

FSE Lifestyle Services (331 HK)

Decent Growth and Handsome Yield Ahead



京基證券集團
KINGKEY SECURITIES GROUP

- FSE boasts dominant positions in its key markets in HK.
- The organic growth momentum and outlook of FSE's key markets have been sound.
- FSE Lifestyle Service's omni ecosystem encompass the whole life span of buildings and facilities. Such one-stop shop capability enhance customer loyalty and differentiate itself from competitors of multiple professions.
- Considerable cross-selling opportunities are generated among member companies in FSE's ecosystem.
- Its revenue grew at 13.2% CAGR for the period of FY17A-FY23A, while its net profit and EPS both increased at CAGR of 20.0%.
- FSE maintained its stable dividend payout ratio with approximately 40.0% from FY17A to FY23A backed by its healthy operational cash flow and zero net gearing ratio since listing. Concurrently, its DPS rose from HK\$0.155 for FY17A to HK\$0.458 for FY23A, representing six-year CAGR of 19.8%. Its dividend CAGR for FY23A-FY26F is projected to be 7.0%.
- At HK\$5.61 per share, the projected FY24E dividend yield per FSE share is expected to be 8.7%, which is higher than the yield offered by HKD one-year time deposit, 10-year US Treasury note and Tracker fund.
- We project FSE's net earnings to grow at CAGR of 6.4% for FY23A-FY26F. On an annualized basis, FSE's net earnings for FY24F and FY25F are projected to grow by 5.4% YoY and 8.5% YoY, respectively, reaching HK\$551.0m and HK\$597.9m.
- Based on projected DPS of HK\$0.49 for FY24E and HK\$0.53 for FY25F, and its current share price at HK\$5.61, prospective dividend yield of FSE's share for corresponding periods are 8.7% and 9.5%, respectively. The counter's current PEG is 0.7x only. We revise up our target price for FSE to HK\$9.5, based on PEG of 1.2x, or 7.7x FY24E PE, representing 69.3% potential upside. We reiterate our Buy recommendation on FSE.

General Information

Rating	BUY
Target Price (HK\$)	9.5
Current Price (Dec 15 HK\$)	5.61
Total shares (m)	450.0
Mkt Cap. (HK\$ m)	2,524.5
Major Shareholders	FSE Holdings Limited (75.0%)
Industry	Real estate services/E&M
Publish Date	Dec/18/2023

Financial Information

HK\$	FY23A	FY24E	FY25F	FY26F
Revenue(m)	7,767.2	7,806.2	8,101.4	8,313.2
Change(%)	8.0	0.5	3.8	2.6
Pre tax Profit (m)	617.7	659.9	716.1	755.3
Change(%)	(8.9)	6.8	8.5	5.5
Net Profit (m)	522.9	551.0	597.9	630.7
Change(%)	(14.3)	5.4	8.5	5.5
GPM(%)	13.5	14.2	14.4	14.4
EPS(HK\$)	1.16	1.22	1.33	1.40
P/E(X)	4.8	4.6	4.2	4.0
P/B(X)	5.8	3.6	2.4	1.8
ROA(%)	13.1	14.8	16.0	17.1
ROE(%)	74.8	53.5	42.9	39.7
BVPS (HK\$)	1.6	2.3	3.1	3.5
DPS	0.458	0.490	0.531	0.561



Investment Thesis

- **Dominant positions in key markets** FSE has been ranked as the second largest residential property manager, third largest non-residential property manager and the second largest car park operator in Hong Kong. Additionally, it is the largest subsidized housing property (HOS/PSPS/GSH) manager in Hong Kong. Its subsidiary, Waihong Service Group, is the second largest cleaning and hygiene service provider in the city. Its security services arm, General Security made the second place in the type 1 general security guarding services market in Hong Kong. FSE Engineering Group is the second largest E&M services providers in the HK E&M services industry.
- **Positive outlook of its key markets** Organic growth in FSE's focus markets has been decent. In terms of revenue, size of the markets of environmental hygiene services, security guarding services, landscaping services and the property management services in Hong Kong expanded by five-year CAGR of 7.1%, 4.0%, 2.9% and 4.3%, respectively, between 2018A-2023A. Concurrently, in terms of output value, the market size of E&M engineering service market in Hong Kong grew at five-year CAGR of 3.2%. Frost & Sullivan has projected the FY24F-FY28F CAGRs of the environmental hygiene services market, security guarding services market, landscaping services market, the property management services market, and the E&M engineering service market in Hong Kong to be 6.8%, 5.8%, 3.9%, 3.5% and 4.3%, respectively.
- **One-stop-shop encompassing the whole life-span of building** FSE Lifestyle Service's omni ecosystem encompasses almost the whole life cycle of buildings/facilities, with constructions, E&M works, real estate, parking spaces and tenancy management, maintenance, cleaning and hygiene, security guarding, and landscaping inclusive. FSE provides comprehensive services and total solutions for buildings and daily life to its clients which help to save their time, costs, and effort. Thus, cost for clients switching to other services providers become exorbitant, as they ought to find multiple services providers in different fields to supplant FSE. Client retention rate at FSE's omni ecosystem is very high, given its one-stop shop service mode and deep understanding of clients' demand and their properties. Its one-stop shop capability is the competitive advantage over its counterparts from multiple fields.
- **Cross selling on its platform** Extensive synergies emerged among member companies in FSE ecosystem. Member companies share intelligence and information, expertise on specific disciplines, business opportunities and manpower resources with each other. More important, immense cross-selling opportunities are generated among member companies within the ecosystem.
- **Higher return DPS to shareholders and rising yield surpassing other investment options** FSE maintained its stable dividend payout ratio with approximately 40.0% from FY17A to FY23A backed by its healthy operational cash flow and zero net gearing ratio since listing. Concurrently, its DPS rose from HK\$0.155 for FY17A to HK\$0.458 for FY23A, representing six-year CAGR of 19.8%, compared to its FY17A-FY23A EPS CAGR of 20.0% over the same period. Under the projected FY23A-FY26F net earnings CAGR and the assumed dividend payout ratio at 40.0%, FSE's dividend CAGR for FY23A-FY26F is projected to be 7.0%. At HK\$5.61 per share, the projected FY24E dividend yield per FES share is expected to be 8.7%, which is higher than the yield offered by HKD one-year time deposit, 10-year US Treasury note and Tracker fund (2800 HK).



