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2015 China Luxury Market trends


Can it rebound?

Jan 20, 2016



Executive summary

- 1** In 2015, the China luxury market declined ~2% to ~113 billion RMB, impacted mostly by the slowdown in watches, men's wear and leather goods; North and Northeast regions were most impacted 
- 2** On the mainland, shopping malls and department store traffic continued to decline while the number of outlet malls continued to grow; overseas purchase destinations shifted: Japan, Korea (except during the MERS virus crisis), the eurozone and Australia grew strongly while Hong Kong and Macau shrank significantly; the Daigou market declined due to brands' efforts to close price gaps, tightening of government controls and emerging cross-border e-commerce sales 
- 3** Global pricing, as a key reaction to increasing parallel channels and overseas purchases, was started by Chanel and gradually adopted by several brands 
- 4** LFL store sales and traffic continued to decline, even among newly introduced brands, prompting store closures, cautious network expansion and increased focus on revamping core store networks 
- 5** Growing customer digital engagement continued and brands continue to increase their digital marketing budget; several brands are experimenting with online channels (brand.com or third-party platforms), but overall full-price e-commerce business for brands remains small (except for cosmetics) 
- 6** Customers' growing individualism continued the trend toward fashion and exclusivity; smaller, fashion-orientated brands are still gaining popularity; meanwhile, luxury experience spending continued to increase 
- 7** Outlook for 2016: No major changes are expected in the macro environment while the rising middle class becomes more sophisticated and knowledgeable about luxury; overseas channels will likely stabilize (and Daigou will decline) while expansion of global pricing by leading brands and the government efforts to localize consumption will spur domestic growth 

 Trend continued and amplified from 2014  New trend in 2015

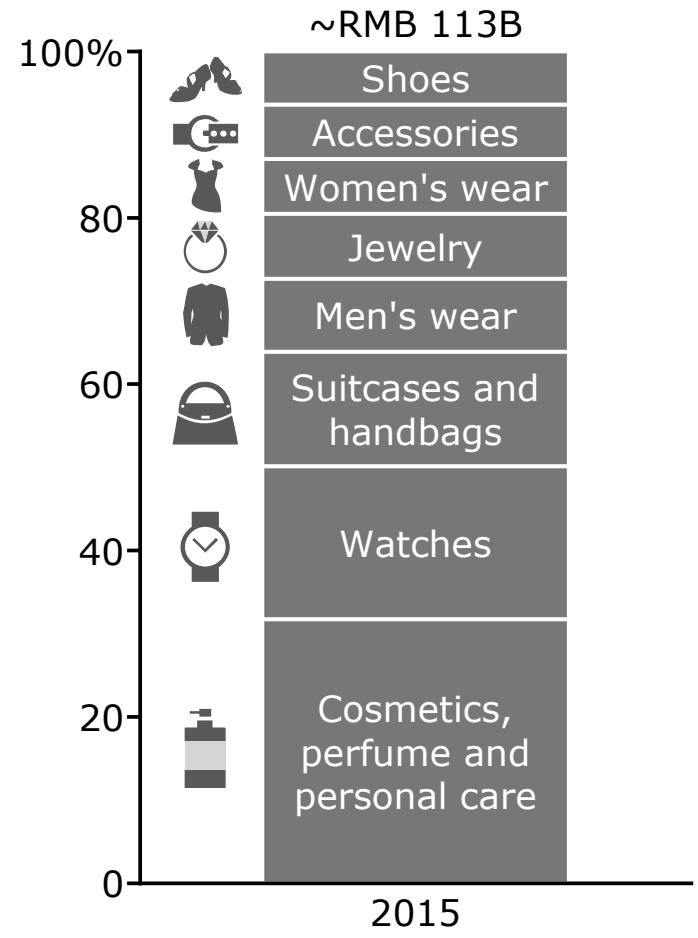
Source: Bain analysis



1

Overall, the mainland China luxury market continued to decline in 2015 by ~2%, to **113B** RMB

2015 Mainland China luxury market by category (RMB B)



	<u>CAGR</u> (12-13)	<u>CAGR</u> (13-14)	<u>CAGR</u> (14-15E)
	2%	-1%	-2%
Shoes	8%	8%	2%
Accessories	8%	0%	-6%
Women's wear	10%	11%	10%
Jewelry	5%	2%	7%
Men's wear	-1%	-10%	-12%
Suitcases and handbags	5%	0%	-5%
Watches	-11%	-13%	-10%
Cosmetics, perfume and personal care	10%	7%	5%

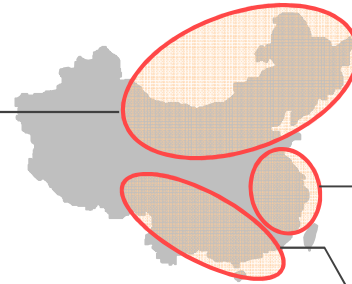


- Market deceleration amplified:
 - Rebasing from anti-corruption and anti-gifting not over yet
 - Significant impact from economic slowdown and stock market crash in Q2/Q3
- Continued rebalancing between male and female
 - Cosmetics, women's wear and jewelry continued to lead the growth in 2015
 - Men's wear and watches continued to decline

Note: Only include purchase conducted by Mainland Chinese living in mainland China, exclude HK, Macau, Taiwan Chinese and other foreigners who live in China; Only premium cosmetics are considered luxury goods in the cosmetics category
Sources: Brand interviews; lit research; Bain analysis

1

Geographic disparity continued; North/Northeast regions struggled while East outperformed



NORTH/NORTHEAST

- Generally North/Northeast China suffered more on luxury mostly due to:
 - Higher impact from anti-corruption rebasing due to prior higher dependence on business gifting
 - Oversupply of shopping malls in some cities such as Shenyang brought in more competition for foot traffic, forcing brands to redistribute their footprint
 - Local economic slowdown
 - Strong competition from neighboring tourism destinations—for example, Japan and Korea
- Beijing is holding up better than the rest of the north and northeast regions

WEST AND SOUTH

- Performance varies among brands
- Key cities in the west such as Chengdu and Chongqing have been growing in importance for major brands due to fast-growing local economies and strong local purchasing power

EAST

- East (especially Shanghai) is the biggest winner this year in luxury performance
 - Less rebasing from anti-gifting
 - Stronger up-and-coming middle class

