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2013 China Luxury Market Study

Beginning of a new era?

Dec 17, 2013

Key trends observed in 2013

1 **Lackluster year** for mainland China luxury market; **further slow down** in 2013, overall year-on-year growth expected to be **~2%** (vs. 7% in 2012)

- Strong variations by category, with watches and men's wear more severely impacted
- **Like-For-Like** (LFL) **store sales & traffic down** for most brands; brands more **conservative** in new store openings, focusing on **renovation** projects and strengthening footprint

2 Many of the 2012 trends **amplified** in 2013

- **Overseas purchasing** continues to grow, mainland Chinese spending **67%** outside China
- Chinese continue to be **#1 nationality** buying luxury worldwide: **29%** of global luxury spend
- **Gifting still relevant** in China market, however business gifting lower especially in tier 1 cities
- **Concentration of top 5 brands** in each category, representing ~50% of category value
- **Consumers gaining sophistication** and perfectly informed, moving from "In the Show" to "In the Know"
- Some brands spend up to **20%~25% on digital** of total marketing and plan to grow

3 New/ Emerging trends changing market landscape

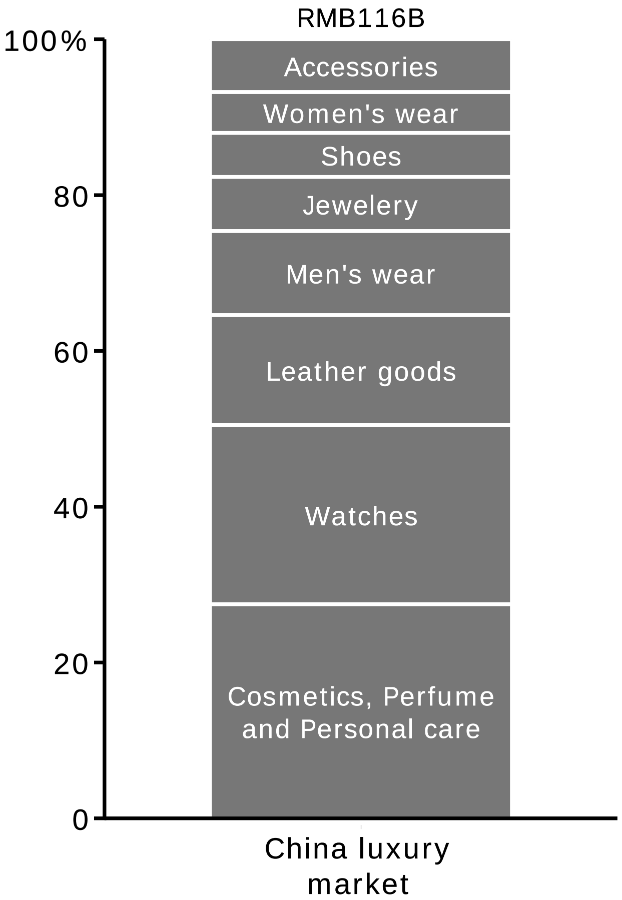
- **Women** oriented categories and **fashion lines** show strong momentum despite overall market slow down; market evolving from male-dominated categories to female, like in Europe
- **Polarization** of consumer attitude towards both high-end and accessible luxury segments
- **Parallel market fast growing**, partly undermining brand equity, and representing 5%~25% of brands' revenues

4 Outlook for 2014

- Macro environment expected to remain similar (growth, exchange rates, etc); government policy on frugality and anti-gifting expected to continue
- Most brands plan for similar growth in 2014 as in 2013 for the sector

Luxury market in mainland China further slowed down in 2013

2013 Mainland China luxury market by category (RMB,B)



	CAGR		
	(10-11)	(11-12)	(12-13F)
Total	**30%**	**7%**	**~2%**
Accessories	20%	10%	8%
Women's wear	35%	15%	10%
Shoes	20%	10%	8%
Jewelery	20%	5%	5%
Men's wear	30%	12%	-1%
Leather goods	30%	10%	5%
Watches	40%	-5%	-11%
Cosmetics, Perfume and Personal care	22%	15%	10%

KEY HIGHLIGHTS

- Chinese luxury market **expected to grow at ~2% only**, even slower than 2012
- Anti-corruption and frugality campaign had large impact on "**gifting luxury**"; watches and men's wear **mostly impacted**
  - The higher the price for watches, the higher the decline
- **Shoes and women's apparel** showed strong momentum although growing from smaller bases
- **Cosmetics** growth slowed down but still healthy, driven by relatively inelastic demand



Note: Only premium cosmetics are considered luxury goods in the "Cosmetics" category
Source: Expert interviews; Literature search; Bain analysis

1 Anti-gifting and frugality campaigns in China while spending increasing overseas

Luxury brand stores in China suffered from traffic decline

Hangzhou Tower used to be crowded during holidays but situation is different this year

- Department stores and shopping malls suffered from lower traffic esp. during holiday seasons due to **anti-corruption and frugality campaigns**
    - o Several provinces asked their **gov't officials** to **return the gift cards** they had received
    - o Gov't sent people to shopping malls and department stores **at the cashier to check** for gift card consumption during Moon Festival and National Day holidays in 2013

While Chinese consumers continue to travel and spend big tickets overseas

Chinese shoppers in UK department stores during National Day holiday

"*Wealthier Chinese continue to shop tremendously during their overseas travels, with **luxury goods** (esp. handbags, shoes, watches and accessories) **on top of their shopping list**.*"

