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The New Chinese Consumer

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The New Chinese Consumer

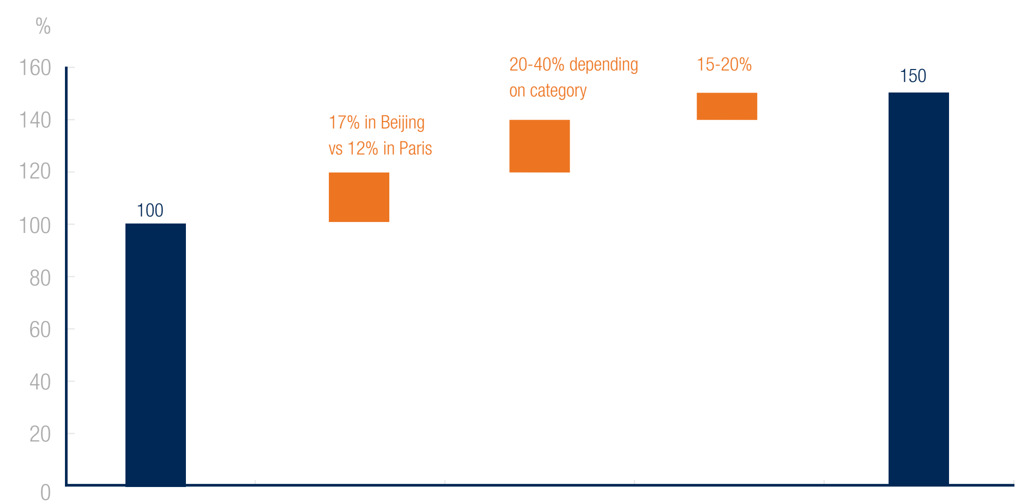
In this article, we highlight key trends which we believe will play out over the next few years in the Chinese consumer discretionary space. **We believe that while luxury spending will continue, consumers are becoming increasingly discerning in terms of making their purchases at the "right" value.** We also delve into an emerging trend where we explore the possibility of some shift back to offline channels as younger Chinese consumers grow their disposable income and cut their time spent shopping online. **We continue to champion the case for burgeoning Chinese travel, and believe that the phenomenon is still in its infancy.** Finally, we take an interesting look at the "Made in China" concept and debate its feasibility and long term prospects.

No Longer Slaves to Luxury

We believe that we are seeing a structural shift in the purchase habits of Chinese consumers towards increasing sophistication and an awareness of the products' value proposition. In short, the days of luxury brands charging any price in China are gone, especially with the rise of e-commerce and the ability of more Chinese to travel overseas (which allows them to compare prices and come to the realization that they may have been overpaying in their local market). This variance in prices stems from a combination of the difference in VAT, import/luxury tax depending on product category, and the "China mark-up" as illustrated in the figure below.

Price Differential Between Europe and China For Luxury Goods

Source: Mirae Asset Global Investments' Estimates (2014)



The "China Mark-Up" days are drawing to a close as international price point awareness propagates.

A Mini Offline Revival?

Despite the trend of e-commerce gnawing away at offline retailers' market share, we note that only a mere 28% of the 29 soft luxury brands (i.e. leather goods, silks, and made-to-wear) and 5% of the 22 hard luxury brands (i.e. watches and jewelry) we sampled had e-commerce offerings. We attribute this to a few factors: 1) internet usage is primarily linked to youths and this demographic tends to have lower purchasing power, which curtails their ability to consume luxury goods; 2) Chinese consumers are wary of the high opportunity costs of purchasing fakes online especially given the high ticket price of luxury goods; 3) Chinese consumers are used to receiving discounts when making online purchases which does not tie in with the "O2O" (online to offline) strategy of luxury goods companies, whose focus is to defend and enhance brand perception.

Taobao and JD are E-Commerce Leaders in China

Source: Google Image Search, Mirae Asset Global Investments (2014)

Emerging trends converge on the online marketplace.