Source: Bain analysis



1

Top five brands in each category in Mainland China market



Cosmetics, perfume and personal care

- Chanel
- Dior
- Estee Lauder
- Lancôme
- Laneige



Watches

- Cartier
- Longines
- Omega
- Rolux
- Tissot



Suitcases and handbags

- Coach
- Gucci
- Hermes
- Louis Vuitton
- Prada



Men's wear

- Armani
- Boss
- Burberry
- Dior
- Ermenegildo Zegna



Jewelry

- Bvlgari
- Cartier
- Chow Tai Fook
- Tiffany & Co.
- Van Cleef & Arpels



Women's wear

- Armani
- Burberry
- Chanel
- Dior
- MaxMara



Accessories

- Ermenegildo Zegna
- Gucci
- Hermes
- Louis Vuitton
- Montblanc



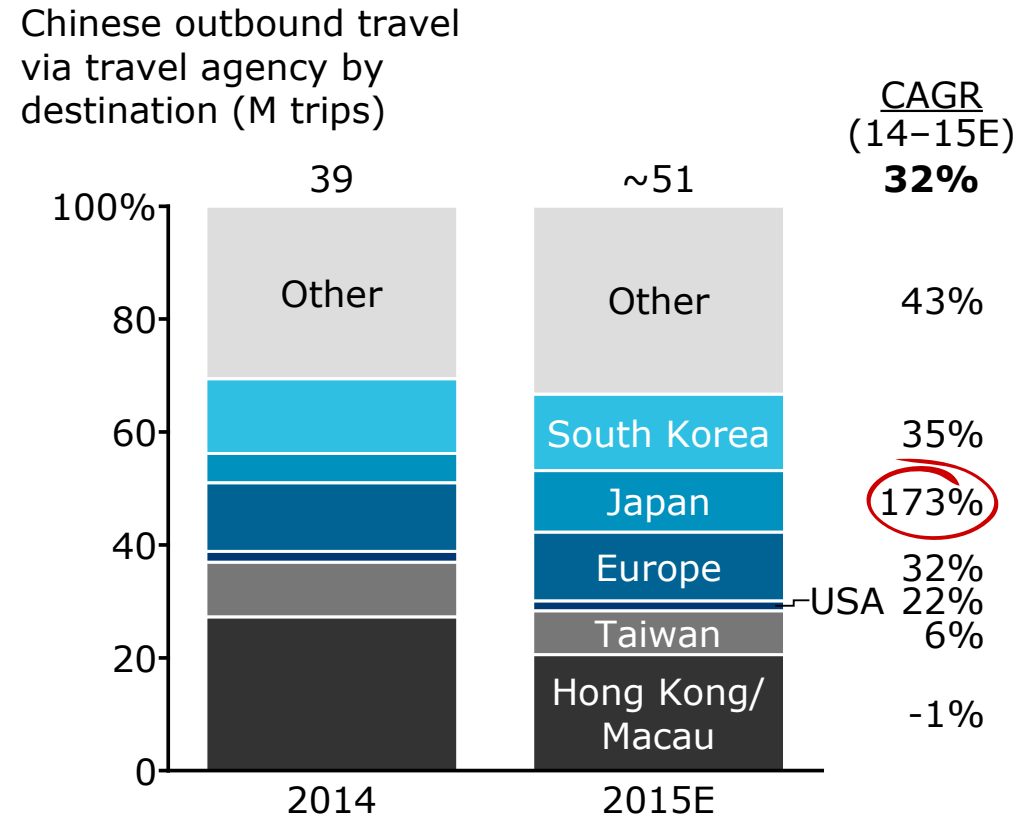
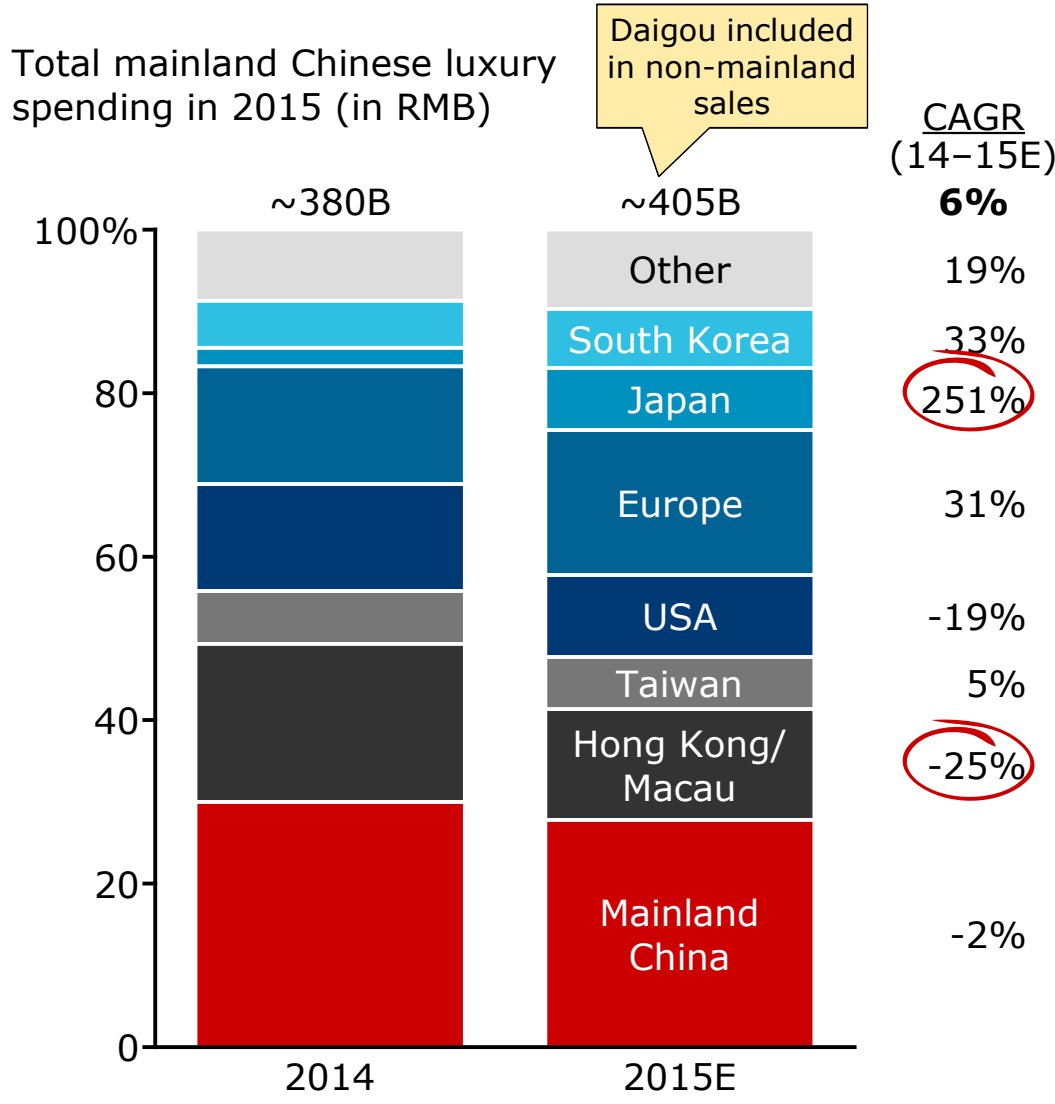
Shoes

- Chanel
- Gucci
- Louis Vuitton
- Salvatore Ferragamo
- TOD's

Notes: Top five brands by category in alphabetical order; "accessories" includes stationary, scarves, sunglasses, etc.; leather goods includes suitcases and handbags, and smaller items such as wallets; Armani brand includes Giorgio Armani, Emporio Armani and Armani Collezioni
 Sources: Brand interviews; department store interviews; analyst reports; company reports and websites; Bain analysis

2

Japan is the winner of mainland Chinese overseas purchases in 2015 while Hong Kong and Macau dropped



