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China Consumer

From reopening to recovery – is the release of household excess savings a silver bullet?

MARKET PERFORM (Maintain)

China Consumer

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We untangle the "household excess saving" enigma. Instead of a silver bullet, we consider it a status-quo in which consumers are confident enough to spend (or invest) beyond their pre-pandemic budgets by tapping into their savings accumulated during the pandemic, after they first normalize their spending to pre-pandemic level. In other words, we believe the use of "excess saving" would predominantly kick-in upon a full-fledged consumption recovery. Comparing China to other reopened nations enables us to deduce that we remain proximate to the initial stage of this spending reversion, albeit an asymmetric one. We assume household will tend to save more in coming years, considering the capital loss from investments (stocks and/or property) and expectation of future income growth. From this perspective, we assert that Chinese consumers will remain cautious and picky as in where and what they are willing to spend. This uneven trajectory has been fueling a skewed recovery that tilts towards selective sub-segments, with luxury and mass-market/ low-end beating middle/ high-end, service outpacing merchandises, traffic outweighing spending, and small-pleasure purchase outperforming big-ticket outlay.

The uneven recovery is the aftermath that inherits from premiumization deceleration and consumption polarization – investment themes that dominated and perpetuated from the pandemic era. When government rhetoric remains mild and likely carries on pro-growth policy without additional fiscal stimulus, we think these trends are here to stay. Against this backdrop, we observe that: 1) the untainted spending power of the ultra-rich on **luxuries** could form a sharp contrast to the languishing propensity to consume the middle income class, 2) China's re-opening should mean the last missing puzzle to global brand owner, but ironically a cannibalization to the domestic **dutyfree** wallet, 3) **beer** will remain an affordable premiumization to every income class, 4) domestic **cosmetic** brands upgrade may not be as effective as in the past, when the low hanging fruit of livestreaming is gone, and 5) **IMF** market share is set to be more diverged between mass market and premium brands in a zero-sum game.

Stock-for-action. We initiate on **CTF, Prada** and **Samsonite**, and their earnings still have legs thanks to revenge spending that drives a double-digit growth. We add **Tsingtao** to our Top Buy, along with CR beer, and we have a HOLD on Budweiser albeit shares are running down lately. We remain buyer on **CTGDF**, but concur that we would need stronger catalyst to flip share price. **Proya** is a trading buy to us, thanks to its operation excellence, and the stock would be more appealing post management sell-off. In the contrary, we downgrade **Jahwa** to HOLD, when valuation runs ahead for an inflection that we think too early to happen. We cut **Feihe** to HOLD, as mass market brands prevail in the segment.

			Price	TP	Mkt Cap	P/E (x)		Div yield (%)		ROE (%)	
Name	Ticker	Rating	(LC)	(LC)	(US$ mn)	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
CR Beer	291 HK	BUY	56.6	74.8	22,834	30.5	26.5	1.3	1.5	17.5	17.9
Tsingtao	168 HK	BUY	75.5	92.9	17,437	19.5	16.8	3.4	3.9	16.0	17.2
Prada	1913 HK	BUY	57.4	72.1	18,814	30.3	27.2	2.0	2.2	15.5	16.0
Samsonite	1910 HK	BUY	23.4	30.2	4,313	13.3	11.3	0.0	0.0	27.0	24.6
CTF	1929 HK	BUY	15.7	20.7	20,103	22.1	17.8	3.4	4.2	20.5	23.7
Botanee	300957 CH	BUY	110.4	141.2	7,311	34.0	27.2	0.9	1.2	21.0	22.1
Proya	603605 CH	BUY	161.5	204	7,472	45.3	36.4	0.7	0.8	23.6	24.1
CTGDF	601888 CH	BUY	149.9	232	50,696	31.0	24.8	1.1	1.3	18.1	19.6
Bud APAC	1876 HK	HOLD	22.2	25.1	37,183	29.8	27.7	1.8	2.0	11.3	11.3
Feihe	6186 HK	HOLD	5.3	5.9	6,161	8.7	7.8	5.1	5.7	18.6	18.7
Jahwa	600315 CH	HOLD	29.7	30.9	3,238	25	23.1	1.2	1.3	10.3	10.4

Source: Company data, BBG, CMBIGM estimates

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Household excess savings

We define excess savings as the gap between household savings and its pre-pandemic trend. We use the savings rate in 2019 to calculate the pre-pandemic trend for household savings. Then we can get the stock of excess savings by aggregating excess savings in each period.

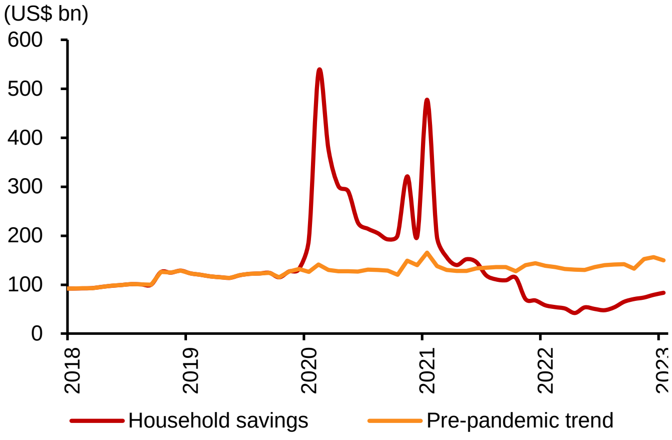
The stock of excess savings for US households peaked at US$2.1trn in 3Q21. It continued to decline from 4Q21 as fiscal support diminished, household income dropped while consumption remained strong. At end-1Q23, the stock of excess savings reached US$0.9trn or 3.6% of 2022 GDP. We expect the stock of excess savings may drop to zero in 4Q23-1Q24. The stock of excess savings dropped faster in the US than in other economies, as consumption recovery was stronger in the country.

Eurozone households saw two peaks for their excess savings as one was in 2Q20, the other was in 1Q21 and the former was higher than the later. The stock of excess savings peaked at EUR0.69trn in 1Q22 and declined slowly after that. It mildly declined to EUR0.62trn or 4.7% of GDP in 4Q22. Eurozone households are still in the process of spending its excess savings.

Excess savings in Japan peaked in 2Q20 and gradually declined after then. The stock of excess savings reached its peak at JPY37.2trn in 1Q22 and gradually declined to JPY32.6trn or 6% of GDP in 4Q22. Japanese households are still in the process of spending its pandemic savings.

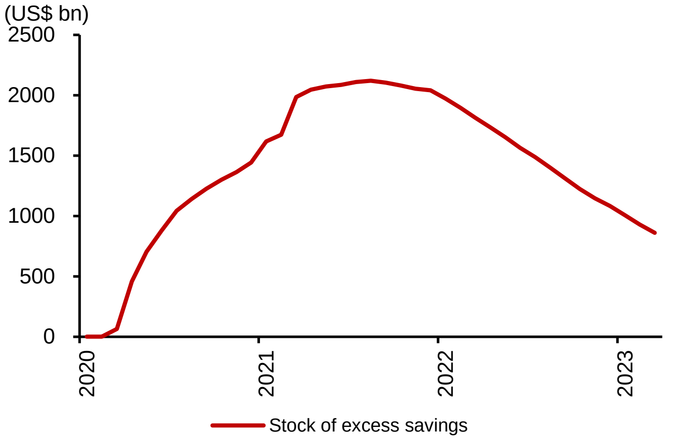
Excess savings of Chinese households reached RMB2.5trn, RMB1trn and RMB2.4trn in 2020, 2021, and 2022, respectively. The stock of excess savings reached RMB5.8trn or 4.8% of GDP in 2022. The release of excess savings in China is still very limited, as it needs some time for consumers to restore their confidence.