- **Earnings forecasts and valuation** FSE's revenue grew at 13.2% CAGR for the period of FY17A-FY23A, while its profit attributable to shareholders and EPS both increased at CAGR of 20.0%. FSE's net earnings for FY24F and FY25F are projected to increase by 5.4% YoY and 8.5% YoY, respectively, to HK\$551.0m and HK\$597.9m. Based on 1.2x PEG of, or 7.7x FY24E PE, we revise up our target price for FSE to HK\$9.5, and reiterate our Buy recommendation on it.



Property & Facility Management Services

Overview The division, comprising Urban, International Property Management and Kiu Lok, is engaged in management of real estates of various types, including residential properties, facilities/buildings of both public and private sectors, development projects, commercial premises, retail complex, industrial facilities, and car parks. Besides, it offers leasing and tenancy management services to its clients.

Operating highlights Subsidiaries of FSE's property & facility management services division are licensed property management companies under the property management services ordinance (cap.626) of the laws of HKSAR. The division boasts a team comprising more than 300 tier 1 and tier 2 real property management professionals and over 500 technicians/engineers. Currently, FSE is managing a considerable portfolio includes 148,600 residential tenements, 3.1m sqm of commercial floor space and more than 61,600 parking spaces. Prominent facilities under FSE's management include Government Property Agency, One Beacon Hill, K11 Masterpiece and EcoPark.

Contracts on hand In FY23A, FSE submitted tenders for 36 service contracts with a total tender sum of HK\$966.0m and won 30 service contracts with a total contract sum of HK\$294.0m. As of the end of June 2023, gross contract sum was worth HK\$1,905.0m, with an outstanding contract sum of HK\$963.0m.

Financial performance Revenue, gross profit and operating profit contributed by the division accounted for 9.1%, 21.9% and 22.3%, respectively of the total revenue, blended profit and operating profit for FY23A. The revenue, gross profit and operating profit contributed by the division increased by 1.8% YoY, 5.2% YoY and 2.2% YoY, respectively for the fiscal year. The GPM of the division for FY23A improved by 1.1 pts to 32.6%, while the OPM remained nearly unchanged at 19.6%.

Market position FSE currently provides residential property management services to 148,600 residential units, which represents 5.8% of the total number of residential property units in HK, making it the second largest residential property manager in HK:

1. SHK Properties (16 HK), estimated number of residential units under management in 2023: 162,000, market share:6.3%.
2. **FSE, estimated number of residential units under management in 2023: 148,600, market share:5.8%.**
3. CK Asset (1113 HK), estimated number of residential units under management in 2023:109,7000, market share:4.3%.
4. Creative Enterprise Holdings Ltd., estimated number of residential units under management in 2023:105,900, market share:4.1%.
5. Savills Plc, estimated number of residential units under management in 2023:94,000, market share:3.7%.

According to Frost & Sullivan, out of the estimated total area of non-residential properties in HK of 51.0777m sqm in 2023, 3.127m sqm is under FSE management. That positions FSE in the 3rd place among the 5 major non-residential property managers in HK:

1. Savills Plc, estimated non-residential area under management in 2023: 5.986m sqm, market share: 11.7%.
2. SHK Properties (16 HK), estimated non-residential area under management in 2023: 5.960m sqm, market share: 11.7%.
- 3. FSE, estimated non-residential area under management in 2023: 3.127m sqm, market share: 6.1%.**
4. Jones Lang LaSalle Management Services Ltd, estimated non-residential area under management in 2023: 2.587m sqm, market share: 5.1%.
5. CK Asset (1113 HK), estimated non-residential area under management in 2023: 2.389m sqm, market share: 4.7%.

FSE is also the second largest car park operator in HK with 61,600 car park spaces under its management, representing 7.8% of the total parking spaces in HK:

1. SHK Properties (16 HK), estimated car park spaces in 2023: 103,000, market share: 13.1%
- 2. FSE, estimated car park spaces in 2023: 61,600, market share: 7.8%**
3. Savills Plc, estimated car park spaces in 2023: 33,700, market share: 4.3%

Moreover, with 37 real estates under its management, FSE is the largest subsidized housing property (HOS/PSPS/GSH) manager in HK, holding 16.1% share of the market:

- 1. FSE, estimated number of blocks under management in 2023: 37, market share: 16.1%**
2. Synergis Management Services Ltd. (16 HK), estimated number of blocks under management in 2023: 24, market share: 10.4%
3. Guardian Property Management Ltd., estimated number of blocks under management in 2023: 21, market share: 9.1%
4. Hong Yip Service Company Ltd., estimated number of blocks under management in 2023: 19, market share: 8.3%
5. Chevalier Property Management Ltd., estimated number of blocks under management in 2023: 18, market share: 7.8%

Division growth outlook According to Frost & Sullivan, the size of the HK property management services market expanded by 4.3% five-year CAGR from HK\$42.9b in 2018A to HK\$63.0b in 2023A.

Market Size of HK Property Management Services Industry



Sources: Frost & Sullivan



For the corresponding period, stocks of residential property in HK (both private and public included) increased at five-year CAGR of 1.2%, from 2.4254m units to 2.8482m units. Over the same period, size of non-residential properties in HK (with both offices, commercial, flatted factories, and others inclusive) increased at five-year CAGR of 0.6% from 49.4538 sqm in 2018A to 51.0777 sqm in 2023A. Car park spaces increased at five-year CAGR of 0.9% from 752,977 in 2018A to 787,770 in 2023A. Frost & Sullivan projected that the size of the HK property management services market will expand by 3.5% four-year CAGR from HK\$54.9b in 2024F to HK\$63.0b in 2026F. Stocks of residential properties in HK are projected to grow by 2.1% four-year CAGR, from 2.6212m units in 2024F to 2.8482m units in 2028F. Meanwhile, size of non-residential properties in HK is projected to increase by 0.4% four-year CAGR, from 51.4722m sqm in 2024F to 52.3064m sqm in 2028F. Frost & Sullivan projected that car park spaces in HK will increase by four-year CAGR of 0.9% from 794,729 in 2024F to 823,629 in 2028F. It is estimated that the supplies of public housing project and private residential real estates will increase by 330,000 units and 440,000 tenements, respectively, in the upcoming decade. The HKSAR government eyes to provide no less than 72,000 private housing units and 158,000 units in HK, respectively, in the period between 2023 and 2028. Demand for property management services is expected to expand alongside the growth in number of homes, offices and shops in town. The completion of construction and commencement of new commercial and retail properties including 11 Skies will create additional demand and tenders for property management services in near term.