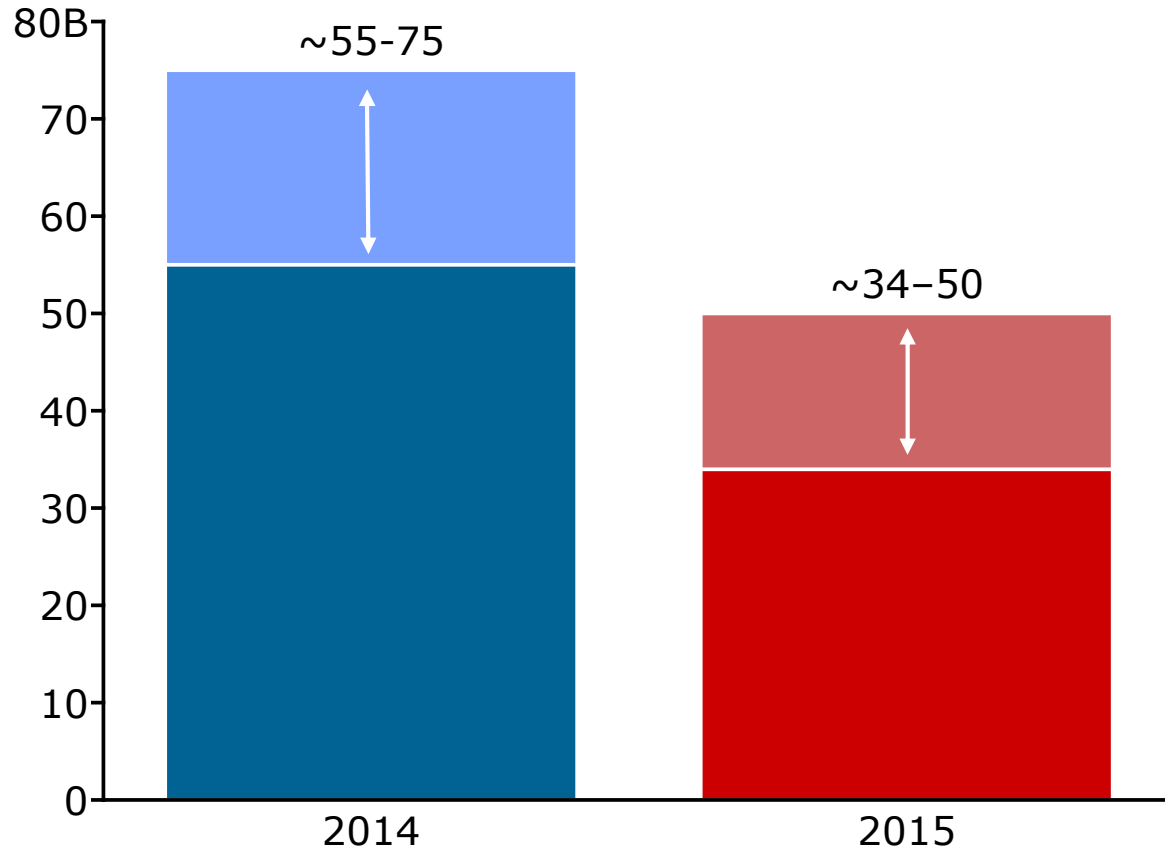
"Japan is one of my favorite traveling destinations. Japanese food is delicious, the scenery is beautiful, and it's also a shopping paradise. I will go there more often as it only takes a few hours by air and the visa policy becomes more open now."
 — Consumer, Shanghai

Note: Include purchase by Mainland Chinese who live in Mainland China only, exclude HK, Macau, Taiwan Chinese and mainland Chinese live in other countries; Australia and Russia are ranked in the top two in the "Other" segment of total luxury spending
 Sources: Bain survey of luxury consumers in mainland China, 2015 (n=1,447); China National Tourism Administration; Bain 2015 global luxury report; Bain analysis

2

Daigou market size estimated to shrink to 34B–50B RMB in 2015

Daigou market size
for luxury goods (RMB B)



HIGHLIGHTS

- Overall, the Daigou market went down in 2015 mostly due to:
 - Price adjustments by key brands that reduced Daigou margins and brought some customers back to China
 - Government efforts to tighten controls over Daigou to localize and officialize consumption
 - Customers tended to shift away from Daigou as more overseas purchase channels emerged—for example, cross-border e-commerce)
- Cosmetics took the biggest Daigou share, followed by leather goods and watches:
 - Daigou for high-value items such as watches is mostly via friends and relatives
 - Categories where size matters such as shoes have less Daigou penetration

Sources: Bain survey of luxury consumers in mainland China, 2015 (n=1,447); Smart-Path; brand interviews; analyst reports; lit research; Bain analysis

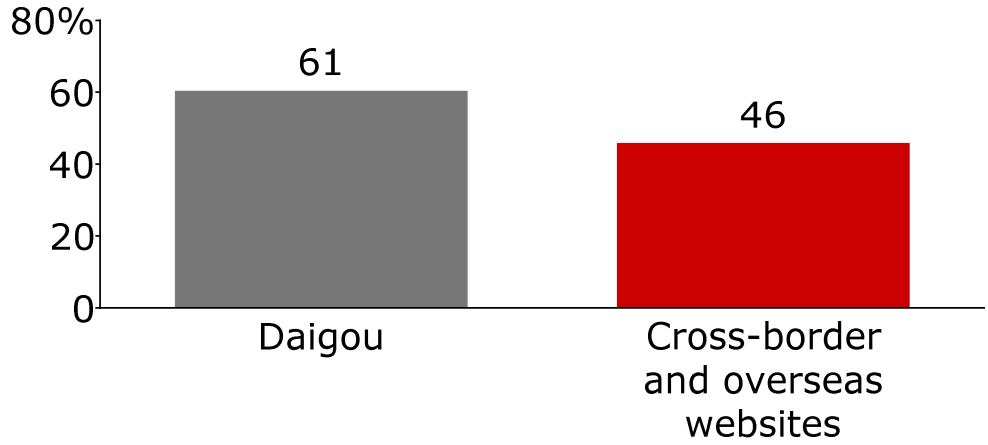


2

Cross-border and overseas websites are emerging, taking 12% of total Chinese luxury goods spending

"Have you ever purchased luxury goods via following channels?"

Percentage of responses



Cross-border and overseas website examples	
JD Worldwide	Amazon
Tmall.HK	Net-A-Porter.com
Kaola.com	ShopBop
Secoo.com	Harrods

"Cross-border is more reliable than Daigou in terms of both process and product quality. Plus, I can reach their customer service very easily."
 — Consumer, Shanghai

HIGHLIGHTS

- Increased accessibility and availability encouraged purchasing via emerging cross-border e-commerce
 - Key players dedicated to providing easy access through user-friendly websites/apps
 - For example, major foreign e-commerce players launched a Chinese version of their sites
 - Increased customer awareness due to heavy marketing investments
 - Improved customer service and product guarantees
 - More convenient cross-border payment tools introduced (Alipay, Union pay accepted by more overseas websites, introduction of installment payments and so on)
- Customers, especially among the emerging middle class, are becoming more knowledgeable and confident in conducting overseas purchases online

"With e-commerce developing, overseas online shopping becomes more convenient. If I am able to purchase luxury goods from other countries at a better price, then why not?"
 — Consumer, Beijing

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

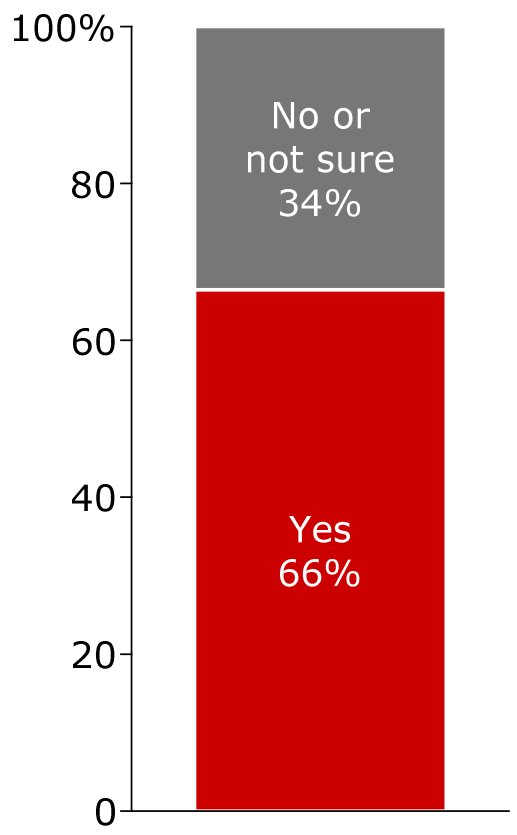


2

Outlet malls are now an important channel to low-price luxury for Chinese customers