Figure 1: US household saving trend



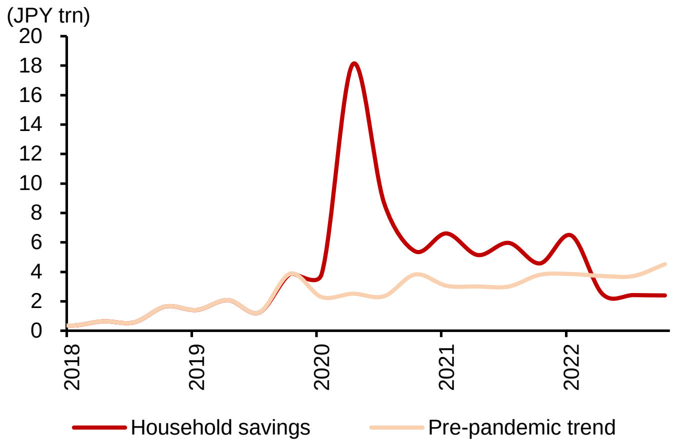
Source: Wind, CMBIGM

Figure 2: US household cumulative excess savings



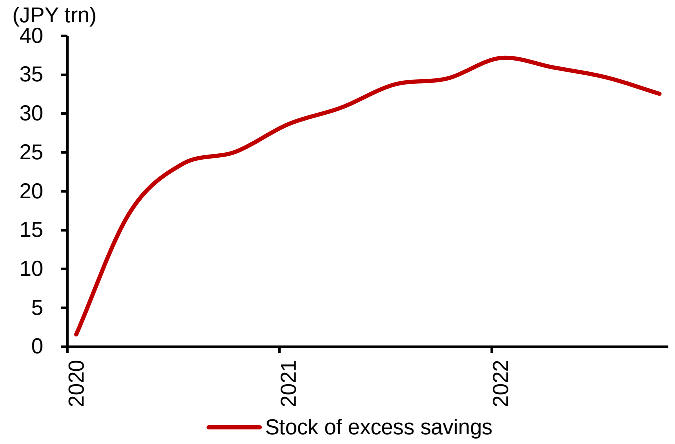
Source: Wind, CMBIGM

Figure 3: Japan household saving trend



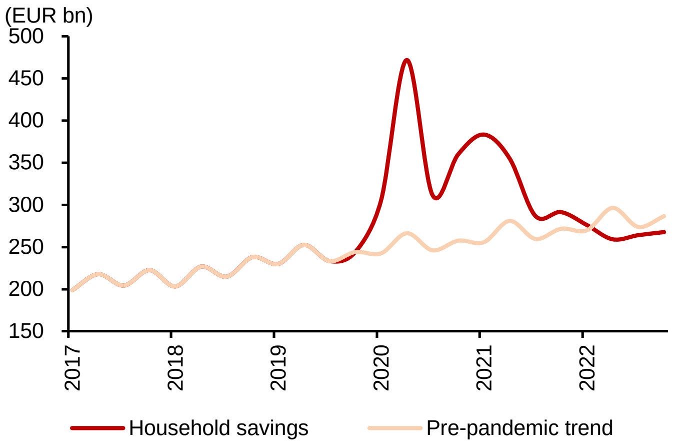
Source: Wind, CMBIGM

Figure 4: Japan household excess saving



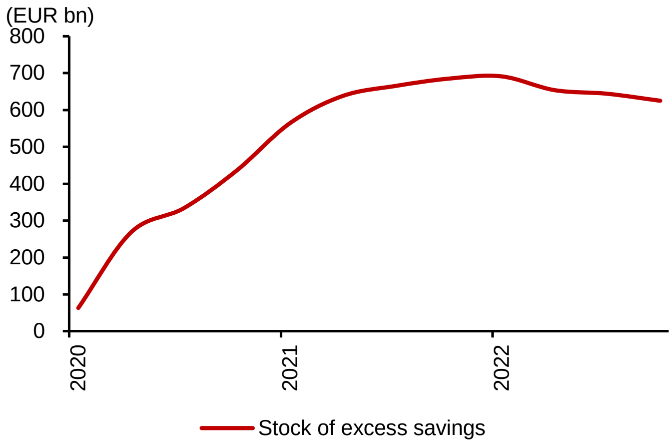
Source: Wind, CMBIGM

Figure 5: Eurozone household saving trend



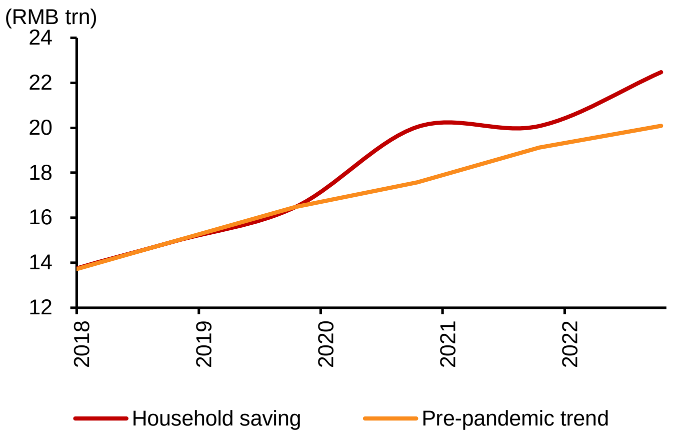
Source: Wind, CMBIGM

Figure 6: Eurozone household excess saving



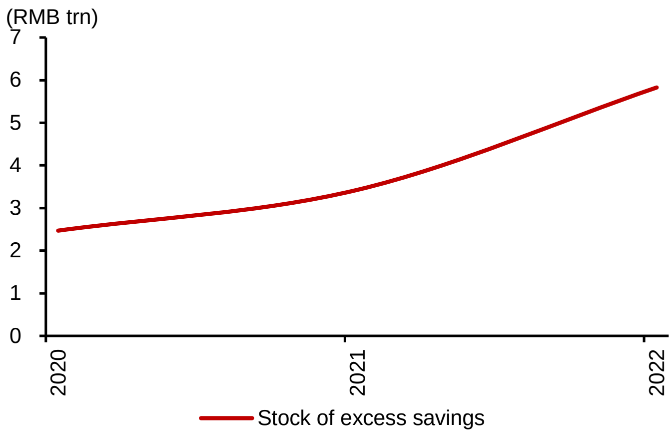
Source: Wind, CMBIGM

Figure 7: China household saving trend



Source: Wind, CMBIGM

Figure 8: China household excess saving



Source: Wind, CMBIGM

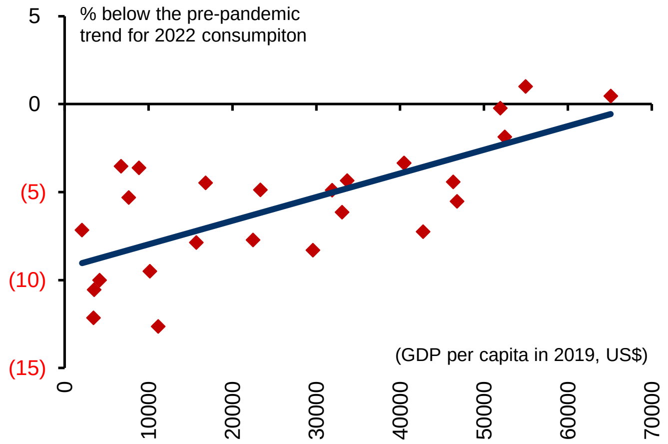
Consumption recovery pattern

Developed economies had better recovery of consumption than developing countries. The more developed the economy, the faster its consumption recovered. Figure 9 shows that the recovery degree of consumption has a significant correlation with GDP per capita. The higher the GDP per capita, the smaller the gap between household consumption and its pre-pandemic trend.

Why is there a strong correlation between consumption recovery degree and economic development level? There are three reasons. First, the effectiveness of vaccination protection and healthcare system has a significant correlation with economic development level. The more developed the country, the stronger the protection of vaccination and healthcare system and the faster the economy can be reopened. Figure 10 shows that the fully vaccinated ratios of countries at end-1H21 are positively correlated with their GDP per capita. Second, the magnitude of policy support has a correlation with economic development level. The more developed the economy, the smaller the internal and external constraints on its macro policies. Developed countries have free capital flows and floating exchange rates with their currencies considered as international currencies. The inflation was very low in developed countries before the pandemic. However, developing countries have a fear of free capital flows and floating exchange rates and their inflation was relatively high before the pandemic. Therefore, developing countries face more constrains on domestic policy stimulus than developed countries. Figure 11 shows that there is a significant positive correlation between the scale of fiscal stimulus after the pandemic shock and GDP per capita in main countries. Third, the effectiveness of social safety net and consumer confidence is correlated with economic development level. The more developed the economy, the stronger the social safety net and the more independent and confident consumers.

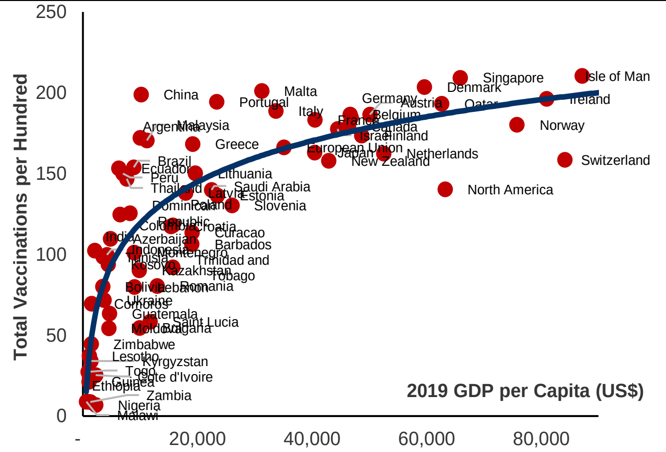
The US took the lead in consumption recovery as its household consumption resumed to above the pre-pandemic trend while the consumption in most other countries remained below the pre-pandemic trend in 2022. The US lead in global consumption recovery was supported by three factors. First, the US had advanced vaccination and healthcare system so that it could reopen the economy rapidly. Second, the policy stimulus was much stronger in the US than in other countries as the US could take advantage of dollar’s status as the dominant international currency. Third, the labor market in the US was much stronger than other economies, supporting wage growth and consumer confidence in the country.

Figure 9: Consumption recovery vs. GDP per capita



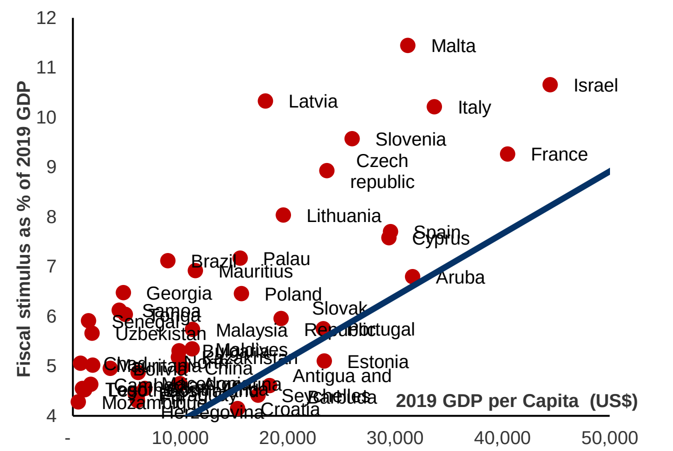
Source: Wind, CMBIGM

Figure 10: Vaccination Ratio vs. GDP per capita



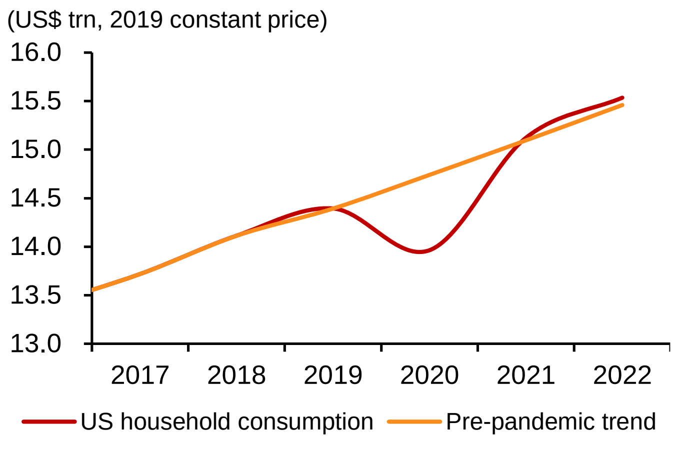
Source: Wind, CMBIGM

Figure 11: Fiscal stimulus scale vs. GDP per capita



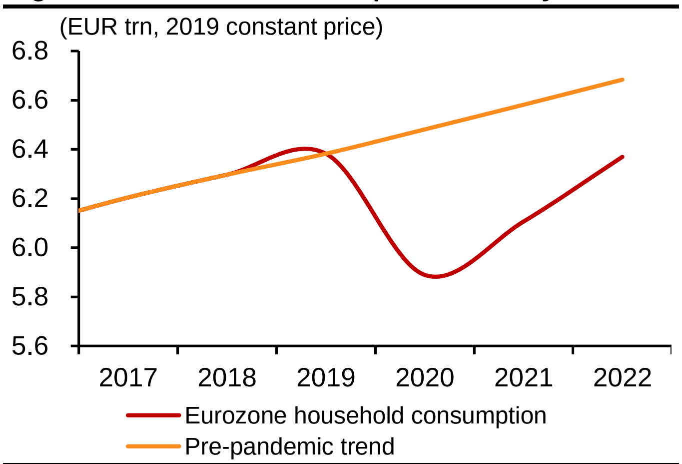
Source: Wind, CMBIGM

Figure 12: US consumption recovery



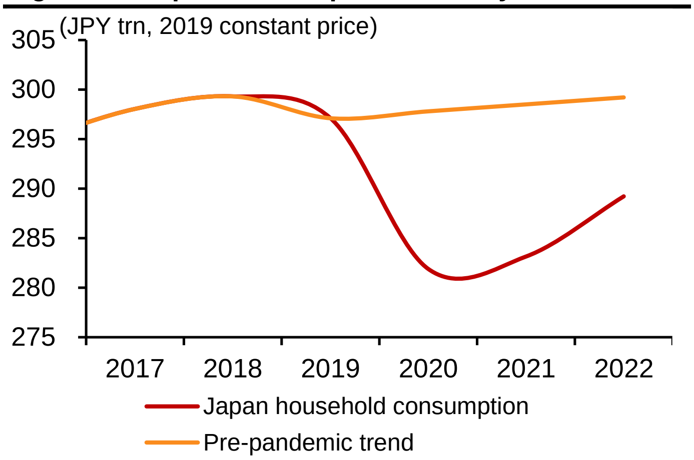
Source: Wind, CMBIGM

Figure 13: Eurozone consumption recovery



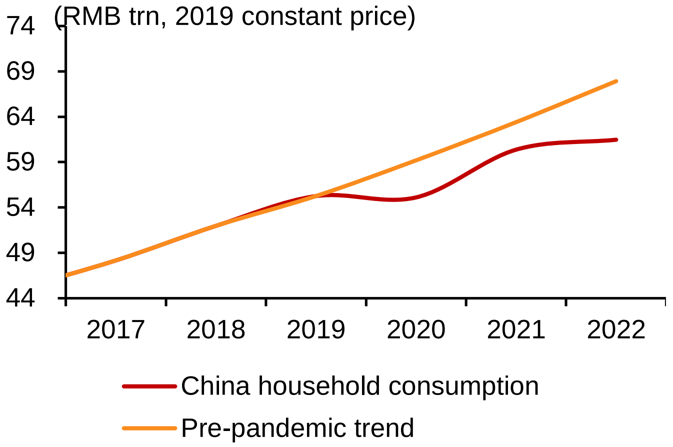
Source: Wind, CMBIGM

Figure 14: Japan consumption recovery



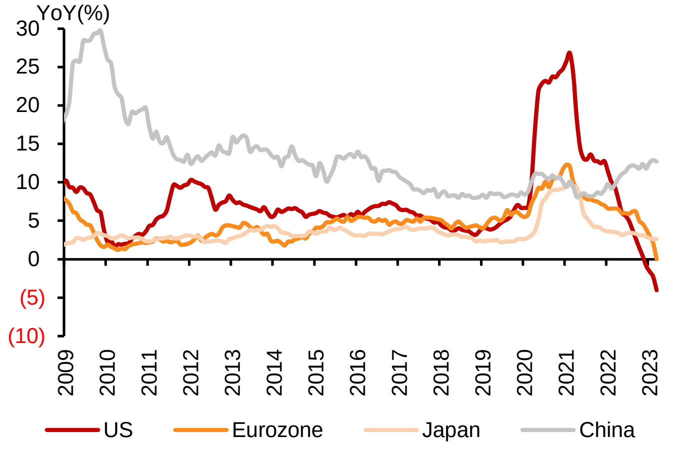
Source: Wind, CMBIGM

Figure 15: China consumption recovery



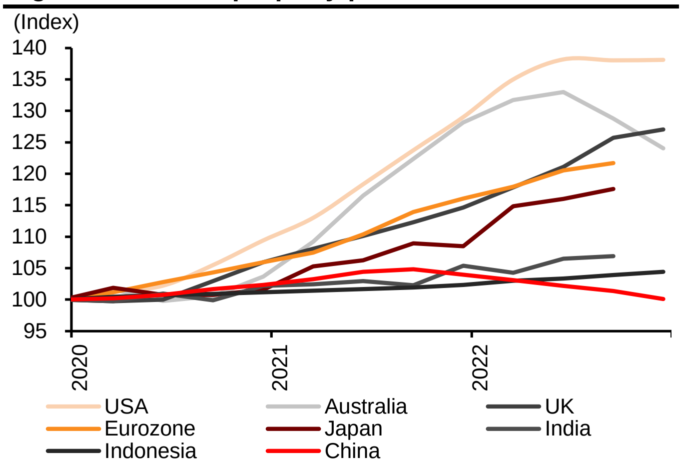
Source: Wind, CMBIGM

Figure 16: M2 supply growth



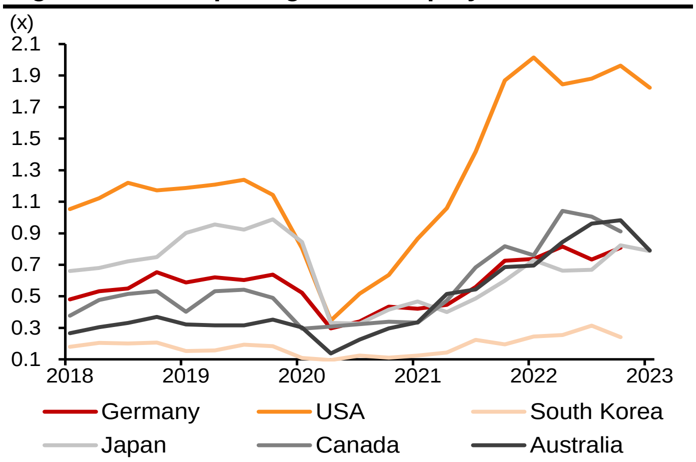
Source: Wind, CMBIGM

Figure 17: Global property price index



Source: Wind, CMBIGM

Figure 18: Job openings to unemployed ratio



Source: Wind, CMBIGM

By Category

During the pandemic, the stay-at-home economy dominated consumer spending as food, beverage, liquor, medicine and other staples increased significantly due to hoarding demand. Work-from-home goods, recreational products and telecom & internet services recovered very quickly. We see a similar pattern of consumption performance in the US, Eurozone and Japan after the outbreak of the pandemic in 1Q20.