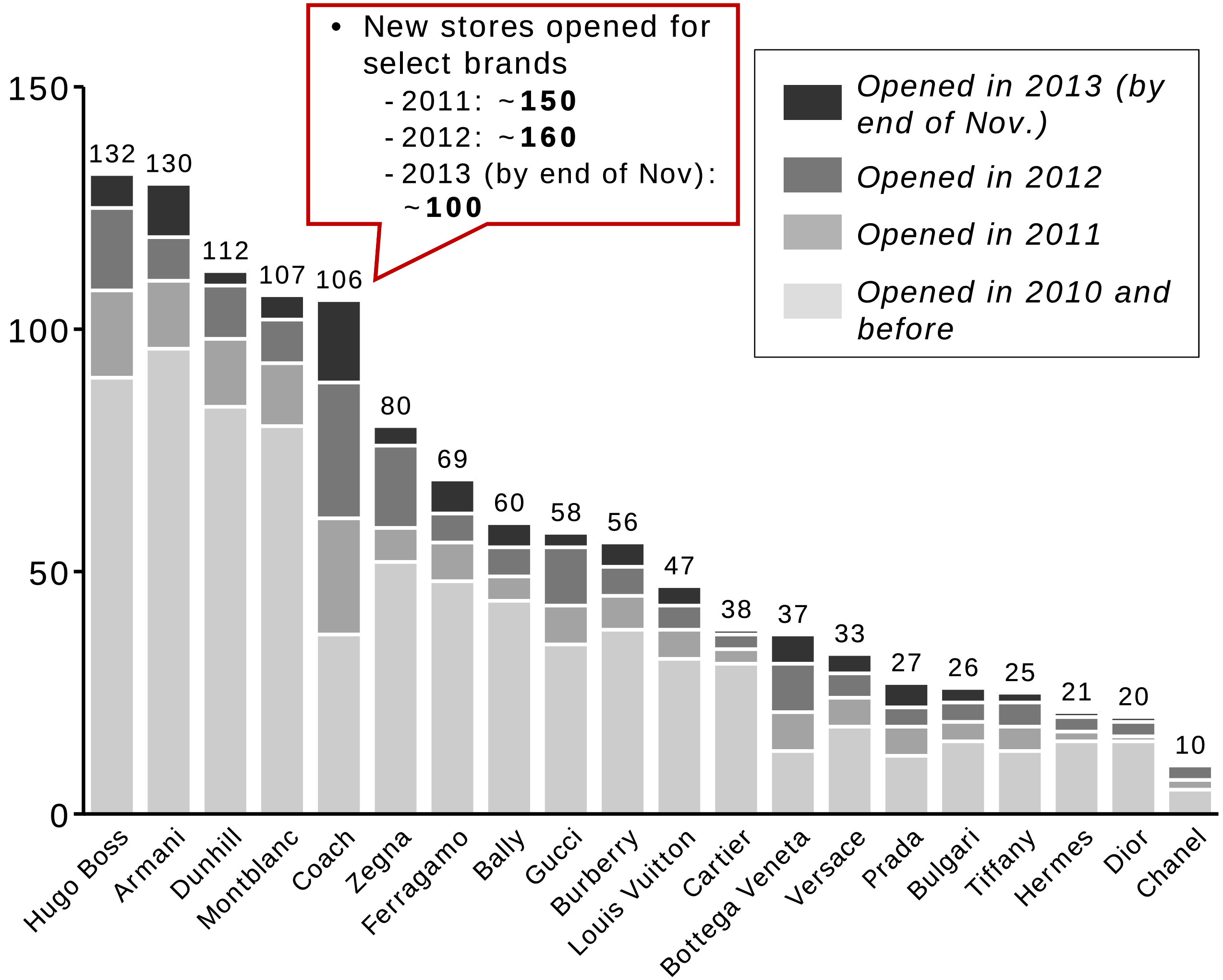
Catherine Ostler, Daily Mail

Note: 2013 outbound travels increased 14% vs. 2012 (11% increase to HK/Macau; 23% increase to US and major European countries)

Source: Expert interviews; Literature search

Store openings conservative in 2013 for most brands, more focusing on renovation or upgrade projects

Store Count of Select Luxury Brands by Nov. 2013



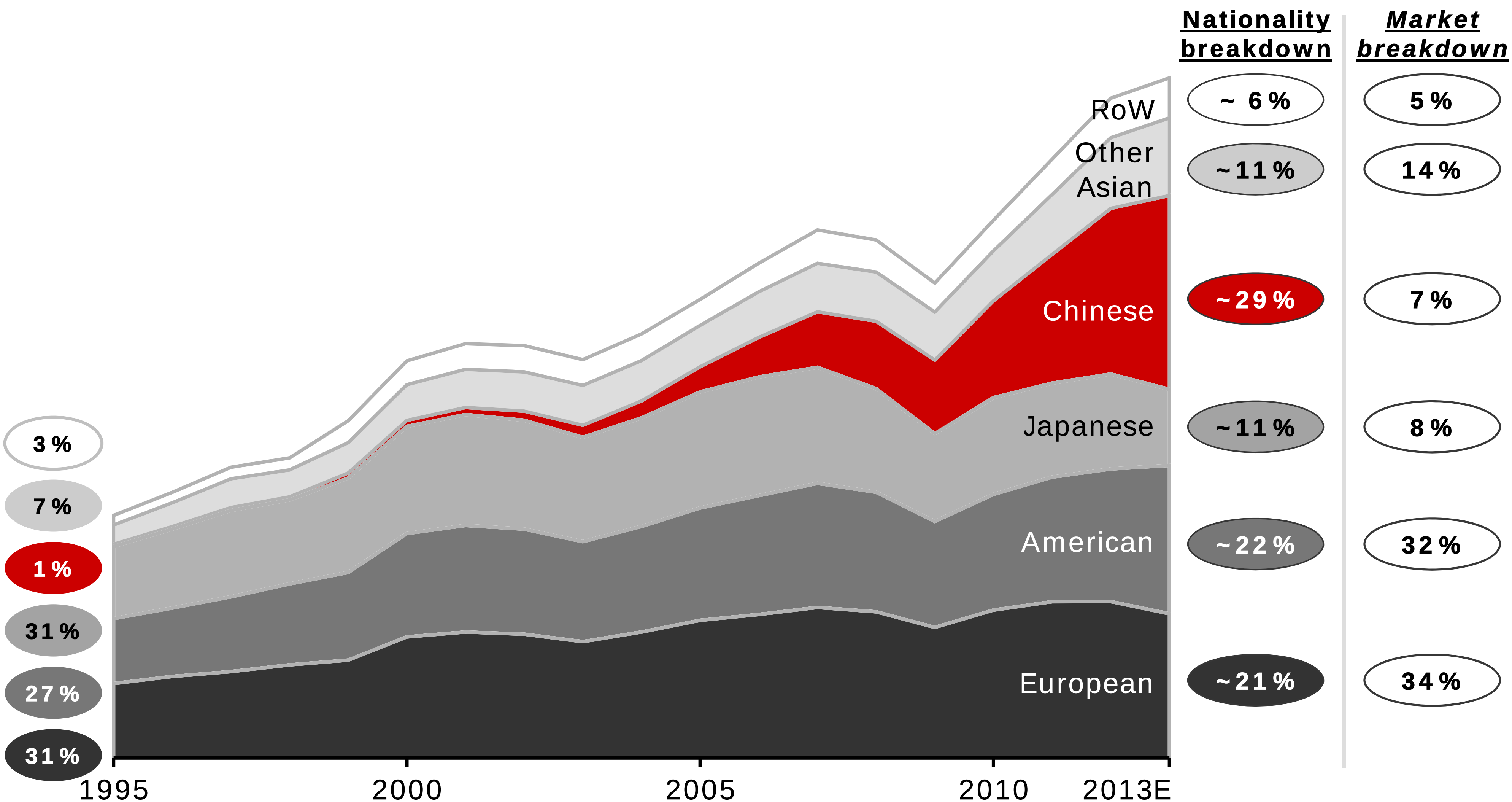
KEY DRIVERS

- New store openings noticeably **slowed down** in 2013
- Most brands are **conservative** about future expansion and focusing more on store **renovation, relocation** and **operational improvement**
- Some brands continued to expand fast in 2013, like Coach, Prada and Bottega Veneta

*Cartier and Bulgari store data excludes watch counters, only include boutiques; Chanel store includes fashion boutiques only
Note: Different series in one store are counted as one (eg. Hugo Boss); Armani brand includes Giorgio Armani, Emporio Armani and Armani Collezioni (same location regarded as one store); Underwear Zegna not included; Children's wear and outlet stores not included for all brands
Source: Analyst reports; Brands' official websites; Literature search; Brand interviews

2 Chinese consumers remain the No. 1 nationality in terms of luxury spending worldwide

LUXURY GOODS MARKET BY CONSUMER NATIONALITY (1995-2013E)



