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€)

<table>
<thead>
<tr>
<th>Country</th>
<th>Luxury Spend (B€)</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>48.1</td>
</tr>
<tr>
<td>Japan</td>
<td>18.1</td>
</tr>
<tr>
<td>Greater China</td>
<td>17.7</td>
</tr>
<tr>
<td>Italy</td>
<td>17.5</td>
</tr>
<tr>
<td>France</td>
<td>13.3 (RMB 87B)</td>
</tr>
<tr>
<td>China (Mainland)</td>
<td>9.6</td>
</tr>
<tr>
<td>UK</td>
<td>9.0</td>
</tr>
<tr>
<td>Germany</td>
<td>8.3</td>
</tr>
<tr>
<td>South Korea</td>
<td>6.3</td>
</tr>
<tr>
<td>Middle East</td>
<td>5.3</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>4.8</td>
</tr>
<tr>
<td>Russia</td>
<td>4.7</td>
</tr>
</tbody>
</table>

*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

**KEY HIGHLIGHTS**

- **Overseas** (including HK/Macau) spending showed **strong growth**; HK & Macau account for >50% of oversea spend
  - Trend expected to **continue in 2011/12**
  - Driven by **RMB appreciation** and **increased oversea 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

<table>
<thead>
<tr>
<th>Product Category</th>
<th>(08-09)</th>
<th>CAGR</th>
<th>(09-10)</th>
<th>(10-11F)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other</td>
<td>14%</td>
<td>15%</td>
<td>~15%</td>
<td></td>
</tr>
<tr>
<td>Womenswear</td>
<td>14%</td>
<td>27%</td>
<td>~30%</td>
<td></td>
</tr>
<tr>
<td>Shoes</td>
<td>17%</td>
<td>20%</td>
<td>15-20%</td>
<td></td>
</tr>
<tr>
<td>Jewelry</td>
<td>17%</td>
<td>22%</td>
<td>~25%</td>
<td></td>
</tr>
<tr>
<td>Menswear</td>
<td>17%</td>
<td>24%</td>
<td>25-30%</td>
<td></td>
</tr>
<tr>
<td>Leather goods</td>
<td>20%</td>
<td>30%</td>
<td>25-30%</td>
<td></td>
</tr>
<tr>
<td>Cosmetics, perfume and personal care</td>
<td>22%</td>
<td>22%</td>
<td>~22%</td>
<td></td>
</tr>
<tr>
<td>Watches</td>
<td>12%</td>
<td>45%</td>
<td>~40%</td>
<td></td>
</tr>
</tbody>
</table>

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

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2011 Bain China Luxury Market Study_Media release_vf SHA
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

- **New stores opened for select brands**
  - 2009: ~150
  - 2010: ~160
  - 2011 (by end Sep): ~90

**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

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*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

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2011 Bain China Luxury Market Study_Media release_vf SHA
>60% of growth in 2011 continue to come from new customers, however share from existing customers improved.

**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

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**China luxury market (RMB B)**

<table>
<thead>
<tr>
<th>Year</th>
<th>New customers</th>
<th>Existing customers</th>
<th>Total spending</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>68.4 (33%)</td>
<td>75.5 (67%)</td>
<td>143.9</td>
</tr>
<tr>
<td>2010</td>
<td>12.5 (37%)</td>
<td>87.1 (63%)</td>
<td>100.8</td>
</tr>
<tr>
<td>2011 Est</td>
<td>14.9 (67%)</td>
<td>110.8 (33%)</td>
<td></td>
</tr>
</tbody>
</table>

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?”

<table>
<thead>
<tr>
<th>% of mentioned (Oct 2011)</th>
<th>Louis Vuitton</th>
<th>Chanel</th>
<th>Gucci</th>
<th>Dior</th>
<th>Armani</th>
<th>Hermes</th>
<th>Rolex</th>
<th>Cartier</th>
<th>Prada</th>
<th>Burberry</th>
</tr>
</thead>
<tbody>
<tr>
<td>46%</td>
<td>46%</td>
<td>38%</td>
<td>30%</td>
<td>22%</td>
<td>15%</td>
<td>15%</td>
<td>14%</td>
<td>14%</td>
<td>8%</td>
<td>8%</td>
</tr>
</tbody>
</table>

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?”

<table>
<thead>
<tr>
<th>Category</th>
<th>1st</th>
<th>2nd</th>
<th>3rd</th>
</tr>
</thead>
<tbody>
<tr>
<td>Watches</td>
<td>OMEGA</td>
<td>Cartier</td>
<td>ROLEX</td>
</tr>
<tr>
<td>Cosmetics, perfumes &amp; personal care</td>
<td>CHANEL</td>
<td>Dior</td>
<td>LANCÔME</td>
</tr>
<tr>
<td>Leather goods</td>
<td>LOUIS VUITTON</td>
<td>GUCCI</td>
<td>HERMES PARIS</td>
</tr>
<tr>
<td>Menswear</td>
<td>GIORGIO ARMANI</td>
<td>Ermenegildo Zegna</td>
<td>BOSS</td>
</tr>
<tr>
<td>Jewelry</td>
<td>TIFFANY &amp; Co.</td>
<td>Cartier</td>
<td>BVLGARI</td>
</tr>
<tr>
<td>Shoes</td>
<td>Salvatore Ferragamo</td>
<td>PRADA</td>
<td>BALLY</td>
</tr>
<tr>
<td>Womenswear</td>
<td>CHANEL</td>
<td>BURBERRY</td>
<td>Dior</td>
</tr>
</tbody>
</table>

