chain.

### **KEY CONSTRAINTS FOR THE APPAREL SUPPLY CHAIN MANAGEMENT INDUSTRY IN HONG KONG**

#### *Overall economic weakness of trading partners*

Over the Review Period, relative weakness of trading partner economies caused a drop in demand for exports. Demand in apparel slowed as consumers tightened spending in the wake of economic uncertainty in their own respective countries as well as globally. In addition, low population growth and an ageing customer base in traditional apparel markets such as the US and EU have also lessened consumption from these markets.

### **KEY BARRIERS OF ENTRY TO THE APPAREL SUPPLY CHAIN MANAGEMENT INDUSTRY IN HONG KONG**

#### *No significant barriers of entry for a highly competitive and fragmented industry*

As a highly competitive and fragmented market populated by a large number of firms ranging from multinational companies, to smaller specialist and small scale firms, there are very few barriers of entry for the apparel and clothing industry in Hong Kong, both for apparel supply chain management with or without a manufacturing base. All that is required is sufficient working capital, a working knowledge of the various procedures and export process, and contacts within the industry as well as with manufacturers to get started.

### **LIKELY OPPORTUNITIES ASSOCIATED WITH FUTURE APPAREL SUPPLY CHAIN MANAGEMENT INDUSTRY DEVELOPMENT**

#### *Growing demand in emerging countries and shift in preference for advanced economies*

While there is stagnation in demand from developed countries, consumers in emerging economies have a growing middle class which is eager to buy apparel products. This is a good opportunity for apparel supply chain management companies to explore opportunities and meet the demand from these consumers.

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On the other hand, consumers in advanced economies now have a growing demand for functional clothing as well as for brands that adopt ethical and green techniques despite their stagnating demand. These products command premium pricing and definitely provide suppliers in Hong Kong who are more environmentally conscious and guarantee product safety an edge over other countries.

### ***Technology can help provide more value-added services to businesses***

Companies which have access to better technology are likely to differentiate themselves from other apparel supply chain management companies. There is a growing use of online system tracking as an add value for buyers in order for them to track and monitor the status of their order. As technology advances, there is bound to be an increase in the number of companies that offer these types of services.

In addition, in order to shorten lead production time to cater to the needs of the fast fashion industry, some companies have now also offered Vendor-managed Inventory systems in which a company helps store inventory for the client. So, instead of clients placing a large number of orders and distributing these themselves, the client instructs the factory to deliver goods in smaller quantities to specific destinations. Functioning as a central warehouse, apparel supply chain management companies are able to act faster according to the demand of the market.

### ***Pure online retailers of apparel a potential growth driver for Hong Kong companies***

The proliferation of pure online retailers of apparel in China, as well as across the world, could potentially be a strong growth driver for Hong Kong's apparel supply chain management companies. Such companies, spanning large online retailers and a plethora of small scale independent retailers selling through online marketplaces, tend to focus on design and marketing, and engage apparel supply chain management specialists to undertake the necessary OEM, and to a lesser extent, ODM work for their supply.

Apparel supply chain companies in Hong Kong can leverage their strong reputation for OEM and ODM work to obtain contracts and partnerships with such companies. Their proximity to China, where one of the largest online marketplaces in the world is based also gives them a competitive advantage in obtaining business from the huge numbers of small independent retailers looking for suppliers.

### ***Development of Hong Kong's nascent fashion industry has the potential to transform the industry***

Apparel supply chain companies in Hong Kong mostly provide specialist services or in some cases manufacturing capabilities to retailers and design labels from overseas, as well as locally, and hence are largely reliant on demand from such overseas partners for their survival. Some mature companies have developed their own brand names and entered the retail space, but these are still few and far between.

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However, the Hong Kong Government is increasingly encouraging the nascent fashion industry in Hong Kong to grow. A handful of local fashion designers have also established a name for themselves globally for their attractive and innovative designs. Further development of the local fashion industry has the potential to be a game changer for the apparel and clothing industry in Hong Kong, providing many new and high-value business opportunities for apparel supply chain companies.

### **LIKELY CHALLENGES ASSOCIATED WITH FUTURE APPAREL SUPPLY CHAIN MANAGEMENT INDUSTRY DEVELOPMENT**

#### *Increasing globalisation reducing the need for some apparel supply chain management services*

Increasing globalisation has decreased the need for Hong Kong as a gateway to China. Some companies are trying to decrease the apparel supply chain by removing the middle men and talking directly to manufacturers in China to help them produce their products. This is especially so as English levels improve in China. Lead buyers have also started establishing sourcing offices in countries so that they do not need to rely on apparel supply chain management companies.