



2011 China Luxury Market Study

Bain Point of View
December 2011

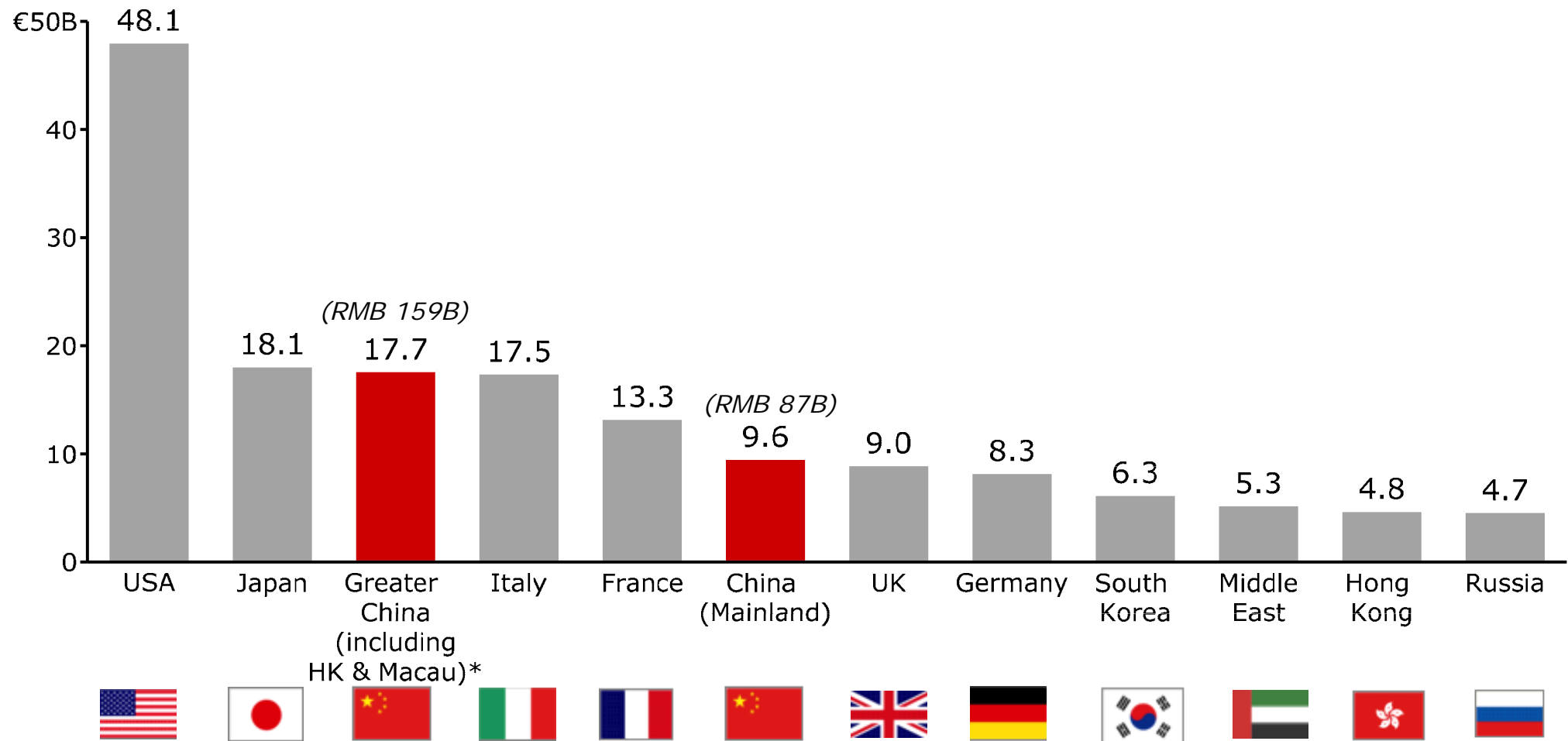
Agenda

- China luxury market overview
- Key trends of China luxury market
- Implications for luxury brands in China



Mainland China ranked top 5 globally in 2010, while Greater China (incl. HK & Macau) already among top 3

Personal Luxury Goods - Ranking by Country (2010, B€)