After economic reopening, stay-at-home economy gradually slowed while spending related to outgoing activity rapidly rebounded. As population mobility resumed, consumption in transportation, energy, catering, accommodation, tourism, healthcare, clothing, cosmetics, sports & recreational services recovered.

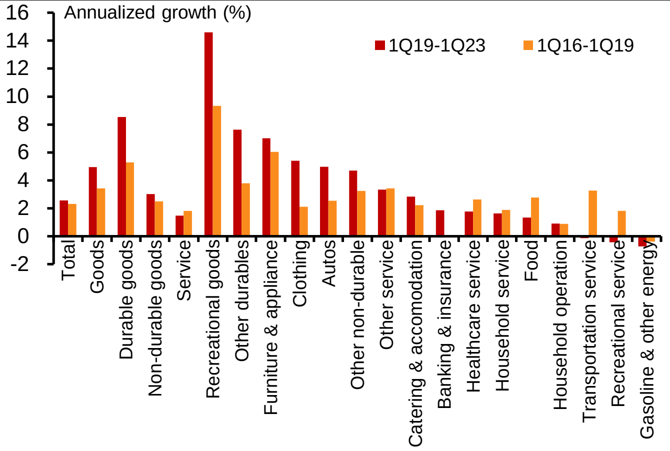
Based on the data of Google mobility index and household consumption in selective economies, we find consumption in gasoline, personal care, catering & accommodation, transportation service, healthcare, recreational service and clothing & shoes has significant correlations with population mobility.

As business sentiment and capex continued to rise after economic reopening, labor market and consumer confidence also improved, supporting recovery of consumption in most durables. However, high inflation was a negative factor for most durables as it pushed up financing costs for consumers.

In the US, household consumption has already recovered to above the pre-pandemic trend. In 1Q20, the pandemic outbreak had severe impact on consumption in gasoline, luggage, clothing & shoes, autos, social service and tourism service. Then stay-at-home related products such as food, beverage, liquor, office equipment and telecom & electronic equipment recovered rapidly. After economic reopening, travel, social service and clothing & shoes quickly rebounded while stay-at-home related products gradually slowed. In 1Q23, total consumption was 1% higher than the pre-pandemic trend. Consumption of durables and non-durable goods respectively reached 12.9% and 2.1% higher than the pre-pandemic trend and service consumption was still 1.3% below the pre-pandemic trend. Specifically, consumption in recreational goods, other durables, clothing and autos was 20.7%, 15.6%, 13.5% and 9.7% higher than the pre-pandemic trend while that in transportation service, recreational service and healthcare service was 12.6%, 8.5% and 3.3% below the pre-pandemic trend.

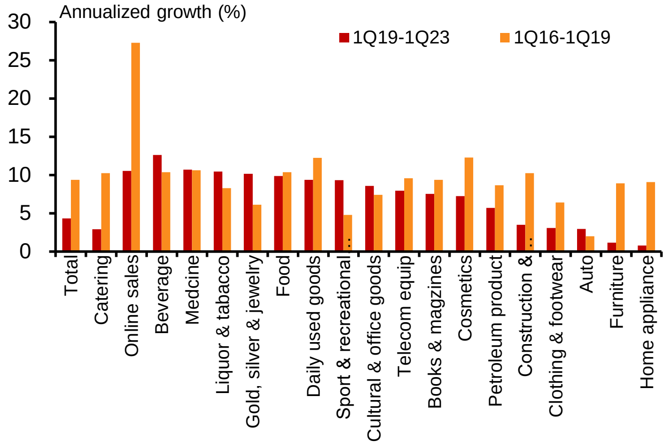
In China, retail sales followed a similar recovery pattern by product after economic reopening. In 1Q23, beverage, medicine, liquor, gold, silver & jewelry, cultural & office equipment and auto recovered to above the pre-pandemic trend, while home appliance, furniture, clothing & footwear, construction & decoration materials, petroleum product and cosmetics remained below the pre-pandemic trend. As the population mobility restored, transportation, tourism, catering & accommodation, medicine & healthcare service, liquor, clothing & shoes, and cosmetics recovered very rapidly. However, auto, home appliance, construction & decoration materials and telecom & electronic equipment resumed slowly as it needs more time for private business to restore their sentiment and capex and for consumers to resume their confidence and marginal propensity to consume.

Figure 19: US consumption growth by category before and after the pandemic



Source: Wind, CMBIGM

Figure 20: China retail sales growth before and after the pandemic

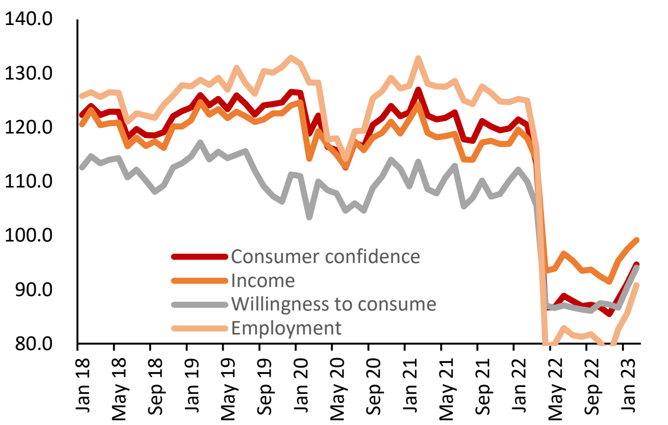


Source: Wind, CMBIGM

From an uneven spending reversion to a full-fledged consumption recovery

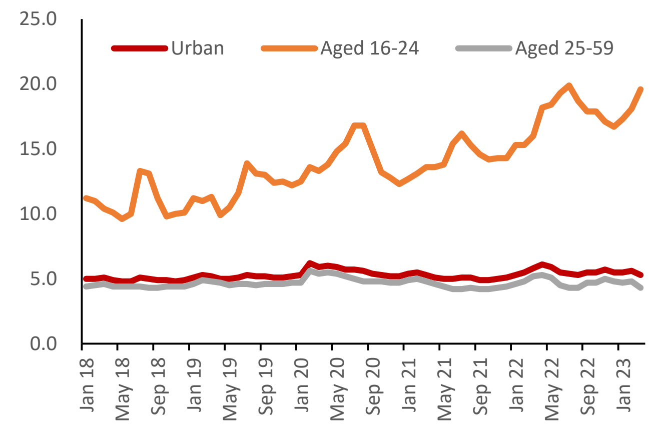
No doubt, part of these householder excess savings could hopefully be released through the well-known “revenge spending”, which could widely range from property ownership and stock investment to leisure spending and daily necessity outlay. However, the process is not as knee-jerk as we expected, and would only take place when households first normalize their spending to pre-COVID level. For now, obviously, households are still at their early stage of the reversion. In our view, the utilization of excess savings would further be subject to other macro factors, and we hold the view that it would only begin when unemployment eases along with a more concrete income and wealth projection. In our view, the damage of household balance sheet, job loss and visibility of future income are barriers, whether psychological or factual, that will continue to jeopardize the release of pent-up demand. Anecdotally, the phenomenon has already manifested into an uneven consumption recovery across income groups, with luxury and mass-market (a.k.a. low-end) beating high-end (a.k.a. entry-luxury), as well as spending categories, with service outpacing products, traffic dominating per-head spending, and small-pleasure purchase outperforming big-ticket outlay. We interchangeably regard this asymmetric recovery as the aftermath of premiumization deceleration and consumption polarization.

Figure 21: Consumer confidence index



Source: Wind, CMBIGM

Figure 22: Monthly unemployment rate tracker



Source: Wind, CMBIGM

Growth beat expectations with recovery underway

China's GDP growth beat expectations in 1Q23 as retail sales and service output recovered better than expected. Our GDP growth forecast for 2023 is 5.7% and that for 2024 at 4.9%. Industrial output growth was in line with expectations as exports still face some uncertainties in future. FAI gradually slowed especially in a few manufacturing and infrastructure sectors. The better-than-expected recovery lowers the possibility of strong policy stimulus in China. However, China will not tighten its monetary and credit policy as the GDP growth remains below the potential growth and the reflation pressure is low.

Figure 23: China Economic Indicators

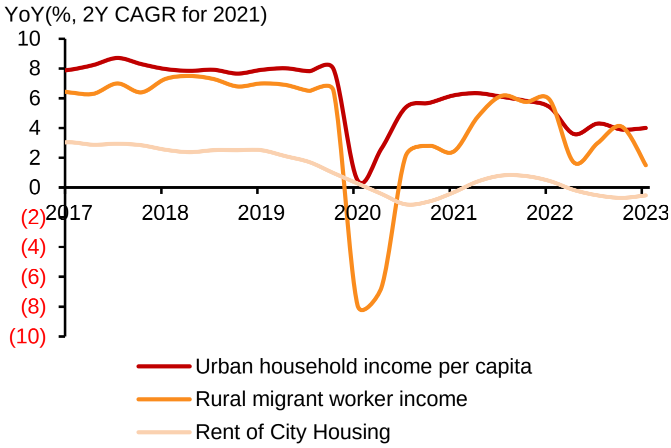
YoY(%)	2019	2020	2021	2022	1Q23
GDP	6.0	2.3	8.4	3.0	4.5
VAIO	5.7	2.8	9.6	3.6	3.0
-Mining	5.0	0.5	5.3	0.6	3.2
-Manufacturing	6.0	3.4	9.8	(2.0)	2.9
-Public utility	7.0	2.0	11.4	(2.2)	3.3
Delivery value for exports	1.3	(0.3)	17.7	5.5	(5.3)
Service output index	6.9	0.0	13.1	(0.1)	6.7
GFA sold for commodity building	(0.1)	2.6	1.9	(24.3)	(1.8)
GFA started for commodity building	8.5	(1.2)	(11.4)	(39.4)	(19.2)
Urban FAI (YTD)	5.4	2.9	4.9	5.1	5.1
-Property development	9.9	7.0	4.4	(10.0)	(5.8)
-Manufacturing	3.1	(2.2)	13.5	9.1	7.0
-Infrastructure	3.3	3.4	0.2	11.5	8.8
Retail sales	8.0	(3.9)	12.5	(0.2)	5.8
Exports of goods	0.5	3.6	29.9	7.0	8.4
Imports of goods	(2.7)	(0.6)	30.1	1.1	0.2

Source: Wind, CMBIGM estimates

- **GDP growth rebounded strongly as service output and retail sales beat expectations.** China's GDP grew 4.5% in 1Q23 after rising 3% in 2022, recording the fastest growth since 1Q22 and beating our forecast of 3.8%-4%. The value added industrial output (VAIO) rose 3% in 1Q23, in line with expectations. However, service output index and retail sales were much stronger than our forecast by rising 6.7% and 5.8% YoY respectively in 1Q23.
- **Our GDP growth forecast for 2023 is 5.7%.** The GDP growth for the remaining three quarters are projected to reach 8%, 4.9% and 5.6%. Our retail sales and service GDP growth forecast is 7.4% and 6.8%.

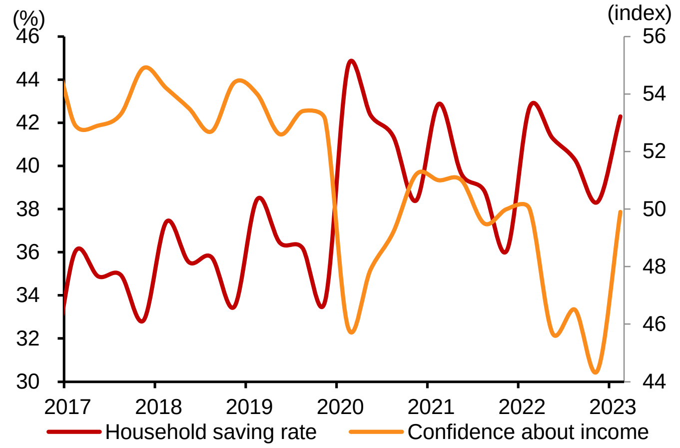
- **Retail sales beat expectations as consumption recovery was underway.** China's retail sales rebounded strongly by rising 10.6% YoY in March and 5.8% YoY in 1Q23. Breaking down, sales of food, beverage and medicine all slowed as China said goodbye to the home-stay economy and rapidly reopened economy. Meanwhile, sales of clothing and cosmetics improved significantly as outgoing and social activity recovered strongly. Sales of auto and communication equipment also rebounded. However, sales in cultural & office products, furniture and construction & decoration materials remained weak.
- **Employment condition improved yet remained tepid.** China's urban unemployment rate dropped to 5.3% in March from 5.6% in February. However, employment condition has deteriorated among those aged 16-24 as unemployment rate within this age group rose to 19.6% in March from 18.1% in February. Consumer confidence rebounded after the reopening of economy, but household saving rate remained high.