City Essential Services

Overview The division is engaged in the provision of cleaning & pest control service (through its wholly-owned subsidiary Waihong Service Group), technical support and maintenance services of E&M for buildings and facilities (through its wholly-owned subsidiaries Far East Engineering Services Group and Turning Technical Services), security guarding & event management services (through its wholly-owned subsidiaries General Security Group and Perfect Event Services), environmental solutions (through its wholly-owned subsidiary FSE Environmental Solution Group) and insurance solutions (through its wholly-owned subsidiary Nova Insurance Group).

Boasting of workforce comprising 11,000 staffs and a fleet of more than 60 municipal vehicles, Waihong Service Group provides cleaning and hygiene related services (including specialist cleaning, general cleaning, initial cleaning, curtain wall cleaning, housekeeping, marble and granite floor maintenance); disinfection services (including space disinfection treatment, support for clinics, formaldehyde removal and antibacterial coating services); pest control services (including general insecticide treatment, fogging treatment, rodent control and termite elimination); and waste treatment services (covering collection, recycling and management for municipal solid waste, medical wastes, sewage and construction debris, medical and clinical waste, wastepaper, used battery as well as kitchen waste)

Waihong provides cleaning and hygiene related services to various premises, including

- 13 government leisure facilities
- 5 shopping malls in various districts
- 3 residential estates in Quarry Bay, Shatin and Fo Tan
- 2 commercial complexes in Sheung Wan and Kai Tak.
- Hong Kong Jockey Club.
- HK Convention and Exhibition Centre
- Asia-World Expo
- HK Stadium

Besides, the subsidiary offers pest control services at in various key facilities in HK, including:

- HK International Airport
- An airport ancillary building
- A hospital in Sai Ying Pun
- Numerous entertaining facilities in Shatin
- A premises in Tuen Mun.

The subsidiary offers waste collection services for various premises:

- Kowloon City
- The science facilities in Tai Po
- The broadcast facilities in Tseung Kwan O
- Asia-World Expo
- The government clinics in the New Territories West

Far East Engineering Services Group and Turning Technical Services provides system retrofitting services (include chiller units replacement, upgrade of electrical supply systems, fire services, plumbing and drainage systems modification and enhancement); facilities operation and maintenance services (such as routine system maintenance and repairing works in heat, ventilation, and air conditioning ("HVAC") systems, testing and commissioning, periodic inspection in electrical and fire services installation works); and E&M systems renovation services.

General Security possess the Type I License for the provision of security guarding services, the Type II License for the provision of armored transportation services, and a Type III License for installation, maintenance and repairing of security device and designing security system that incorporate security device. The subsidiary provides guarding and security services for residential properties, commercial premises, retail properties construction sites, exhibition venue and other venue. It also provides surveillance services for jewelry stores and prestigious luxury detached housing via its 24-hours central alarm monitoring station. FSE's another security arm, Perfect Event, is specializing on the provision of event management services.

Nova Insurance Group is consisted of Nova Insurance Consultants and International Reinsurance Management. Both of which are Insurance Authority licensed insurance brokers. Nova Insurance Consultants is also a registered Mandatory Provident Fund Intermediary under the Mandatory Provident Fund Schemes Authority. Boasting of a professional team consisting of 810 agents, Nova Insurance Group is engaged in the provision of insurance advisory and brokerage services, risk management services, global and regional insurance management services, reinsurance broking services and MPF intermediary services.

FSE Environmental Solution Group provides solutions for HVAC water treatment services, air and water quality assessment, deodorization system and electro chlorination system, as well as extra low voltage ("ELV") building technology with smart facility systems to its clients. Additionally, the subsidiary offers landscaping management services to its clients.

Contracts on hand In FY23A, Waihong submitted tenders for 476 cleaning services contracts with a total tender sum of HK\$10,989m and won 158 new service contracts with a total contract sum of HK\$3,312m, which is equivalent to win rate of 30.1%.

Far East Engineering Services Group and Turning Technical Services submitted tenders for 462 maintenance service contracts with a total tender sum of HK\$3,920m. The two FSE's subsidiaries were conferred 109 projects with net contract sum of HK\$613.0m, representing a win rate of 15.6%.

General Security and Perfect Event submitted tenders for 90 security guarding and event services contracts with a total tender sum of HK\$1,507m. The two subsidiaries were awarded 51 service contracts worth HK\$528m, which represents a win rate of 35.0%.

Nova Insurance Group won 16 service contracts with total value of HK\$31.0m.

FSE Environmental Solution Group submitted tenders for 16 environmental and landscape service contracts with a total tender sum of HK\$99.0m. It was awarded 16 environmental and landscaping projects worth HK\$42.0m, as well as 4 extra low voltage projects with total contract value of HK\$53.0m. Meanwhile, FSE Environmental Solution Group submitted 17 quotations for building material trading contact with a total quotation sum of HK\$34.0m, and took 4 orders with total sum of HK\$6.0m.

As of the end of June 2023, sum of FSE's city essential services segment's total contract on hand and outstanding contracts were HK\$9,857m and HK\$6,196m, respectively.

Financial performance Revenue, gross profit and operating profit contributed by the division accounted for 48.5%, 44.3% and 34.7%, respectively of the total revenue, blended profit, and operating profit for FY23A. The revenue, gross profit and operating profit contributed by the division increased by 15.8% YoY, 7.2% YoY and 6.9% YoY, respectively for the fiscal year. The GPM of the division for FY23A fell by 1.0 ppts to 12.4%, while the OPM dwindled by 0.5 ppts to 5.7%.

Market position According to Frost & Sullivan, upon June 2023, FSE's flagship of cleaning and hygiene service, Waihong Service Group, held 9.9% share in the HK environmental hygiene services market in terms of revenue size, making it the second largest service provider in the sector:

1. Johnson Cleaning Services, market share:12.6%.
- 2. FSE's Waihong Service Group, market share: 9.9%**
3. Integrated Services Solutions Ltd., market share:8.9%.
4. Baguio Cleaning Services Company Ltd., market share: 7.7%
5. Nixon Cleaning Company Ltd., market share 6.6%

Holding 2.3% share in the type 1 security guarding services market in Hong Kong, FSE's security services arm, General Security was the second largest type 1 security guarding services provider as of the end of June 2023:

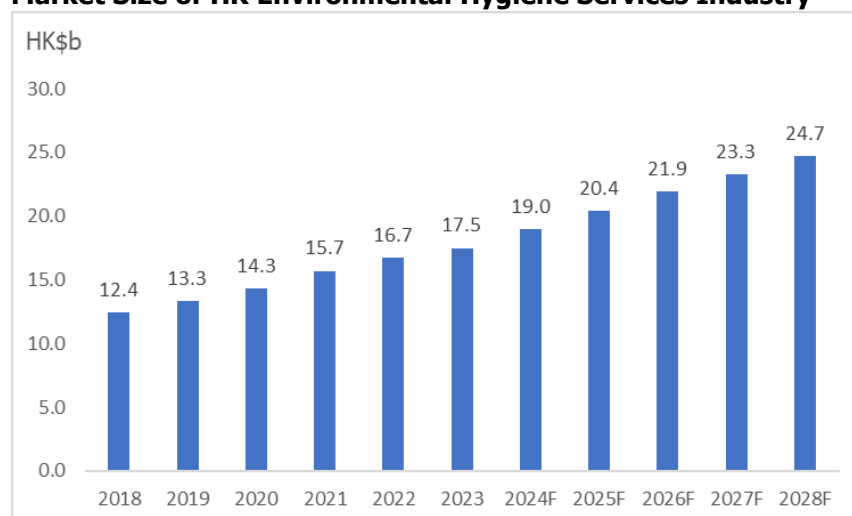
1. G4S (HK-Holding) Ltd, market share 2.8%
- 2. FSE's General Security Group, market share 2.3%**
3. ISS Group, market share 1.9%
4. Certis Centurion Facility, market share 1.8%
5. IWS Group, market share 1.5%

In terms of gross insurance brokerage income, FSE's insurance brokerage arm, Nova Insurance, ranks the fifth place among the top five insurance brokerage firms in HK in 2023.

1. Marsh (Hong Kong) Ltd, gross insurance brokerage income generated in 2023: HK\$780.0m
2. Aon Hong Kong Ltd, gross insurance brokerage income generated in 2023: HK\$402.5m
3. Willis Hong Kong Ltd, gross insurance brokerage income generated in 2023:HK\$193.5m
4. Lockton Companies (Hong Kong), gross insurance brokerage income generated in 2023: HK\$110.0m
- 5. Nova Insurance Consultants, gross insurance brokerage income generated in 2023: HK\$108.7m**

Division growth outlook According to Frost & Sullivan, in terms of revenue, the market sizes of environmental hygiene services in Hong Kong expanded from HK\$12.4b in 2018A to HK\$17.5b in 2023A, representing a five-year CAGR of 7.1%. Frost & Sullivan has projected that the market sizes of environmental hygiene services in Hong Kong in terms of revenue will expand at 6.8% four-year CAGR, reaching HK\$24.7b in 2028F.

Market Size of HK Environmental Hygiene Services Industry



Sources: Frost & Sullivan

As the HKSAR government embarks the implementation of long-term waste treatment initiatives including the Waste Blueprint 2035, and climate change and the Climate Action Plan 2050, the demand for cleaning and environmental hygiene services in HK is expected to grow steadily going forward. The government offers cleaning and environmental hygiene service contracts worth about HK\$5.0b for tender annually. As one of the two key cleaning and environmental hygiene services providers dominating the local market, Waihong Service Group has the upper hand among its competitors in public tender, thanks to its solid track record, established brand, efficiency and economic of scale. Waihong had been conferred cleaning and pest control services contracts worth more than HK\$1.7b from the Food and Environmental Hygiene Department and the Leisure and Cultural Services Department in 2023. As numerous new residential and commercial projects in Kai Tak districts and the Northern Metropolis are completed and put onstream, the demand for cleaning and hygiene services in these two districts is expected to rise, which in turn will presents more opportunities for Waihong to capitalize on.

The municipal solid waste charging scheme (MSW charging) is slated to be implemented starting from April 2024. Under the scheme, there will be two charging modes, by designated bags/labels and by weight through gate-fee. Under the by weight charging mode, private waste treatment companies that use rear-loader waste collection vehicles without rear compactor for transporting garbage to landfills or refuse transfer stations will be subject to a gate fee based on the weight of the waste being transported. The implementation of MSW charging mode by weight provides potential upside for municipal solid waste handling fees charged by Waihong, alongside expansion in demand for the services, leading to expansion in Waihong's revenue and profitability from waste treatment.

Moreover, the bill concerning regulation of disposable plastic tableware and other plastic products was passed by the Legislative Council in October 2023. The bill is scheduled to be effective starting from 2Q 2024 onward. That will expand the demand for plastic waste treatment service, particularly from catering industry, substantially, creating additional revenue avenue for Waihong.

According to the research conducted by the Urban Renewal Authority, more than 10,000 buildings in Hong Kong that are over 50 years old. Further, more than 300 hotels and 50 shopping malls in HK are outdated. Demand for building maintenance and retrofitting services in Hong Kong is significant. The HKSAR government has set target to renovate façade of 10 public residential housing estates and conduct retrofitting and landscaping works at 20 public residential housing estates in phase, starting from 2023 onward. In the near term, five public residential housing estates will undergo upgrading. As the number of building renovation and retrofitting projects in Hong Kong is expected to increase each year attributable to aging of the city, Far East Engineering Services Group's projects pipeline will continue to expand.

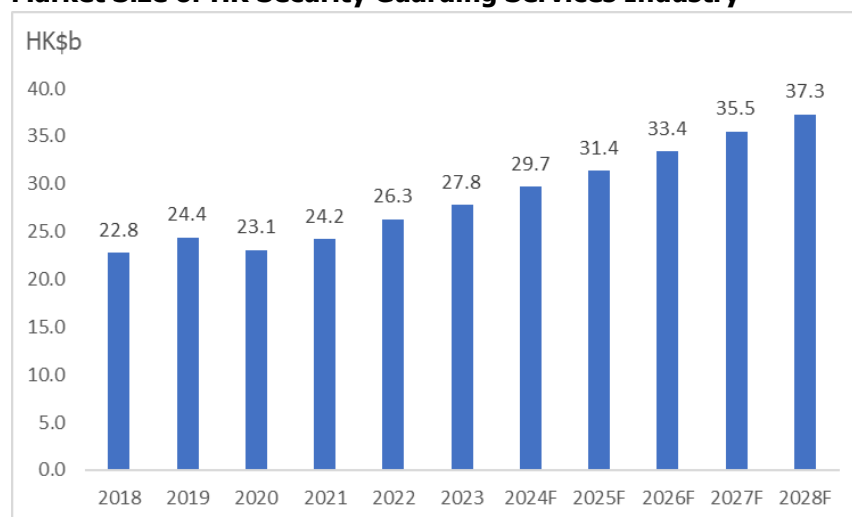
The HKSAR government eyes to elevate overall energy efficiencies of governmental buildings and infrastructures by 6.0% by the end of 2025, based on the base case standard of parameters for 2018-2019. Under the climate action plan 2050, the HKSAR government intends to achieve carbon neutrality in HK by 2050 through undertaking initiatives including:

- terminating the use of coal as fuel for daily electricity generation;
- increasing the share of renewable energy in the energy mix for electricity generation to 7.5%-10.0% by 2035, and to 15.0% subsequently;
- reducing the electricity consumption of commercial buildings by 30.0%-40.0% and that of residential buildings by 20.0%-30.0% from the 2015 level by 2050, and to achieve half of the above targets by 2035, through the promotion of green buildings and improving buildings' energy efficiency.