*Indicates luxury spend in Mainland China, HK & Macau

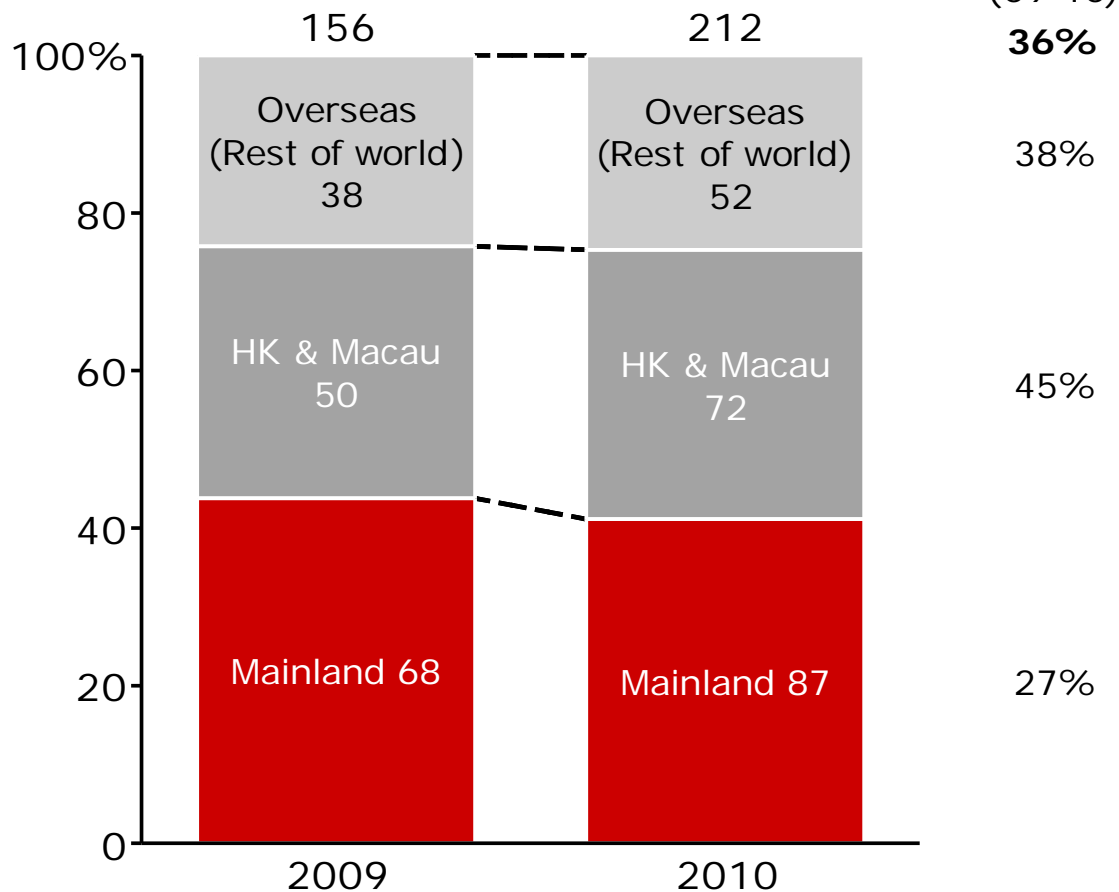
Note: 2010 Euro/RMB exchange rate = 9.0

Source: Bain luxury goods worldwide study 2011; Bain Survey of Luxury Goods Consumers in Mainland China 2011 (n=1,959); Bain analysis



Total luxury spend by mainland Chinese reached RMB212B in 2010; ~60% spent outside mainland

Total China luxury spend (RMB B)



KEY HIGHLIGHTS

- **Overseas** (including HK/Macau) spending showed **strong growth**; **HK & Macau** account for **>50%** of overseas spend
 - Trend expected to **continue in 2011/12**
 - Driven by **RMB appreciation** and **increased overseas travels**
- Purchase in **Mainland** continued to increase, however still **<50%**

*"The **price gap** between domestic & overseas **remains**; and **with RMB appreciation**, consumers are **travelling abroad more** and **buying a lot overseas**."*

VP, Luxury watch distributor

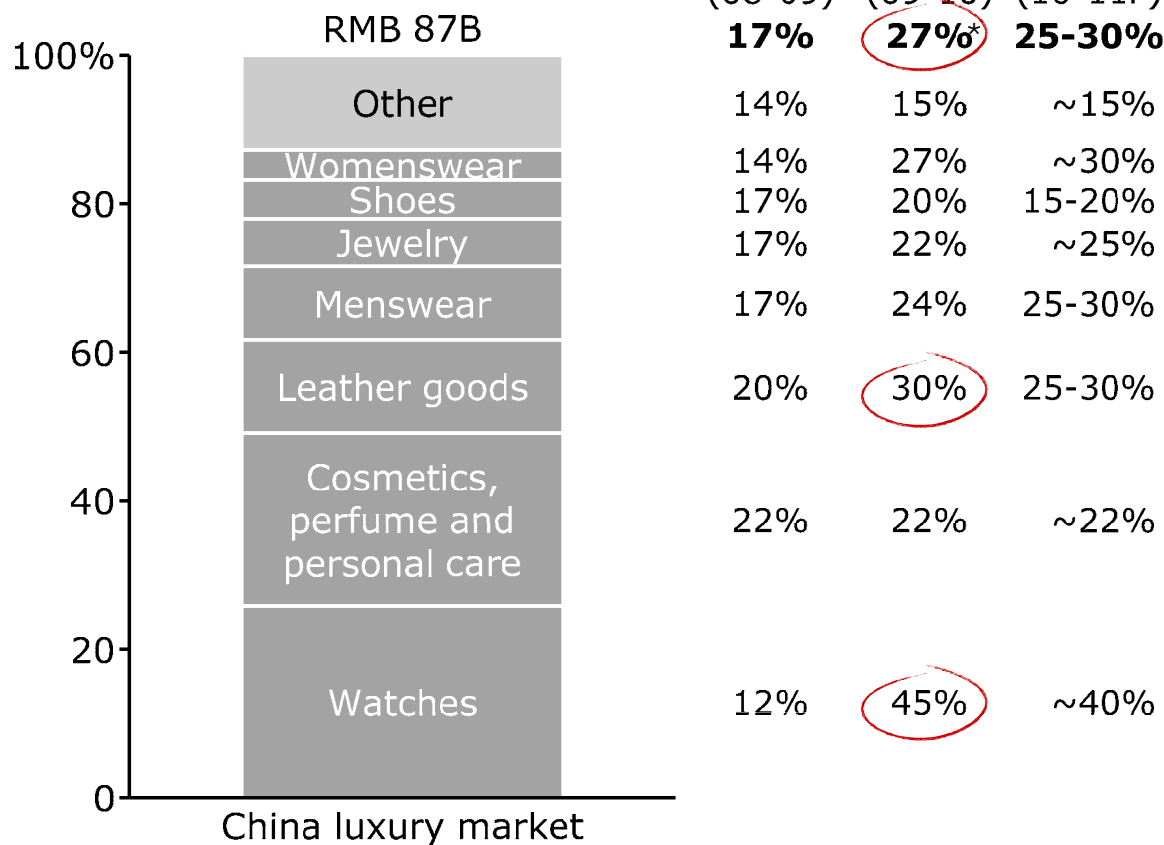


Source: Bain Survey of Luxury Goods Consumers in Mainland China 2011 (n=1,959)



Phenomenal growth in 2010 across categories; momentum continued in 2011 with a gradual softening in Q4

2010 Mainland China luxury goods market by product category



KEY HIGHLIGHTS

- China's domestic luxury market **growth picked up speed in 2010** and reached RMB 87B
- 2011** expected to be another good year for China luxury; **however a gradual softening in consumption** appeared in Q4
- Watches and leather goods lead the growth**
 - Watches** saw a clear rebound after '09, driven by economic recovery and aggressive brand marketing
 - Leather goods** expect to continue past growth trends, as major gift choice for personal and business



*Growth in RMB is ~27%; growth expressed in Euros factoring currency appreciation is ~35%