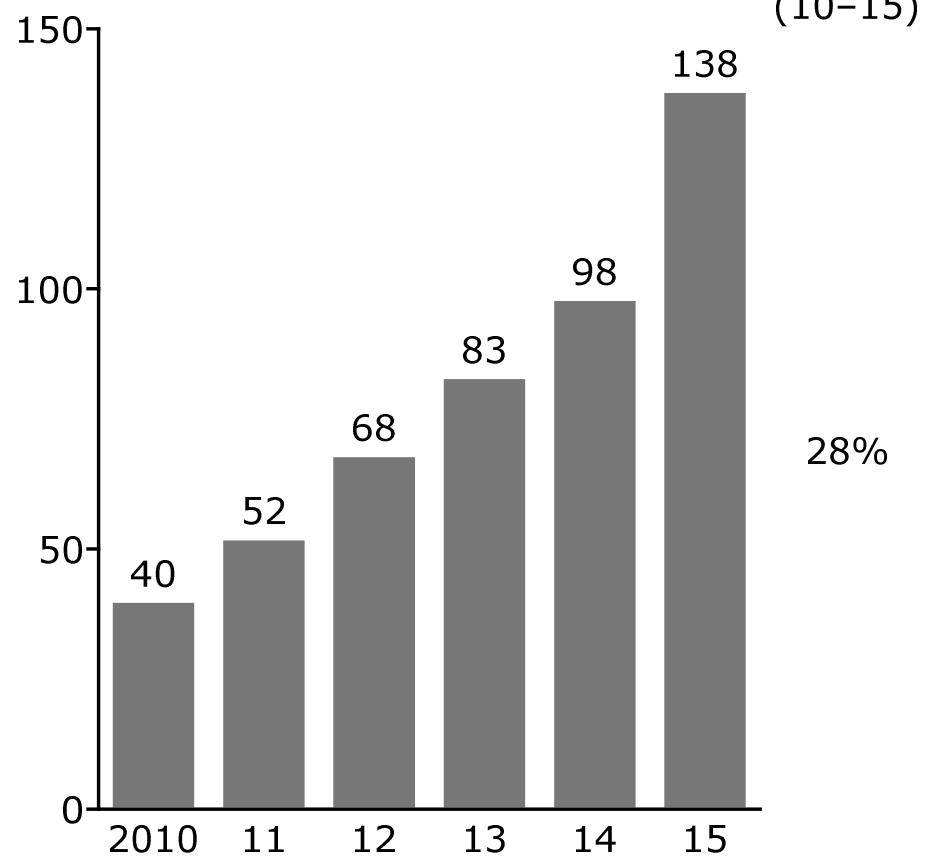
"Will you increase your spending on luxury in outlets next year?"

Percentage of responses



OUTLETS EXPANDING THEIR FOOTPRINTS

Number of outlet malls in China



HIGHLIGHTS

- Growing middle class has easier access to outlets
- Brands' strategies have evolved:
 - Certain brands are treating the outlet as a strategic channel
 - More brands pushed outlet sales to compensate for their struggling retail business
- However, there is some concern over the long-term growth outlook:
 - Traffic dropped in outlet malls after the stock market decline in Q3
 - Fast expansion of footprint caused cannibalization of sales among stores

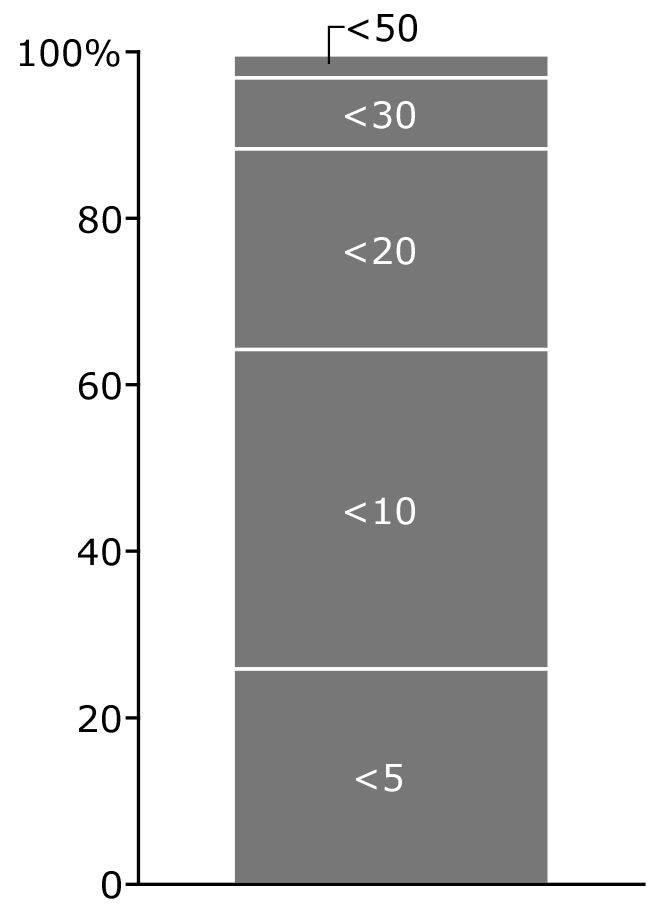
Sources: Bain survey of luxury goods consumers in mainland China, 2015 (n=1,447); brand interviews; outlet malls interviews; analyst reports; Bain analysis

3

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"

Percentage of responses



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

3

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



Tighten control over gray markets

- 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 alternatives to Daigou

- 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



Reduce import duties

- 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%



Monetary policy

- 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%."

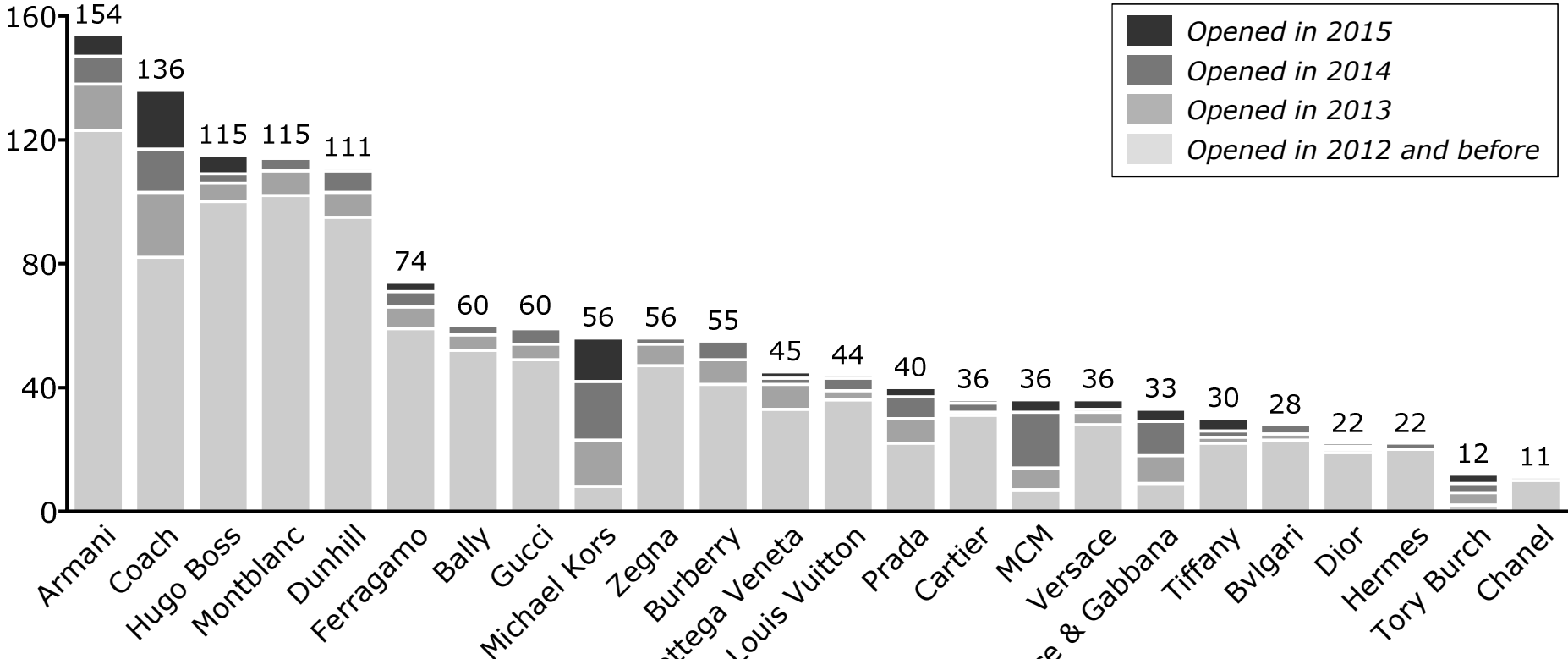
- Macquarie Group



4

Store closures are more prevalent, and store openings are more cautious, except for a few brands

