China Setting Luxury Trends

2017 China Luxury Market Study

BAIN & COMPANY

Key messages

Spectacular growth of Chinese luxury spending in 2017	**1**	• **In line with 2015 Bain China luxury report forecasts, the domestic market outgrew overseas purchases and reached 20% growth in 2017**; also, category rebalancing continued with female categories outgrowing male categories
Millennials define new luxury trends	**2**	• **New consumers, mostly Millennials** have been major contributors to the market growth; Millennials are **digital savvy** and very **knowledgeable about luxury**. They like "**fashion and casual**," **favor designer brands** and start buying luxury goods at a **young age** with relatively high frequency
Online and offline footprints being adjusted	**3**	• **Most brands continue to adjust their footprint**: fewer but bigger stores, preferably in shopping malls, that offer integrated "retailtainment" experience • Also, most brands have launched **their Brand.com (or are planning to do it in 2018),** but only few are considering other online options
Large variation of growth performance across brands	**4**	• Outperforming brands focus on **ready to wear, creating constant "newness" and "freshness,"** harnessing the power of **digital marketing** and adopting a "**fast fashion**" supply chain model, all of which result in higher store productivity
Strong momentum to continue in 2018	**5**	• **Strong market momentum** is likely to continue, fueled by millennials and ready-to-wear, but growth is likely to **slow down** to **low-mid teens**, given high growth rates achieved in 2017

1 In 2015 report, we expected improvement in luxury domestic sales driven by efforts of government and brands

SNAPSHOT OF 2015 CHINA LUXURY REPORT

Government efforts to localize and officialize consumption tend to change the landscape

Tighten control over gray markets	Promote alternatives to Daigou	Reduce import duties	Monetary policy
• Tighten customs control toward passengers and parcels – Strengthened checkpoints in customs, especially toward travelers/parcels returning from popular shopping destinations such as Japan and Hong Kong, in September 2015 • Stricter checks and supervision over professional Daigou agents	• Promote cross-border e-commerce – Expand the free trade zone to more cities where those conducting cross-border e-commerce can enjoy tax benefits – Increase the cross-country online payment limit from \$10,000 USD to \$50,000 USD in January 2015 – But some uncertainty on policy changes remains	• Slashed import duties on various items, including leather shoes and skin care products, in May 2015 • Further import tariff adjustment on certain categories starting in January 2016 – Tariff adjustments: Wool and cotton apparel will be reduced from 16% to 8%, selected footwear from 24% to 12%, selected luggage and handbags from 20% to 10%	• RMB depreciation started in August 2015 and continued in January 2016 "RMB depreciation will continue in 2016, with a range of ~10% against US dollars." - Merrill Lynch "If US dollars remain strong in 2016, RMB is still likely to continue to depreciate 5%-7%." - Macquarie Group

Sources: Brand interview; Bain analysis; lit research

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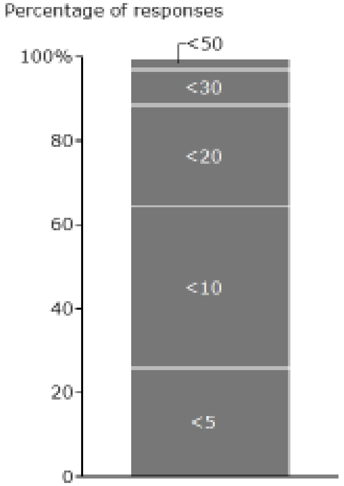
All parallel channels pushed the luxury industry to a point where the price differential issue had to be addressed

"What price difference level can you accept to purchase luxury items in China"



Several brands cut prices to bring customers back to China ...

Chanel plans price hikes in Europe, Cuts in China — March 17.2015 11:36 AM — Reuters

Cartier Cuts prices in China — Apr 21, 2015 — CPP.LUXURY.COM

... but opinions differ on global pricing

"Although some brands claim no plan on large-scale price harmonization, they have adjusted prices for selected items in a very low-key way; brands are nervous about any negative impact."
— Brand executive

More price adjustments expected in 2016, driven by competitive situation and helped by RMB depreciation

Sources: Bain survey of luxury goods consumers in mainland China, 2015 (n=1,447); Bain analysis

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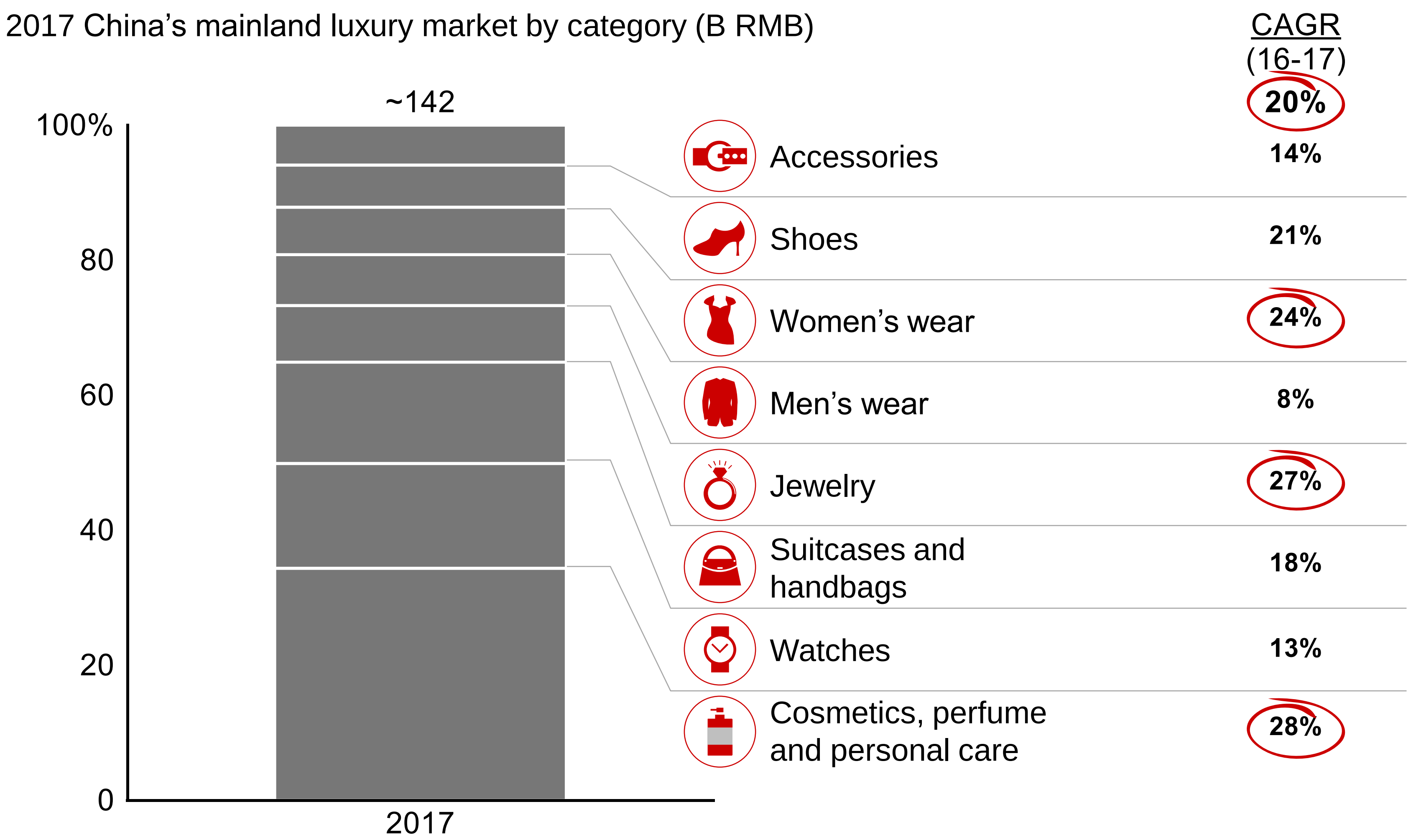
Government and brands have contributed to bring luxury consumption back to China