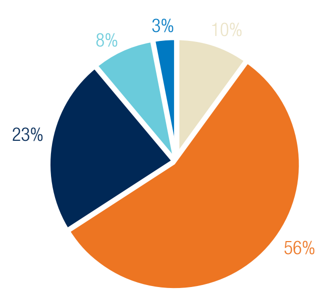
We think it is possible to see a shift of these post-90s consumers back to offline stores

On the topic of e-commerce, the post-90s consumers – those born in the decade of the 1990s, a period defined by the internet boom and rapid economic development – accounted for 56% of online shoppers in China in 2013. We think it is possible to see a shift of these post-90s consumers back to offline stores due to: 1) enhanced purchasing power; 2) less disposable time to scour the internet for trustworthy deals; and 3) the need for higher-end products due to a change of social status.

Age Breakdown of Online Shoppers

Source: CNNIC, Mirae Asset Global Investments (2014)

Below 20 | 20-29 | 30-39 | 40-49 | Above 50

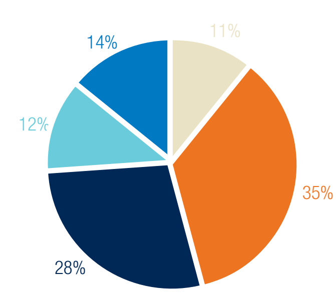


Younger shoppers account for over half of online consumers.

Monthly Income Breakdown of Online Shoppers (1 USD = 6.25 RMB)

Source: CNNIC, Mirae Asset Global Investments (2014)

Below 1K | 1k-3k | 3k-5k | 5k-8k | Above 8k



Three quarters of online shoppers earn below RMB 5,000 a month.

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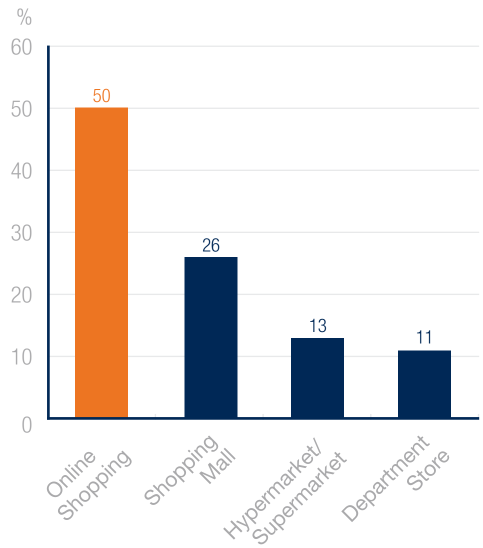
We believe that most of the "post-90s" in China are either still in college or have only recently entered the workforce. As such, they are attracted to e-commerce for the lower prices it offers since 70-80% of online shoppers earn below RMB 5,000 (USD 800) per month, according to the China Internet Network Information Centre (CNNIC). A recent Standard Chartered survey points to four key findings: 1) 50% of students place online shopping as their preferred shopping channel; 2) apparel, footwear and accessories are the main product categories purchased online; 3) about 60% of respondents spend RMB 100-800 (USD 16-128) per month online; and 4) the majority spend less than five hours a week on online shopping.

Shopping Channel Selection of Chinese Post-90s Consumer

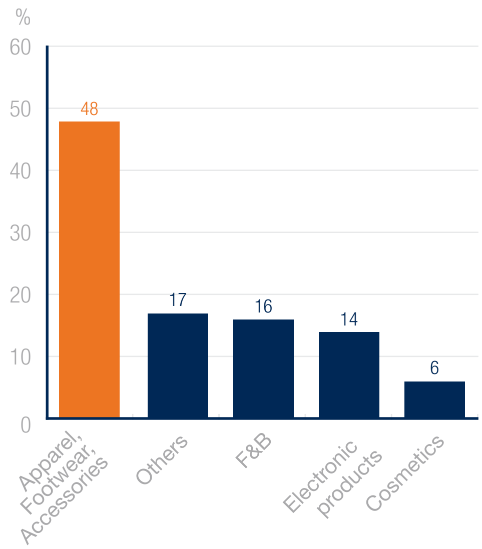
Source: Standard Chartered, Mirae Asset Global Investments (2014)



Online is the preferred channel for post-90s consumers.

Shopping Segments of Chinese Post-90s Consumer

Source: Standard Chartered, Mirae Asset Global Investments (2014)



Most post-90s consumers purchase the category of apparel, footwear, and accessories.
Note: Figures may not sum to 100% due to rounding.

Clothes on Your Back

Source: Mirae Asset Global Investments (2014)

Chinese post-90s consumers gravitate towards Apparel, Footwear, and Accessories online.