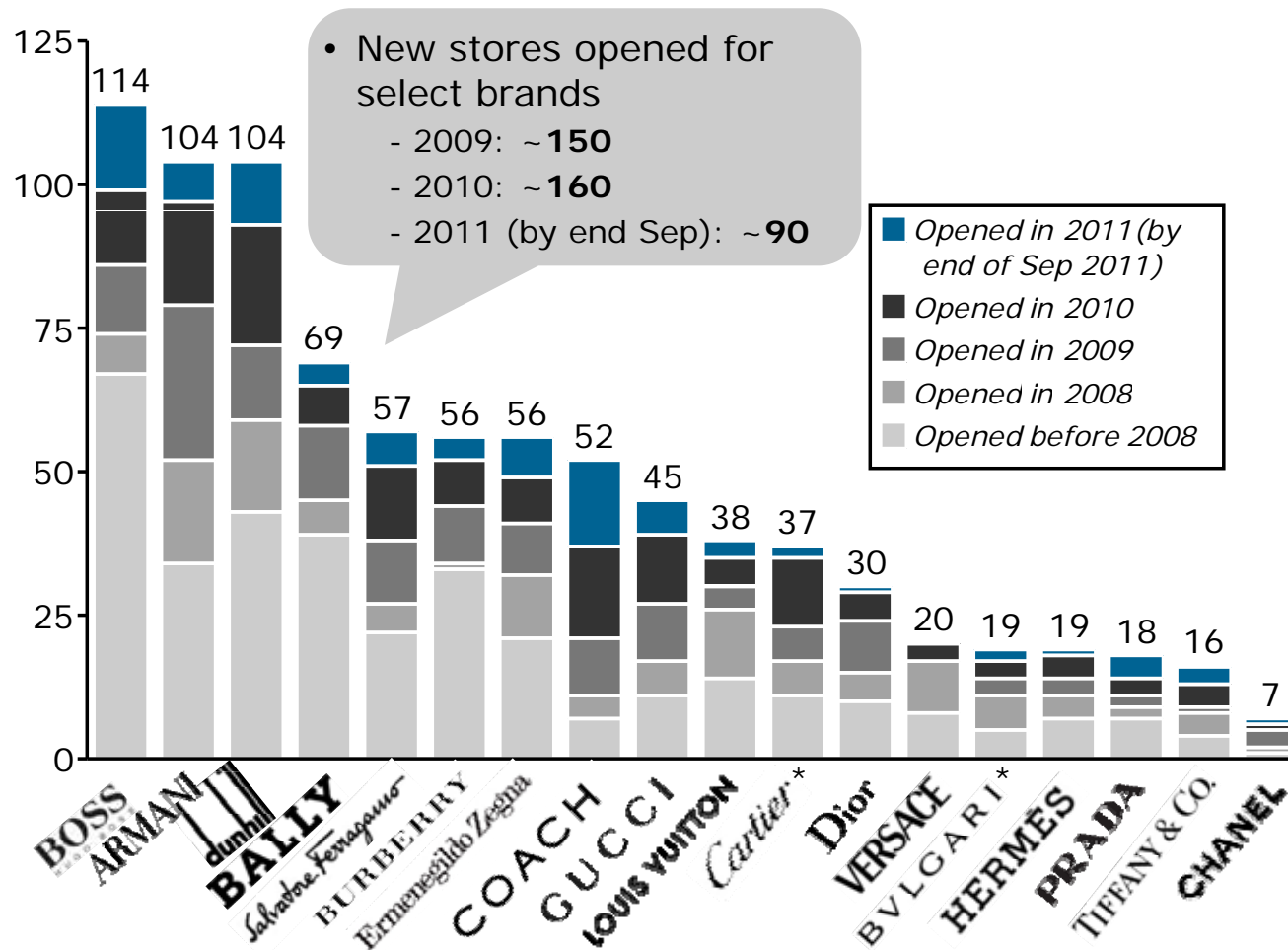
Note: Only premium cosmetics are considered luxury goods in the "Cosmetics" category

Source: Expert interviews; Brand interviews; Literature search; Bain analysis



Brands continue to expand aggressively in 2010, however, some slowing down evidenced in 2011

Store Count of Selected Luxury Brand by end of September 2011



*Cartier and Bulgari store data excludes watch counters

Note: Armani brand includes Giorgio Armani, Emporio Armani and Armani Collezioni; Dior brand includes Dior Ladies and Dior Homme

Source: Analyst reports; Literature search; Brand interviews

KEY DRIVERS

- **Some investment reduction planned during 2008-2009 crisis**
- Some brands are making **conscious decisions** to **reduce** the **pace** of expansion and focus more on store **performance improvement**
- Despite high growth of commercial real estate, brands are being **more selective** on **top quality locations** with great infrastructure & management
- **Talent shortage** and **rising labor cost** remain major hurdles for store expansion, especially in tier 2/3 cities

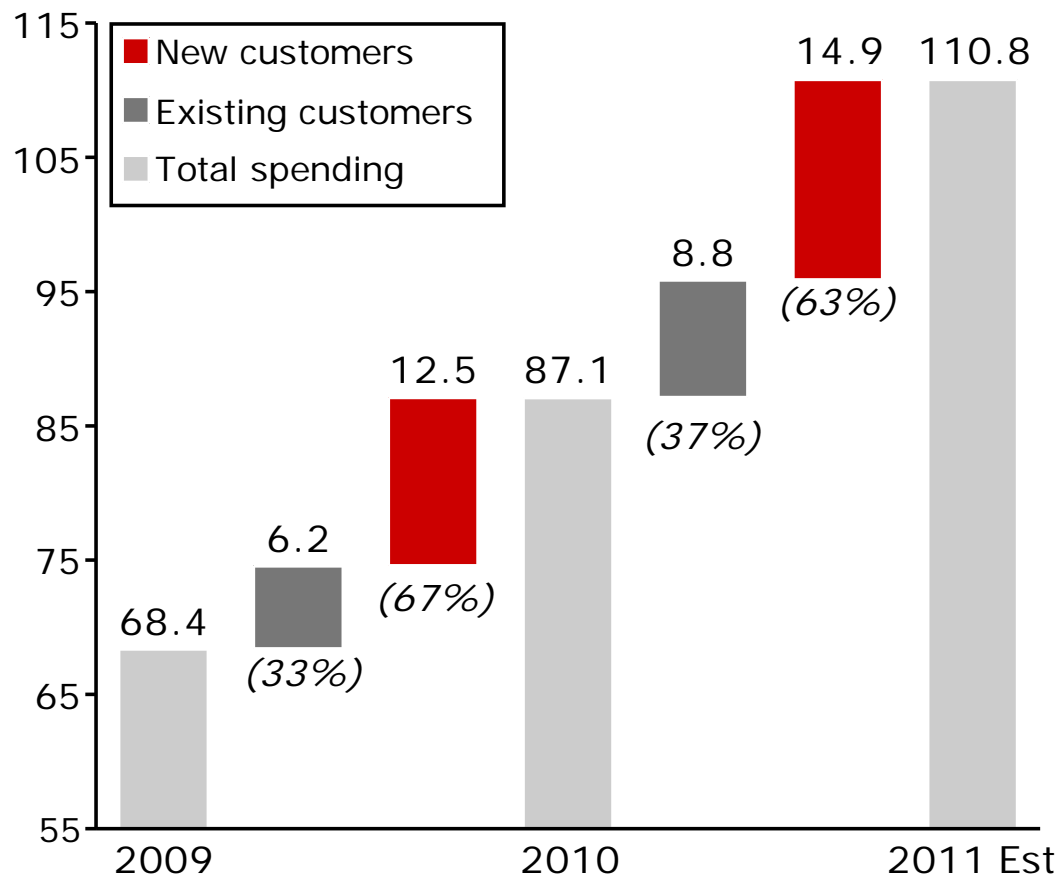
*"We are **intentionally slowing down** the expansion, because we have already established great awareness, and we will be **very selective on locations** to open new stores."*