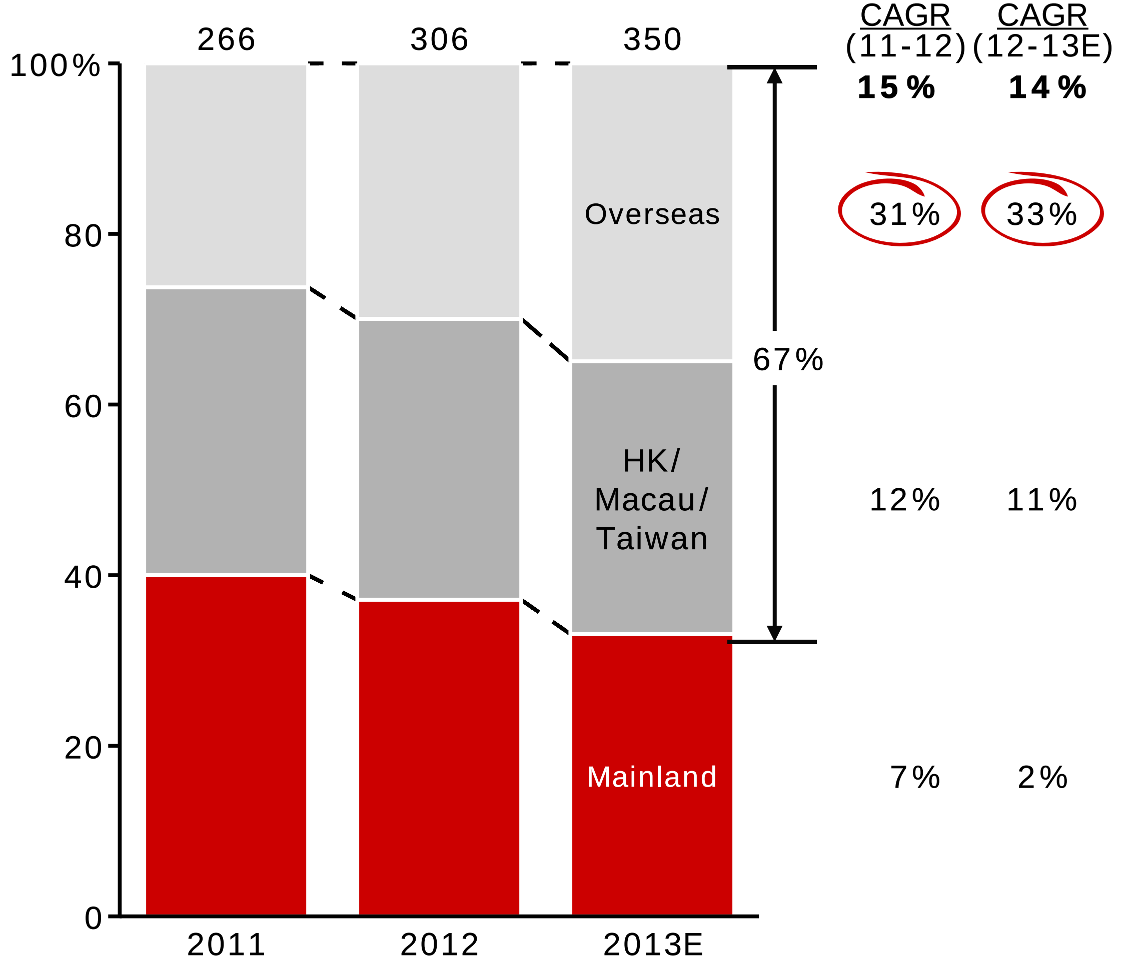
Note: Chinese includes mainland Chinese, Hong Kong, Macau and Taiwan Chinese; Other Asian countries include South Korea, South East Asia etc; RoW includes Middle East, Australia and Africa, etc

Source: Bain Global Luxury Report 2013

2 Growing luxury spend outside of mainland China, up to 67% of total spend in 2013

PRELIMINARY

Total mainland Chinese luxury spending (RMB B)



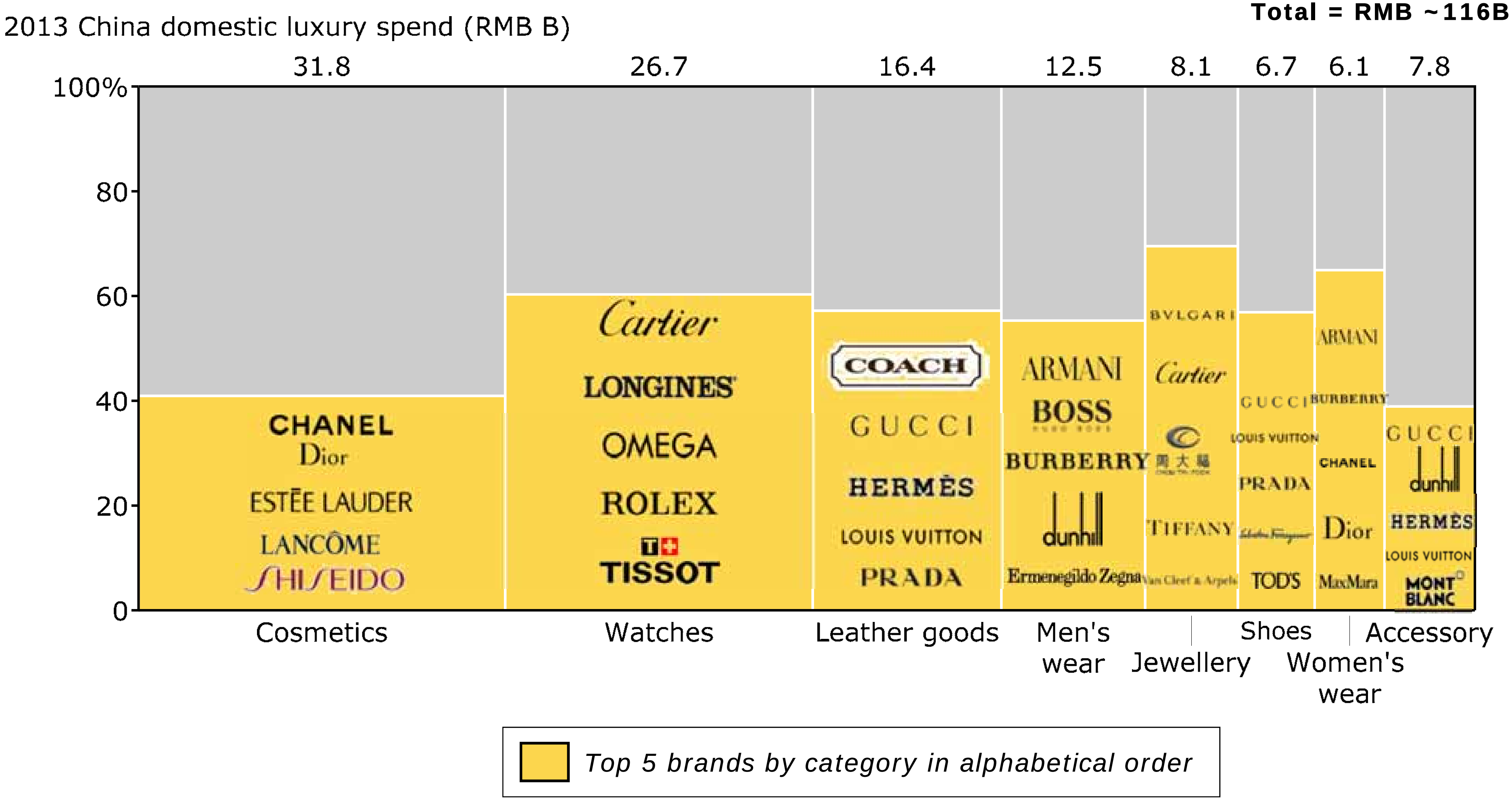
KEY HIGHLIGHTS

- **Increasing growth of overseas** spending
  - **Continued wide price gap** due to Chinese tax and tariff policy
  - RMB continue to be strong, with **favorable exchange rates** when buying abroad
  - Continued growth of **overseas travels**
  - More extensive **product offering** outside of mainland China
- **HK** growth **slows down** while **Macau** maintained high growth

Source: Bain Survey of Luxury Goods Consumers in Mainland China 2013 (N=1,400); Bain analysis

In each luxury category, the top 5 brands still account for ~50% of sales

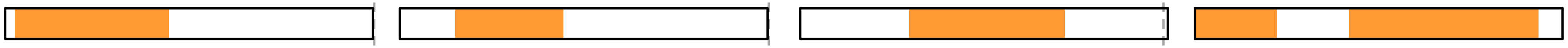
Total = RMB ~116B



Note: Market value is composed of sales at retail value; "Accessories" includes stationary, scarves, sunglasses, etc; "Leather goods" includes suitcases & handbags, and smaller items such as wallet; Armani brand includes Giorgio Armani, Emporio Armani and Armani Collezioni
Source: Experts interviews; Brand interviews; Dept store interviews; Analyst reports; Company reports and websites; Bain analysis