Domestic market growth has been led by female categories-cosmetics, women’s wear and jewelry…

1



HIGHLIGHTS

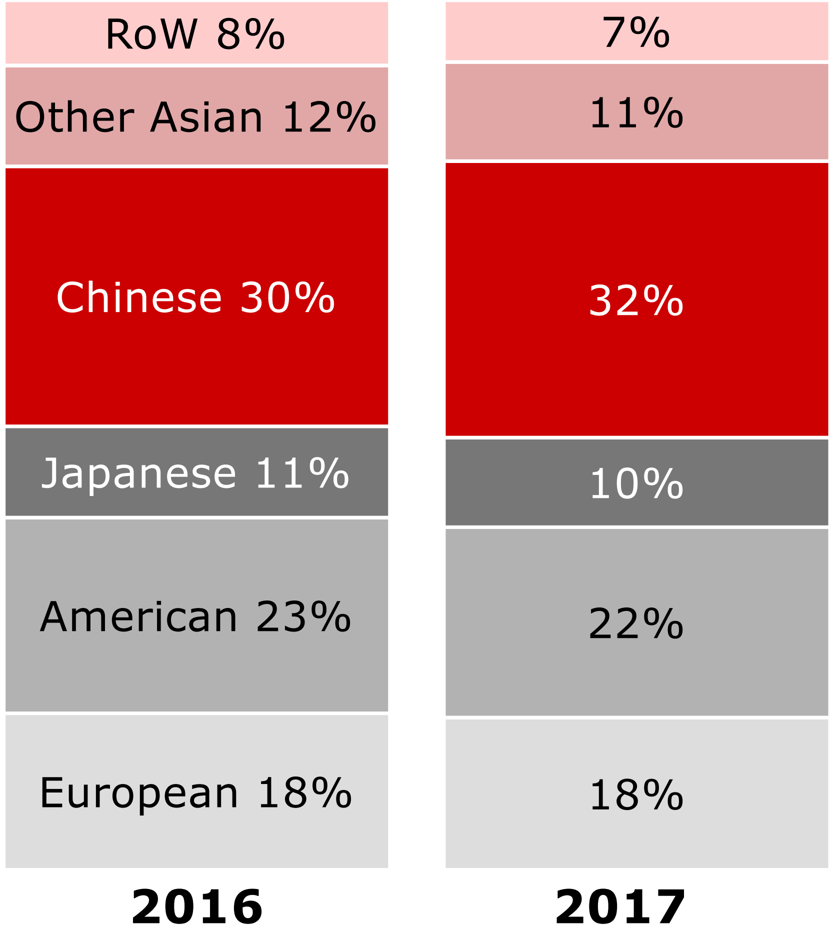
- **Spectacular growth overall in 2017**, after 4 years of lukewarm performance and decline
- **Female categories** outgrew the overall domestic market; **rebalancing** between male and female categories continues:
  - Cosmetics driven by premiumisation from masstige, make-up, online and overall recruitment of new consumers
  - Jewelry growth driven by very high end as well as more affordable fashion and bridal ranges
  - Women’s ready-to-wear and shoes driven by younger generation appetite for streetwear and casual wear
- **Growth in bags and leather products** driven by new design and fashion features for both entry-level and high-end products

Note: Only premium cosmetics (e.g., Estée Lauder and Lancôme) are considered as luxury goods in the cosmetics category
Sources: Lit research; Expert interview; Bain analysis

…Chinese luxury spending globally also enjoyed strong growth and represented 32% of the global luxury market in 2017

1

MARKET BY CONSUMER NATIONALITY



HIGHLIGHTS

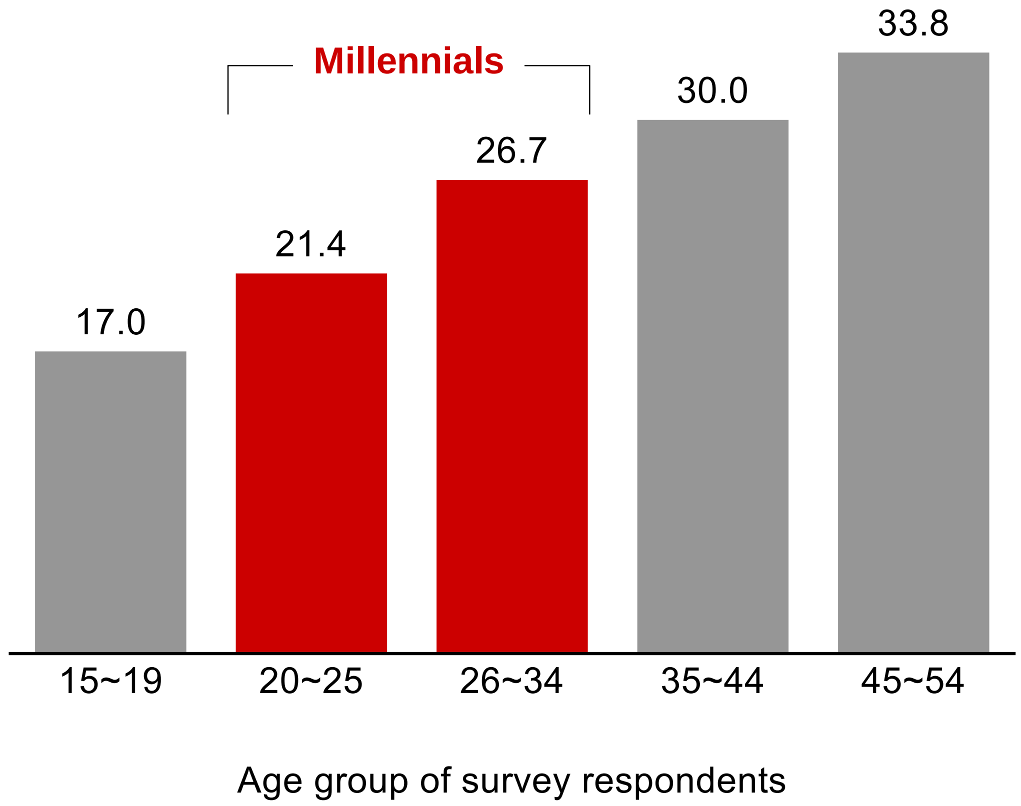
- **Many new Chinese consumers, mostly Millennials**, accelerated spending on luxury
  - Partially triggered by brands' repositioning toward younger generation
- **"Wealth effects"** driven by strong residential property appreciation and stock market gains in China
- **The domestic market booming in 2017**, **mainly due to** renewed consumer confidence and narrowing price gaps