PR Director, Luxury brand



>60% of growth in 2011 continue to come from new customers, however share from existing customers improved

China luxury market (RMB B)



KEY HIGHLIGHTS

- **China market is still supply driven**; new store openings create new demand
- A **gradual shift towards store performance improvement** expected

*"As more brands open new stores in tier 2/3 cities, **more** people have **access** to luxury goods, and brands are **attracting** many **new customers**."*

PR Manager, Luxury brand

*"Many brands are **starting to move** from **land grabbing stage** to **performance improvement**."*

Industry expert

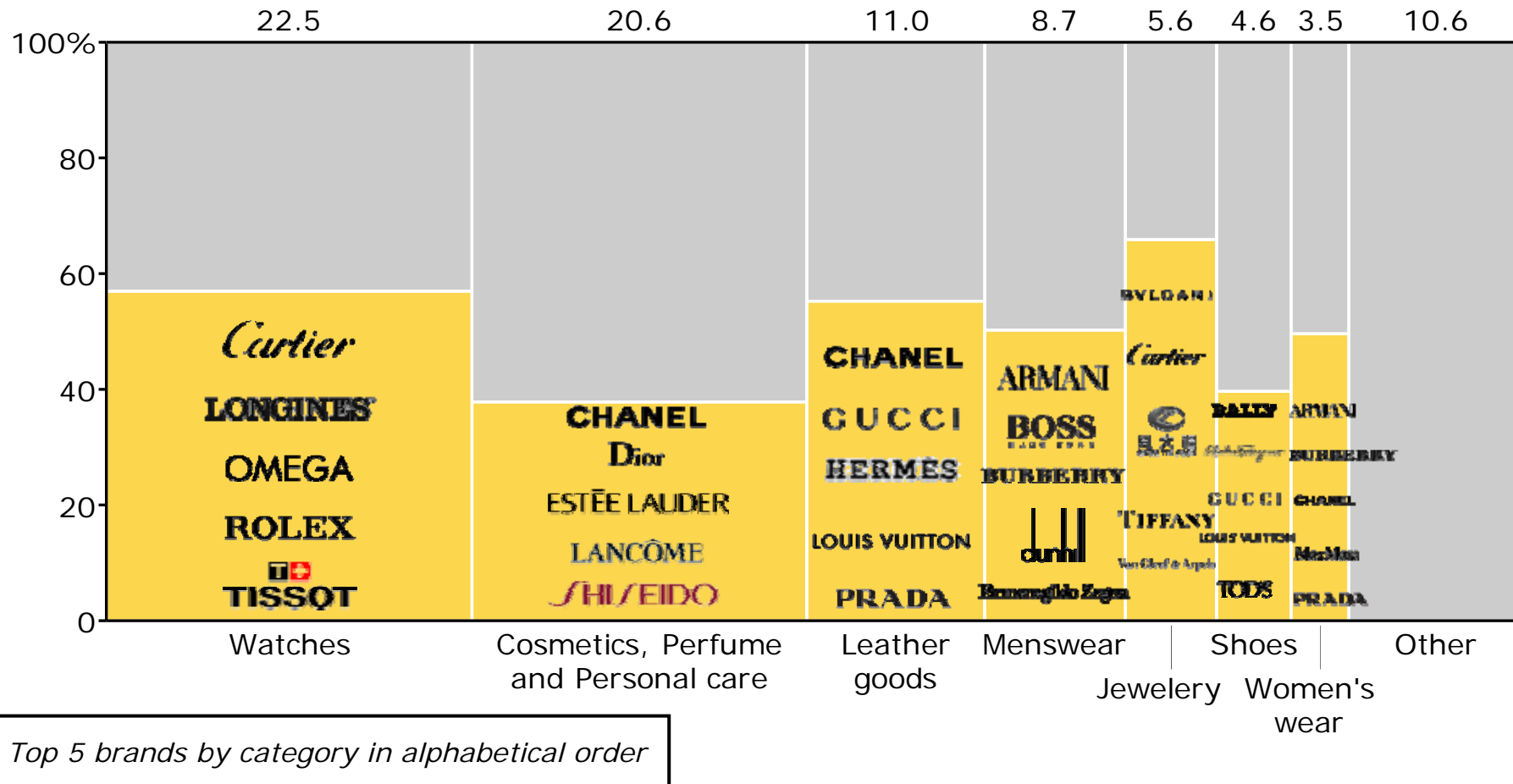
Source: Bain Survey of Luxury Goods Consumers in Mainland China (2009: n=1,410; 2010: n=1,471; 2011: n=1,959); Expert interviews; Brand interviews; Analyst reports; Company reports; Literature search; Bain analysis



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

2010 China domestic luxury spend (RMB B)

Total = RMB 87B



Note: Market value is composed of sales at retail value; "Other" category includes tableware/silverware, stationery, sunglasses, accessories and other niche luxury goods items; "Leather goods" includes smaller items such as wallets; ranking of luxury brands is in alphabetical order; Armani brand includes Giorgio Armani, Emporio Armani and Armani Collezioni