2 Multiple consumer segments: Aspirants fast growing, fashion addicts also developing

				
	Aspirants	**Fashion addicts**	**Nouvea riches**	**Core customers**
Age	18 40 65	18 40 65	18 40 65	18 40 65
Typical profile	• Male & female • Annual income: ~RMB 100-300K • Middle class; White collars • From tier 1/2/3 cities	• Mostly female • Annual income: ~RMB 150-500K • White collars; House wives • Tier 1/2 cities; Like to travel and explore new things	• Mostly male • Annual income: >RMB 500K • Wealthy individuals; entrepreneurs • Mostly from tier 2/3/4 cities	• Male & female • Annual income: >RMB 800K • Executives, rich Taitai, rich 2nd generation, entrepreneurs, gov't officials and socialites • Tier 1 cities; Often travel around the world
Purchase occasion	• Self-use	• Self-use	• Self-use • Gifting	• Self-use • Gifting
Fashion motto	*"To stand out from crowd"*	*"Afraid to be outdated on fashion"*	*"Love logos"*	*"Enjoy sophisticated luxury life style"*
Average spending	◔	◑	◕	●
Group size	~50% ↑	~5% ↑	~30%	~15%



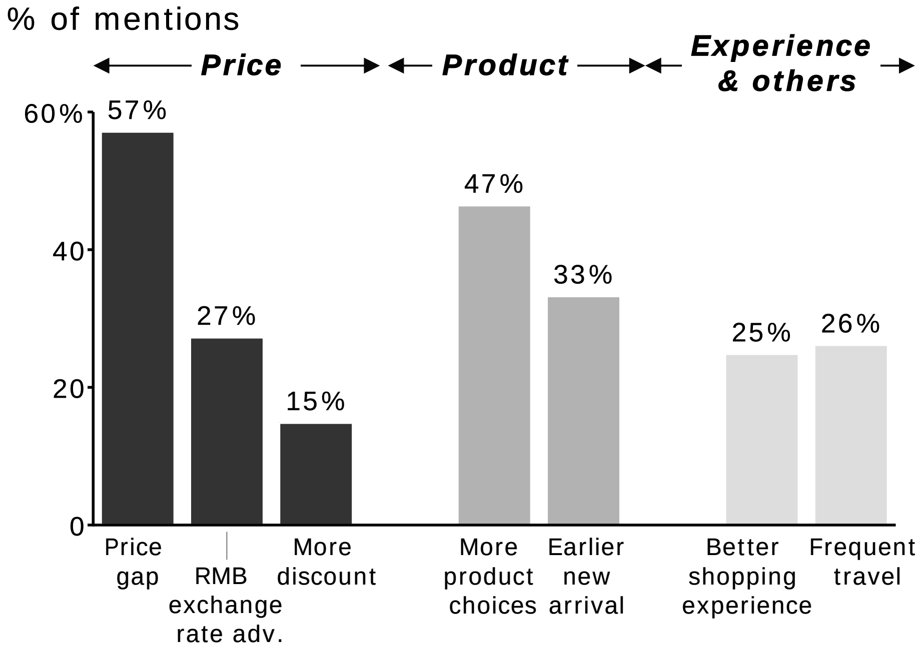
● ***Highest consumption***

Note: Group size for aspirants and fashion addicts expected to grow in the next few years based on interviews
Source: Brand interviews; Dept store interviews; Bain Survey of Luxury Goods Consumers in Mainland China 2013 (n=1,400)

Most Chinese consumers are price sensitive and perfectly informed; either go overseas or to outlets for better deals

OUTSIDE CHINA

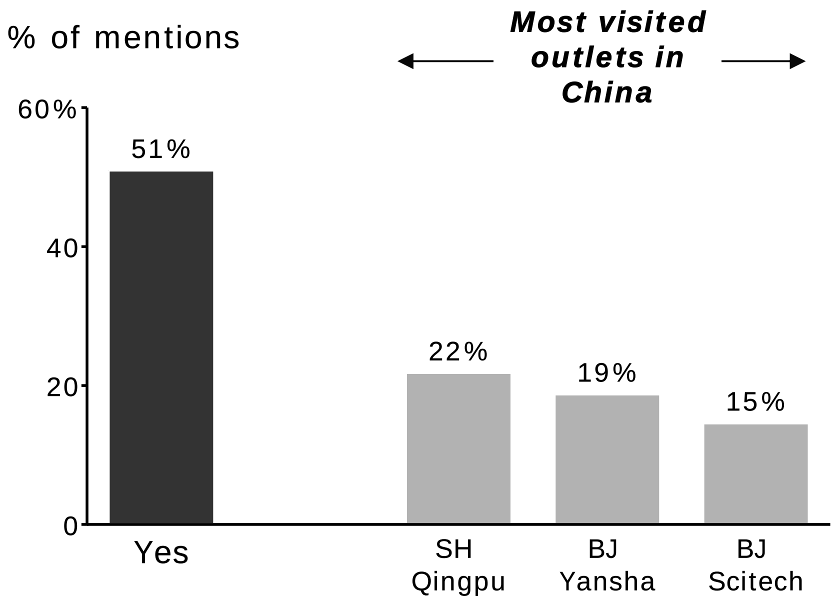
"Why do you purchase from HK/Macau/Taiwan or overseas?"



~70% of consumers mentioned price, and ~55% mentioned product offering

OUTLETS IN CHINA

"Have you ever purchased luxury products from outlets in China?"



*"We have ~**20K** people **traffic** during workdays and **~40K-50K** daily during weekends."*

General manager of Yansha Outlet

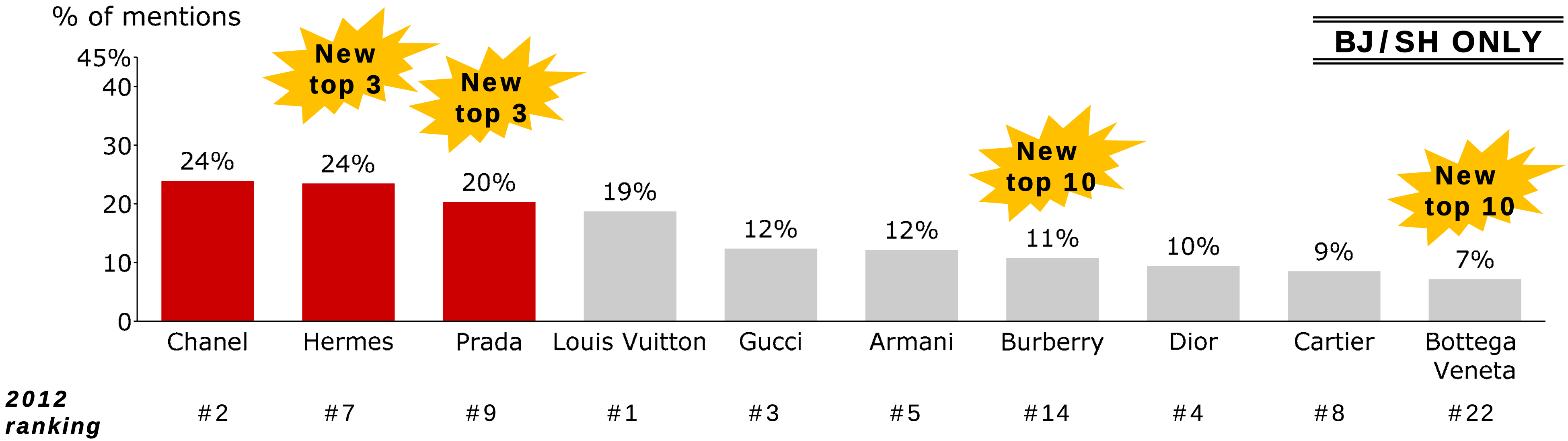
*"I like outlets since you can get a good brand at **much bigger discount**!"*