Note: Millennials in the report were defined as 20-34 years old, born between 1983 and 1997
Sources: Bain global luxury report; Bain analysis

Millennials have been major contributors to luxury growth: they start purchasing luxury at an earlier age and buy more frequently

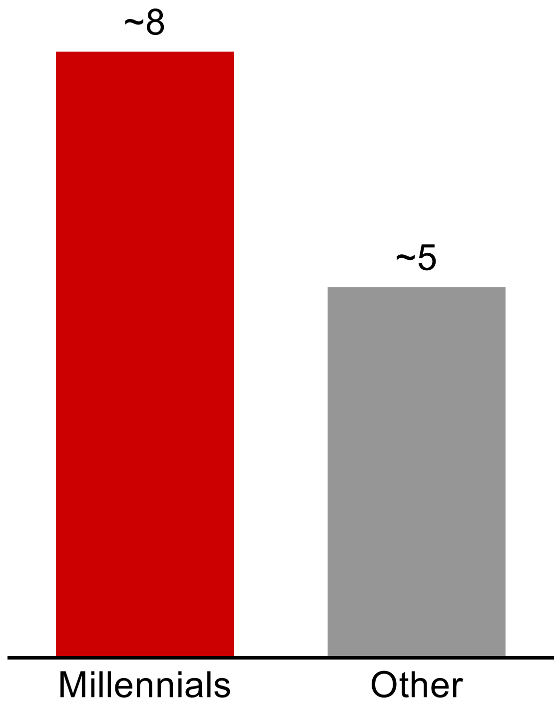
"At which age did you purchase luxury goods for the first time?"

Age of survey respondents at first luxury purchase



"How many times have you purchased luxury goods in 2017?"

Average number of times survey respondents made luxury purchases



"I started to be fascinated by luxury brands when I was in high school. It was quite common for my classmates and friends to follow the trend of global fashion. We just imitated our idols and fashion bloggers and bought what they wear."

Consumer in Beijing (21-year-old)

"Five years ago, Chinese luxers were 10 years younger than other countries; now, Chinese luxers are closer to 20 years younger than other countries"

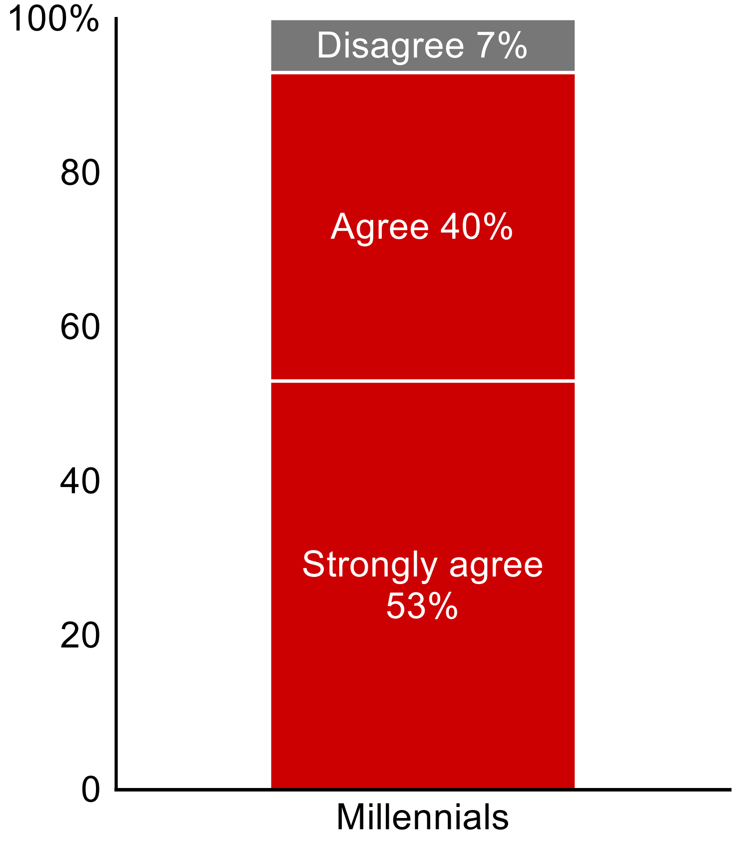
Executive, Luxury Brand

Sources: Bain China luxury consumer survey, 2017 (N=1,170); Bain analysis

2 Millennials prefer “fashion,” “street casual,” “new” and “in-season” luxury products

“In the next three years, will you tend to buy more fashionable luxury brands?”

Percentage of survey responses within millennials (n=502)