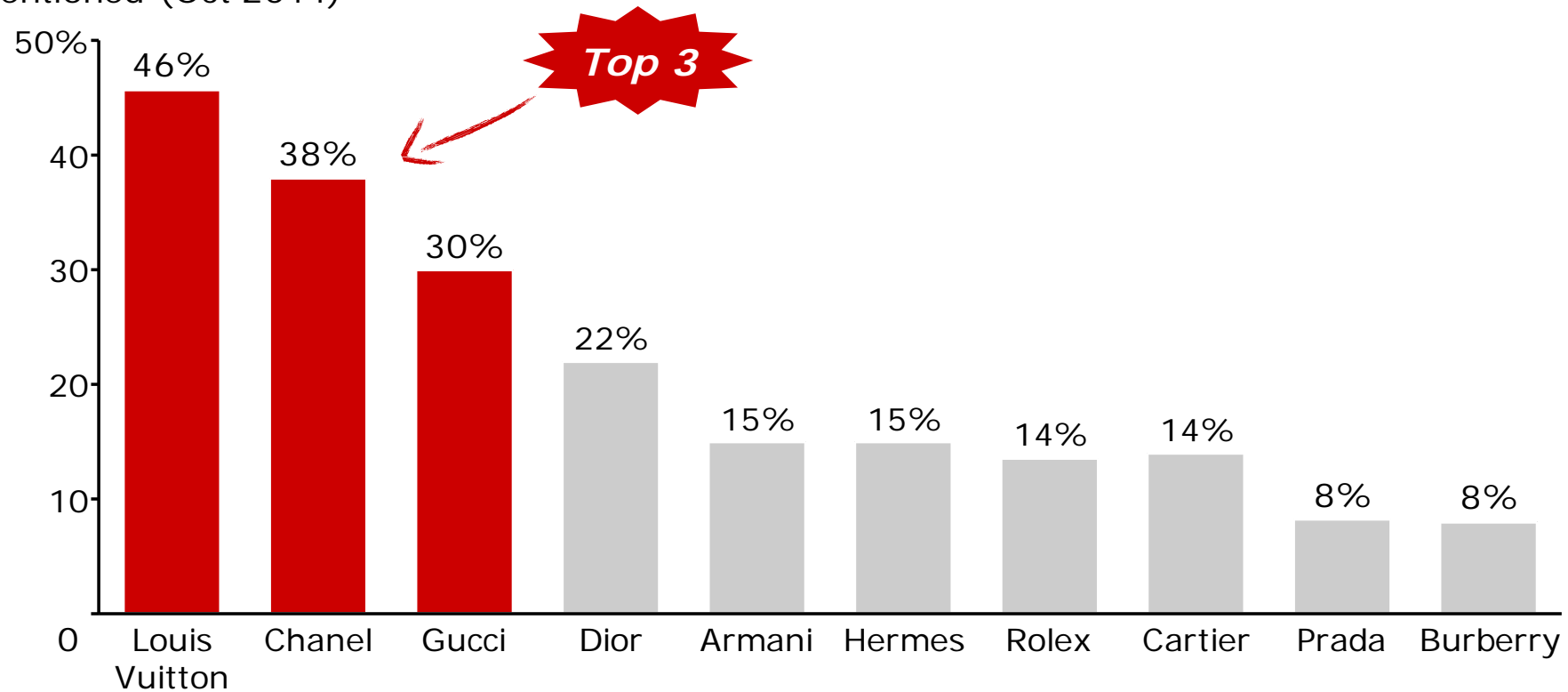
Source: Expert interviews; Brand interviews; Analyst reports; Company websites and reports; Literature search; Bain analysis



Louis Vuitton, Chanel and Gucci remained the most desired luxury brands in China in 2011

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

% of mentioned (Oct 2011)



Rank (2010)	1	2	3	5	4	8	6	7	9	16
% of mentioned in 2010 survey	46%	36%	22%	17%	20%	8%	14%	11%	8%	3%

Note: Bain survey focuses on people who are interested in luxury brands, and therefore, brand desirability is very high

Source: Bain Survey of Luxury Goods Consumers in Mainland China 2011 (n=1,959)





BJ/SH: a few new brands entered top 3 in BJ/SH compared with overall China market in 2010

"What are the top 3 brands you are most likely to purchase in each category in 2011?"

BJ/SH ONLY

		<u>1st</u>	<u>2nd</u>	<u>3rd</u>
	Watches	OMEGA	Cartier	ROLEX
	Cosmetics, perfumes & personal care	CHANEL	Dior	LANCÔME
	Leather goods	LOUIS VUITTON	GUCCI	 HERMÈS PARIS
	Menswear	GIORGIO ARMANI	Ermenegildo Zegna	 BOSS HUGO BOSS
	Jewelry	TIFFANY & CO.	Cartier	 BVLGARI
	Shoes	Salvatore Ferragamo	PRADA	 BALLY
	Womenswear	CHANEL	BURBERRY	 Dior

 Ranking improved in 2011*  New to Top 3 in 2011*

* Ranking compared with view on overall China market in 2010; not for BJ/SH only

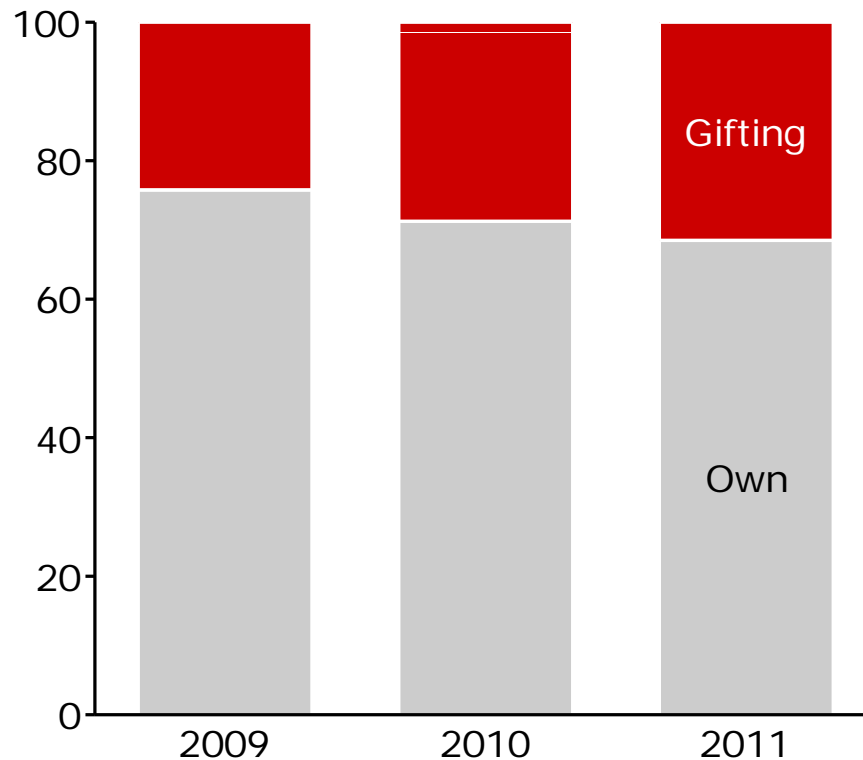
Source: Bain Survey of Luxury Goods Consumers in Mainland China 2011 (n=571 for BJ/SH)



Gifting remains a significant part of luxury spending

“What percent of the luxury goods you’ve purchased is for gifting vs. own consumption?”