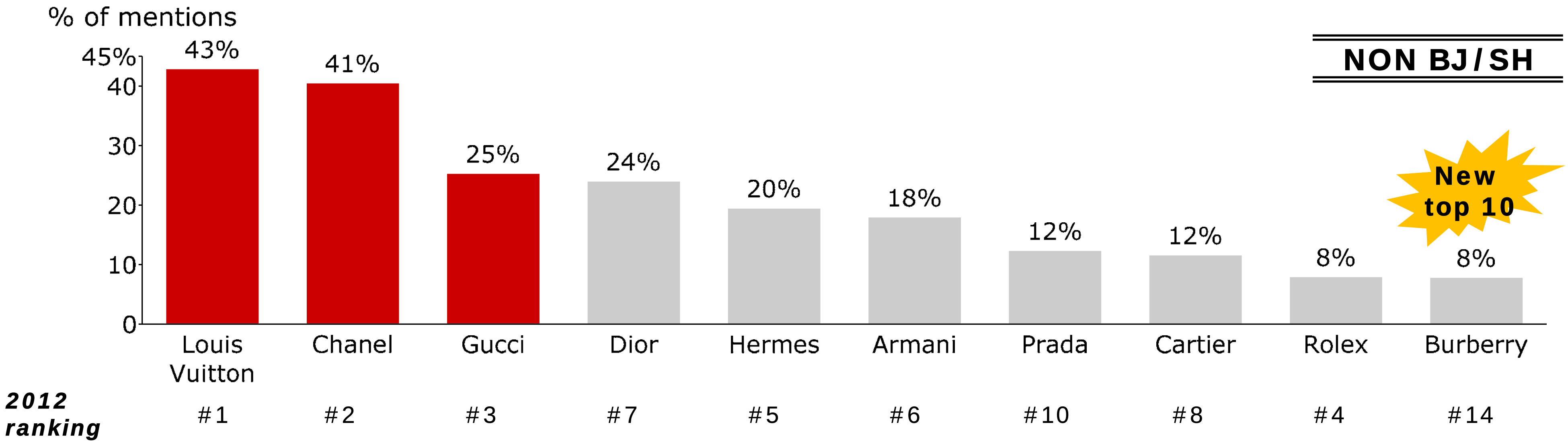
Consumer, Tianjin

Source: Bain Survey of Luxury Goods Consumers in Mainland China 2013 (N=1,400), Literature search, Bain analysis

Brand preference show bigger difference in tier 1 cities vs. 2012

"What are the 3 brands that you desire most?"





Source: Bain Survey of Luxury Goods Consumers in Mainland China 2013 (N=1,400)

2 Younger generation have distinctive characteristics and needs regarding luxury

Age 25-35	Age 35-45

Source: Bain Survey of Luxury Goods Consumers in Mainland China 2013 (n=1,400); Brand interviews; Literature search; Bain analysis

There is also a growing customer group who value culture, heritage and craftsmanship about luxury brands

ChristianDior

- "**Esprit Dior**", Shanghai, Sep 2013
  - **First time outside Paris** to show in China
  - Estimated over 130,000 people visited the exhibition in 2 months, extended for 10 days because of the **huge popularity**
  - Exhibition room of **Dior** handwork was **most successful**

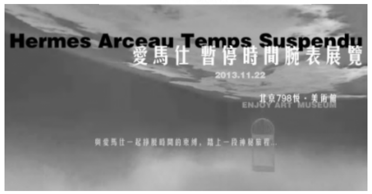
CHANEL

- "**The Little Black Jacket**" by Chanel, Beijing & Shanghai, Jul 2013
  - **First time** of this series exhibited **in China**, launched both offline and online
  - Display **how to wear and match Chanel** little black jacket

"I spent at least half an hour taking 'sunshine shower' outside and waiting in the queue to view the exhibition."

Visitor from Shanghai

HERMÈS
PARIS



- "**Arceau, Le Temps Suspendu**" watch exhibition, Beijing, Nov 2013
  - Emphasize **creation** of time suspension
  - Theme of the watch and exhibition: "Time can only stop in Hermes"

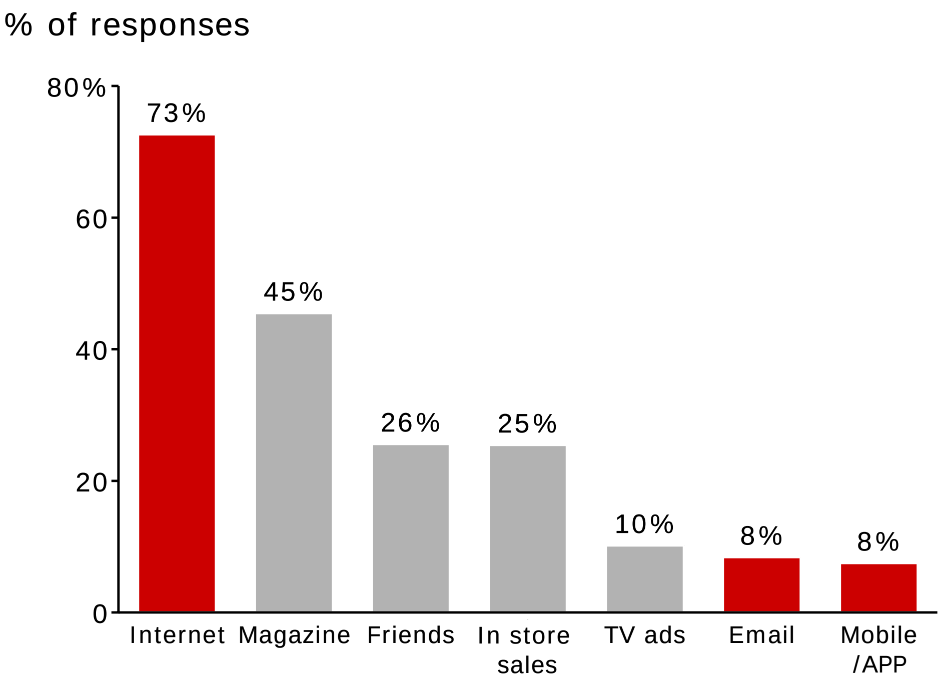
*"I can only say: **beautiful exhibition**. I **love it**."*

Visitor from Beijing

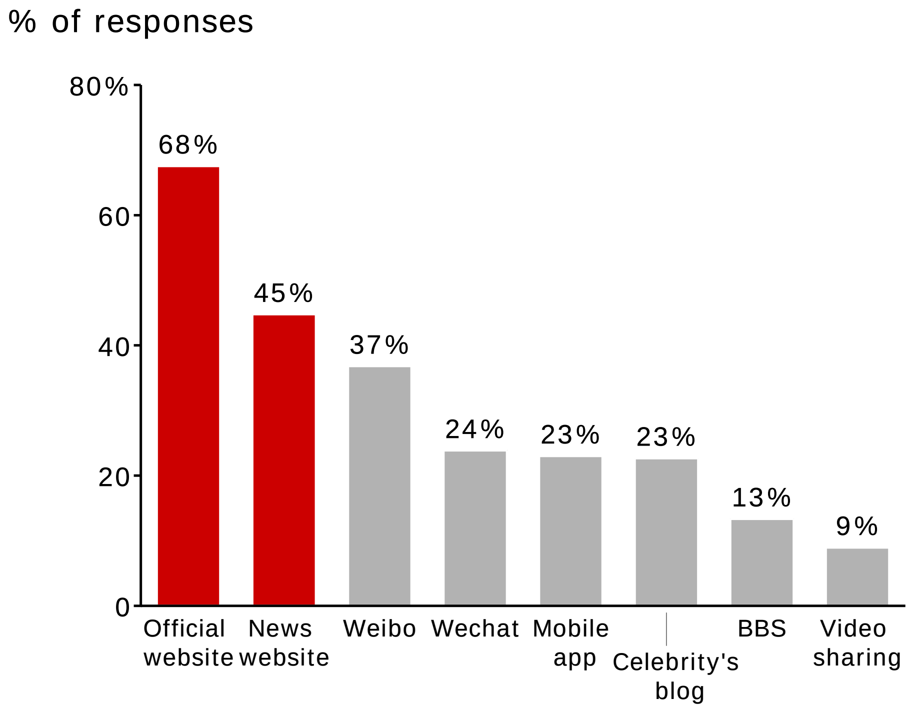
Source: Literature search

2 Digital media is the most popular among consumers to get brand information

"Where do you normally get information on luxury goods?"