Properties owners in private sectors are consistently improving the energy efficiencies of their properties and lowering their emission level. Enterprises in private sectors are supplanting their existing air conditioning systems in facilities and buildings with that of higher efficiency. Initiatives for carbon neutrality is creating significant opportunities for Far East Engineering Services Group to capitalize on. Besides, the HKSAR Government is implementing its plan to install EV chargers at 7,000 parking spaces in government premises by 2025. Additionally, the government plans to expand the proportion of EV charger equipped parking space to total parking space in governmental premises from 30.0% currently to 100.0%. Going forward, significant number of EV chargers will be installed across HK. As the leading engineering firm and largest carpark operator with more than 60,000 parking spaces under its management in HK, FSE has absolute edge over its counterparts in the EV charging station market.

According to Frost & Sullivan, in terms of revenue amount, size of the Hong Kong security guarding services market grew at five-year CAGR of 4.0% from HK\$22.8b in 2018A to HK\$27.8b in 2023A. Frost & Sullivan projected that from 2024F-2028F, that market size will expand at four-year CAGR of 5.8% from HK\$29.7b in 2024F to HK\$37.3b in 2028F.

Market Size of HK Security Guarding Services Industry



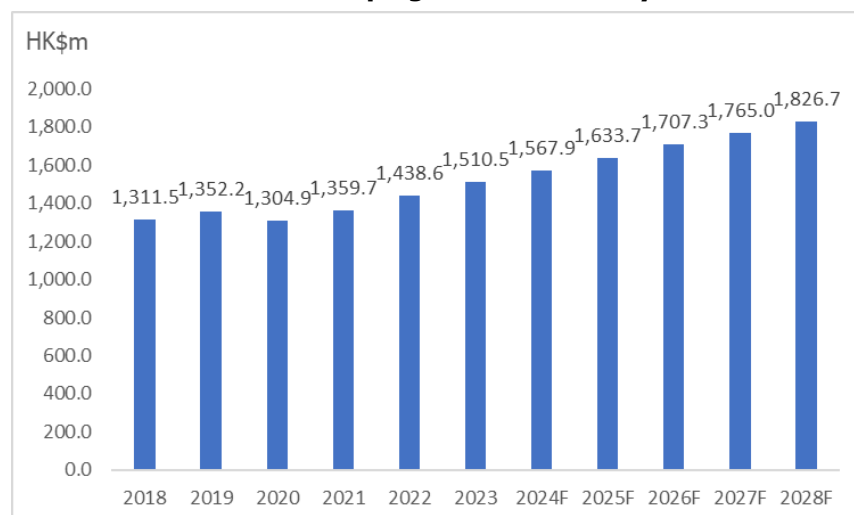
Sources: Frost & Sullivan

The launching of the Hong Kong Airport third runway, Kai Tak Sports Park and 11 Skies (the commercial complex adjoining HK Airport), as well as the competition of mega infrastructure projects including AsiaWorld-Expo Phase 2, and the Lok Ma Chau development project soon are expected to create more tender opportunities of non-residential general security services in the near term. On the residential front, it is estimated that supplies of public housing project and private residential real estates will increase by 330,000 units and 440,000 tenements, respectively, in the upcoming decade. Demand for property management services and general security services catering residential properties is expected to expand alongside the expansion in residential housing market.

The HKSAR government plans to increase seats numbers in venues for performing arts to 45,000. The constructions of the two new facilities for performing arts, the New Territories East Cultural Centre and Heritage Conversation and Resource are underway and scheduled to be completed in 2027 and 2028, respectively. The Airport Authority of Hong Kong will commence the construction of Asia World-Expo Phase 2 after the North Lantau Hospital HK Infection and Control Center cease operation. Besides, the HKSAR government has pledged to support conducting more than 200 exhibitions between 2023 and 2025. With more MICE and other events including concerts and art performance to be held in HK, and more new MICE venues and performing art facilities to be deployed, demand for event management service is set to rise.

According to Frost & Sullivan, in terms of revenue, size of landscaping services market in HK increased at five-year CAGR of 2.9% between 2018A and 2023A, from HK\$1,311.5m to HK\$1,510.5m. Frost & Sullivan projected the size of landscaping services market in HK to grow by four-year CAGR 3.9% from HK\$1,567.9m in 2024F to HK\$1,826.7m in 2028F.

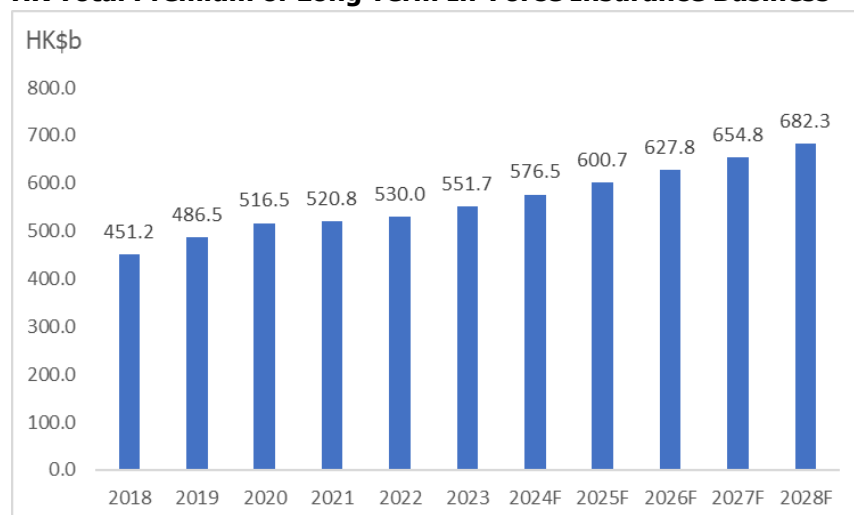
Market Size of HK Landscaping Service Industry



Sources: Frost & Sullivan

According to Frost & Sullivan, between 2018A and 2023A, the total premium of long term in-force insurance business in HK grew at five-year CAGR of 4.1% from HK\$451.2b to HK\$551.7b. Gross premium of general insurance business in HK increased at five-year CAGR of 6.2% from HK\$50.7b in 2018A to HK\$68.4b in 2023A. Frost & Sullivan estimated that between 2024F and 2028F, total premium of long term in-force insurance business in HK will increase at four-year CAGR of 4.3%, from HK\$576.5b to HK\$682.3b. Moreover, Frost & Sullivan estimated the gross premium of general insurance business in HK to expand by 6.1% four-year CAGR from HK\$72.5b to HK\$91.9b over the same period.