% of luxury spending



*“Giving luxury goods as business gifts can **show my taste and social status**, also it makes the recipients feel **important and respected**.”*

Luxury consumer

*“Luxury gifts always **pleasantly surprise** my clients and they help me **get the deal done more easily**.”*

Luxury consumer

Source: Bain Survey of Luxury Goods Consumers in Mainland China 2011 (n=1,959); Literature search



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Brand landscape is becoming more dynamic; cautiously optimistic outlook on China luxury market

Strong growth in 2010 & majority of 2011; with a more dynamic and active brand landscape

*"2010 was a recovery year for luxury watch market with an **unprecedented high growth.**"*

VP, Luxury watch distributor

*"With such a **fast growing** and **dynamic** market, brands are doing everything they can to ride the growth and **strengthen their presence** in China."*

China CEO, Luxury brand

Overall business environment remains positive with a few uncertainties

*"We are still having quite good growth during Q4 of 2011, just not as spectacular as the first 3 quarters...We are **cautiously optimistic** about 2012."*

China MD, Luxury brand

*"Overall we are quite **positive and confident** about the China market; but there are things happening that we **don't have enough visibility.**"*

China MD, Luxury brand



Brand landscape is becoming more dynamic; cautiously optimistic outlook on China luxury market

Strong growth in 2010 & majority of 2011; with a more dynamic and active brand landscape

- 1 Continued expansion into tier 2/3 cities, with a slower pace
- 2 Leading brands emphasizing more and more on improving customer experience
- 3 Acceleration of online platforms as channel for brand marketing and ecommerce
- 4 Heritage-focused brand building activities
- 5 Emerging Chinese-culture-inspired luxury brands
- 6 Risk of negative media exposure

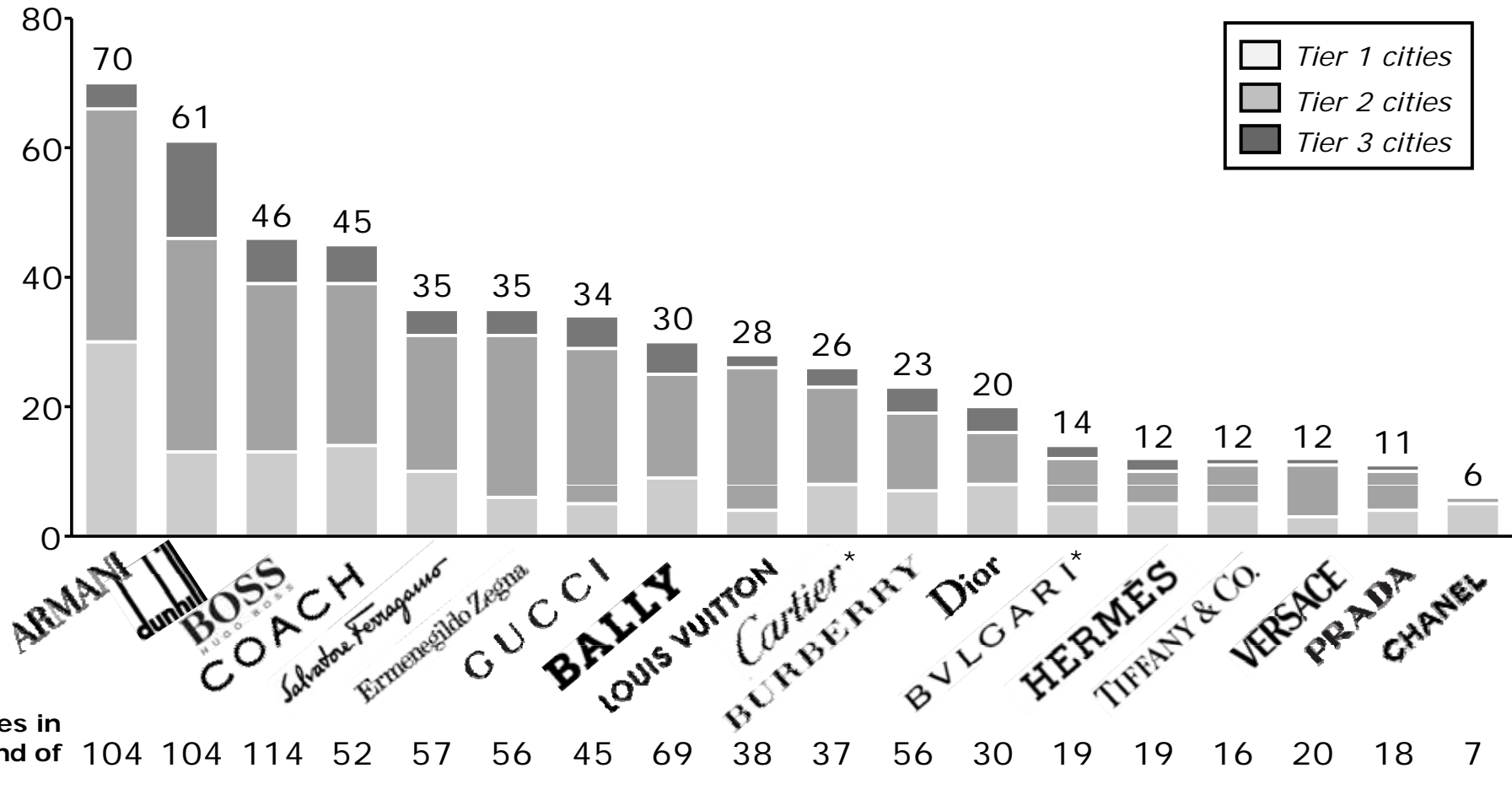
Overall business environment remains positive with a few uncertainties

- Overall macroeconomic environment favors continued growth, despite recent economy slowdown
- Consumers confidence remains high; level of sophistication rising
- Evolving regulatory environment requires close monitoring and compliance by brands



1 Tier 2/3 cities continue to be an important battlefield for luxury brands in China

new stores opened since 2008 (by end of Sep 2011)



Total # stores in China (by end of Sep 2011)

*Cartier and Bulgari store data excludes watch counters

Note: Tier 1 cities are Beijing, Shanghai, Shenzhen, Guangzhou; tier 2 cities are Chongqing, Tianjin + all remaining provincial capitals + other major cities; tier 3 cities are remaining prefectural cities