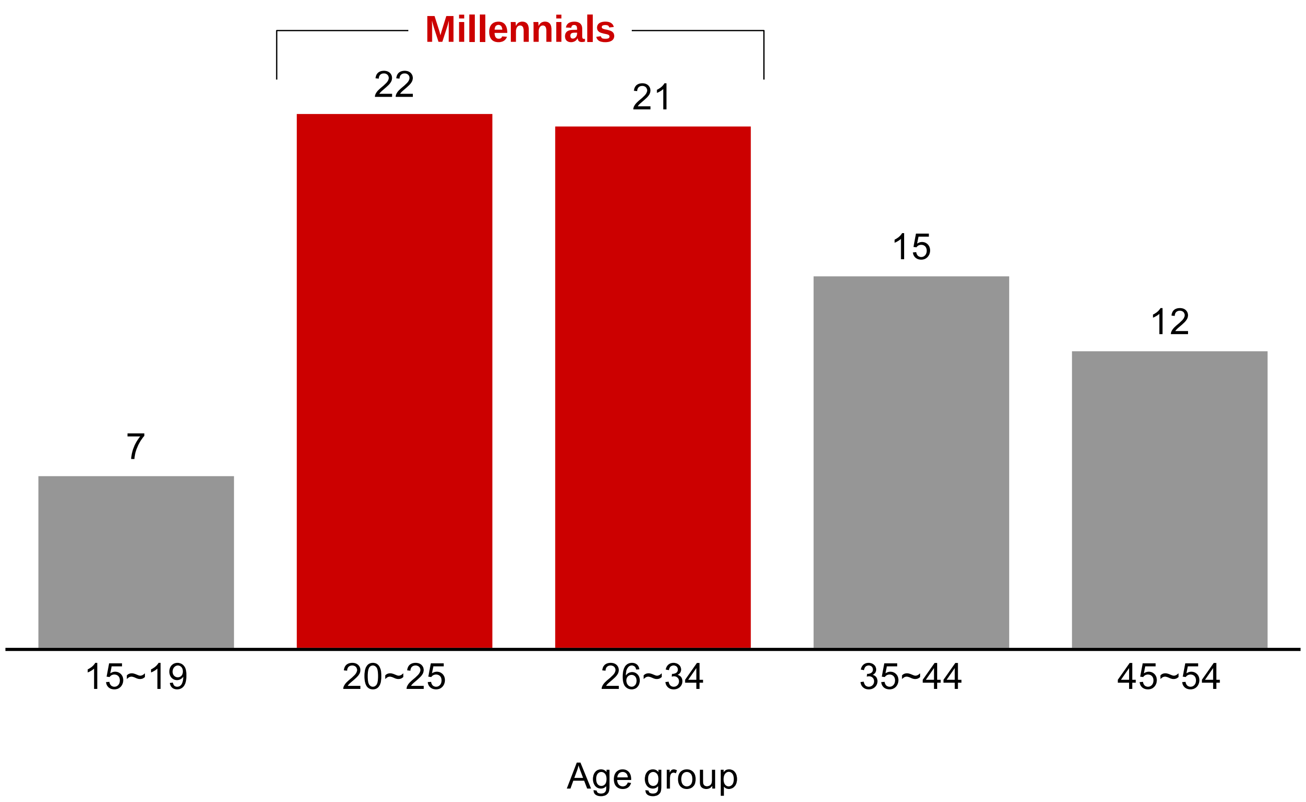
TOP WORDS MENTIONED BY MILLENNIALS

Sources: Bain China luxury consumer survey, 2017 (N=1,170); Bain analysis

2 Millennials are digital savvy, relying on digital to receive information or even to purchase luxury products

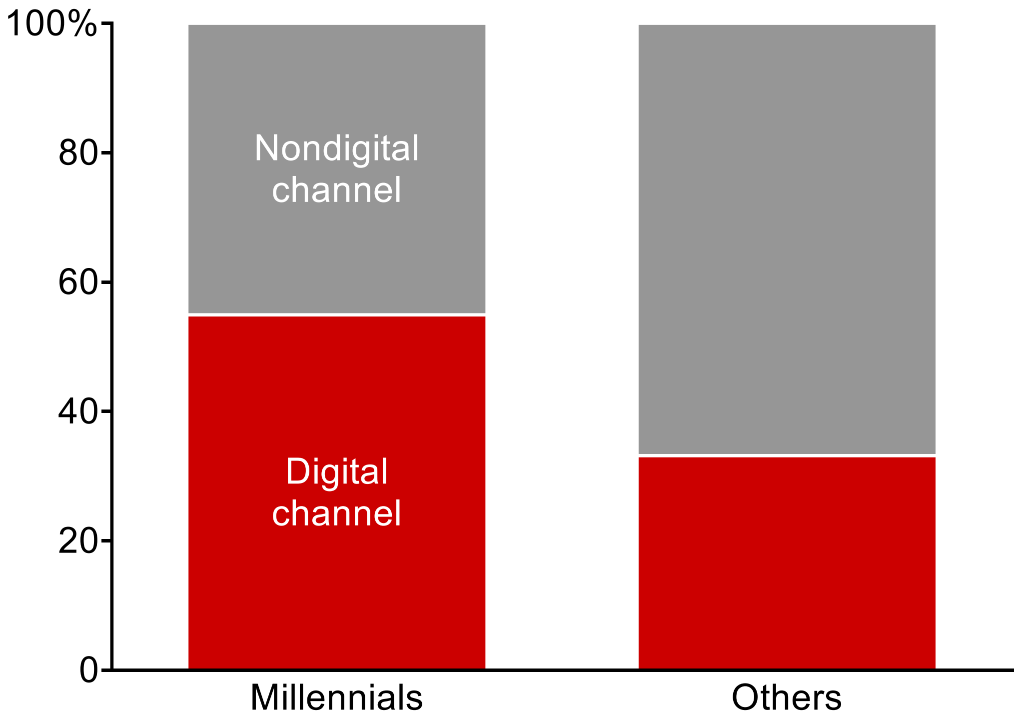
"How much time do you spend on digital every week?"

Time spent on digital in hours per week, by age group, in 2017



"On which channel do you receive luxury information?"

Percentage of mentions



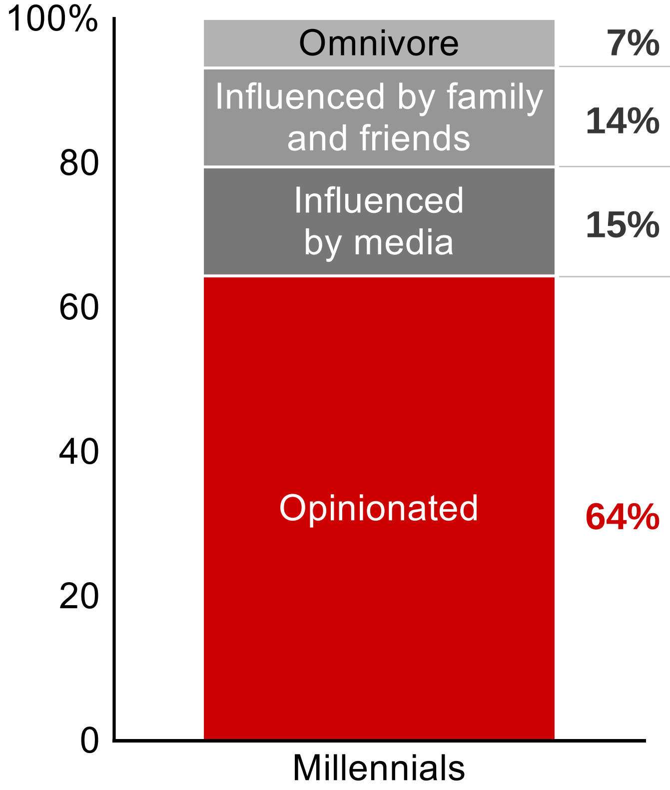
Notes: 1. Time spent on digital refers to Weibo, WeChat, etc.; 2. digital channel refers to Internet (PC and mobile) and TV; nondigital channel refers to friends, in-store sales
Sources: Bain China luxury consumer survey, 2017 (n=1,170); CNNIC; Bain analysis

2 Millennials are knowledgeable and opinionated about luxury products

MILLENNIALS ARE MORE OPINIONATED

"How would you describe your luxury shopping behavior?"

Percentage of luxer type of millennials in survey respondents (n=502)



TYPE	MOTTO and DESCRIPTION
	***"Whatever is fine…"*** • Less knowledgeable about product differences
	***"I want the same as my friends"*** • Easily influenced by recommendations from acquaintances
	***"Let's buy what the celebrities wear"*** • Make decisions based on information on media platforms
	***"Only my opinions matter"*** • Knowledgeable and discerning about brands and products; spread voice on social media

HIGHLIGHTS

- As **one-child generation**, millennials are more **educated** and grown up, with a **multitude of choices**
- Fast development of **Internet and social media** with transparent information sources helps millennials build their own mindsets
- Millennials are keen on creating their **own unique style** profile