Estimated number of retail stores for select brands by end of 2015



	Armani	Coach	Hugo Boss	Montblanc	Dunhill	Ferragamo	Bally	Gucci	Michael Kors	Zegna	Burberry	Bottega Veneta	Louis Vuitton	Prada	Cartier	MCM	Versace	Dolce & Gabbana	Tiffany	BVLGARI	Dior	Hermes	Tory Burch	Chanel	Total
2015 opened	7	19	6	1	1	3	0	1	14	0	0	2	1	3	1	4	3	4	4	0	1	0	3	0	78
2015 closed	4	3	11	0	5	2	3	5	1	4	2	6	4	0	2	1	1	0	0	1	2	1	0	0	58

Notes: Different labels in one store are counted as one (e.g., black, orange and green label for Hugo Boss); Cartier and BVLGARI store data exclude watch counters and only include boutiques; Chanel stores include fashion boutiques only; for Coach, two separate stores—one for men and one for women—are counted as two stores, although they are exactly adjacent to each other; Dolce & Gabbana may have multiple stores in one mall; Armani brand includes Giorgio Armani, Emporio Armani and Armani Collezioni (the same location is regarded as one store); Zegna’s underwear line not included; children’s wear and outlet stores not included for any brands; Kate Spade closed eight stores mostly due to a change of partnership
 Sources: Analyst reports; official brand websites; brand interviews; Bain analysis

Brands focus more on core stores and malls to increase efforts to retain top brands

KEY ACTIVITIES

DESCRIPTION

Brand footprint: back to "exclusivity"

- Brands taking action to avoid overexposure
 - Focus on identifying "right place to play" and "right store number" by city
 - Several brands, particularly established ones, have slowed expansion or withdrawn from certain malls or entire cities
 - Other brands are being more selective in choosing their landlords and are relocating stores to well-operated, well-maintained malls to better capture traffic

"For us, there is a one-store city or a two- to three-store city; we need to stick to this and really think about what's the place we need to be and how much exposure we want there."

— Brand executive

In store: increase productivity

- Consolidated smaller stores to achieve higher productivity per square meter
- Continued to invest in key/flagship stores, including renovations and improving service quality
 - Improve overall in-store shopping experience
 - More in-store activities provided to increase customers' in-store time

"We just renovated the flagship store in Shanghai, and it's beautiful ... we observed an obvious increase of in-store traffic and sales revenue after the renovation. This will continue to be our focus as we roll out to other cities."

— Brand executive

Luxury malls: effort to retain top brands

- Bring in more traffic
 - Some malls are bringing in new brand categories to help attract traffic in key locations—for example, women's accessories on the ground floor)
- Compete for brands' leases
 - As brands become more selective, landlords in mainland China are more willing to renegotiate rent

"As brands reduce their footprint, landlords are trying to cooperate with brands to get through hard times together, and the first thing we can think of is to discount the rent."

— Real estate analyst

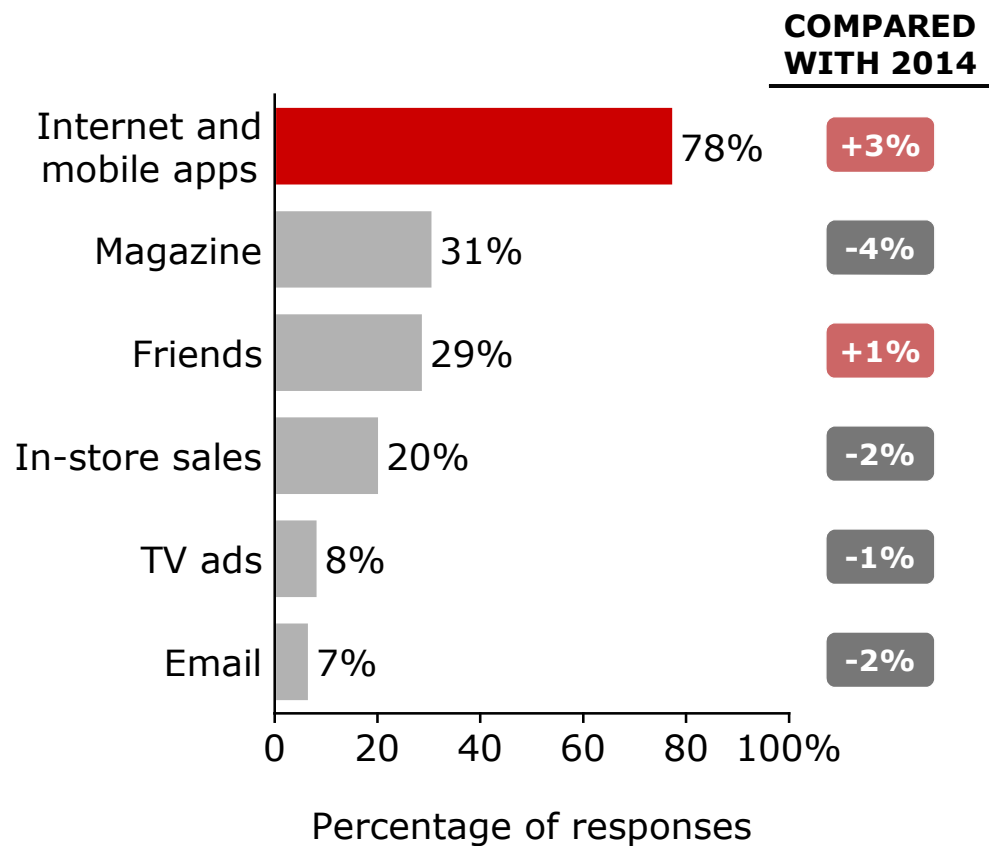
Sources: Analyst reports; brand interviews; Bain analysis



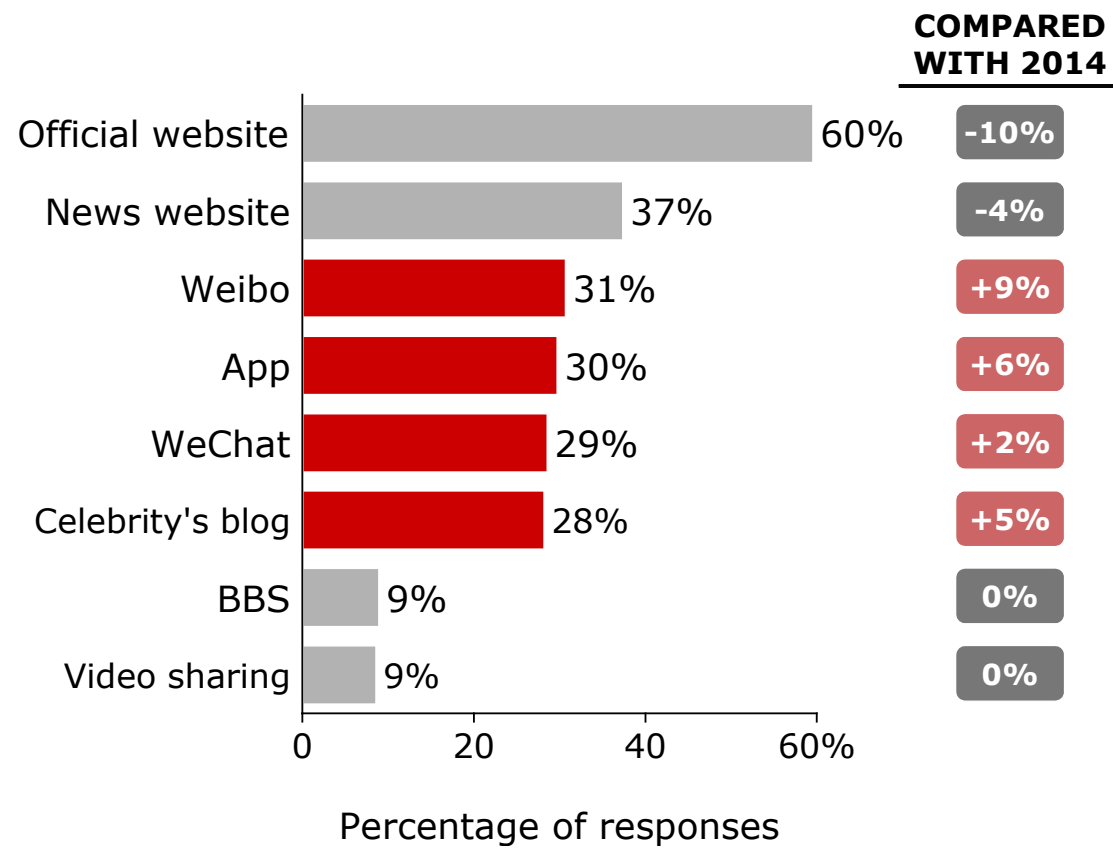
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Digital engagement is up, which encourages brands to increase their digital marketing budgets