Figure 24: Household Income & Housing Rent



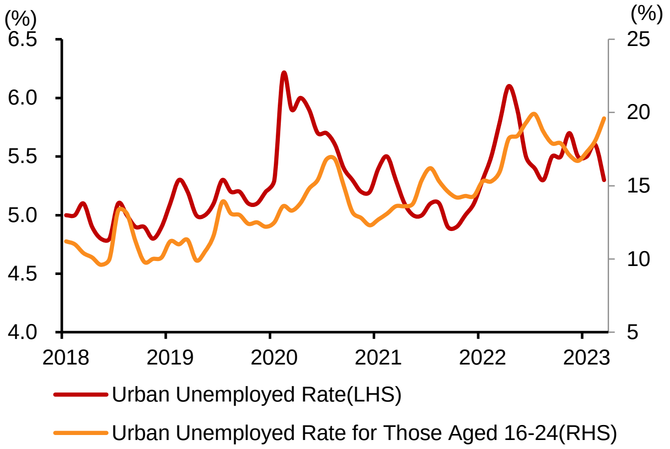
Source: WIND, CMBGM

Figure 25: Consumer Confidence



Source: WIND, CMBGM

Figure 26: Urban Surveyed Unemployment Rates



Source: WIND, CMBGM

Figure 27: Employment Index

Source: WIND, CMBGM

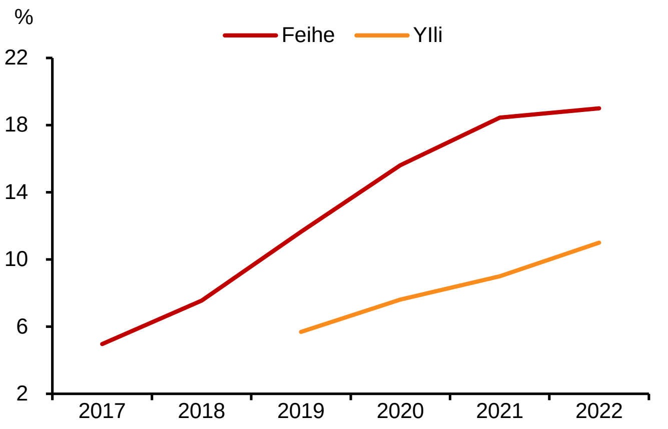
Masstige FMCGs could be a sweetspot of sustained growth under decelerating premiumization

An improved social sentiment does not necessarily contradict to a lower propensity to consume. Instead, altogether these phenomena could funnel to better foot traffic with a more dedicated mass/ masstige consumption in FMCG. In other words, despite the reopening, we expect the premiumization trend to decelerate in some consumption segments. In other words, we still expect household to spend, yet at a more selective way and largely reorient to small pleasures in daily life at a more affordable cost.

■ Dairy: where masstige brands prevail

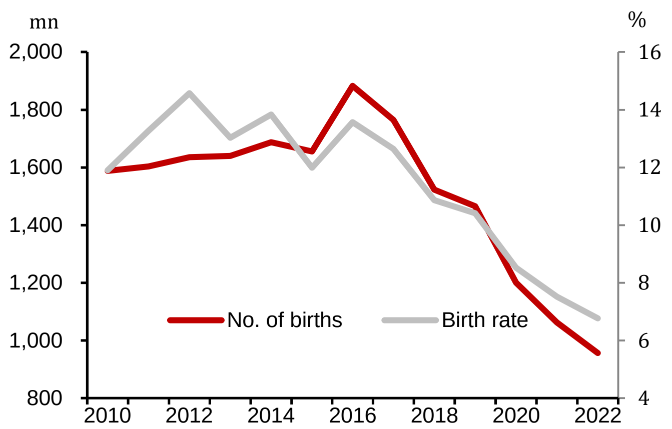
Subsequent to its takeover on Ausnutria, Yili has been aggressive in the IMF segment. With its established distribution channel (70% of IMF sales come from mother-care channel, 20% come from online platform, the rest from KA) and more importantly, a mass market positioning, the company has been gaining market share, from 9% in 2021 to 11% in 2022, according to the company. This is despite intensifying competition given a low birth rate during the pandemic.

Figure 28: Market share trend between Feihe and Yili



Source: Company data, CMBIGM

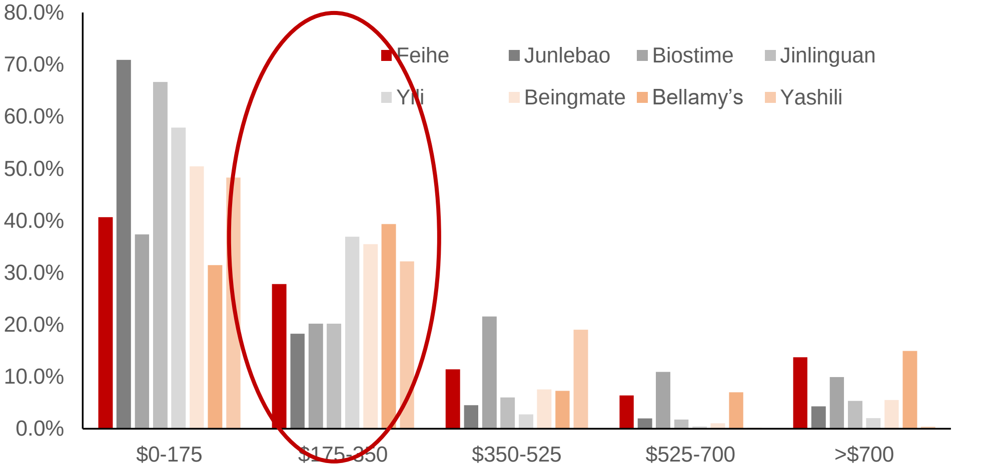
Figure 29: Birth rate is declining during the pandemic



Source: Wind, CMBIGM

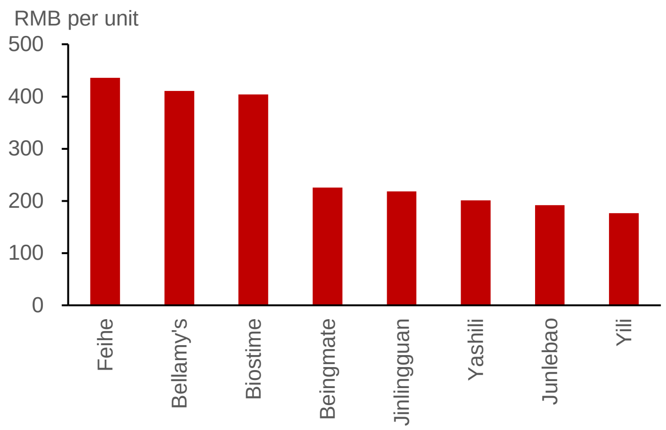
Comparing the price range on Tmall/ Tabao across major domestic brands, we note that Yili derived a much higher sales mix from mass market/ entry premium SKUs (those below RMB350) than Feihe (95% vs 68%) in 2022. We think this explained why Yili has been taking market shares from foreign high-end brands, while Feihe is maintaining its market share, when spending incentives remained lackluster amid a slower birth rate.

Figure 30: Price range among major domestic IMF producers in China 2022



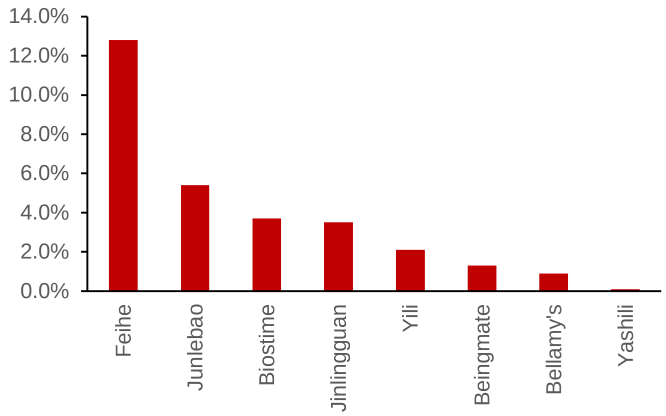
Source: Moojin, CMBIGM

Figure 31: Online ASPs across local brands 2022



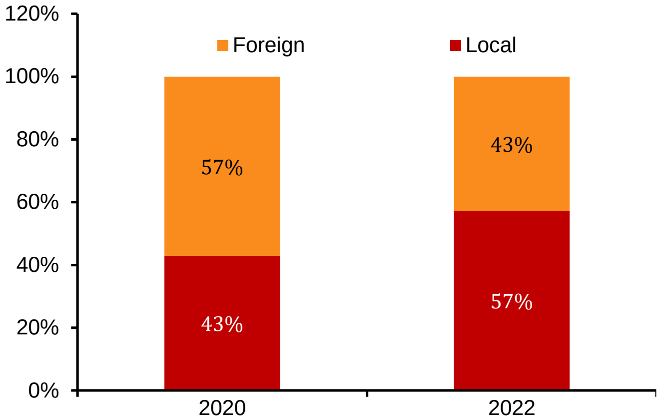
Source: Moojin, CMBIGM

Figure 32: Online shares across local brands 2022



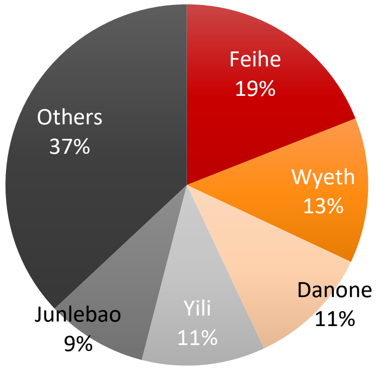
Source: Moojin, CMBIGM

Figure 33: Market share of local and foreign brands



Source: CMBIGM

Figure 34: IMF market share breakdown 2022

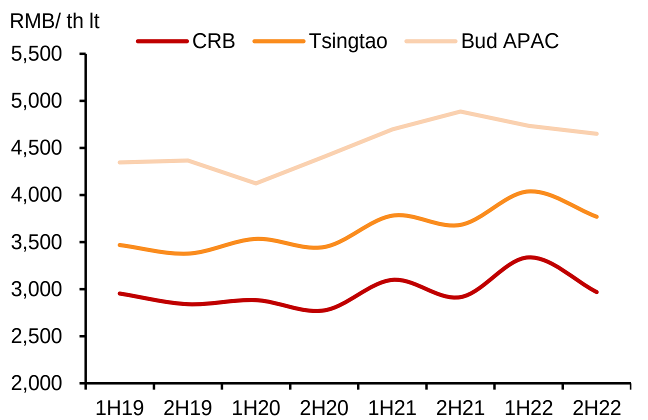


Source: Company data, CMBIGM

- **Beer: affordable price hikes match well with willingness to pay by young consumers at social events**

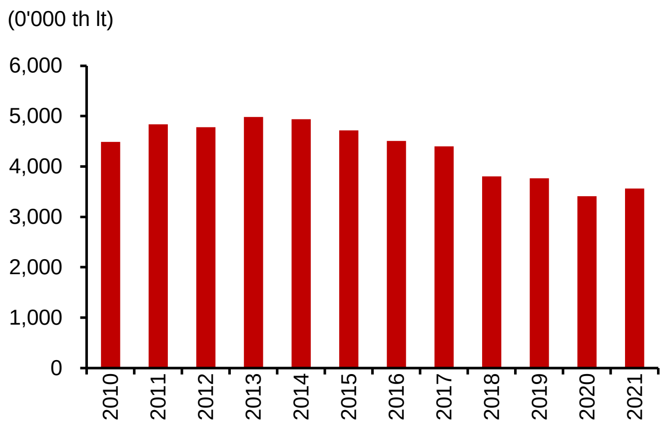
The current round of price hike can be traced back to 2017, when the sector was clouded by overcapacity and homogenous price-based competition. While some might think a price hike by then was cost-driven, instead, it was proposed along with a premiumization initiative that intended to make beer more appealing again to consumers, especially the younger ones.

