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

**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

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

<table>
<thead>
<tr>
<th>Category</th>
<th>2013</th>
<th>CAGR (10-11)</th>
<th>(11-12)</th>
<th>(12-13F)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accessories</td>
<td>20%</td>
<td>30%</td>
<td>7%</td>
<td>8%</td>
</tr>
<tr>
<td>Women’s wear</td>
<td>35%</td>
<td>20%</td>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td>Shoes</td>
<td>20%</td>
<td>5%</td>
<td>5%</td>
<td></td>
</tr>
<tr>
<td>Jewelery</td>
<td>30%</td>
<td>12%</td>
<td>-1%</td>
<td></td>
</tr>
<tr>
<td>Men's wear</td>
<td>30%</td>
<td>10%</td>
<td>5%</td>
<td></td>
</tr>
<tr>
<td>Leather goods</td>
<td>40%</td>
<td>-5%</td>
<td>-11%</td>
<td></td>
</tr>
<tr>
<td>Watches</td>
<td>22%</td>
<td>15%</td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td>Cosmetics, Perfume and Personal care</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: Only premium cosmetics are considered luxury goods in the “Cosmetics” category

Source: Expert interviews; Literature search; Bain analysis
Anti-gifting and frugality campaigns in China while spending increasing overseas

### Luxury brand stores in China suffered from traffic decline

- Department stores and shopping malls suffered from lower traffic esp. during holiday seasons due to **anti-corruption and frugality campaigns**
  - Several provinces asked their **gov’t officials** to **return the gift cards** they had received
  - 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

- New stores opened for select brands
  - 2011: ~150
  - 2012: ~160
  - 2013 (by end of Nov): ~100

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 Collezione (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

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

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

- **Chinese**: ~29% of market
  - ~6% of nationality breakdown
- **Japanese**: ~11% of market
  - ~11% of nationality breakdown
- **American**: ~22% of market
  - ~31% of nationality breakdown
- **European**: ~21% of market
  - ~34% of nationality breakdown
- **Other Asian**: ~14% of market
  - ~7% of nationality breakdown
- **RoW**: ~5% of market
  - ~1% of nationality breakdown

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

Total mainland Chinese luxury spending (RMB B)

<table>
<thead>
<tr>
<th>Year</th>
<th>Mainland</th>
<th>HK/Macau/Taiwan</th>
<th>Overseas</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>266</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td>306</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2013E</td>
<td>350</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

CAGR (11-12): Overseas 15%, Mainland 7%, HK/Macau/Taiwan 12%
CAGR (12-13E): Overseas 14%, Mainland 2%

67% of total mainland Chinese luxury spend in 2013 was outside of mainland China.

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

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

<table>
<thead>
<tr>
<th>Segment</th>
<th>Age</th>
<th>Typical profile</th>
<th>Purchase occasion</th>
<th>Fashion motto</th>
<th>Average spending</th>
<th>Group size</th>
<th>Highest consumption</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aspirants</td>
<td>18-65</td>
<td>Male &amp; female; Annual income: ~RMB 100-300K; Middle class; White collars; From tier 1/2/3 cities</td>
<td>Self-use</td>
<td>“To stand out from crowd”</td>
<td>~50%</td>
<td>~5%</td>
<td></td>
</tr>
<tr>
<td>Fashion addicts</td>
<td>18-65</td>
<td>Mostly female; Annual income: ~RMB 150-500K; White collars; House wives; Tier 1/2 cities; Like to travel and explore new things</td>
<td>Self-use</td>
<td>“Afraid to be outdated on fashion”</td>
<td>~5%</td>
<td>~5%</td>
<td></td>
</tr>
<tr>
<td>Nouvea riches</td>
<td>18-65</td>
<td>Mostly male; Annual income: &gt;RMB 500K; Wealthy individuals; entrepreneurs; Mostly from tier 2/3/4 cities</td>
<td>Self-use</td>
<td>“Love logos”</td>
<td>~30%</td>
<td>~30%</td>
<td></td>
</tr>
<tr>
<td>Core customers</td>
<td>18-65</td>
<td>Male &amp; female; Annual income: &gt;RMB 800K; Executives, rich Taitai, rich 2nd generation, entrepreneurs, gov’t officials and socialites; Tier 1 cities; Often travel around the world</td>
<td>Self-use</td>
<td>“Enjoy sophisticated luxury life style”</td>
<td>~15%</td>
<td>~15%</td>
<td></td>
</tr>
</tbody>
</table>

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?”

<table>
<thead>
<tr>
<th>% of mentions</th>
<th>Price gap RMB exchange rate adv.</th>
<th>More discount</th>
<th>More product choices</th>
<th>Earlier new arrival</th>
<th>Better shopping experience</th>
<th>Frequent travel</th>
</tr>
</thead>
<tbody>
<tr>
<td>60%</td>
<td>57%</td>
<td>27%</td>
<td>15%</td>
<td>47%</td>
<td>33%</td>
<td>25%</td>
</tr>
</tbody>
</table>

**OUTLETS IN CHINA**

“Have you ever purchased luxury products from outlets in China?”

<table>
<thead>
<tr>
<th>% of mentions</th>
<th>Yes</th>
<th>SH Qingpu</th>
<th>BJ Yansha</th>
<th>BJ Scitech</th>
</tr>
</thead>
<tbody>
<tr>
<td>60%</td>
<td>51%</td>
<td>22%</td>
<td>19%</td>
<td>15%</td>
</tr>
</tbody>
</table>

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

"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

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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)

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Younger generation have distinctive characteristics and needs regarding luxury

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

**Christian Dior**

- **“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

**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

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

“Where do you normally get information on luxury goods?”