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



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

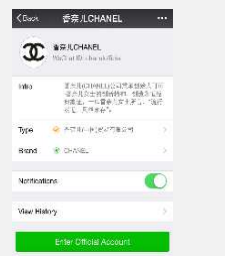










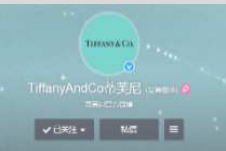






On average, luxury brands are spending more than 35% of their marketing budgets on digital

Sources: Bain survey of luxury goods consumers in mainland China, 2015 (N=1447); Bain analysis

5

Brands invest both in digital platform engagement and digital content creation

	DIGITAL PLATFORM ENGAGEMENT				DIGITAL CONTENT CREATION
	新浪微博 Sina Weibo	微信 WeChat	Brand.com/ Mobile apps	Other digital platform	
Chanel	 <p>香奈儿CHANEL (已认证)</p> <p>~1.6M followers ~900 posts</p>	 <p>香奈儿CHANEL</p> <p>Enter Official Account</p>	 	 <p>Chanel News</p>	<ul style="list-style-type: none"> Leverage Weibo to interact with Zhou Xun, Chanel's celebrity spokesperson in China, to increase brand awareness <ul style="list-style-type: none"> For example, release of Zhou Xun's Chanel candid series through Weibo Launch CN version micro movie series "Inside Chanel" exclusively through Weibo, WeChat and official website Release of new Chanel ads and fashion shows across digital platforms
Coach	 <p>~2.1M followers ~6,000 posts</p>	 <p>Coach 蔻驰</p>	 		<ul style="list-style-type: none"> Create hot topics on Weibo to generate awareness <ul style="list-style-type: none"> For example, "CoachSpring2016" on Weibo, receiving ~120M views and ~100K comments; repost prize activity, ~5K participants Launch interactive picture-sharing activity on Coach app <ul style="list-style-type: none"> For example, "My Coach and puppies"
Burberry	 <p>~1M followers ~4,000 posts</p>	 <p>Burberry</p>			<ul style="list-style-type: none"> Produce digital content on a wide range of topics exclusively through Burberry's official site and Youku platform <ul style="list-style-type: none"> For example, Burberry make-up video courses, fashion shows and Burberry Acoustic Leverage WeChat to host virtual launch events for new items and fashion shows such as the 2014 Burberry Shanghai fashion show
Tiffany	 <p>~0.5M followers ~1,000 posts</p>	 <p>Tiffany 蒂芙尼</p>	 		<ul style="list-style-type: none"> Produce content for Weibo, WeChat and Tiffany app <ul style="list-style-type: none"> For example, gift recommendations, engagement ring introductions and educational information Localized global digital content to better fit the Chinese market <ul style="list-style-type: none"> Key campaign used Liu Wen and Zhang Aijia as local spokespersons, receiving ~40M views on Weibo Bridal campaign shared the love story of local celebrities Li Na and Jiang Shan on Weibo and WeChat

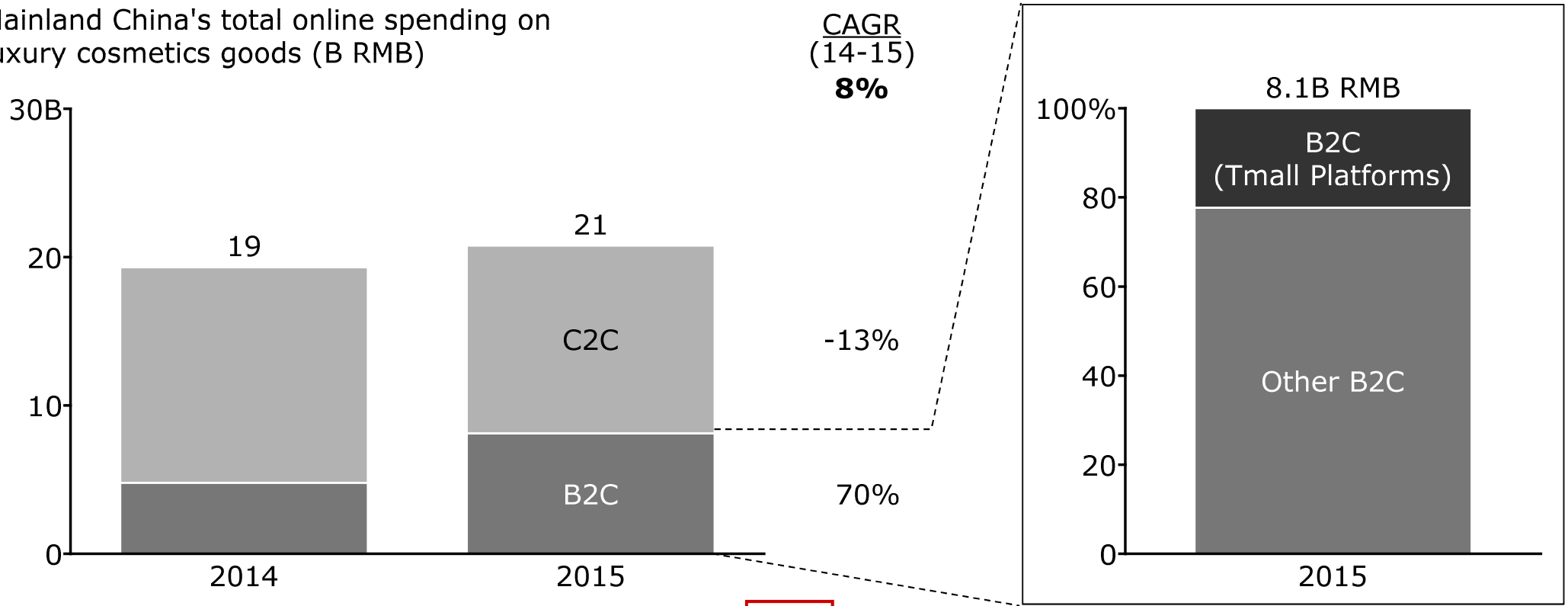
Sources: Official websites; Weibo.com; Youku.com; Lit research; brand interviews; cold calls

5

Cosmetics is the primary online category; B2C channels gradually overtaking C2C

B2C TAKES SHARE FROM C2C

Mainland China's total online spending on luxury cosmetics goods (B RMB)



B2C growth driven by Brands' official website sales and fast growing cross border e-commerce

Notes: Taobao makes up ~95% of C2C; B2C (Tmall platform) includes brands' Tmall flagship stores, other Tmall seller and Tmall international; other B2C includes other third-party platforms and cross border ecommerce; cosmetics goods includes makeup, skincare and perfume