Source: Analyst reports; Company websites; Literature search; Brand interviews; Bain analysis



2

Many brands upgrading existing stores and building larger ones to improve shopping experience

Dior expanded Shanghai Plaza 66 store to 2 floors in 2010 (480 M²)



Burberry opened largest China store in Beijing in 2011 (1200 M²)



MaxMara opened 3rd largest store WW in Chengdu 2011 (720 M²)



LV opened flagship store with VIP room in Hangzhou in 2010 (1900 M²)



Zegna opened SH concept store in 2010 (1100 M²)

Source: Literature search



3

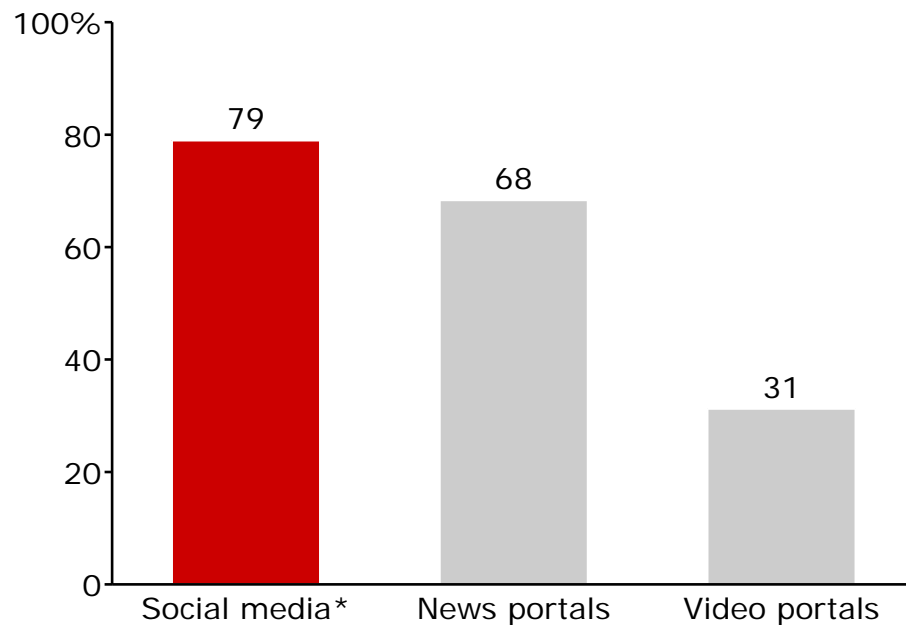
Proliferation of online marketing through social media to generate excitement and increase mindshare

Social media has become most popular info source for luxury consumers

Brands actively exploring various Chinese social media platforms

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

% of respondents who use Internet as info source



*Social media includes blogs, microblogs and BBS

Source: Bain Survey of Luxury Goods Consumers in Mainland China 2011 (n=1,959); Literature search; Site visits; Bain analysis



Burberry on Kaixin



Coach on Renren



Lancome on iPhone app



Bottega Veneta on Weibo

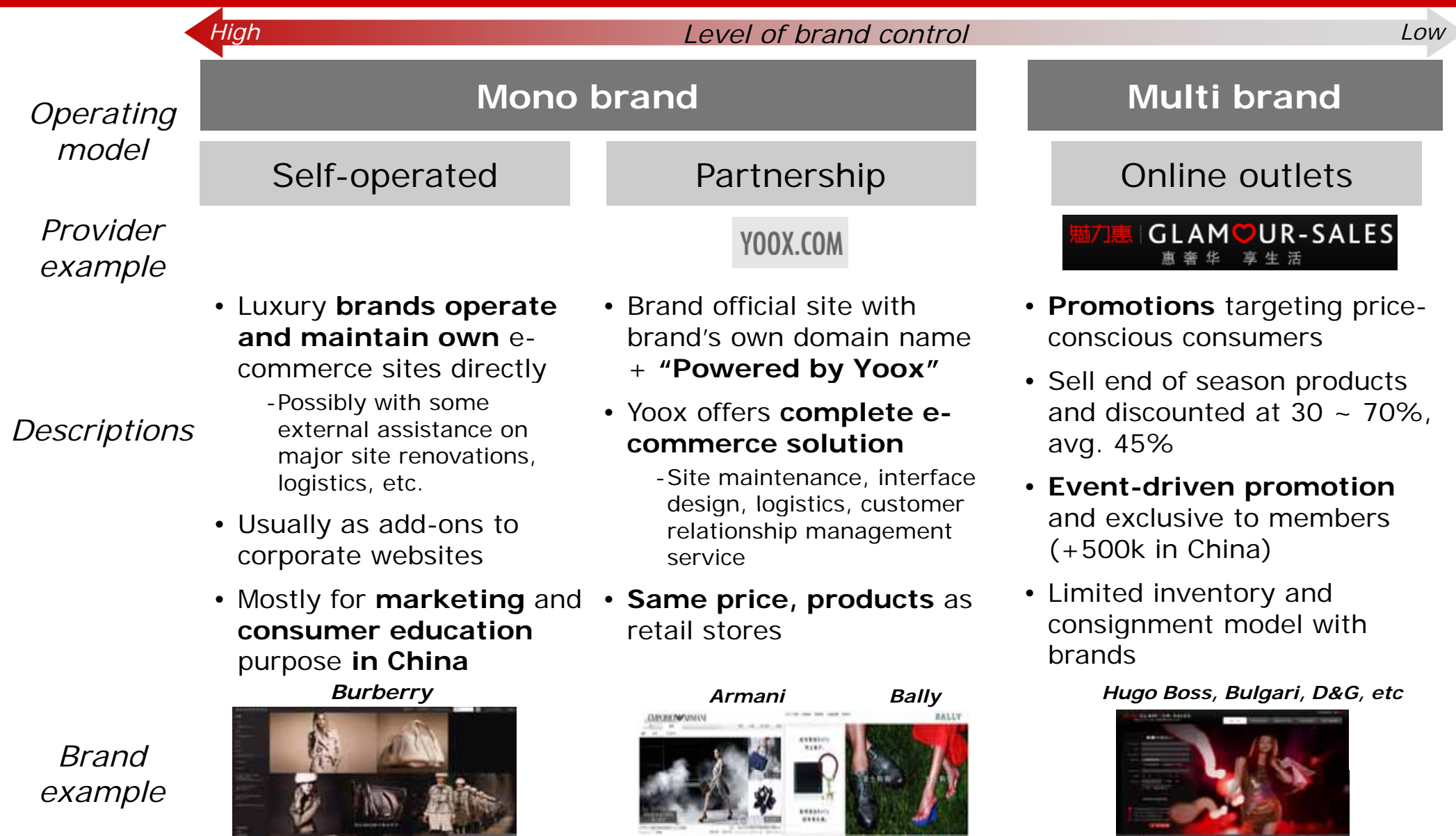


LV on Jiebang



3

Luxury ecommerce in China is emerging but still nascent; various operating models exist



Source: Literature search



4

Brands deepening communication efforts with consumers by actively showcasing culture & heritage...