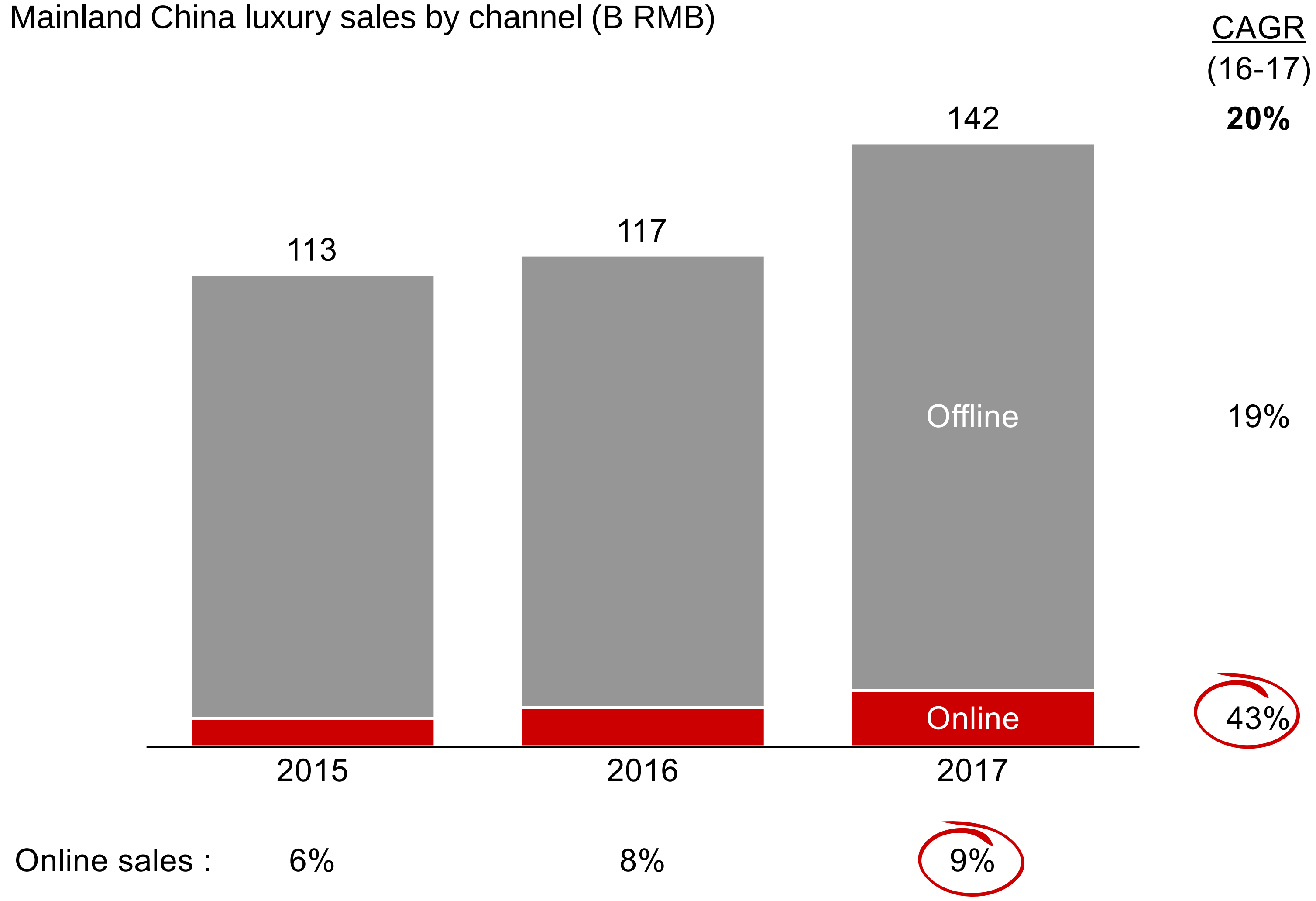
*"As Chinese millennials are **maturing**, they become more **selective and demanding**. The generation tends to develop **savvier spending habits**, while **not compromising on quality or taste**."*

Executive, Luxury Brand

Sources: Bain China luxury consumer survey, 2017 (N=1,170); Expert interview; Lit research; Bain analysis

3 Online luxury sales continue to grow fast but still remain small

Mainland China luxury sales by channel (B RMB)



Note: Online sales include only the official online channel
Sources: Expert interview; Bain analysis

HIGHLIGHTS

- **Online channel grew very fast**, driven by the high growth of cosmetics and rising penetration of handbags and ready-to-wear
- **Overall online penetration still remained low, except for cosmetics** (15-20%)
- Offline steadily grew, mainly driven by **store productivity uplift**

*"It used to be common for everyone to shop on the ground floor of premium malls to buy cosmetics, but it is really **time-consuming**. Nowadays, I can find nearly **every cosmetics brand online with fast delivery**."*

Consumer in Shanghai

3 Many brands re-assessing and reducing their store footprint

STORE FOOTPRINT OF TOP 20 BRANDS

Aggregated number of retail stores of Top 20 brands

HIGHLIGHTS

- **Most brands are reassessing their store footprints**
  - More than 50% of the top 20 brands consolidated their networks with fewer but bigger stores
- A few **accessible luxury brands** continue to extend their footprint at a rapid pace

Notes: Underwear, children's wear, watch/jewelry/accessory counters and outlet stores not included for any brand; Different labels in one store are counted as one; multiple stores of one brand in a single shopping mall are also counted as one (e.g., shoe store on 1st floor while outfit store on 3rd floor)
Sources: Analyst report; Official website; Expert interview; Bain analysis

Four types of online channels were active in the domestic luxury market

NONEXHAUSTIVE

Price level	BRAND OWNED	'COOPERATE'	AGGREGATORS	LUXURY VERTICALS
	• Built and operated by brands	• Brands have strong control on the store and the aggregator traffic being leveraged	• Built and operated by aggregators • Brands provide input on interface design and product portfolio	• Vertical players sell luxury products and offer selective series and items with a large discount
Full price	**Brand.com** 26 / 45	**Tmall flagship** 9 / 26 **WeChat commerce** 26 / 35		
Discount on selected items and brands			*Some promotion sales driven by platform* **Tmall Pavilion** 7 / 12 **JD Toplife** 2 / 2	
Generally all have discounts or are sold at the overseas price		**Mei.com** 23 / 45	← *Flash sale with heavy discount* →	*Overseas retail price with discounts/promotion* **Secoo** 51 / 69 **Vip.com** 12 / 30

More brand control ← **Channel** → **Less brand control**

Number of brands without / with cosmetics

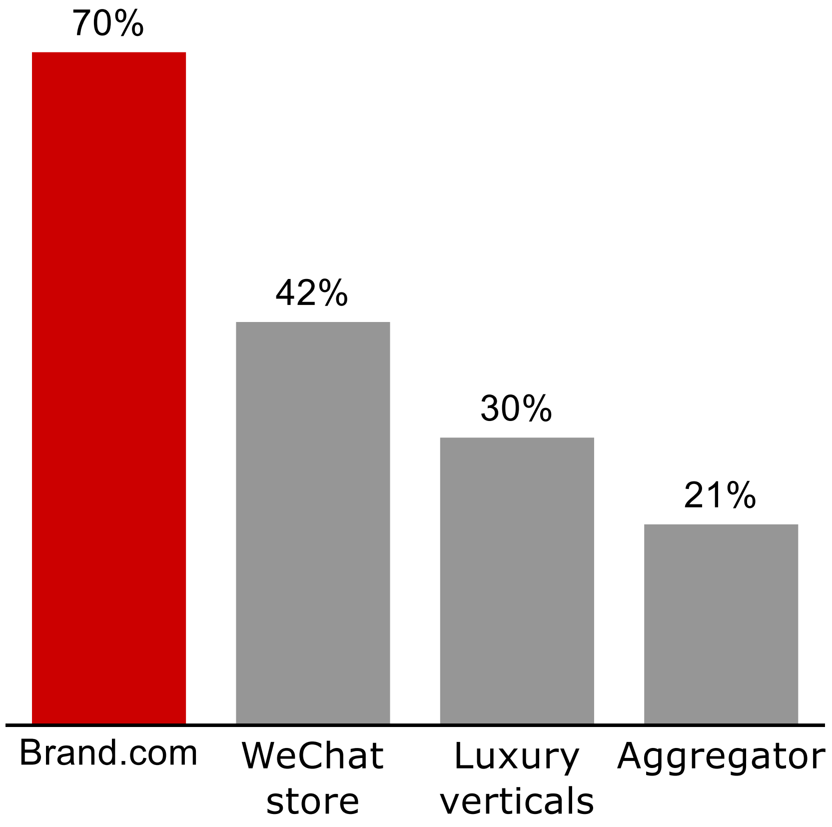
Note: By Dec. 2017. In total, 76 luxury brands (20 cosmetics, 26 watches and jewelry, 30 lifestyle, shoes and handbags) are counted; only domestic online channel was included
Sources: Brand interviews; Lit research; Bain analysis