Sources: Smart-Path; Bain analysis

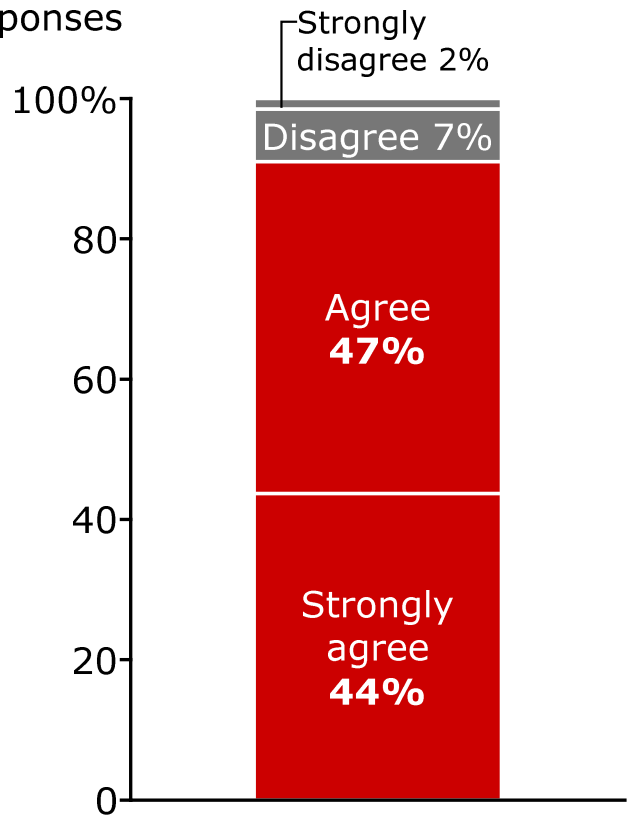


6

Brands with more fashion elements have strong momentum among consumers, albeit from a low base

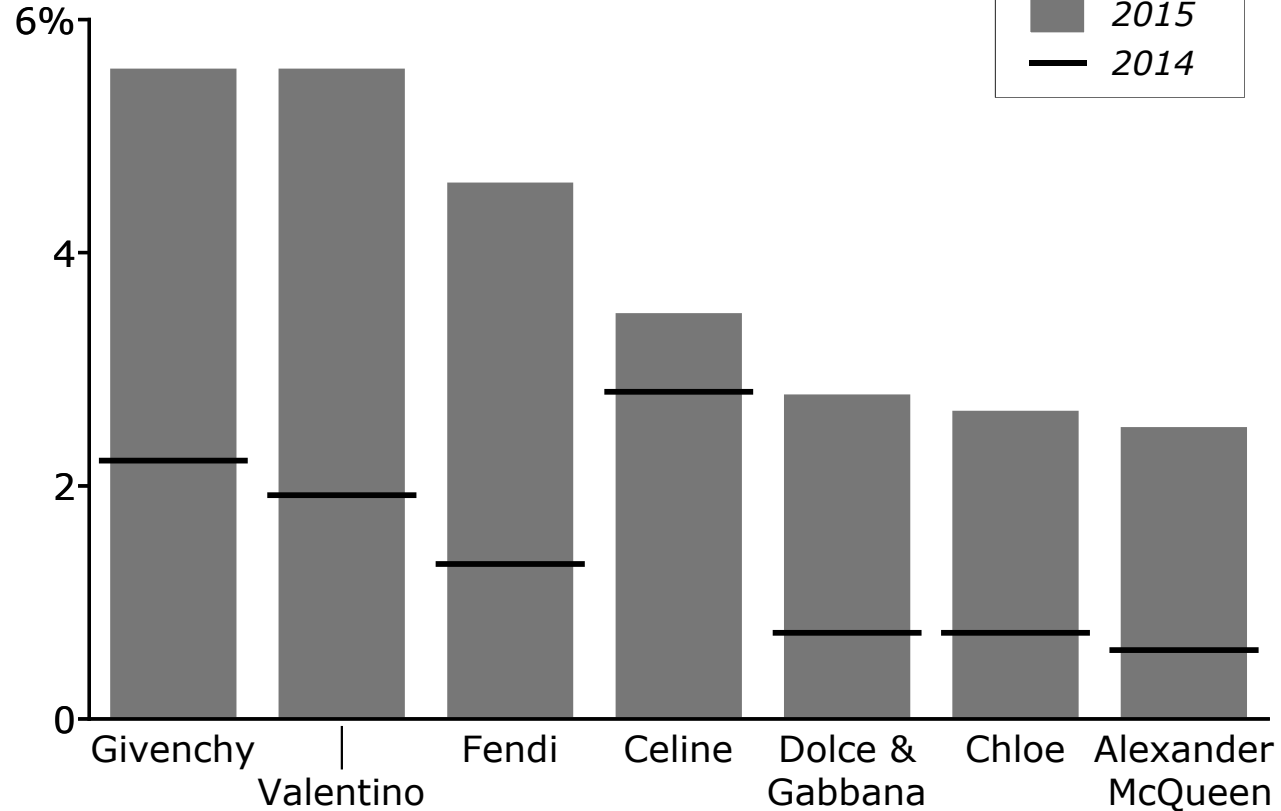
"In the next three years, you tend to buy more fashionable luxury brands with more design elements."

Percentage of responses



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

Percentage of responses of fashion brands



TIER-1 CITIES

Legend: 2015 (Grey bar), 2014 (Black line)

Note: Tier 1 cities include Beijing, Shanghai, Shenzhen, and Guangzhou (n=715)
 Sources: Bain survey of luxury goods consumers in mainland China, 2015 (n=1,447); Bain analysis

These brands continue to push the definition of what consumers consider to be luxury and fashionable

CONTINUOUS EFFORT TO DEFINE FASHION

EXAMPLE

Givenchy

- Collaboration with iconic designers
 - Invited Donatella Versace, chief designer of Versace, to represent Givenchy's Autumn 2015 ready-to-wear collection
 - Design collaboration with Marina Abramović on the 2016 spring collection
- Engaging with a wider audience on high fashion
 - Open 2016 New York fashion show to public
 - Brought in first CN celebrity, Chris Lee (viewed as an icon with strong personal style), to attract more young, trend-driven customers

"Chris Lee is an iconic idol who is leading fashionable trends and has a strong impact on China's younger generation. As a brand ambassador of Givenchy, she has likely been enlisted to support the design house in a number of capacities."

— A fashion website

Fendi

- Doubling down on its core fur element in the 2015 autumn/winter collection
 - Karl Lagerfeld designed the "haute fourrure" collection and held the first fur fashion show in Paris in July 2015
 - Applied fur elements to more women's ready-to-wear collections

"I love Fendi awesome pre-fall 2015 season's collection. There is [a] kind of retro futuristic touch [that] is seen through geometrics, furs, color blocking and other high visual garments. Each look is not only desirable but commercially wearable."

— The Best Fashion Blog

Valentino

- Expanded retail networks, leveraging fashionable store design to express Valentino fashion
 - ~20–30 new stores opened in 2015 globally
- External investments to strengthen design and quality
 - Bought 51% share of Pelletterie Sant'Agostino, Valentino's upstream supplier
 - Bought 41% share of Figli di Enio Pescini Srl, handbag metal parts supplier (also a supplier to Gucci)

"If you go to Valentino's flagship store [on] Fifth Avenue in New York, you will feel the 'high fashion' there just from the store decoration; I guess that's how Valentino express their attitude toward fashion."

— A fashion blogger

Dolce & Gabbana

- Continually add new fashion themes for "all ages" into ready-to-wear collections
 - Release new collection exclusively in Plaza 66 store with Italian pottery pattern
 - Combine "family life celebration" theme into marketing campaigns and runway shows, e.g., campaigns that focus on multiple generations and runway presentation that touts the relationship between mothers and children

"Previous advertising campaigns have targeted both young and old Dolce & Gabbana consumers. The incorporation of the elderly ladies into this season's campaign continues to emphasize that Dolce & Gabbana is a brand for all ages' Fashion."