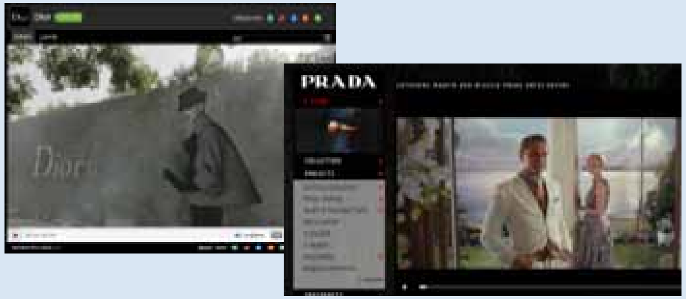


"Where on internet do you normally get information on luxury goods?"



Source: Bain Survey of Luxury Goods Consumers in Mainland China 2013 (N=1,400), Bain analysis

2 More brands trying to interact with consumers and experimenting the “know-me” channel thru digital media



PRADA

Dior

- **Prada Dress Gatsby** show on the official website
- **Dior Spirit Exhibition** video series on Youku Dior district

HERMÈS

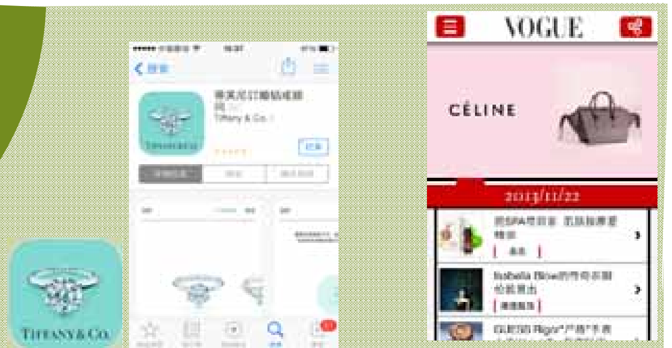
CHANEL

- **Chanel Color Cosmetics Classroom** teaches how to make up
- **Hermes silk knots app** shows ways to wear scarf

FENDI

COACH LEATHERWARE EST. 1941

- **Fendi** held Wei-topic chatting district to **interact with weibo fans** for its 88th birthday
- **Leehom Wang** has acted **ad videos of Coach** with theme of “Modern New Yorker”, and **posted on Weibo**



- Brands are cooperating with **media press,** like **Vogue,** to promote via mobile channels
- **Tiffany** developed its own App “Engagement ring consultant” to **promote** products on **mobile channels**

Source: Bain analysis; Literature search

3 Consumers gaining sophistication and starting to enjoy fashion and style more, especially the younger people

*"Chinese consumers started to consume luxury **cosmetics** in the **1990's**; then **bags and accessories** got most popular in the **2000's**. **Now** they have entered **the fashion and style** stage."*

China Luxury Executive

Miranda Kerr's mix & Match for winter

*"**Sophisticated** shoppers: they think the only way to look **unique** is through **fashion**. This will be a **growing trend** in China."*

Luxury Brand Executive

*"**Mix & Match is a trend**. There are many magazines, websites and Mobile APPs teaching you how to do a **total look** with Zara clothes and luxury bag. I also **follow the celebrities** like Miranda kerr, Olivia Palermo or Alex Chung **to learn how to dress up**."*

Luxury Addict consumer

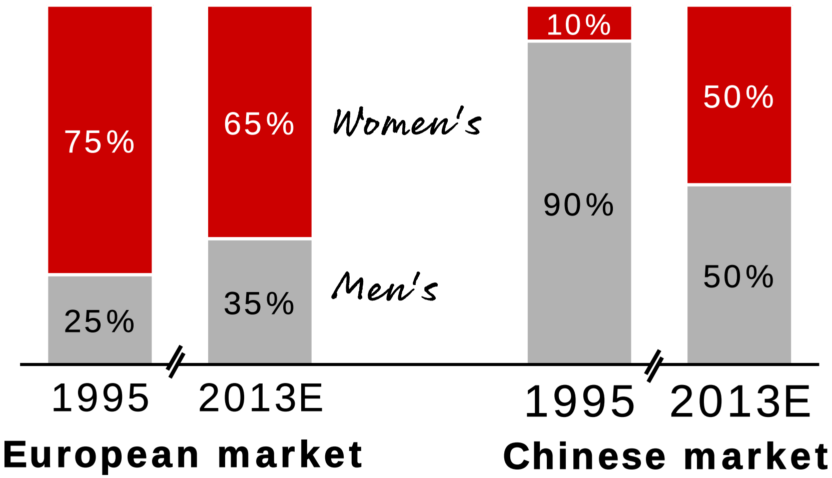
Source: China luxury brands executive interviews; Bain analysis

Female consumers quickly emerging, driving the growth of women's fashion categories

3

Women's segments are catching up in China

Luxury Spending by gender



Source: Bain Global Luxury Market Report (2013)

- In **mature markets**, **women dominate** the personal luxury consumption
- In **China**, men have driven the market growth however **women**'s segments are **catching up now**

Driven by increasing power and willingness to indulge themselves

- In China, near **70% of women have paid work**, much higher than global average at 53%
  - Chinese women also made to more top management positions than global average*

*"I buy myself luxury products to **make myself happy**. I work and I take care of my family. I deserve a reward for myself. And I **can totally afford** it."*

Female consumer from interview

*Grant Thornton report in Mar 2013

Source: Bain Global Luxury Report; Literature search

3 Brands are also transitioning to cater to women’s needs, offering more women’s fashion products

SEVERAL BRANDS STARTED TO ENTER WOMEN’S LINES

TOD'S

- First fashion show in Milan on Sep 20th, 2013
- Will introduce **women’s wear** in China

BOSS HUGO BOSS

- Just brought in **women’s wear** in China; to further develop women’s fashion lines

COACH

- Newly started to sell **women’s wear and footwear** in China

A FEW OTHERS ARE ENHANCING POSITION IN WOMEN’S FASHION

LOUIS VUITTON

- **Upgraded stores** to allocate **more space** to **women’s fashion**
- Increasing **fashion consultancy** in selling efforts

CHANEL

- Chanel continues to **focus on women’s fashion** product lines (higher prioritization than handbags)