HK Total Premium of Long Term In-Force Insurance Business



Sources: Frost & Sullivan



E&M Services

Overview Boasting of strong pool of engineers and patented technologies including modular integrated construction (“MiC”), multi-trade integrated mechanical, electrical and plumbing (“MiMEP”), design for manufacture and assembly (“DfMA”), FSE’s E&M division, along with Analogue (1977 HK) is one of the two dominant players in local E&M industries. The division comprises Young’s Engineering Group, Majestic Engineering Group and FSE Engineering Group. It is engaged in the provision of all E&M services for various buildings and facilities in GBA, including governmental/public buildings and facilities, commercial buildings, shopping malls. Hotels, resorts, sports parks, residential properties, hospitals, and airports, in GBA.

FSE E&M division has pocketed bids for numerous large-scale projects in HK recently, including:

- Kai Tak Sports Park,
- the Immigration Headquarters in Tseung Kwan O,
- the District Court at Caroline Hill Road,
- expansion project of the Legislative Council Complex,
- three residential development projects adjoining the Ho Man Tin Station in Kai Tak and Kwun Tong,
- a public housing development project in Wang Chiu Road
- the New Public Markets in Tin Shui Wai.

FSE E&M is eyeing several major projects including the district cooling system project, projects in the Kwu Tung North new town extension plan, the new MTR railway lines and light public housing project and projects in the northern metropolis development initiative.

Contract on hands FSE submitted tenders for 152 E&M engineering projects which worth HK\$22,089m and the group won 34 contracts valued at HK\$3,288m, representing win rate of about 15.0%. As of the end of June 2023, the value of FSE’s E&M division’s gross and outstanding contracts on hand were HK\$11,378m and HK\$5,857m, respectively.

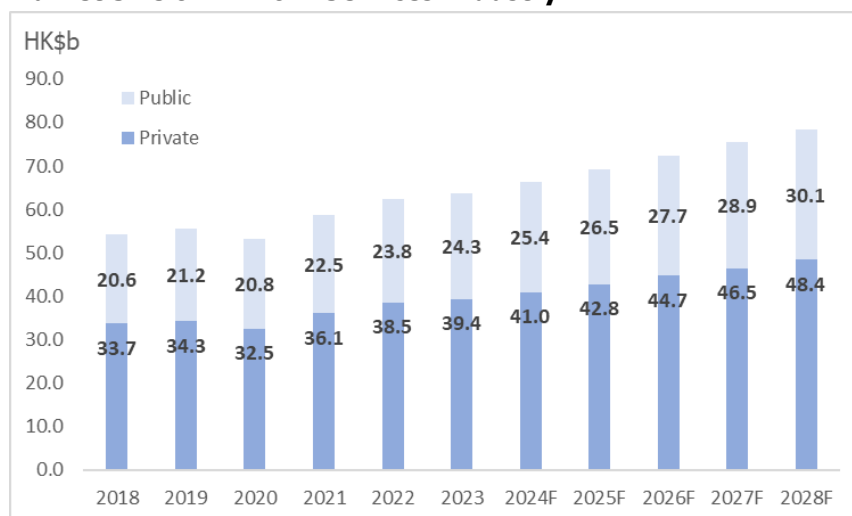
Financial highlight Revenue, gross profit and operating profit contributed by the E&M division accounted for 42.4%, 33.8% and 30.0%, respectively of the total revenue, blended profit, and operating profit for FY23A. Revenue, gross profit and operating profit contributed by the division increased by 9.1% YoY, 4.8% YoY and 7.5% YoY, respectively for the fiscal year. The GPM of the division for FY23A was 10.8%, compared to 11.2% for FY22A. Meanwhile, the OPM of the division remained stable at 5.7%.

Market position According to Frost & Sullivan, FSE Engineering Group is the second largest E&M engineering firm in HK just after ATAL Engineering (1977 HK). It accounted for 6.0% of revenue generated from the HK E&M engineering service market as of the end of June 2023.

1. ATAL Engineering Group (1977 HK), estimated revenue generated in 2023: HK\$5,575.6m, estimated market share: 8.8%
2. **FSE, estimated revenue generated in 2023: HK\$3,831.8m, estimated market share: 6.0%**
3. Chinney Shun Cheong Holdings Ltd., estimated revenue generated in 2023: HK\$2,300m, estimated market share: 3.6%
4. Yau Lee Holdings Ltd., estimated revenue generated in 2023: HK\$2,100m, estimated market share: 3.3%
5. Alliance Contracting Co. Ltd., estimated revenue generated in 2023: HK\$900.0m, estimated market share: 1.4%

Division growth outlook According to Frost & Sullivan, in terms of output value, the market size of E&M engineering service market in Hong Kong grew at five-year CAGR of 3.2% from HK\$54.3b in 2018A to HK\$63.7b in 2023A. Frost & Sullivan has projected that the market sizes of E&M engineering market in Hong Kong will grow at four-year CAGR of 4.3% from HK\$66.4b in 2024E to HK\$78.5b in 2028F.

Market Size of HK E&M Services Industry



Sources: Frost & Sullivan

The average capital expenditure on E&M constructions works by public and private sectors are expected to exceed HK\$29.b and HK\$24.0b in upcoming 12 months period. On the residential housing front, the HKSAR government has set target of providing no less than 72,000 private housing units in HK between 2023 and 2028. Meanwhile, it plans to increase the supply of public housing by 158,000 units, encompassing conventional public residential estates, light public residential housing, and housing under the subsidized scheme. Amid the planned public housing supplies, 30,000 units would be allocated for light public housing. The tenders for the design and build contracts of 17,000 units out of the planned 30,000 units of light public residential housing which are scheduled to be completed in 1Q 2025 have reverted to governmental bodies for review. Besides, the government provided land for the development of 10,150 private housing units in September 2023. It will unleash 1.2m sqm of developable land in 2023-2024.