% of responses

<table>
<thead>
<tr>
<th>Source: Bain Survey of Luxury Goods Consumers in Mainland China 2013 (N=1,400), Bain analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internet</td>
</tr>
<tr>
<td>73%</td>
</tr>
</tbody>
</table>

“Where on internet do you normally get information on luxury goods?”

% of responses

<table>
<thead>
<tr>
<th>Official website</th>
<th>News website</th>
<th>Weibo</th>
<th>Wechat</th>
<th>Mobile app</th>
<th>Celebrity's blog</th>
<th>BBS</th>
<th>Video sharing</th>
</tr>
</thead>
<tbody>
<tr>
<td>68%</td>
<td>45%</td>
<td>37%</td>
<td>24%</td>
<td>23%</td>
<td>23%</td>
<td>13%</td>
<td>9%</td>
</tr>
</tbody>
</table>

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

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

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

- **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

- **Tiffany** developed its own App “Engagement ring consultant” to promote products on mobile channels

Source: Bain analysis; Literature search
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

"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

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

Luxury Brand Executive

Source: China luxury brands executive interviews; Bain analysis
Female consumers quickly emerging, driving the growth of women’s fashion categories

**Women’s segments are catching up in China**

<table>
<thead>
<tr>
<th>Luxury Spending by gender</th>
<th>European market</th>
<th>Chinese market</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1995</td>
<td>2013E</td>
</tr>
<tr>
<td>Women’s</td>
<td>75%</td>
<td>65%</td>
</tr>
<tr>
<td>Men’s</td>
<td>25%</td>
<td>35%</td>
</tr>
<tr>
<td>1995</td>
<td>90%</td>
<td>10%</td>
</tr>
<tr>
<td>2013E</td>
<td>50%</td>
<td>50%</td>
</tr>
</tbody>
</table>

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

### SEVERAL BRANDS STARTED TO ENTER WOMEN’S LINES

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

### A FEW OTHERS ARE ENHANCING POSITION IN WOMEN’S FASHION

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

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

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

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

- 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

<table>
<thead>
<tr>
<th>Price (RMB, K)</th>
<th>~10K</th>
<th>~5K</th>
<th>~10K</th>
<th>~10K</th>
<th>~50</th>
<th>~90</th>
<th>~30</th>
<th>~25</th>
<th>~40</th>
<th>~45</th>
<th>~40</th>
</tr>
</thead>
<tbody>
<tr>
<td># of models in each price range (handbags as example)</td>
<td>~70 models</td>
<td>~50 models</td>
<td>~90 models</td>
<td>~30 models</td>
<td>~25 models</td>
<td>~40 models</td>
<td>~45 models</td>
<td>~40 models</td>
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</tr>
</tbody>
</table>

% of models

- ~40 models: 33%
- ~45 models: 32%
- ~25 models: 10%
- ~100 models: 25%

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’)?

- Yes
- No
- Still no

If yes, would you increase your spending on parallel channels?

- Increase
- Remain
- Decrease

If no, would you consider parallel channels in the future?

- Yes in the future

How much have you spent within different ‘DaiGou’ channels in 2013?

- Friends & relatives from overseas: 53%
- Taobao agencies: 23%
- Professional agencies & websites: 24%

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

# of global "DaiGou" agencies on G.Taobao.com

- **Cosmetics**
  - Estée Lauder: 502
  - Chanel: 432
  - Lancôme: 350
  - Prada: 346

- **Fashion, bags & accessories**
  - Armani: 211
  - Louis Vuitton: 195
  - Salvatore Ferragamo: 148
  - Hermès: 145
  - Gucci: 102
  - Cartier: 80
  - Tod’s: 51
  - Longines: 42
  - MaxMara: 31

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

- **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

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

### Professional DaiGou agencies

![Professional DaiGou agencies](image1)

### Express firms for overseas DaiGou shipping

![Express firms for overseas DaiGou shipping](image2)

**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

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Note: Only selected websites and platforms listed
Source: Literature search
Chinese consumers are both global and local, presenting unique challenges to brands.

### 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.
- Re-evaluate **global pricing strategy**; potentially adjust pricing locally.
- Re-consider **product collection** in China.
- **Increase store size & renovation** to show breadth and depth of collection.
- **Training** on fashion selling skills in stores.

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**GLOBAL CRM**

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**PRICING STRATEGY**

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**INCREASING FASHION TREND**

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All these factors require well-rounded management skillset to succeed

<table>
<thead>
<tr>
<th>KEY CHALLENGES FOR BRANDS</th>
<th>MANAGEMENT SKILLS REQUIRED</th>
</tr>
</thead>
<tbody>
<tr>
<td>• China market more complex and sophisticated now, with well informed consumers</td>
<td>• Retail/ Business development skills not enough to drive brands’ growth in the future</td>
</tr>
<tr>
<td>• Store expansion slowing down and not enough to drive overall growth</td>
<td>• Need broader set of management skills covering:</td>
</tr>
<tr>
<td>• Emergence of fashion suggesting category migration of Chinese luxury consumers</td>
<td>- Product (fashion categories/lines)</td>
</tr>
<tr>
<td>• Significant regional differences across the country</td>
<td>- Merchandising management</td>
</tr>
<tr>
<td>- City tier difference</td>
<td>- Inventory management</td>
</tr>
<tr>
<td>- Coastal vs. inner land difference</td>
<td>- Digital marketing and tailored messaging</td>
</tr>
<tr>
<td></td>
<td>- Training/People development</td>
</tr>
<tr>
<td></td>
<td>- Customer experience/ Like-for-like growth (conversion selling skills)</td>
</tr>
</tbody>
</table>