Figure 35: ASP trend for major local breweries



Source: Company data, CMBIGM

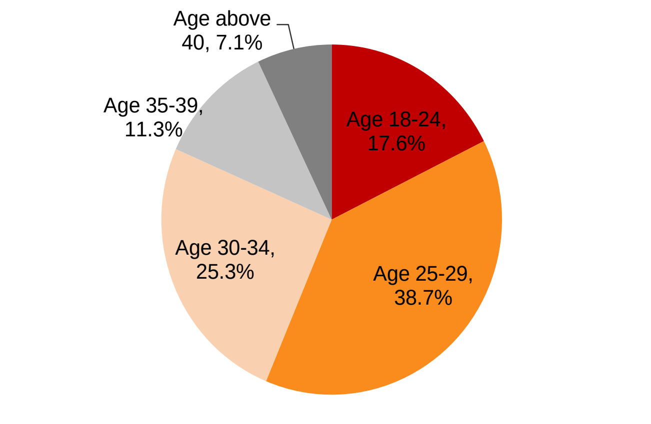
Figure 36: China beer production



Source: Wind, CMBIGM

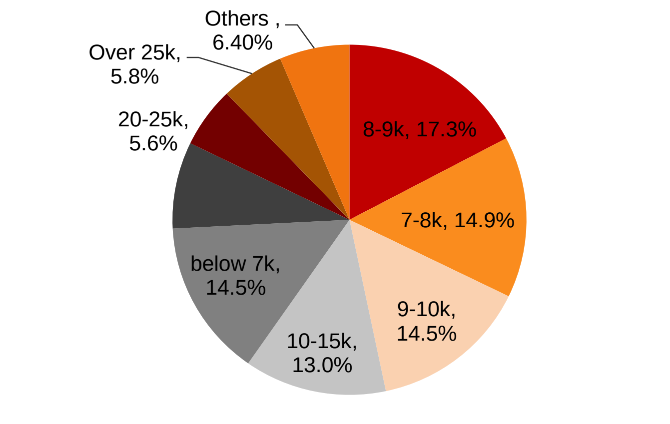
Although there has been criticisms that higher prices could upset consumers with high price elasticity, with a more precise marketing positioning (craft beer, black beer etc) and a refreshed product packaging, the industry is on its right track to 'select' its own consumers. Of note, the number of alcohol consumption has been on the rise in the past 10 years, with approximately 40% of the total deriving from the post-90s consumers by 2021, according to different news sources we consolidated. While beer notably shares a similar age profile to the total alcohol consumption, female drinkers are contributing a more significant proportion than in the past. For instance, post 90/95 female drinkers had already represented half of the total by 2020.

Figure 37: Alcohol consumption by age group



Source: various new source, CMBIGM

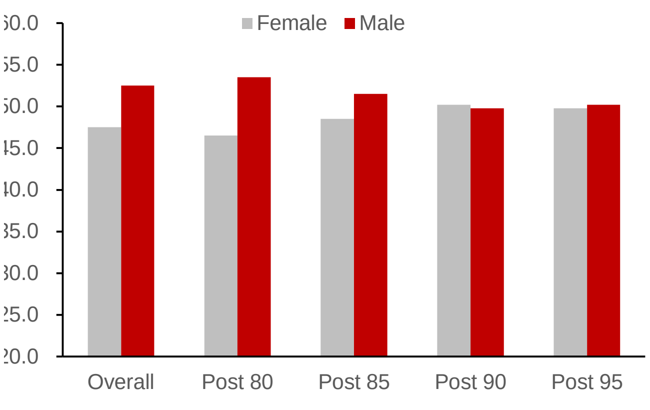
Figure 38: Alcohol consumption by income group



Source: CBD data, CMBIGM

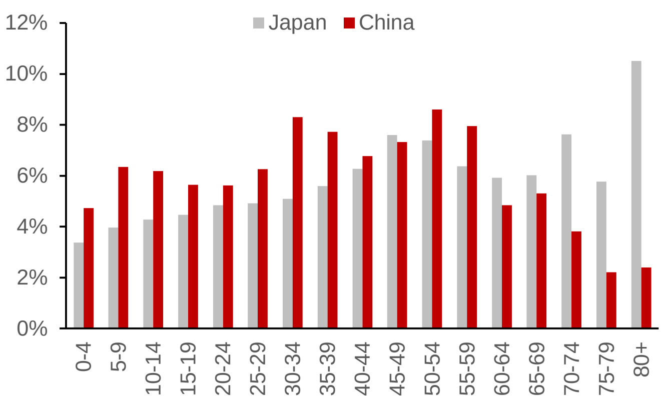
On a separate note, China's relatively higher youth contribution (age 29-40) suggests that the trend for product segmentation and innovation is happening, and more importantly, sustained, and will be rewarded by higher eagerness to spend during social gatherings. For instance, over 23% of the survey participants are willing to spend over RMB 50 per bottle for low alcoholic drinks.

Figure 39: Beer consumption breakdown by gender



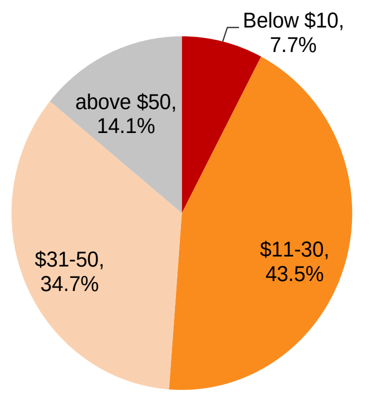
Source: various new source, CMBIGM

Figure 40: Age distribution, China and Japan



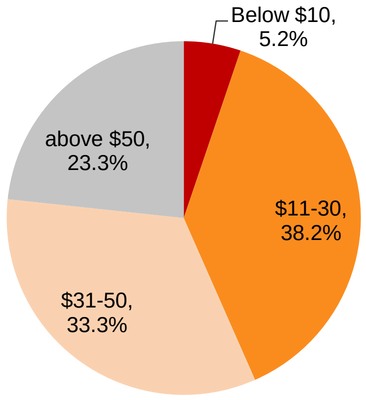
Source: World Bank, CMBIGM

Figure 41: Home consumption by spending range



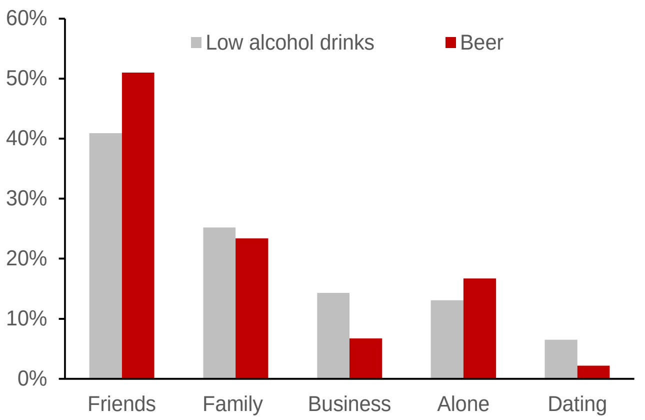
Source: iimedia, CMBIGM

Figure 42: Social consumption by spending range



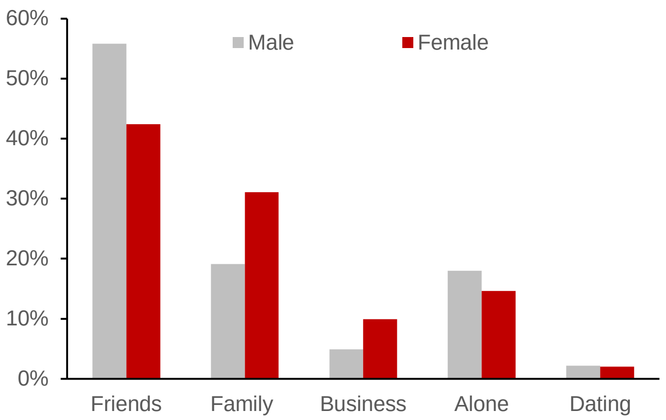
Source: iimedia, CMBIGM

Figure 43: Drinking occasions by type



Source: iResearch, CMBIGM

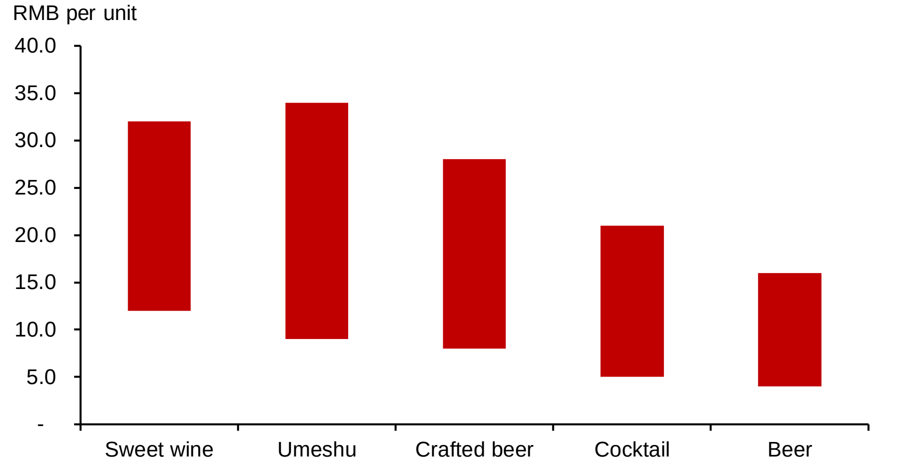
Figure 44: Drinking occasions by gender



Source: iResearch, CMBIGM

In fact, when compared to other low alcoholic substitutes, such as cocktail and sweet wine (cider/ Ratafia etc), we still see ample room for average beer prices to go up, should that commensurate with higher quality, better drinking experience and more diversified drinking occasions. In other words, we argue that there should still be huge potential for beer to further premiumize in China relative to other mature markets such as Japan.

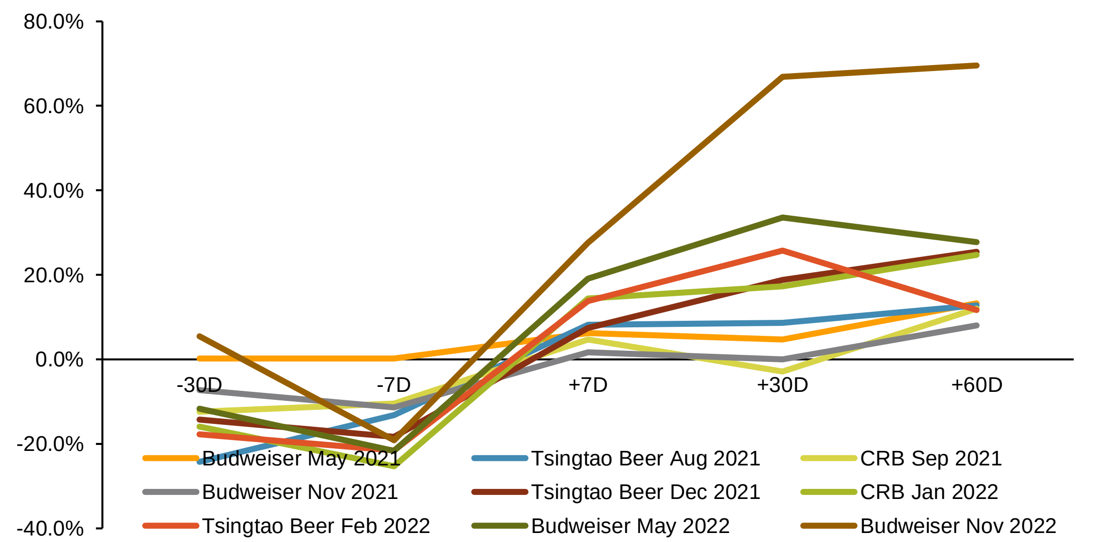
Figure 45: Price range across major low-alcoholic beverages in China



Source: Tmall, Suning, CMBIGM
Note: Price we calculated is volume-adjusted, and may not accurately reflect the difference in alcohol content.

Price hikes by breweries are highly correlated to share price performance historically. While we tracked the share price performance for CR Beer, Tsingtao, and Budweiser after the announcement of price hikes since 2021, we see that almost all of the events have triggered shares to react positively, regardless market externalities.