On the infrastructure front, the development of the Northern Metropolis project, which includes new development projects of Kwu Tung North/ Fanling North, Hung Shui Kiu/Ha Tsuen and Yuen Long South is underway. Further, the site formation for San Tin Technopole project is scheduled to be commenced in end-2024.

FSE is the sole E&M engineering firm with patented technologies for modular integrated construction and decentralized integrated modeling approach. It is one of the very few E&M engineering firm in HK which is able to take advantage of the opportunities arising from the HKSAR governmental mandate of adaptation of the MiC and DfMA in public housing construction projects. Starting from 2023, the HKSAR government requires all public housing projects that are scheduled for completion between 2023-2028 to adopt the decentralized integrated modeling approach (DfMA) in constructions, with the adoption of modular integrated construction (MiC) in suitable projects. Moreover, the Hong Kong Housing Authority and Housing Department (HKHA) intends to have half of the public housing projects which are under constructions and scheduled to be completed between 2023 and 2028 to adopt MIC approach in their constructions processes, while the remaining projects apply design for manufacturing and assembly (DFMA) approach in their construction processes. Moreover, HKHA has mandated that half of the public residential construction projects which are scheduled for completion between 2023 and 2028 must adopt design and build procurement mode.

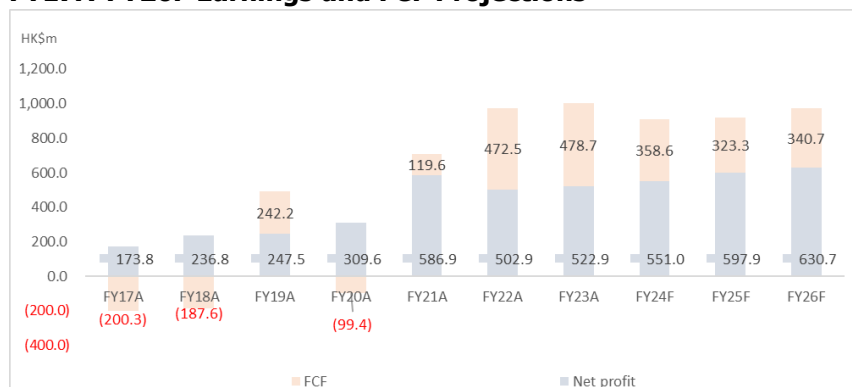


Mainland China is expected to be the next growth engine for FSE E&M division. As one of the very few HK-based E&M general engineering contractors with Class I Qualification in Mainland China, FSE has established comprehensive E&M platform in Mainland China to capitalize on opportunities in world largest construction & infrastructure market. Its E&M projects in Qianhai district, Shenzhen and Guangzhou are almost done. In FY23A, FSE has secured numerous large scale mixed-use development projects in major Mainland cities including three commercial complex development projects in Hangzhou and Ningbo, and a hotel complex project in Huangpu district, Shanghai.

Financial Track Record, Earnings Forecasts, Valuation, and Recommendation

Solid track record FSE's revenue grew at 13.2% CAGR for the period of FY17A-FY23A, while its profit attributable to shareholders and EPS both increased at CAGR of 20.0%. FSE has been consistently elevating profitability of its operations over time. Its GPM, OPM and NPM enhanced from 11.0%, 5.5% and 4.7% in FY17A, respectively, to 13.5%, 8.0% and 6.7% in FY23A.

FY17A-FY26F Earnings and FCF Projections



Sources: FSE Lifestyle, KKSG

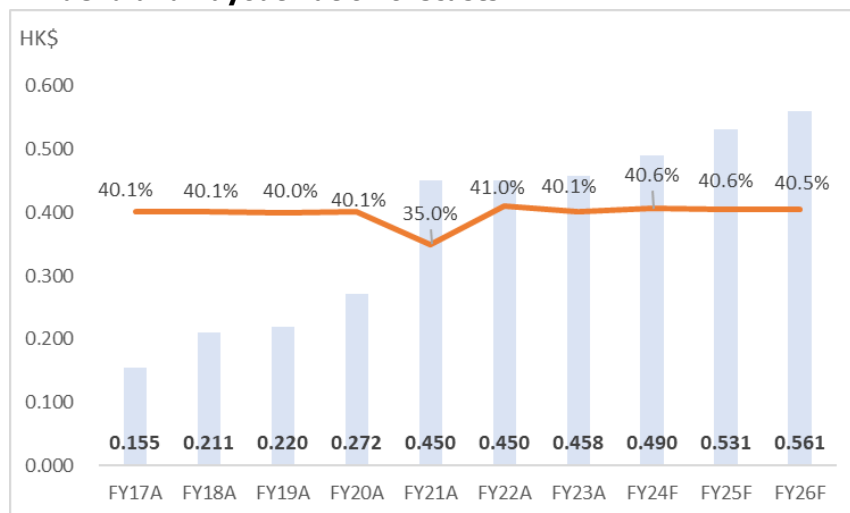
High earnings growth visibility We estimate that about 57.6% of FSE's FY23A revenue is derived from fee-based, periodic, and recurrent sources (city essential service division and property & facility management service division). Besides, incomes derived from E&M division are recognized upon percentage of completion of contract, and the value of outstanding contract in progress is transparent in our view. Thus, visibility of FSE's revenue growth outlook is very high.

FY24F-FY26F earnings forecasts FSE's revenue and profit attributable to shareholders for FY23A were up by 11.5% YoY and 4.0% YoY, respectively, to HK\$7,762.2m and HK\$522.9m. Excluding non-recurrent item of HK\$77.0m government grants, the group's FY23A core profit attributable to shareholders increased by 7.5% YoY to HK\$445.9m. Under the assumptions of a 2.0% three-year CAGR in value of remaining works, a 2.3% revenue three-year CAGR and a 14.3% GPM in FY24F-FY26F, we project the group's net earnings to increase at CAGR of 6.4% for FY23A-FY26F. On an annualized basis, FSE's net earnings for FY24F and FY25F are projected to increase by 5.4% YoY and 8.5% YoY, respectively, reaching HK\$551.0m and HK\$597.9m. Our FY24F-FY26F earnings forecasts do not take into account subsidies from the government.