* 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)

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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

- **Gifting**
- **Own**

- 2009
- 2010
- 2011

“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
Agenda

• China luxury market overview

• Key trends of China luxury market

• Implications for luxury brands 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 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 and compliance by brands
- Risk of negative media exposure

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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)

- **Tier 1 cities** (Beijing, Shanghai, Shenzhen, Guangzhou)
- **Tier 2 cities**
- **Tier 3 cities**

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

<table>
<thead>
<tr>
<th>Brand</th>
<th>Tier 1 Cities</th>
<th>Tier 2 Cities</th>
<th>Tier 3 Cities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Armani</td>
<td>104</td>
<td>114</td>
<td>14</td>
</tr>
<tr>
<td>Boss</td>
<td>104</td>
<td>114</td>
<td>12</td>
</tr>
<tr>
<td>Coach</td>
<td>52</td>
<td>57</td>
<td>11</td>
</tr>
<tr>
<td>Ermenegildo Zegna</td>
<td>35</td>
<td>35</td>
<td>34</td>
</tr>
<tr>
<td>Bally</td>
<td>30</td>
<td>28</td>
<td>28</td>
</tr>
<tr>
<td>Louis Vuitton</td>
<td>38</td>
<td>37</td>
<td>14</td>
</tr>
<tr>
<td>Cartier*</td>
<td>56</td>
<td>30</td>
<td>12</td>
</tr>
<tr>
<td>Bvlgari*</td>
<td></td>
<td>19</td>
<td>12</td>
</tr>
<tr>
<td>Dior</td>
<td></td>
<td>19</td>
<td>12</td>
</tr>
<tr>
<td>Hermès</td>
<td></td>
<td>16</td>
<td>12</td>
</tr>
<tr>
<td>Tiffany &amp; Co.</td>
<td></td>
<td>20</td>
<td>11</td>
</tr>
<tr>
<td>Versace</td>
<td></td>
<td>18</td>
<td>6</td>
</tr>
<tr>
<td>Prada</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chanel</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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

*Cartier and Bulgari store data excludes watch counters.
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
Proliferation of online marketing through social media to generate excitement and increase mindshare

Social media has become most popular info source for luxury consumers

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

% of respondents who use Internet as info source

- Social media*: 79%
- News portals: 68%
- Video portals: 31%

Brands actively exploring various Chinese social media platforms

*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

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

<table>
<thead>
<tr>
<th>Operating model</th>
<th>Mono brand</th>
<th>Multi brand</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provider example</td>
<td>Self-operated</td>
<td>Partnership</td>
</tr>
<tr>
<td>Description</td>
<td>- Luxury brands operate and maintain own e-commerce sites directly. - Possibly with some external assistance on major site renovations, logistics, etc. - Usually as add-ons to corporate websites. - Mostly for marketing and consumer education purpose in China.</td>
<td>- Brand official site with brand’s own domain name + “Powered by Yoox” - Yoox offers complete e-commerce solution - Site maintenance, interface design, logistics, customer relationship management service - Same price, products as retail stores - Promotions targeting price-conscious consumers - Sell end of season products and discounted at 30 ~ 70%, avg. 45% - Event-driven promotion and exclusive to members (+500k in China) - Limited inventory and consignment model with brands.</td>
</tr>
<tr>
<td>Brand example</td>
<td>Burberry</td>
<td>Armani, Bally, Hugo Boss, Bulgari, D&amp;G, etc.</td>
</tr>
</tbody>
</table>

Source: Literature search
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

“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

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

| 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 |

• **Jewelry brand created by Hong Kong designer & French entrepreneur**
• **Integrate traditional Chinese inspiration and French craftsmanship**
• **Aim to obtain international recognition first**
• **Plan to expand into luxury watch category**

Source: Literature search

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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

Source: Literature search
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

1. Continued expansion into tier 2/3 cities, with a slower pace
2. Leading brands emphasizing 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
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
Agenda

• China luxury market overview
• Key trends of China luxury market
• Implications for luxury brands in China
## Implications for luxury brands in China

<table>
<thead>
<tr>
<th>Main challenges ahead</th>
<th>Implications for luxury brands</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Organic growth/exclusivity</strong></td>
<td>• As more brands have established broad presence through expansion, there is increasing need for of <strong>ensuring availability while maintaining exclusivity</strong></td>
</tr>
<tr>
<td><strong>Digital marketing</strong></td>
<td>• Be <strong>selective</strong> on locations for geo expansion</td>
</tr>
<tr>
<td><strong>Superior service</strong></td>
<td>• Focus on improving shopping experience, offering <strong>differentiated products/services</strong>, etc to boost organic store growth and <strong>stay exclusive</strong></td>
</tr>
<tr>
<td><strong>Talent building</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Explosion of social media</strong></td>
<td>• Choose media and formats <strong>carefully</strong></td>
</tr>
<tr>
<td></td>
<td>• Maintain <strong>clear brand</strong> positioning and personality</td>
</tr>
<tr>
<td></td>
<td>• Ensure sufficient <strong>training</strong> and <strong>tracking/incentive</strong> mechanism to deliver professional service</td>
</tr>
<tr>
<td></td>
<td>• Maintain <strong>consistent</strong> service level across shops in all city tiers</td>
</tr>
<tr>
<td></td>
<td>• Continue to invest in <strong>talent management</strong>: recruiting, training, career management and retention</td>
</tr>
<tr>
<td></td>
<td>• Actively <strong>monitor and manage potential PR risks</strong> exacerbated by online media exposure</td>
</tr>
<tr>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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