Figure 46: Stock returns are the most obvious after 7 days post price hike announcement



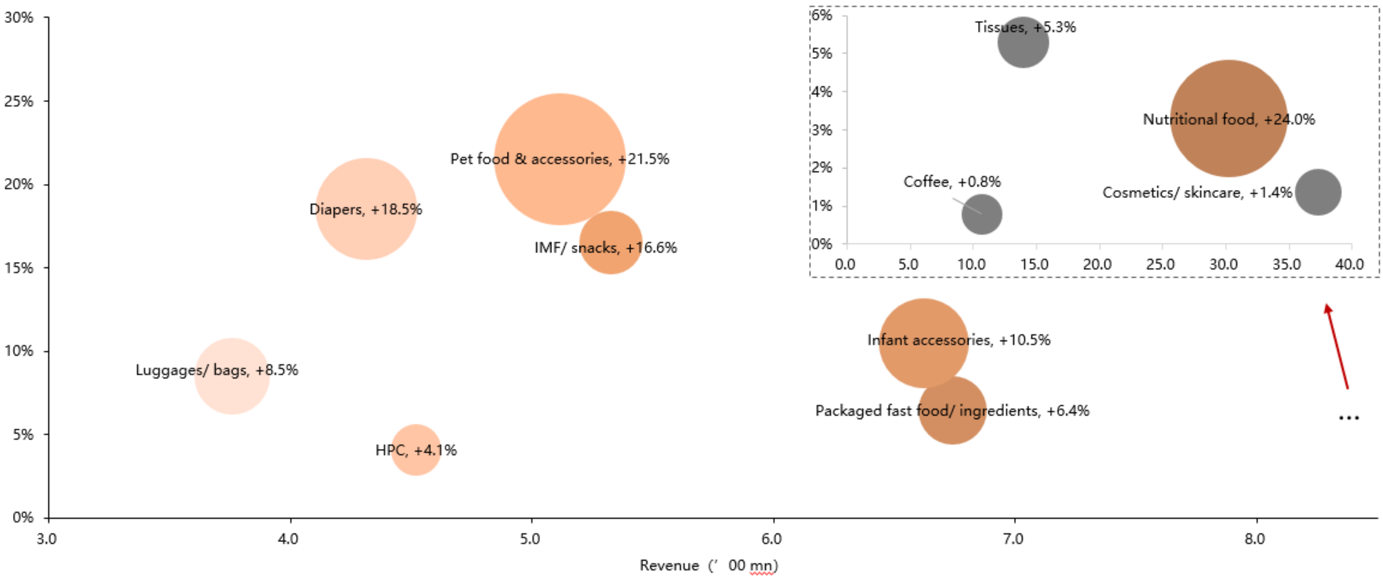
Source: Bloomberg, CMBIGM

Consumption polarization is selectively happening

- **Cosmetics - local brand's ongoing premiumization may not be as effective**

The unceasing pursuit of beauty has not only extended from the 3-year lockdown to a 3.8% cosmetic sales growth to RMB65.6bn in 2M23 (vs 3.5% of China retail sales), but has also to 1.4% growth (relative to the total GMV) during the 3.8 shopping festival this year. For 3M23, cosmetic sales grew 10% YoY, in line with that of China's social retail sales.

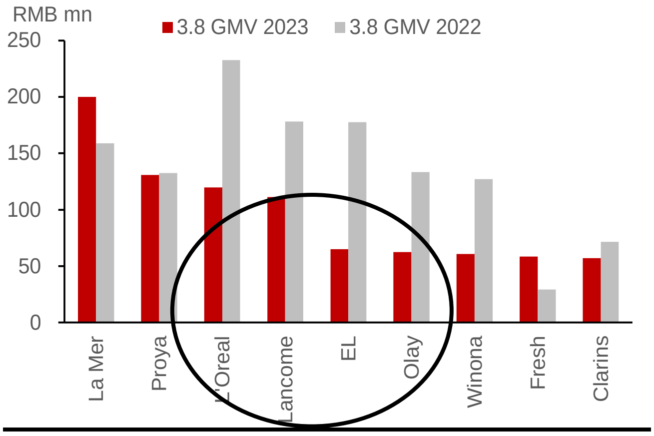
Figure 47: Market size and growth for key consumer necessities during 3.8 online shopping festival 2023



Source: Moojing, CMBIGM

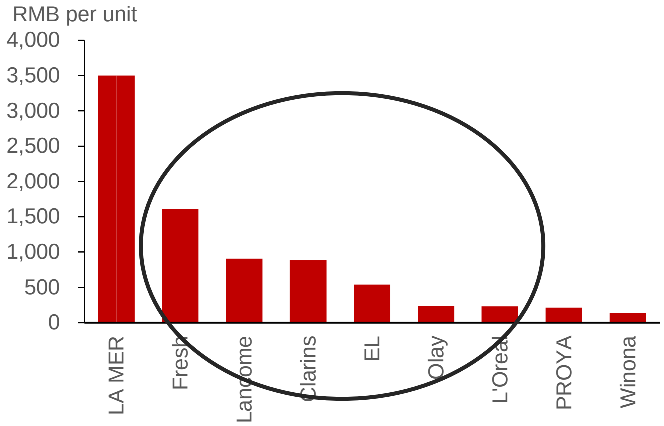
We argued domestic brands were collectively catching-up and taking market shares from foreign brands. But now, we notice the situation is slightly twisted, with demand polarization becoming more obvious. Data from 3.8 shopping festival alone may not be conclusive; but indeed alarming enough to raise the eyebrow - La Mer (ultra-premium foreign brands, ASP RMB3,000 plus) and Proya (masstige local brand; ASP RMB100-200) were the major brands not seeing sales decline, and this came at the costs from those who "stuck in the middle" across the brand spectrum. While we mainly attribute the phenomenon to consumption polarization, on the other hand, emerging local brands such as Runbaiyan (润百颜), Comfy (可复美), QuaDha(夸迪), have been doing a better job in catering local demand, particularly in the RMB200-500 segment (entry price level for foreign brands), when the locals increasingly care about value-for-money.

Figure 48: La Mer/ Proya seeing stable GMV YoY…



Source: Moojing, CMBIGM

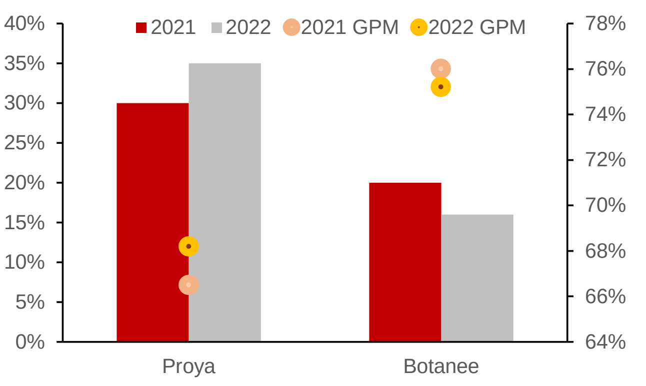
Figure 49: …and brands with mid-price range suffer



Source: Moojing, CMBIGM

Four years after Proya initiated and successfully executed industry's first hero product strategy for its double-anti serum and Ruby-series, we argue that the low hanging fruits are mostly gone, when live streaming has also become a standardized marketing tool. Premiumization is a logical next step, in our view, and unsurprisingly we have seen leading brands like Proya and Botanee have already 'testing the water' through the "Deep Ocean Serum" and "AOXMED" brand, respectively. While we do believe that these initiatives should effectively enhance local brands' competitiveness (especially against foreign brands), however, we think growth trajectories would not be as obvious under the backdrop of demand polarization, especially when "premium" or "superiority" takes time to build (consider EL/ Olay acquired Tom Ford/ Aesop to break into the high-end cosmetic segment).

Figure 50: Hero products contribution drives up blended GPM



Source: Company data, CMBIGM

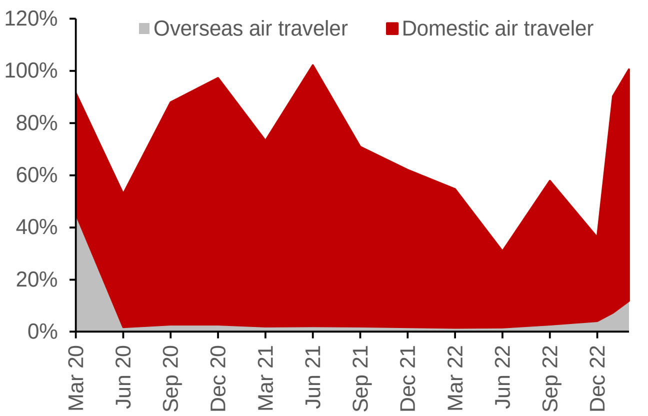
Figure 51: Proya "Deep Ocean" serum is priced at RMB420+

Source: Company data, CMBIGM

- **Dutyfree – stable per-head-spending; but foot traffic could diverge to overseas despite the lead of local tour year-to-date**

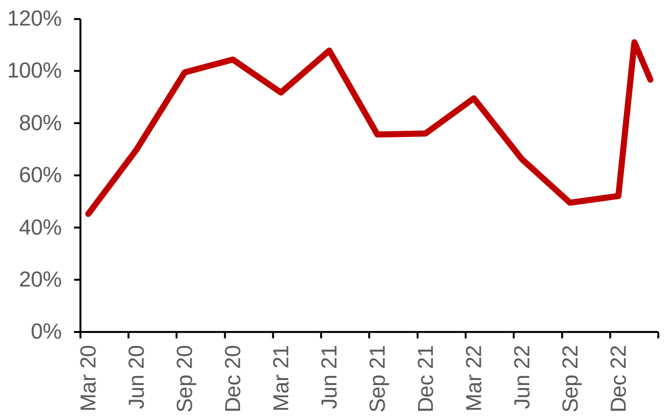
Relative to the travelling rate in 2019, the number of quarterly domestic traveller has been higher than that of international travel since 2020. The gap has further widen since China's reopening by end-22. While we do not have official forecasts in how the trend will further be extrapolated in the next few quarters, we see grounds, such as visa approval, pilot shortage and hence bottleneck in flight capacity, for the former to maintain its lead to the latter. In other words, we still expect the strong Hainan foot traffic to benefits local touristic play like CTGDF within 2023E.

Figure 52: Domestic/ overseas air travelers vs 2019



Source: Wind, CMBIGM

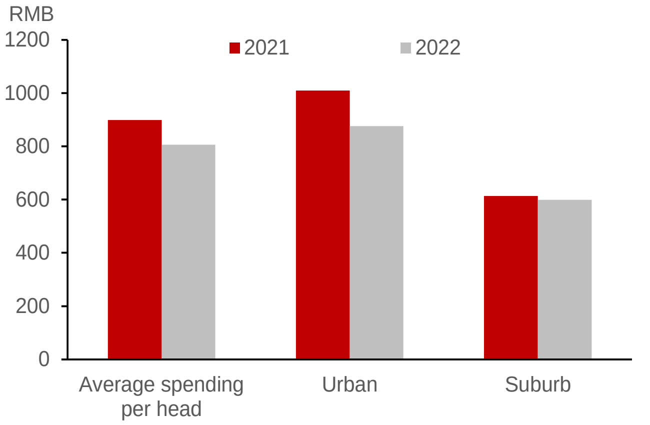
Figure 53: Hainan overnight visitations



Source: Wind, CMBIGM

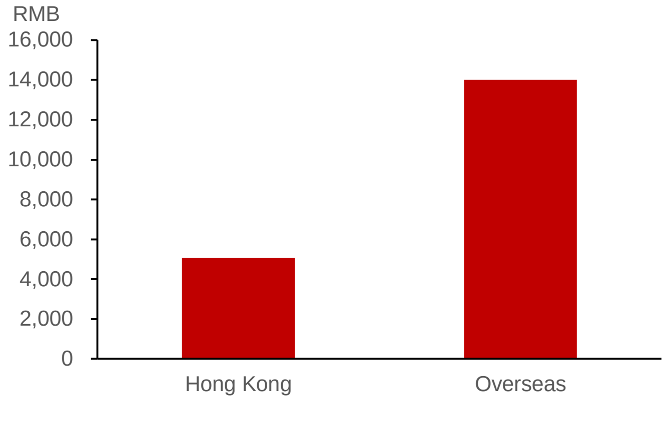
From another perspective, another 'pull factor' to sustain the current trend would be the spending gap between the two. China Tourism Association (CTA) pointed out that the average spending per head for domestic travellers was about RMB 900/ 807 per head for the year 2021-2022, respectively. On the other hand, data published by OliverWyman suggested that the average tourist spending for HK and overseas travel were about RMB5,000 and RMB14,000 in 2019. Although the surveys might not represent a fair comparison, (considering the difference in timing, and parameters such as accommodation/ shopping spending etc), the spending gap between the two looks to be significant enough to dissuade an abrupt jump in long-haul trips, when spending power is unlikely meaningfully recover.

Figure 54: Domestic travel spending per head



Source: CTA, CMBIGM

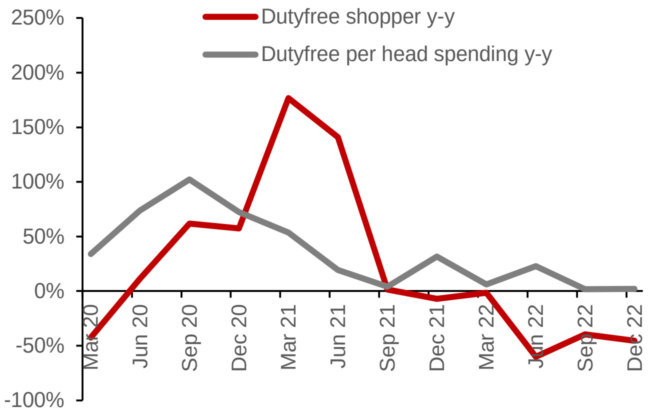
Figure 55: Overseas/ HK travel spending per head



Source: Oliverwyman, CMBIGM

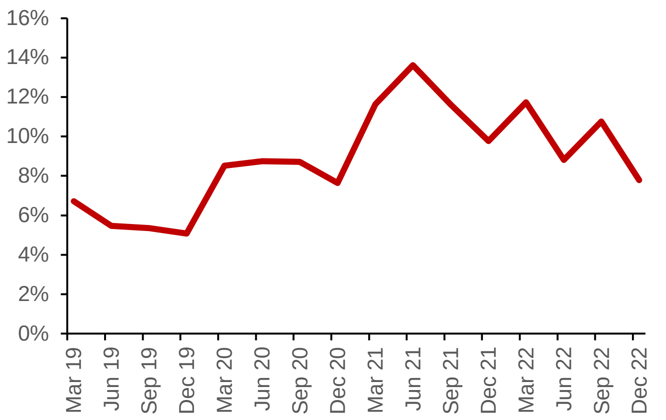
When we dig deeper into the details of Hainan's tourist traffic, a large proportion of the overnight tourist was driven by sightseeing demand, when the number of dutyfree shoppers, or essentially, the dutyfree shopper conversion rate has been on its decline since mid-21. Meanwhile, spending per-head has remained relatively robust with a 2% increase in 2022. In our view, the seemingly contradictory data set was in line with global trend that 1) despite lockdowns and economic cyclicality, the untainted spending power among a small proportion of ultra high net-worth shoppers sustained a stable per-head luxury spending, and 2) ultra-luxury brands tend to have exceptional pricing power to buyers, i.e. consumers are essentially price takers.