Among online channels, Brand.com is more appealing to consumers, mainly due to exclusivity and authenticity

3

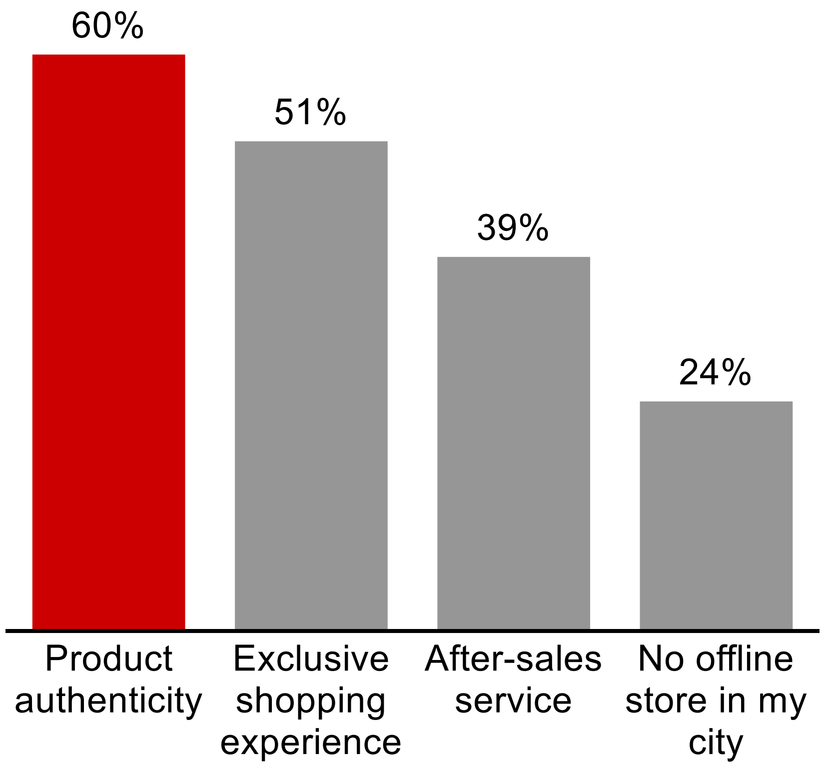
"Which online channel do you use to purchase luxury goods?"

Percentage of mentions



"Reason to choose Brand.com"

Percentage of mentions



"I really ***enjoy*** *shopping through official websites nowadays. They have a* ***Chinese version*** *and are very* ***user-friendly****. Furthermore, I can check my* ***membership status and benefits****."*

Consumer in Chengdu

"Shopping on Brand.com is ***easy, secure and extremely convenient****. I can spend as long as I want to* ***select my desired color and size****."*

Consumer in Beijing

"From my point of view, ***genuineness comes first****. I cannot imagine what my colleagues would say about me if I wear a fake coat."*

Consumer in Hangzhou

Sources: Bain China luxury consumer survey, 2017 (n=1,170); Bain analysis

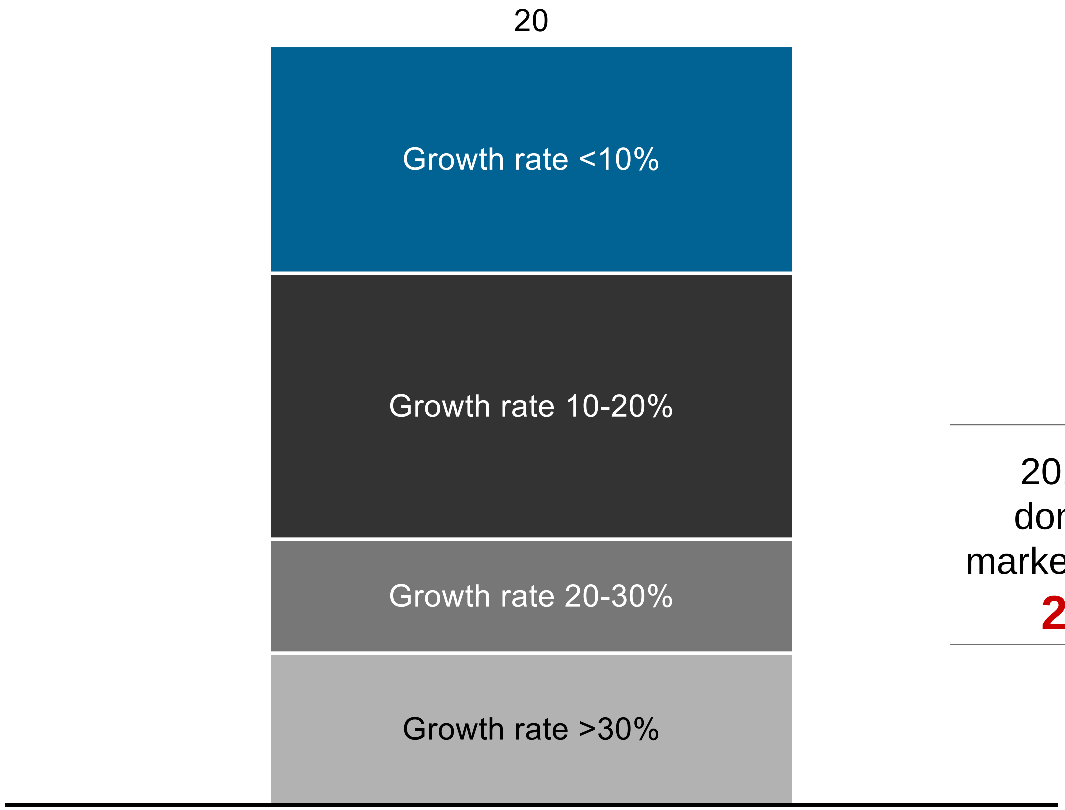
4

Large variance observed across fashion and lifestyle brands' performance

PERFORMANCE OF LUXURY BRANDS SHOW LARGE VARIANCE

TOP 20 LUXURY FASHION AND LIFESTYLE BRANDS

Number of brands by growth rate



2016-17 domestic market growth: **20%**

KEY SUCCESS FACTORS OF WINNING BRANDS

Constant "newness" and "fashion" creation

Harness the power of digital

Improve store experience and customer service

Use fast fashion model to enable speedy replenishment

Note: Top 20 fashion brands ranked by revenue by 2017, covering leather goods, men's wear, women's wear and shoes.
Sources: Expert interview; Lit search; Bain analysis

4

Winning brands continue to push for “**newness**” and “**uniqueness**” in their designs to reshape fashion