Brands showcasing culture & heritage
in top tier museums



"Louis Vuitton Voyages" Exhibition

Exhibited iconic travel pieces & handbags with history of travel in National Museum of China, Beijing from May to Aug 2011



BVLGARI

"125 years of Italian Magnificence" Exhibition

Showcased 600 pieces of Bulgari jewelry & its 125-year history in National Museum of China from Sep to Nov 2011



CHANEL

"Culture Chanel" Exhibition

Exhibiting >400 pieces from Chanel's past and present, including paintings, drawings, etc, at National Art Museum of China from Nov to Dec 2011



Source: Literature search



5

Chinese luxury brands emerging, although still at experimental stage; some with support from Western luxury companies



("UP DOWN")

Brand origin

- Brand co-created by Hermes and Chinese designer
 - Hermes created Shangxia brand in 2008 with Chinese artist Jiang Qiong'er as brand CEO & Creative Director

Brand concept

- Chinese heritage deeply rooted, with Chinese craftsmanship
 - Pushed Chinese influence from product design further to utilize **Chinese artisans** and **rare local materials** like zitan wood
 - Product launch once a year with many items taking months to make
 - Offers **handcrafts, clothing & accessories**

Market strategy

- Target Chinese customers and then expand outside China
 - 1st store launched in Shanghai in Sep 2010 and plan to launch stores in **Beijing and Paris by 2013**
 - 60-70% customer base are Chinese **opinion-leaders** with wide age range and deep cultural background



qeelin

- Jewelry brand created by Hong Kong designer & French entrepreneur

- Founded and opened its first store in Paris in 2004, entered Mainland China in 2008

- Integrate **traditional Chinese inspiration** and **French craftsmanship**

- Each piece of jewelry has a remarkable Chinese culture inspired symbol

- Aim to **obtain international recognition first**

- **9 boutiques around the world**, with **steady** expansion plan
- Plan to open store in Shenyang, Dalian in the future

- Plan to expand into **luxury watch** category



Source: Literature search



6

With prosperity of online media, luxury brands need to proactively manage negative media exposure in China

Luxury brands getting more scrutiny from consumers and authority

- Luxury brands are **scrutinized** for **quality issues**, some even got **penalized**
- Increasing complaints on brands' inadequate **after-sales service** in China, which is often **complex** and **time consuming**
 - Many brands don't have customer service hotline in China

*"Chinese consumers used to **assume** that luxury brands have superior quality simply because of their big name and high price. However, consumers are becoming **more aware of their legal rights** in recent years."*

Lawyer, China Consumer Association

Brands sometimes unintentionally got associated with negative publicity

- Prosperity of online media facilitated **broadcasting** of negative events, especially those related to **social tensions** such as labour dispute, corruption, quality issues, etc
- **Showing-off** of luxury products often cause unprecedented public discussions and criticisms on social media

*"Luxury brands have been building their premium image with good quality and cultural background. But they often get associated with **showing-off of wealth**, which may have **negative impact** on them."*

Industry expert



Brands need to be more sensitive to media exposure risks & proactively manage PR in China



Brand landscape is becoming more dynamic; cautiously optimistic outlook on China luxury market

Strong growth in 2010 & majority of 2011; with a more diverse and active brand landscape

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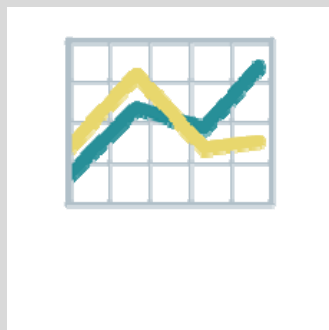
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Overall business environment remains positive with some uncertainties

Macro economy



- Increasing number of **HNWIs, affluent households** & middle class with **rising disposable income**
- **Slow down** of store expansion
 - **High-end shopping malls** becoming increasingly important compared to department stores, powered by **booming commercial real estate** market

Consumer



- Consumer **confidence** remains high
 - Individual luxury spend expected to **maintain or increase**
- **Rising** level of **sophistication**
 - New needs & expectations to be satisfied
- Still **male dominant** market; **women** categories catching up
 - Business gifting still important part of luxury spending

Regulatory environment



- Potential reduction of **luxury import tariff** may impact domestic/overseas consumption of certain categories
- New **regulations on prepaid cards** to curb corruption
- **More stringent quality standard and process for importation** may cause delay of new product introductions into China market



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Implications for luxury brands in China

	Main challenges ahead	Implications for luxury brands
A Organic growth/ exclusivity	<ul style="list-style-type: none"> As more brands have established broad presence through expansion, there is increasing need for of ensuring availability while maintaining exclusivity 	<ul style="list-style-type: none"> Be selective on locations for geo expansion Focus on improving shopping experience, offering differentiated products/services, etc to boost organic store growth and stay exclusive
B Digital marketing	<ul style="list-style-type: none"> Digital platforms getting more crowded, and difficult for brands to fully engage consumers and maintain luxury image/experience online 	<ul style="list-style-type: none"> Choose media and formats carefully Maintain clear brand positioning and personality
C Superior service	<ul style="list-style-type: none"> More sophisticated Chinese consumers demanding services (shopping & after-sales) that are consistent across China and more personalized 	<ul style="list-style-type: none"> Ensure sufficient training and tracking/incentive mechanism to deliver professional service Maintain consistent service level across shops in all city tiers
D Talent building	<ul style="list-style-type: none"> Talent shortage remain major obstacles for brand expansion and organic growth, especially in Tier 2 & 3 cities 	<ul style="list-style-type: none"> Continue to invest in talent management: recruiting, training, career management and retention
E Explosion of social media	<ul style="list-style-type: none"> Multiple cases of luxury brands being exposed to an extent that's unheard of before Exposure/vulnerability to PR risks 	<ul style="list-style-type: none"> Actively monitor and manage potential PR risks exacerbated by online media exposure



Bain contacts

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