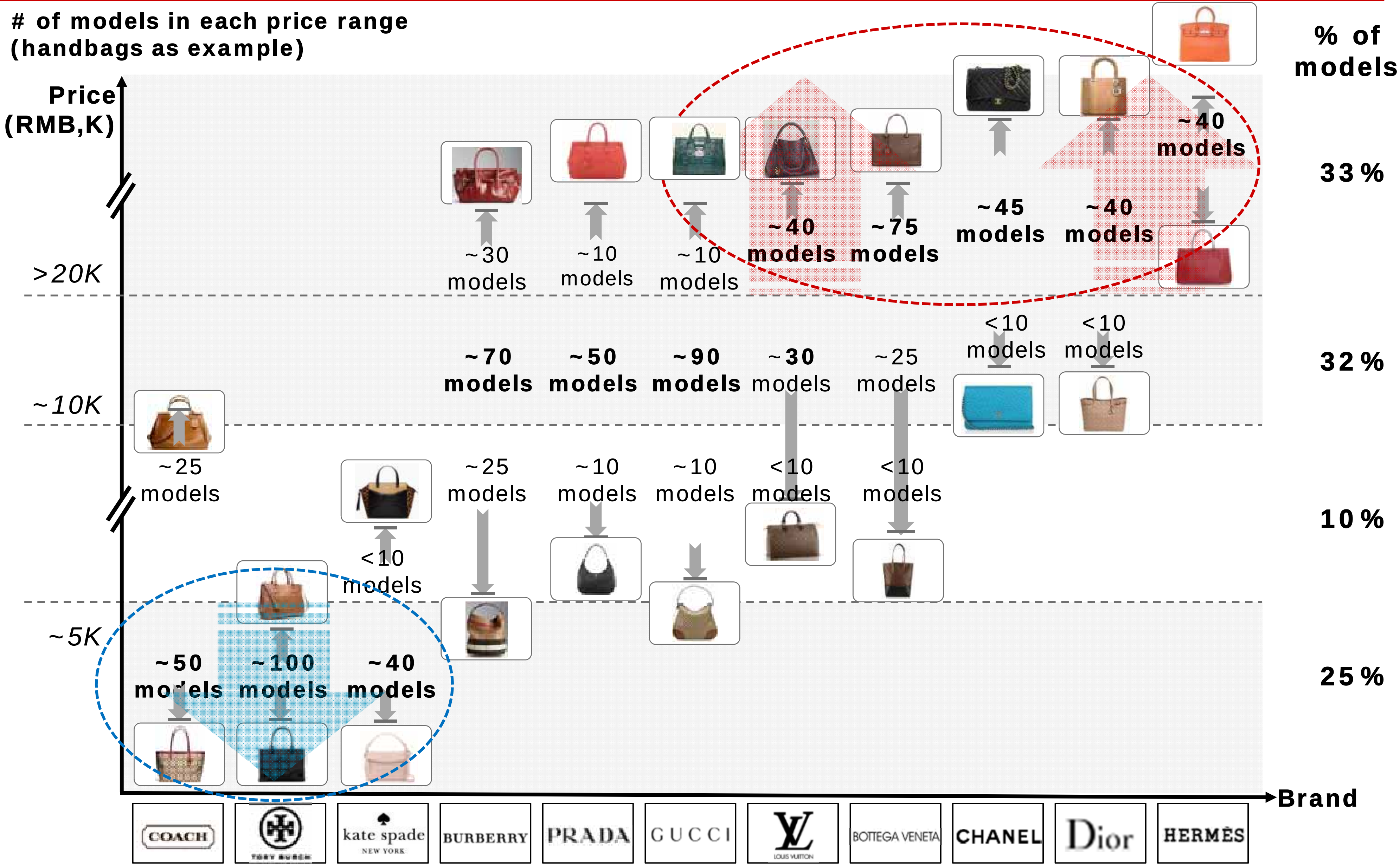
Salvatore Ferragamo

- Launched jewelry line in 2011 globally
- Introduced **jewelry series** into China in end of 2012

Source: Executive interviews; Literature search

Brands are also pushing product collections into both high-end and accessible segments

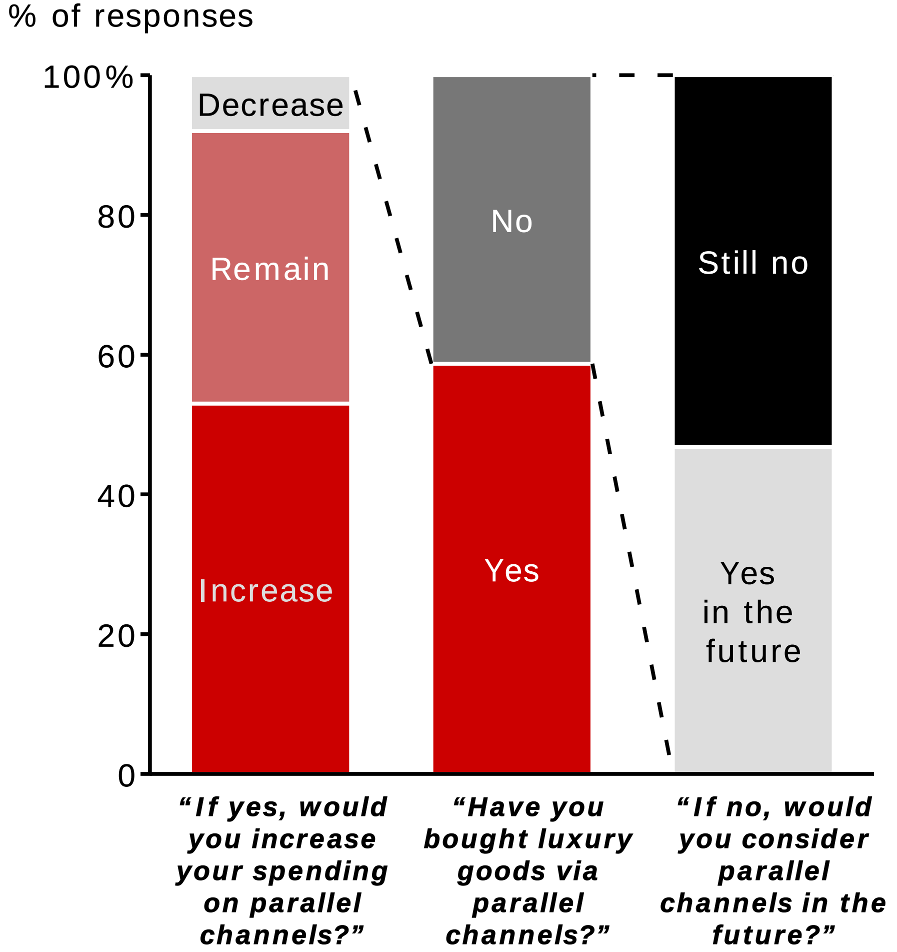
HANDBAG EXAMPLE



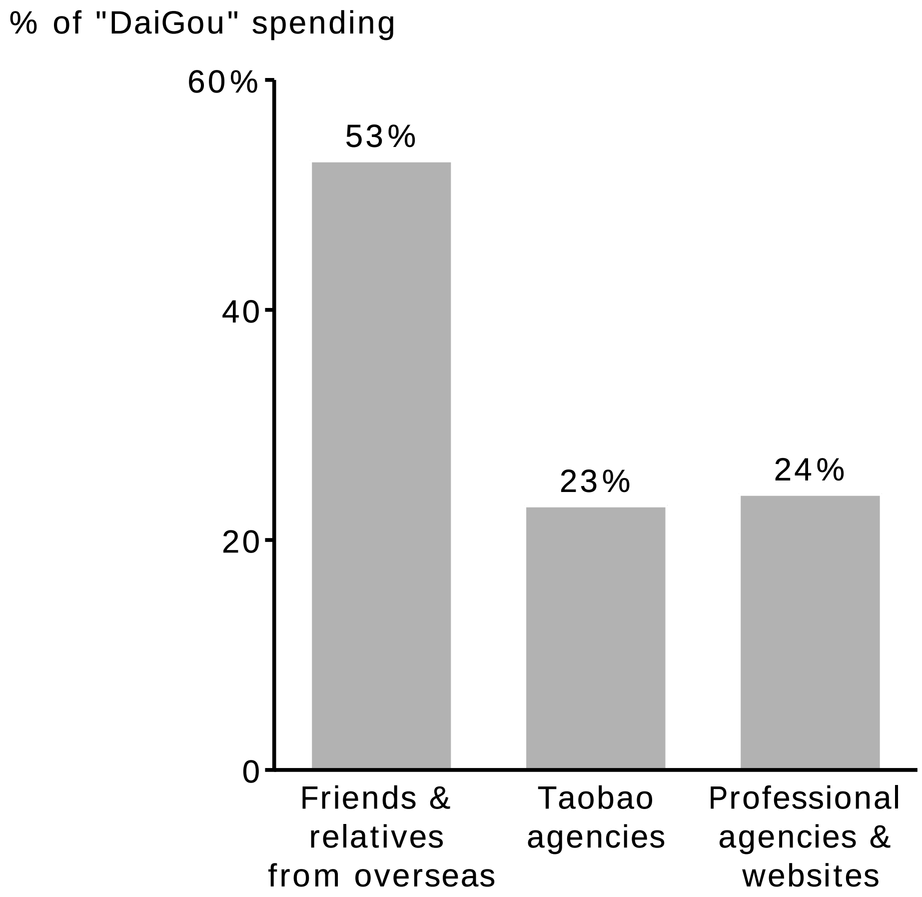
Source: Literature search; Bain analysis

Parallel plays a significant role in mainland China luxury market known as "DaiGou" agencies

"Have you ever purchased luxury goods via parallel channels ('DaiGou')?"