Figure 56: DF spending per head YoY stayed positive



Source: Wind, CMBIGM

Figure 57: Hainan dutyfree shopper conversion rate

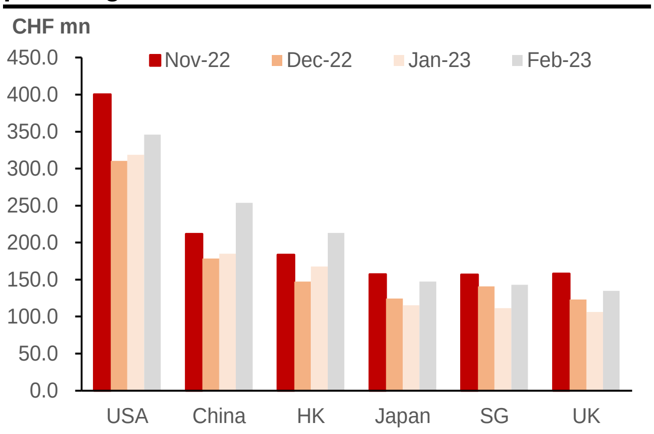


Source: Wind, CMBIGM

- **Other luxury goods – an inelastic wallet to macro changes, but it is not totally counter-cyclical**

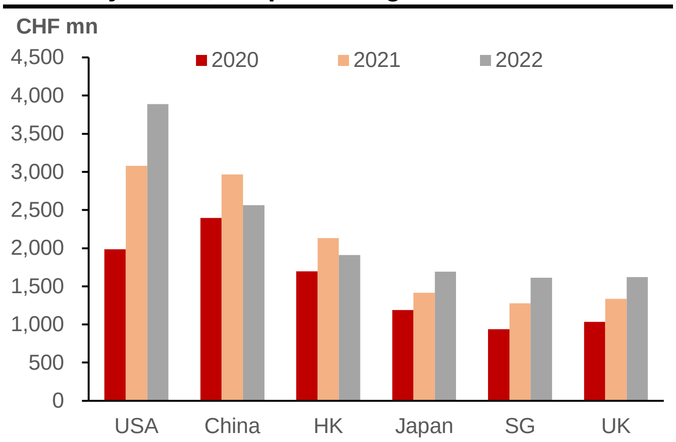
Luxury consumption has been a subjective term locally. Read-across from global data provides us an alternative way to gauge the trend when domestic data is not officially available. Swiss-watch has been one of the most readily available benchmarks of luxury consumption. Data published by the Federation of the Swiss Watch Industry FH indicated 8.2% export sales growth to China in February. This does not only represent an improvement from January of -17.3% YoY, but also the first positive number in the last 4 months despite an unfavourable base effect. The growth seemed to be mainly driven by China's reopening.

Figure 58: Swiss watch exports to China returned to positive growth in Feb 2023



Source: Federation of the Swiss Watch Industry FH, CMBIGM

Figure 59: Swiss watch exports to China have been relatively stable, despite a longer lockdown



Source: Federation of the Swiss Watch Industry FH, CMBIGM

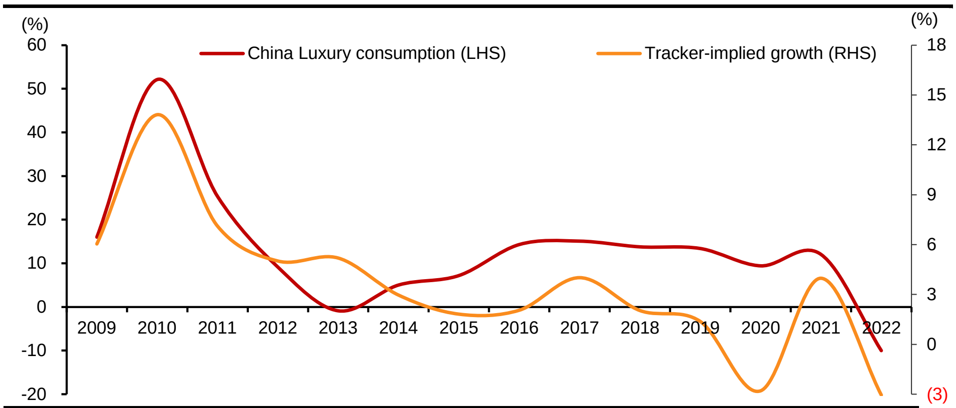
On the other hand, latest quarter results from luxury brands also pointed to similar conclusions with China delivering untainted luxury growth. For instance,

- **LVMH** maintains an optimistic outlook for the China market and acknowledges the recovery in its Fashion and Leather segment of which sales of the quarter grew by double-digit. Management believes the positive 1Q momentum could extent into the rest of 2023.
- **Hermes** delivered 23% sales growth in Asia ex-Japan, driven by a very good gifting demand over the Chinese New Year. In January, the brand's Nanjing store reopened at a new address after renovation and extension.
- **Gucci** revenue grew 1% cFX, when APAC revenue gained 6% thanks to China's reopening which offset weakness in the US that saw a 19% decline. In China, Gucci commented that an obvious recovery in sales was seen in March with double-digit growth seen across its brand portfolio.

In fact, despite economic cyclicality, luxury consumption in China has displayed a relatively stable trajectory from 2009 to 2022, with the exception in 2020 and 2022. We attribute this to any COVID lockdowns, when luxury consumption were mostly taken place in offline premises and required physical presence to the consumption spots.

We constructed a luxury consumption tracker to dissect, if not to trace, the luxury consumption data we scavenged from different sources. Our tracker consists of 10 indicators that represent the 3 aspects that we think best in mimicking the trend. This includes 1) legit luxury spending items such as dutyfree/ jewellery/ luxury auto sales, Macau GGR, 5-star hotel RevPar, Moutai production volume; 2) consumption sentiment such as HK/ China Social Retail Sales; as well as 3) wealth effect parameters such as tier-1 housing price and CSI 300 stock index performance.

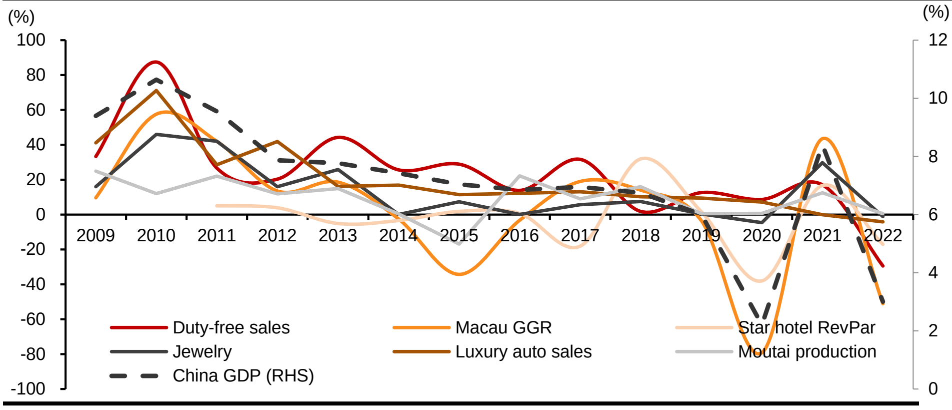
Figure 60: Our China luxury consumption tracker vs numbers reported by various market consultants



Source: Wind, Euromonitor, Company data, CPCA, CMBIGM

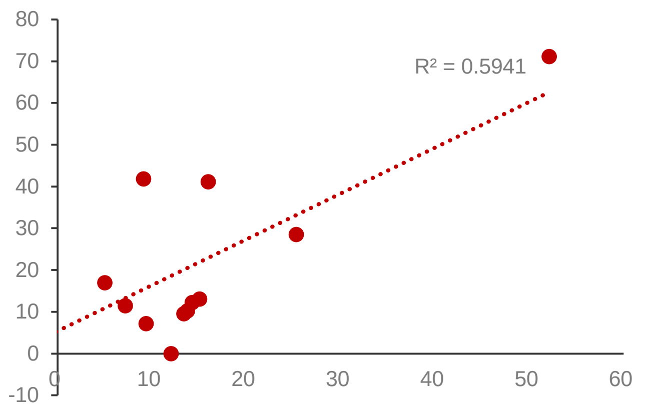
Among the 6 spending indicators we monitored, luxury auto sales (Audi, Benz, and BMW) has the highest correlation to overall luxury consumption with a R-squared of 0.59, followed by 0.57 of dutyfree sales. Sentiment (China/HK retail sales) and wealth effect indicators (CSI300 performance/ tier-1 cities property price) does not have a high correlation to overall luxury spending. This reinforces our view that consumer wallet to luxury goods has a high inelasticity to macro environment, yet not totally counter-cyclical.

Figure 61: Luxury spending parameters we surveyed vs China GDP change



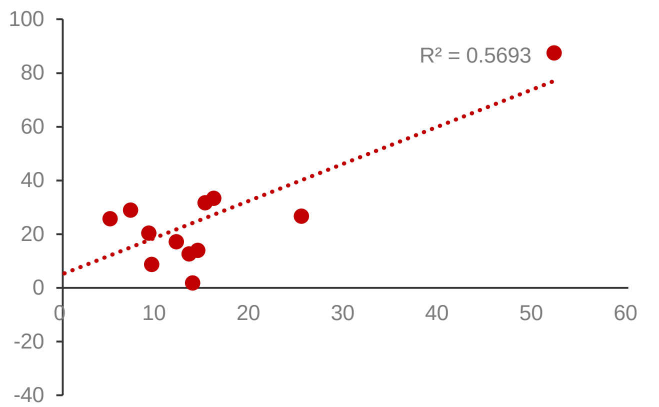
Source: Wind, Company data, CPCA, CMBIGM

Figure 62: ABB auto sales vs luxury consumption (Data from 2009-2022)



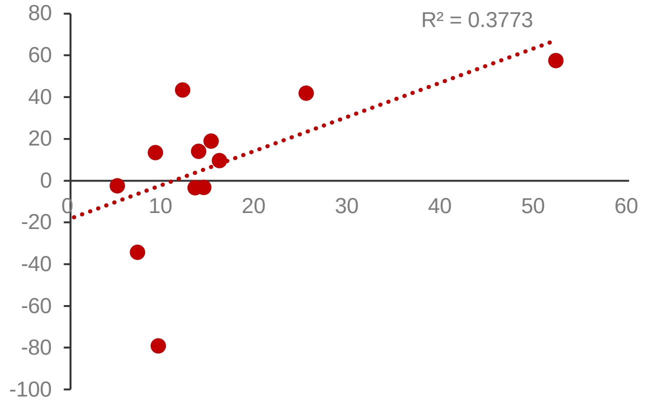
Source: CPCA, CMBIGM

Figure 63: Dutyfree sales vs luxury consumption (Data from 2009-2022)



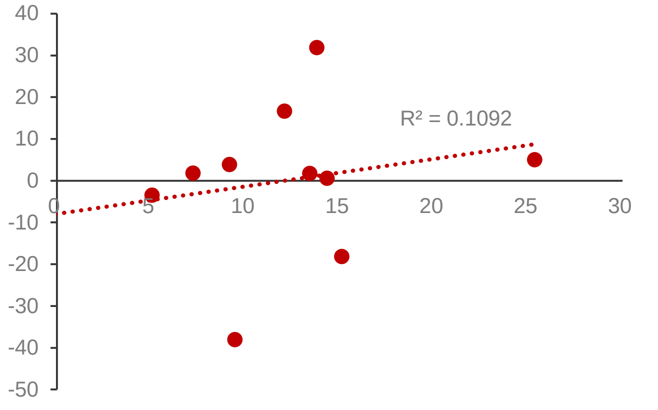
Source: Hainan government website, CMBIGM

Figure 64: Macau GGR vs luxury consumption (Data from 2009-2022)