KEY INITIATIVES		KEY ELEMENTS
	**Create “newness”**	• Bring **innovative designs** to the brand by **renovating** the traditional elements, highlighting the expression of personality and distinctiveness
	**Uniqueness in every detail**	• Cater to **individualism** in the details of designs • Dare to break from tradition and rules
	**Partnership for fashion**	• Partner with fashion icons and brands to achieve **creative momentum** and strengthen “fashion” image
	**Always in style**	• **Innovate on iconic models** with stylish elements and designs to **keep a trendy image**

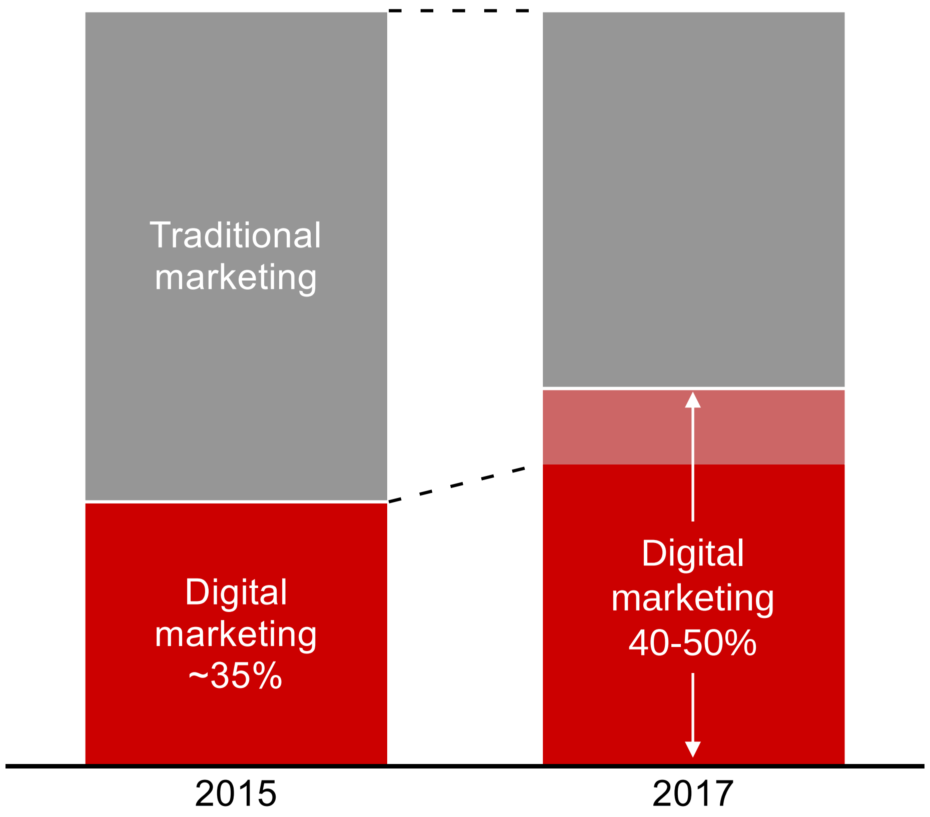
Sources: Lit research; Bain analysis

Brands invested heavily in digital marketing, with increasing investment in WeChat

4

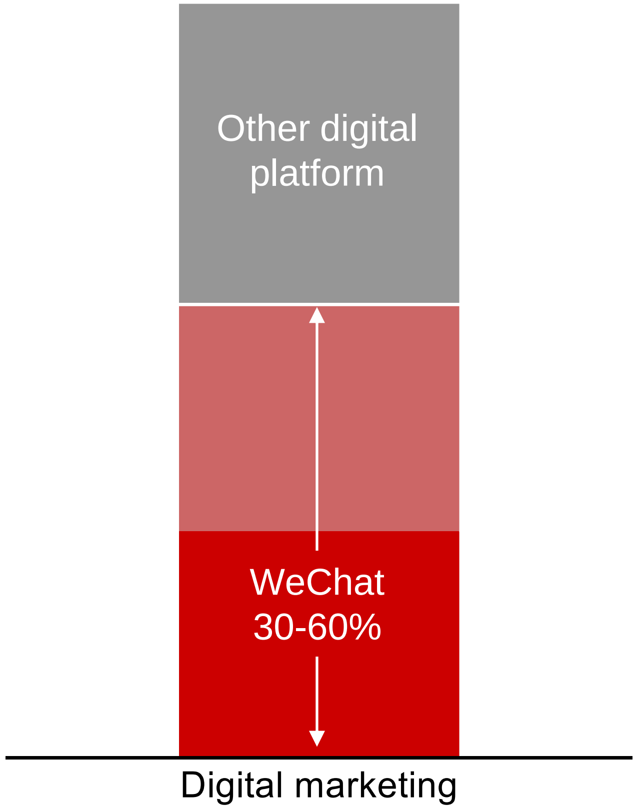
MANY BRANDS AGGRESSIVELY INCREASE SHARE OF DIGITAL MARKETING SPENDING…

Marketing spending split (%)



…AND SPENT 30-60% OF DIGITAL MARKETING BUDGET ON WECHAT

Digital marketing spending split (%, RMB, 2017)



"WeChat is a great platform to connect consumers, and ***increasingly capable of targeting the right consumers****. We will* ***take more initiatives*** *in the future."*

Executive, Luxury Brand

"We have been taking actions to ***invest in digital marketing on locally influential platforms****. Local popular digital media, especially WeChat, is becoming* ***increasingly important to our communication strategy****."*