— A fashion website

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



6

More established brands continue to invest to be perceived as more young and fashionable

EXAMPLE

NEW DESIGNERS AND COLLECTIONS WILL REVITALIZE BRANDS

FEEDBACK

Gucci

- Appointed Alessandro Michele as new creative director starting in January 2015, who's dedicated to making Gucci a young brand
- Revamped its 2016 fall collection to include more young, fashionable elements



"Slithering snakes, blooming flowers, embellished swallows—the symbols that appear in Alessandro Michele's Gucci collections signal a vibrant story just waiting to be told."

— Vogue

Coach

- Stuart Vevers continued to drive design toward fashion and young; newly launched Madison bag collection has been a fashion hit
- By participating in fashion weeks in New York and Shanghai, Coach started to build its ready-to-wear fashion image



"I stopped buying Coach since I was in high school as it was a 'mom's brand"; now I might need to change my view and have a try."

— Fashion blogger

Louis Vuitton

- Launched its Me & Me accessories collection by Nicolas Ghesquière, targeting fashionable young customers who pursue new and unique designs



"I like Me & Me of LV, it feels like someone always elegant suddenly showing her cute side to me."

— Fashion blogger

Hermes

- Collaborated with Apple to launch Apple Watch with Hermès watchband, which is popular among young consumers



"With leather straps handmade by Hermès artisans in France and an Hermès watch face reinterpreted by Apple designers in California, Apple Watch Hermès is a product of elegant, artful simplicity."

— Fashion website

Dior

- Appointed Rihanna, the iconic US pop star, as new spokeswoman, trying to capture more young, trend-conscious consumers



"Rihanna can illustrate mixed fashion style better and bring stronger visual impact. I am totally impressed by her new Dior ads 'Secret Garden IV'."

— Fashion blogger

Chanel

- Appointed Lucia Pica, famous for creativity in cosmetics design, as Chanel cosmetics' new director
- More young elements in the 2016 ready-to-wear collection, bringing modernity and youthfulness to Chanel



"With her singular beauty vision, the make-up artist Lucia Pica is bringing a cool new attitude to Chanel. 'She's got creative vision,' says legendary makeup artist Charlotte Tilbury. 'It's been great to see her develop her own makeup style over the years, which has a fresh, cool edge to it.'"

— Vogue

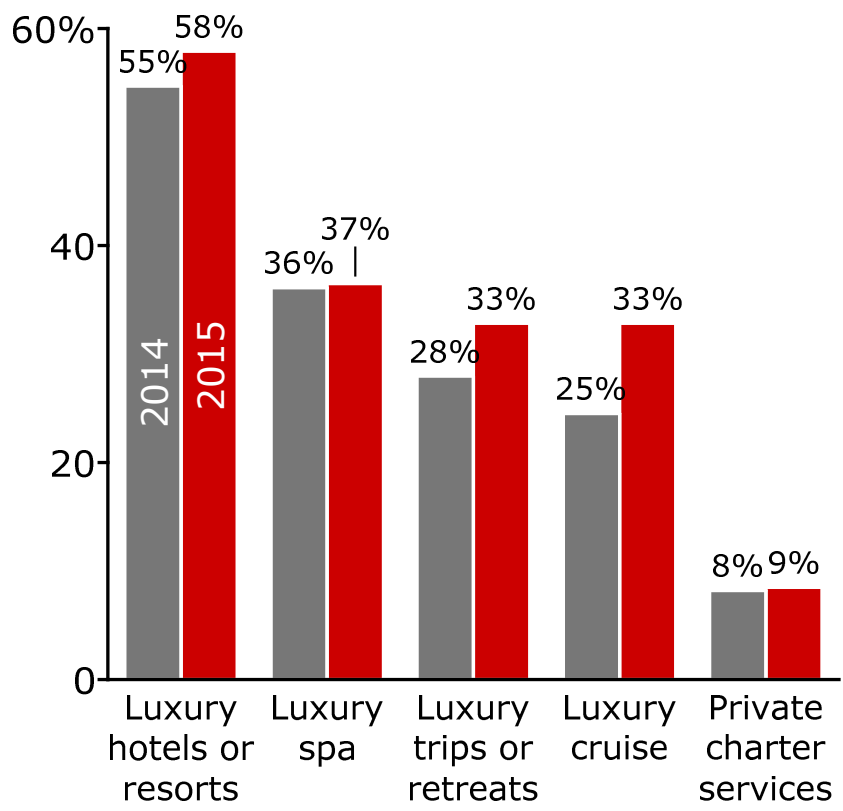
Sources: Lit research; Bain analysis

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Meanwhile, consumers' shift toward experiential luxury continues to grow

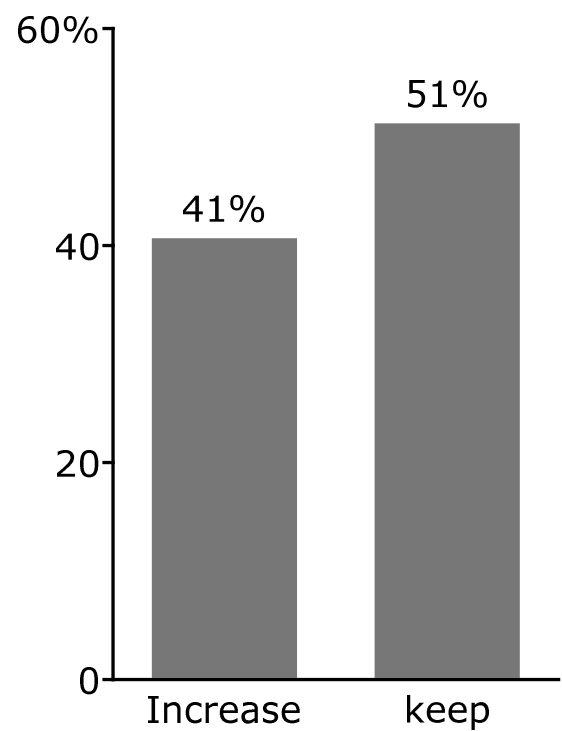
"Have you spent on the following luxury experience?"

% of mentions



"Will you increase/ keep/ decrease the spending on those luxury experiences next year?"

% of mentions



MORE PEOPLE TEND TO TRAVEL INDIVIDUALLY

"Young people like to plan their own trip instead of following a fixed schedule now. Therefore, self-guided tours are more popular among young Chinese outbound tourists."

—China Daily

"I'm a bit tired of group tours as more choices have emerged for entertainment. Now I like to plan my own relaxation time, for example, by finding a resort nearby to spend a few days with families or go somewhere I am really interested and spend some time to experience local culture."

—Consumer in Shanghai

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

2016 expected to see improvement in domestic sales, prompting new challenges and requirements for brands



Brand repositioning and footprint reduction

- Making brands appeal to younger, more fashionable consumers to capture the trendy market segment will require effort
- To create exclusivity, brands must reduce their store footprint. At the same time, brands must be more selective about where to play in terms of cities and rental negotiations with landlords
- Brands must continuously improve their in-store productivity



Global pricing and Chinese P&L

- Global pricing is one of the key solutions to address overseas purchases issues. It will likely spread to key segments of the collections of other brands
- Important to think about Chinese P&L vs. China P&L to encourage and recognize local teams' investments, brand-building efforts, and strategies for engaging consumers



Digitalization and e-commerce

- Strengthen digital platform building—such as Weibo, WeChat and apps—and digital content creation and localization to fit into local market
- Consider channel extension to brand.com and third-party full price platforms

Note: China P&L means revenues generated in China market; Chinese P&L means revenue contributed by Chinese globally
Source: Brand interviews; Bain analysis



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