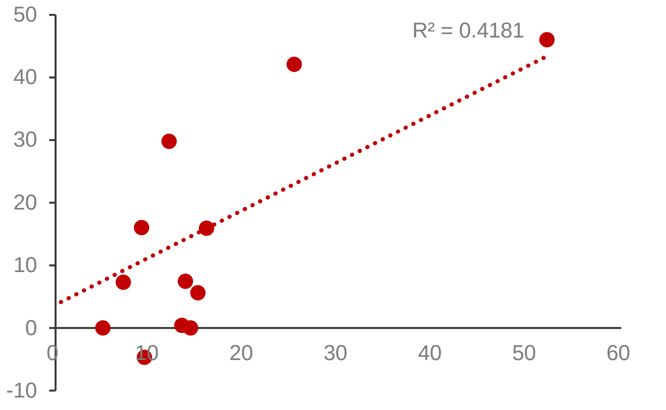
Source: Wind, CMBIGM

Figure 65: Star hotel RevPar vs luxury consumption (Data from 2009-2022)



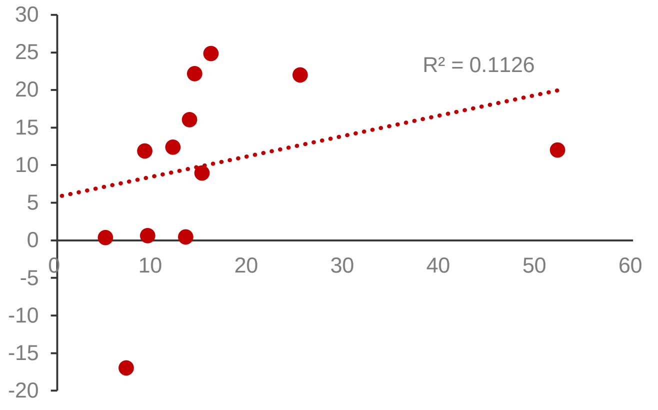
Source: Wind, CMBIGM

Figure 66: Jewellery sales vs luxury consumption (Data from 2009-2022)



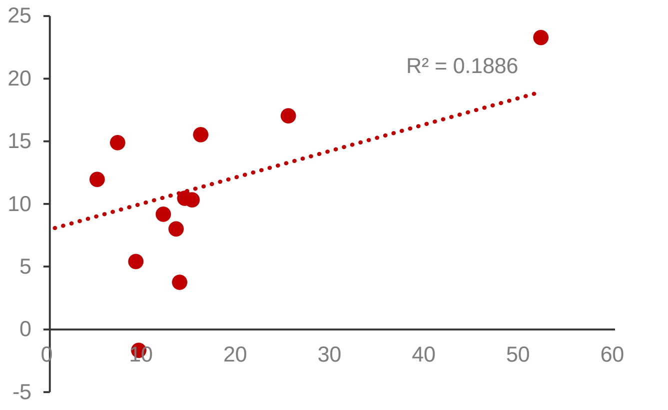
Source: Wind, CMBIGM

Figure 67: Moutai production vs luxury consumption (Data from 2009-2022)



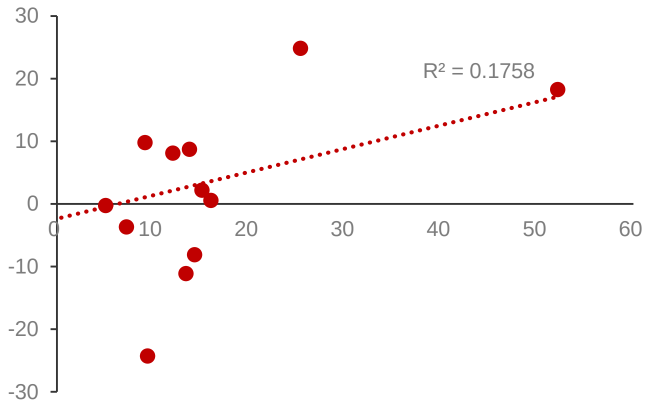
Source: Wind, CMBIGM

Figure 68: China Social Retail Sales vs luxury consumption (Data from 2009-2022)



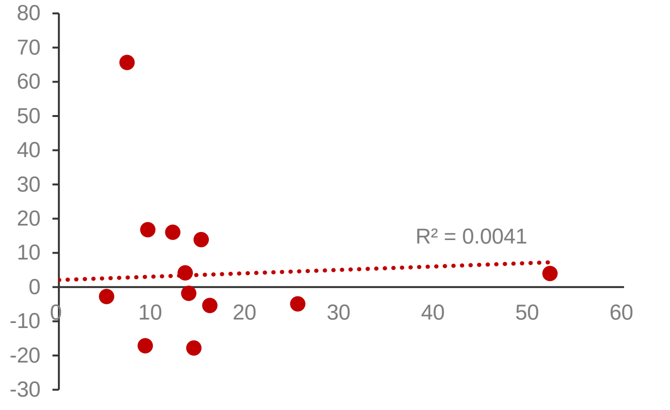
Source: Wind, CMBIGM

Figure 69: Hong Kong Social Retail Sales vs luxury consumption (Data from 2009-2022)



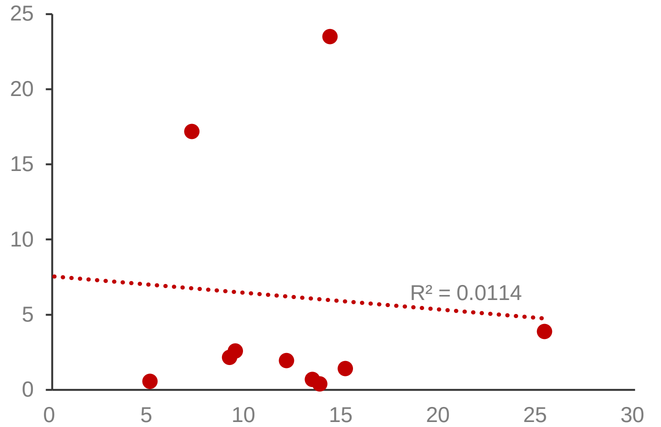
Source: HKG website, CMBIGM

Figure 70: CSI 300 index perf vs luxury consumption (Data from 2009-2022)



Source: Wind, CMBIGM

Figure 71: T1 property price vs luxury consumption (Data from 2011-2022)



Source: Wind, CMBIGM

Release of pent-up demand aids robust travel and consumption recovery

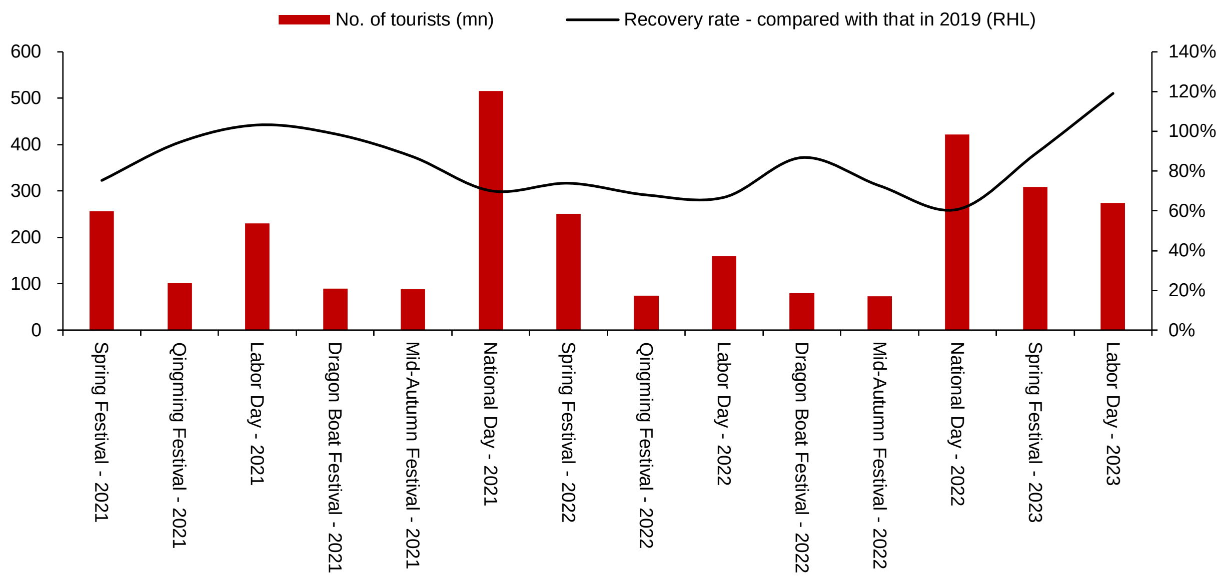
According to our China Internet team, Labour Day (LD) Holiday data revealed a strong recovery trend for travel industry aided by the release of pent-up demand, which is likely to trend into 3Q22 aided by the coming of peak summer holiday travel period. With the recovery of offline activities and low base effect, local consumer services industry also saw robust recovery, while the evolvement of competitive landscape is the key to watch.

- Strong recovery of travel industry is likely to trend into 3Q22. Per Ministry of Culture and Tourism, domestic tourism volume/spending reached 119.1%/100.7% of 2019 level during this year's LD holiday, compared to 67%/44% for 2022 LD holiday and 89/73% for 2023 Spring Festival. Data from Meituan revealed that the number of accommodation reservation volume for long-haul travel has increased by 40% during the first three days of this year's LD holiday, compared with the same period in 2019. Per Tongcheng, during 2023 LD Holiday, booking volume for international hotel has surpassed that in 2019. In addition, HK Immigration Department estimated trips to and from HK to reach 4.61mn for this year's LD holiday period (29 Apr-4 May), recovered to c. 69% of 2019 level. Labour Day travel data reviewed a strong release of pent-up demand, in our view, with long-haul travel demonstrated robust recovery trend. The strong recovery is likely to trend into 3Q23 aided by the peak summer holiday travel period.

- Offline activities saw solid recovery and has surpassed 2019 level. According to Ministry of Transport, the number of passenger volume reached 57.0mn on 29 April 2023, up 151.8% YoY and has surpassed that in 2019. Per Wind, the daily average subway passenger volume in China's 10 large cities between 28 April and 1 May 2023 was up 14% compared to the comparable period in 2019 (30 Apr-3 May).

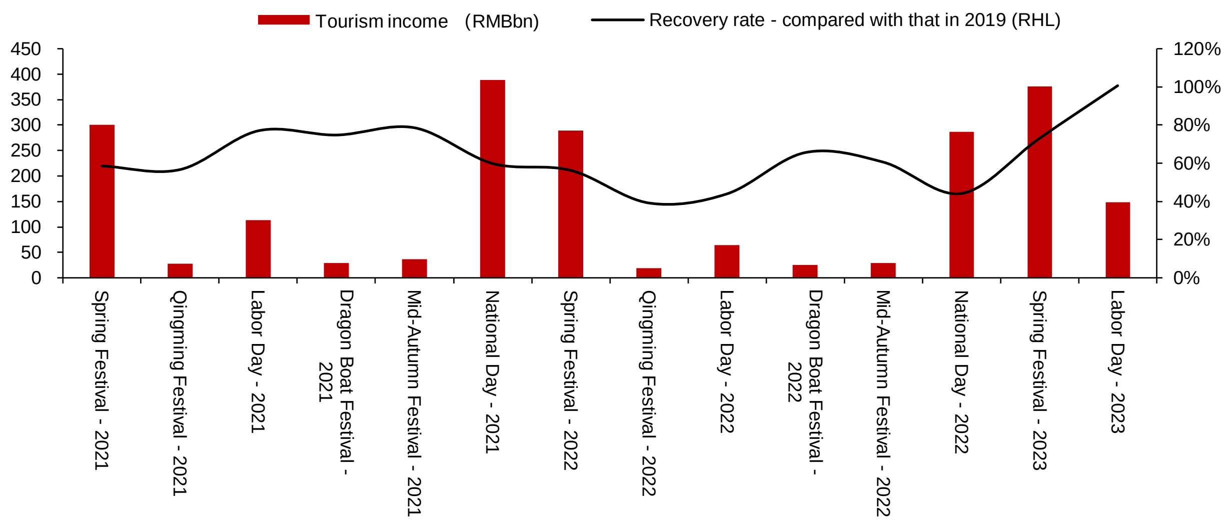
- Recovery in travel and offline activities aided consumption recovery during LD holiday. Per Ministry of Commerce, China's key retail and catering enterprises saw sales GMV growth of 18.9% YoY during this year's LD holiday. Data from Meituan also revealed a solid consumption recovery trend: during the first three days of this year's LD holiday: 1) compared to the same comparable period in 2019, daily average consumption GTV for life services related industries on Meituan platform increased by 133%, indicating a 4-year CAGR of 23.5% (2023 New Year Day holiday: 15.0% CAGR), and catering services GMV increased by 92% (17.7% 4-year CAGR); 2) the proportion of consumption made by users from cities that are not currently living in increased by 10pp compared to that in the same period in 2019. Per Alipay, total consumption GTV during this year's LD holiday increased by 200% YoY and was up 70% compared to that of 2019. Local consumer services industry is likely to see strong GMV growth in 2Q23, due to a constant recovery in offline activities and low base effect, in our view, while the evolvement of industry competition and related long-term impact is the key to watch.

Figure 72: Domestic tourism volume and recovery rate



Source: Ministry of Culture and Tourism, CMBIGM

Figure 73: Domestic tourism spending and recovery rate



Source: Ministry of Culture and Tourism, CMBIGM

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