Executive, Luxury Brand

Sources: Brand interviews; Bain analysis

4 Brands use WeChat official accounts to engage target consumers and provide services…

WECHAT OFFICIAL ACCOUNT TO ENGAGE CONSUMERS

All top 40 luxury brands launched WeChat official accounts…

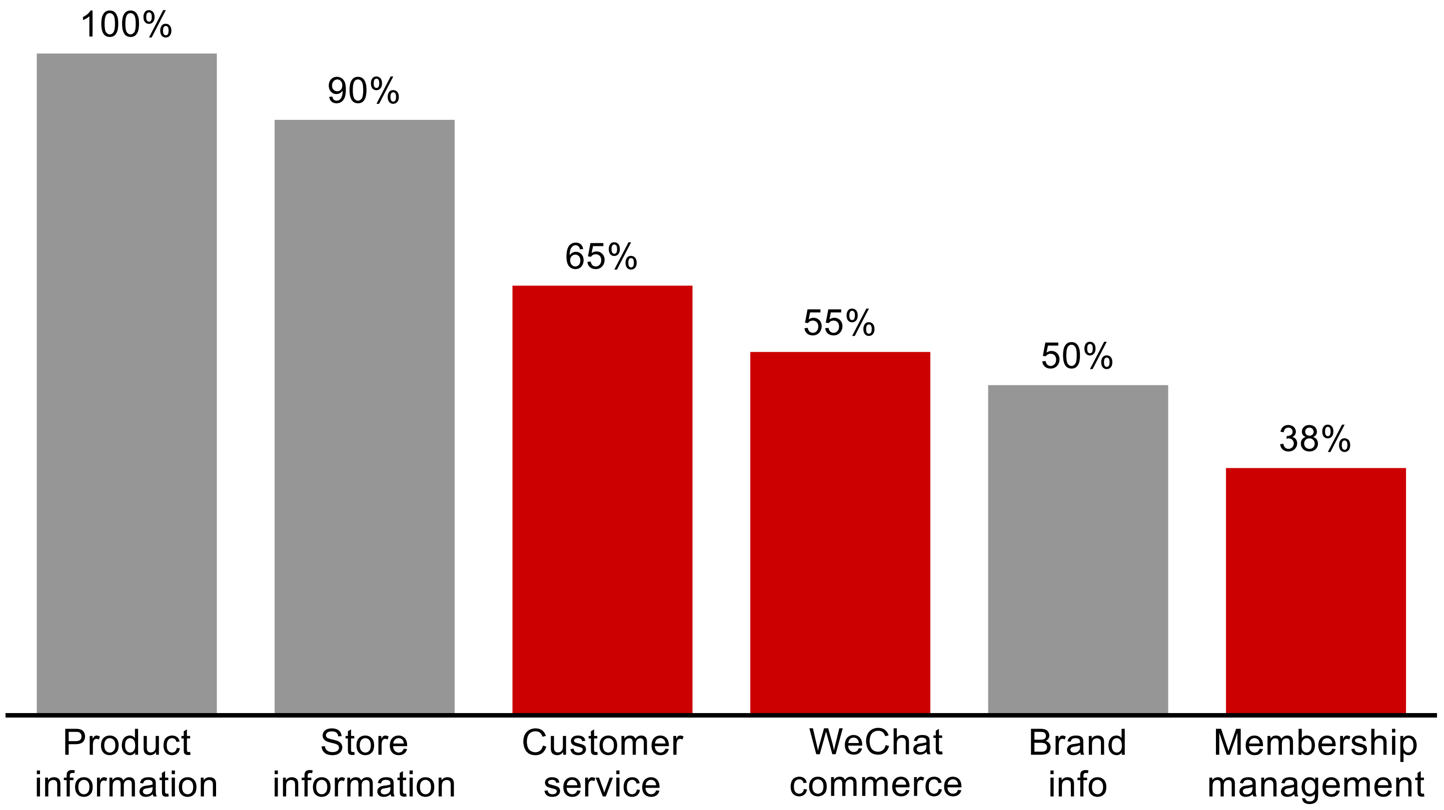
…each of the top 10 brands has 300-500K followers

…each post has 40-60K views on average

OFFICIAL ACCOUNTS HAVE BEEN BEYOND THE FUNCTION OF PROVIDING PRODUCT INFORMATION

Percentage of WeChat official account functions used by luxury brands

TOP 40 LUXURY BRANDS

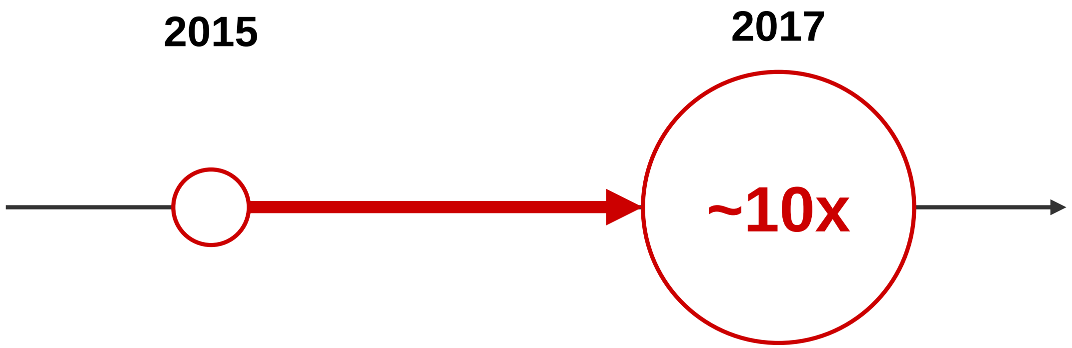


Service-oriented function

Note: As of Dec. 2017, in total top 40 luxury brands are counted, including cosmetics category.
Sources: Lady Max; Lit research; Bain analysis

…and WeChat moments campaign to drive traffic to stores or even convert into sales

WECHAT CAMPAIGN BECOMING MORE POPULAR



Number of luxury brands launching WeChat campaign

Frequency of WeChat campaign for each brand

…EFFECTIVELY DRIVING TRAFFIC AND CONSUMER ENGAGEMENT

New product campaign on Valentine's Day

- ~16M views
- Achieved ~10M clicks

Special product offering

- ~45M views
- Converted to ~200 online purchases in 36 hours

Product marketing

- ~70M views
- Converted 30-50K consumers as followers to official account

Note: WeChat campaign refers to moments ads
Sources: Tencent; Bain analysis

4 Some brands are borrowing from the **fast fashion** playbook

INITIATIVES	ELEMENTS
 **Launch collections more often**	• Bring new products **more often**, with **more products** per collection to market • Emphasize **item diversification** in each collection and create exclusive content • Offer a limited collection for specific holidays, and reflect Chinese theme
 **Renew shop windows more frequently**	• Update windows with **fresh elements and inspirational designs** more often to attract the attention of buyers and pedestrians *“I can see very different exterior window displays in a brand’s store every month when I visit the mall. The fresh displays are eye-catching and drive me to walk into the stores.”* Consumer in Shanghai
 **Speed up supply chain**	• Optimize supply chain to bring new collection quickly **to domestic markets** • **Exercise stronger vertical control** over product design, testing and manufacturing • Optimize manufacturing process to shrink manufacturing time

Sources: Lit research; Bain analysis

5 **2018 Outlook**: Strong momentum of domestic market expected to continue

	KEY DRIVERS FOR 2018	IMPACT ON DOMESTIC MARKET GROWTH
Millennials remain the engine	• **Strong momentum expected from Millennials, as long as brands can provide what they look for** • Spillover effect to other generations for ready-to-wear fashion	High positive impact
Strong complementarity between offline and online	• Offline stores continue to **be built with shopping experience and a service-oriented approach**, facilitated by digital campaigns and consumer engagement • **Increasing brand online penetration** will better cover cities without offline stores	High positive impact
Price harmonization	• More brands expected to **narrow the price gap** with overseas regions	Medium positive impact
Domestic consumption stimulation	• Government continues to **encourage domestic consumption** through adjustment on tax and customs controls	Medium positive impact
Recovering overseas markets	• **Recovery from political situations in Korea and terrorism in EU** indicate potential for overseas market to pick up	Negative impact
Uncertainty of the effects of politics	• **Uncertainty** of **government policies and interventions on luxury spending** still exists	?

High positive impact *Medium positive impact* *Negative impact* ? *Uncertain*

Sources: Lit research; Bain analysis

5 China is increasingly setting the trend in luxury

Most knowledgeable consumers, with growing spending power	• More Chinese luxury shoppers are emerging, who are **young, sophisticated and knowledgeable** • Chinese luxers **expected to spend more** with continuous trading up and growing spending power
Most advanced digital marketing experiences and engagement models	• China remains a pioneer in experimenting with **the most innovative digital services and models** for customer engagement • Brands will continue to **increase their digital investments** (e.g., Brand.com)**, digital content creation and digital marketing**, creating a unique **local** digital environment for their shoppers
Largely improved in-store experience	• **Shopping malls in China** will continue to emphasize **"retailtainment" and multipurpose environments** • **More extensive collaboration** between brands and malls will more effectively drive traffic and improve in-store experience • **Brand efforts** remain on optimizing store footprint, via renovating and upgrading stores

Source: Bain experience

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