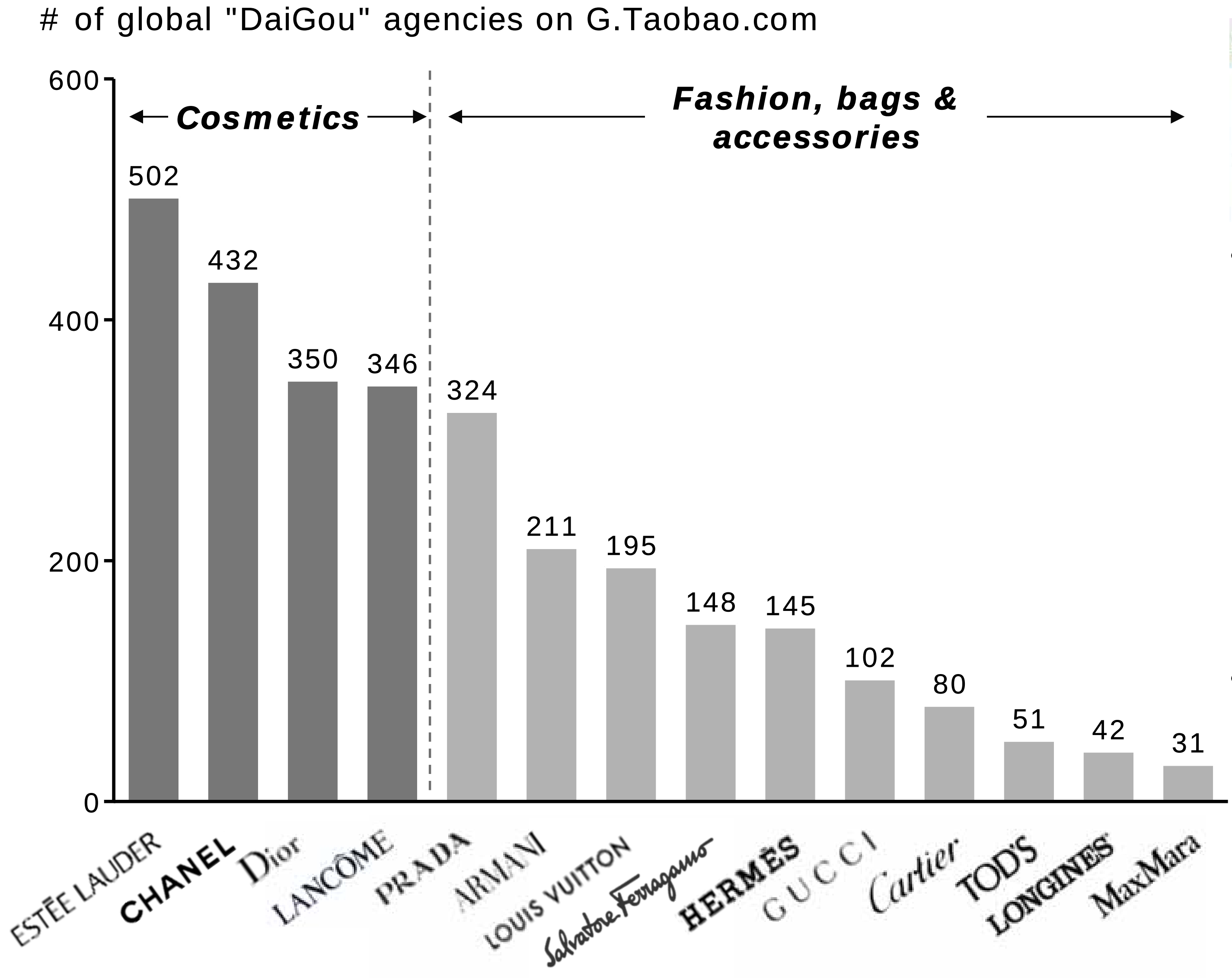


"How much have you spent within different 'DaiGou' channels in 2013?"



Source: Bain Survey of Luxury Goods Consumers in Mainland China 2013 (N=1,400), Bain analysis

Taobao has thousands of registered "DaiGou" agencies for luxury brands



- G.Taobao.com is a **dedicated overseas purchase agency "DaiGou" platform** within Taobao.com system
  - Usually sell at **discount** compared with China full price
  - Taobao or G.Taobao doesn't really validate the authenticity of products
- It was established in 2007 and attracted **over 200,000 daily visits** in 2012
  - During a holiday in Dec 2011, G.Taobao **single day** sales revenue was **RMB 148M**; the biggest ticket was a limited edition of Hermes bag sold at RMB 388,000

Note: # of agencies are sellers with label of "G.TAOBAO", counted by 14th Nov 2013
Source: Taobao.com; Bain analysis

3 Professional "DaiGou" platforms and websites are also growing quickly, a potential threat to traditional channels

Professional DaiGou agencies

Express firms for overseas DaiGou shipping

PROFESSIONAL PARALLEL MARKET

- **Professional "DaiGou" agencies** offer direct purchasing options for Chinese shopping from China
  - These professional players usually have many **international professional buyers**
  - **20+ professional overseas "DaiGou" websites**
- **Professional express firms** offer shipping services from overseas for Chinese, boosting the increase of overseas "DaiGou"
  - Offer local warehouse address and **transfer the products** back **to China**; consumers pay for express shipment fee
  - ~**50 express firms** compete in this segment
- Professional "DaiGou" market **grows quickly**, and **cosmetics** is the largest category in that channel
  - **Ymatou**, a medium-sized "DaiGou" website, has achieved **>RMB 100M sales in 2013**
- There are also **fashion forums** (e.g. MoGuJie, MeiLiShuo) **to recommend "DaiGou" platforms**

Note: Only selected websites and platforms listed
Source: Literature search

4 Chinese consumers are both global and local, presenting unique challenges to brands

GLOBAL CRM

Key challenges to brands

- Chinese consumers are **spending globally**, almost everywhere
- Meanwhile they still carry many local characteristics and **shop locally** as well
- Significant **regional** differences in China

Implications for brands

- Develop **global CRM** to better track and serve target customers at different locations

PRICING STRATEGY

Key challenges to brands

- Chinese consumers are **price savvy**: perfectly informed on price gaps across channels & geographies
- However they're also **willing to spend on high ticket items** for some occasions

Implications for brands

- Re-evaluate global **pricing strategy**; potentially adjust pricing locally

INCREASING FASHION TREND

Key challenges to brands

- Diverse consumer segments, **more sophisticated**
- China luxury market is shifting towards **fashion and style**
- Market becoming **more female oriented**

Implications for brands

- Re-consider **product collection** in China
- **Increase store size & renovation** to show breadth and depth of collection
- **Training** on fashion selling skills in stores

4 All these factors require well-rounded management skillset to succeed

KEY CHALLENGES FOR BRANDS

- China **market more complex** and sophisticated now, with **well informed consumers**
- **Store expansion** slowing down and **not enough to drive overall growth**
- Emergence of **fashion** suggesting category migration of Chinese luxury consumers
- Significant **regional differences** across the country
  - City tier difference
  - Coastal vs. inner land difference

MANAGEMENT SKILLS REQUIRED

- **Retail / Business development** skills not enough to drive brands' growth in the future
- Need **broader set of management skills** covering:
  - Product (**fashion** categories/ lines)
  - **Merchandising** management
  - **Inventory** management
  - **Digital marketing** and tailored messaging
  - **Training / People** development
  - **Customer experience**/ Like-for-like growth (conversion selling skills)

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