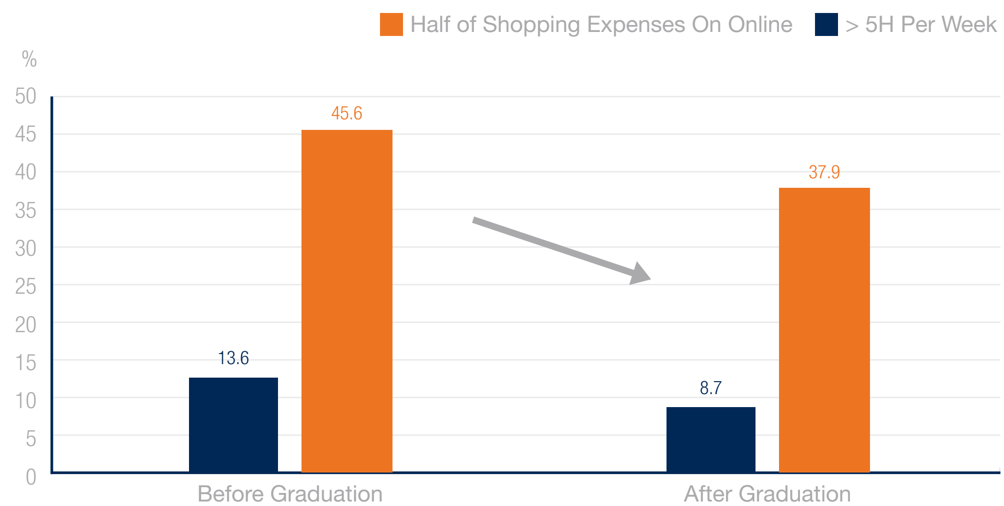
The "post-90s" tended to trade up when armed with higher income

We argue that the downward spiral of bricks and mortar will not persist indefinitely and we could witness the bottom of the cycle soon as consumption habits continue to evolve

The survey also showed that after graduation, the "post-90s" tended to trade up when armed with higher income (with 77% expecting to earn at least RMB 60,000, or roughly USD 9,600, annually), reduced time dedicated to online shopping, and spent a lower proportion of their shopping expenses online. While not representative of the entire demographic, we find that the survey's findings provide us with valuable insights into the psyche of the new generation of Chinese consumers. We believe bricks and mortar stores will continue to remain challenged, particularly due to the overlap of the apparel and accessories categories, which account for 45-50% of department store sales and 48% of online sales for post-90s shoppers. However, we argue that the downward spiral of bricks and mortar will not persist indefinitely and we could witness the bottom of the cycle soon as consumption habits continue to evolve.

Percentage Of Chinese Post-90s Consumers Who Spend >5H Per Week & Half of Shopping Expenses On Online Shopping

Source: Standard Chartered, Mirae Asset Global Investments (2014)



Time is more precious when working and aspirations change with higher income.

More Money, More Wants

Source: Google Image Search, Mirae Asset Global Investments (2014)

Income gains after graduation translate into higher consumption demand outside of online channels.

Only 58 million Chinese, or 4% of the population, have travelled abroad in 2013

Around the World in 80 Days

We envision that the “Decade of the Chinese and ASEAN Tourism Boom” is only now beginning, and is on a course similar to that of Japanese tourists during the years of 1964-1999 and Koreans since 1987. According to Euromonitor data, only 58 million Chinese, or 4% of the population, have travelled abroad in 2013, which compares to 14% in Japan, 24% in Korea, and 50%-90% in more developed countries. Moreover, even within existing Chinese outbound trips, 70% have been destined to Hong Kong (48%) and Macau (22%) in 2013. Historically, the tourism “sweet spot” for per-capita GDP has been around USD 8,000, which is forecasted to more than double in number to over one billion people in China by 2020. If we thus assume that the unique Chinese outbound traveler penetration is to reach 15% within one to two decades, meaning approximately 200 million travelers taking 300-400 million trips at USD 1,000-2,000 spending for each trip, this would deliver a level of economic output of nearly a trillion US dollars. The incremental impact on many of the tourist destinations would be significant and meaningful.