Higher return DPS to shareholders and rising yield surpassing other mainstream investment options available FSE maintained its stable dividend payout ratio with approximately 40.0% from FY17A to FY23A backed by its healthy operational cash flow and zero net gearing ratio since listing. Concurrently, its DPS rose from HK\$0.155 for FY17A to HK\$0.458 for FY23A, representing six-year CAGR of 19.8%, compared to its FY17A-FY23A EPS CAGR of 20.0% over the same period. Dividend yield of FSE's share has been consistently above 5.8% since FY17A. Under the projected FY23A-FY26F net earnings CAGR and the dividend payout ratio at 40.0%, FSE's dividend CAGR for FY23A-FY26F is projected to be 7.0%. Yield on FSE's equities increased from 24.6% for FY17A to 74.8% for FY23A. At HK\$5.61 per share, the projected FY24E dividend yield per FES share is expected to be 8.7%, compared to HKD one-year time deposit rate ranging of 3.0%-5.0%, yield of 10-year US Treasury note of about 3.9% + and dividend yield of Tracker fund (2800 HK) below 4.0%. Even at our 12-month Target HK\$9.5, the projected FY24E dividend yield per FES share is expected to be 5.1%, which still represents a handsome return.



Dividend and Payout Ratio Forecasts



Sources: FSE Lifestyle, KKSG

Valuation and recommendation FSE's PE for FY24E and FY25F are 4.7x and 4.3x, respectively. Based on projected DPS of HK\$0.49 for FY24E and HK\$0.53 for FY25F, and its current share price at HK\$5.61, FSE's share's prospective dividend yield for the corresponding periods are 8.7% and 9.5%, respectively. Current PEG of FSE share is 0.7x only. In our view, the group's prospective earnings growth and handsome dividend yield are still yet to be fully factored into its valuation. We revise up our target price for FSE to HK\$9.5, based on 1.2x PEG, or 7.7x FY24E PE, representing 69.3% potential upside. We reiterate our Buy recommendation on FSE.



Income Statement FY ended 30 June

Financial Ratio

HKS m	FY23A	FY24E	FY25F	FY26F		FY23A	FY24E	FY25F	FY26F
Revenue	7,767.2	7,806.2	8,101.4	8,313.2	Trade rec. turnover days	101.9	101.6	101.9	101.9
COS	(6,715.6)	(6,700.5)	(6,938.2)	(7,115.0)	Inv/turnover days	6.3	6.4	6.4	6.4
Gross Profit	1,051.6	1,105.6	1,163.2	1,198.2	Trade pay. turnover days	111.4	208.0	149.2	124.7
Admin exp.	(470.7)	(456.3)	(454.3)	(458.5)	GPM (%)	13.5	14.2	14.4	14.4
Others income	42.0	3.0	3.0	3.0	OPM (%)	8.0	8.4	8.8	8.9
EBIT	622.9	652.4	711.9	742.7	EBITDAM (%)	9.0	9.3	9.6	9.5
Finance income	10.6	20.5	13.8	13.8	NPM (%)	6.7	7.1	7.4	7.6
Finance costs	(16.9)	(12.9)	(9.7)	(1.3)	ROE (%)	74.8	53.5	42.9	39.7
Asso./JV. Profit	1.2	0.0	0.0	0.0	ROA (%)	13.1	14.8	16.0	17.1
Pretax Profit	617.7	659.9	716.1	755.3	Current ratio (x)	1.2	1.5	1.7	1.9
Taxation	(93.5)	(108.9)	(118.2)	(124.6)	Quick ratio (x)	1.0	1.3	1.5	1.7
M.I.	(1.3)	0.0	0.0	0.0					
Net. Profit/ loss	522.9	551.0	597.9	630.7					

Balance Sheet as at 30 June

Cash Flow Statement FY ended 30 June

HKS m	FY23A	FY24E	FY25F	FY26F	HKS m	FY23A	FY24E	FY25F	FY26F
Fixed/Int. assets	322.0	314.8	316.8	316.4	Pre-tax profit	617.7	659.9	716.1	755.3
Assoc./JV. Interests	1.2	1.2	1.2	1.2	D&A	74.8	71.3	63.1	59.5
Deferred tax assets	11.3	12.6	12.6	12.6	Net finance inc./exp.	6.4	(7.6)	(4.1)	(22.4)
Others	3.6	3.6	3.6	3.6	Others	(0.2)	0.0	0.0	0.0
NCA	338.0	332.1	334.1	333.7	EBITDA	698.7	723.6	775.0	792.4
AR/Prepayment	2,319.0	2,178.3	2,260.6	2,319.7	Change in WC	(181.1)	(331.9)	(417.6)	(417.6)
Contract assets	560.2	400.0	400.0	400.0	Tax paid	(64.6)	(85.9)	(133.1)	(183.0)
Inventory	21.3	23.6	24.5	25.1	Change in trust cash	3.8	0.0	0.0	0.0
Cash	751.9	790.3	720.2	619.7	Interest paid	(16.7)	(12.9)	(9.7)	(9.7)
CA	3,652.4	3,392.2	3,405.3	3,364.6	Operating CF	440.0	292.9	214.5	182.1
AP/Payables	2,042.8	1,669.5	1,336.1	1,180.0	Capex	(38.9)	(33.1)	(34.1)	(34.1)
Other liabilities	822.1	587.8	571.8	513.5	Interest received	10.6	20.5	13.8	32.1
Borrowings	64.2	63.3	64.3	65.5	Others	4.1	0.0	0.0	0.0
CL	2,929.0	2,320.6	1,972.2	1,759.0	Investing CF	(24.2)	(12.6)	(20.2)	(2.0)
Borrowings	291.8	301.6	300.6	280.6	Net borrowings	(121.6)	(0.1)	0.0	0.0
Other long-term liabilities	70.2	71.5	71.5	71.5	Leases	(49.4)	(36.1)	(26.9)	(26.9)
NCL	362.0	373.1	372.1	352.1	Dividend	(218.7)	(197.2)	(229.0)	(245.2)
Share capital	45.0	45.0	45.0	45.0	Dist. to c.preference shr.	(8.5)	(8.5)	(8.5)	(8.5)
Preference shares	140.9	140.9	140.9	140.9	Others	(23.9)	0.0	0.0	0.0
Reserves	513.3	844.5	1,209.0	1,401.0	Financing CF	(422.0)	(241.9)	(264.4)	(280.6)
Shareholders' funds	699.2	1,030.4	1,394.9	1,586.9	Change in cash	(6.2)	38.4	(70.2)	(100.5)
M.I.	0.3	0.3	0.3	0.3	Beginning cash	727.3	715.9	754.4	684.2
Equity	699.4	1,030.6	1,395.1	1,587.2	Exchange	(5.2)			
					Ending cash	715.9	754.4	684.2	583.8
					Trust cash	(36.0)	(36.0)	(36.0)	(36.0)

Sources: FSE Lifestyle (331 HK), KKSG Research estimated

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