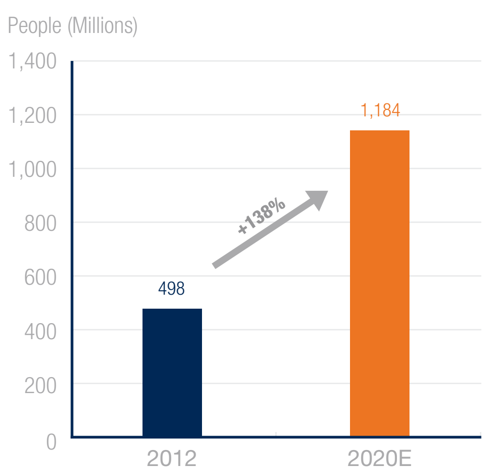
Just Starting to Takeoff

Source: Instagram, Mirae Asset Global Investments (2014)

Many more planes will be flying as the Chinese follow the tourism path of their Japanese and Korean peers.

Chinese Population with USD 8,000 per-capita GDP

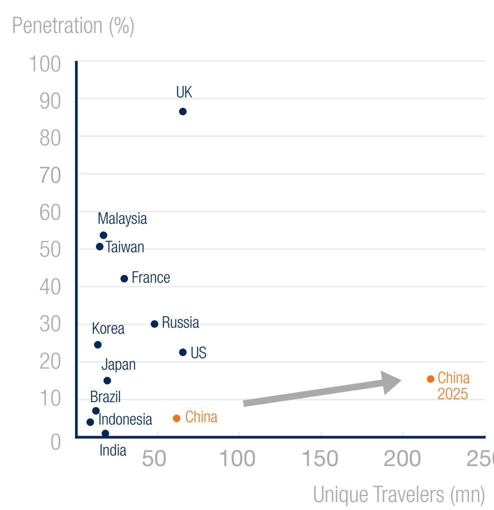
Source: CLSA (January 2015)



The USD 8,000 per-capita GDP threshold where individuals adopt travel habits is set to reach over one billion people within the next decade.

Outbound Tourist Penetration Landscape

Source: Euromonitor, Mirae Asset Global Investments (2013)



China tourism is underpenetrated and is on the cusp of leaping ahead.

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Investment principles

We identify the sustainable competitiveness of companies

What does it mean to us?

We believe companies that have strong moats will have stable earnings growth and cash flow, and share prices will rise as these companies add considerable value each year. This tenet drives our investment ideas, not short-term trading profits.

How do we apply it?

Sustainable competitiveness scorecards: We thoroughly analyze 30 factors for each company to identify the competitiveness of the company for the long term. This scorecard includes six main categories, which are: Barriers to Entry, Competitive Dynamics, Sustainability of Returns, Management Track Record, Reliance on Outside Support, and Ownership of Distribution/Production Supply Chain.

Extensive company meetings and research trips: Third party research is useful for us to know the consensus, but it cannot be the sole input when making investment decisions. We have investment professionals around the globe; we frequently hold meetings in our offices and conduct numerous on-site visits and meetings.

We invest with a long term perspective

What does it mean to us?

Many of our investors are investing with us for their retirement, or even for their children. Long-term does not mean only three to five years for us. Our goal is to find companies that can last and prosper in the next several decades and invest in them – these are companies with high terminal values.

How do we apply it?

Analysts and portfolio managers are evaluated by their long-term performance. To add a new position into a fund, we spend considerable time researching and evaluating it. We're not looking to rush in based on a news headline, we are more concerned with generating solid, long-term, well researched ideas.

We assess investment risks with expected return

What does it mean to us?

We constantly monitor the changes in regulation, competitive environments, and managements strategies. We do not fall in love with our holdings, and will exit a position when the investment thesis is no longer valid. The potential upside and downside and our conviction drives the sizing of our positions.

How do we apply it?

In addition to risk analysis done by research team, where we quantify the upside and downside to earnings and valuation, our risk team monitors various parameters including sector volatility and liquidity, and gives active feedback to the research team. Our risk team is aided with a range of third-party risk management systems such as Factset, Axioma, Thomson Reuters, and Bloomberg POMS/AIM.

We value a team based approach in decision making

What does it mean to us?

We do not rely on any single star portfolio manager or star analyst. We believe in sharing information and analysis among ourselves. We rely on our collective knowledge and invest in long-term ideas.

How do we apply it?

We openly discuss and examine key ideas in Investment Committee meetings where investment professionals participate.

We share our research notes globally on MARS (Mirae Asset Research System) online, over email and we have regular video conference calls with other overseas offices.

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