

Interview: The China Duty Free Group (CDFG) talks about new expansion plans



The China Duty Free Group (CDFG) talks in-depth to The Business about expanding its store network substantially as luxury brand retailing spreads across China.

In addition to new airport retail activities which will increasingly include duty paid luxury brand outlets in domestic airport terminals, along with international terminal duty free sales, CDFG plans to expand downtown duty free retail activities on Hainan Island and open downtown shops in Beijing and other major cities.

Other locations where CDFG is working to develop travel retail operations in future include luxury brand shops in China's new high-speed railway stations, while expanding retail operations at major frontier crossing points along the country's long border.

The retailer recently launched its latest airport duty free retail operation at the new Kunming Changshui International Airport, which opened on June 28 in the capital of Yunnan Province. It is now the sole concessionaire for all duty free and luxury brand shops in Kunming's 35,000sq m international passenger section where the duty free retail area comprises around 2,000sq m and features a modern international interior décor theme. [Aer Rianta International is the operator on the domestic side-Ed].



[Above: CDFG liquor store at Kunming Airport, southwest China]

PERFECT SHOPPING EXPERIENCE'

Located in southwest China, Kunming Airport's new terminal is designed to handle up to 70m domestic and international passengers a year and is now the country's largest airport terminal. It is initially expected to handle 24m passengers annually, of which around 95% are expected to be domestic. The number of passengers using the terminal is expected to double within the next five years.



In a statement issued by CDFG marking the

Kunming Airport shops opening the retailer said: "The main representative brands include perfume and cosmetic brands of Chanel, Clinique, Laneige, L'Occitane, Biotherm, Lancôme, L'Oréal, Dior, Elizabeth Arden, etc.; Watches and glasses brands of Longines, Tissot, Armani, CK, Gucci, Boss, Dior, etc.; Bags and jewellery brands of Lesibo, Samsonite, Swarovski, etc., as well as nice foods and alcoholic beverages."

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[Right: Tobacco at CDFG store in Kunming Airport]

“With impeccable service and perfect shopping experience, CDFG will provide the best products for tourists and business people in more airports around the world.”

CDFG also tells The Business that it is increasingly working on developing duty paid retail activities in domestic airport terminals, as regional airports across China build more new domestic terminals and offer these passengers similar shopping opportunities to their international counterparts but at duty paid rather than duty free prices.



[Above: CDFG stores at Hangzhou Xiaoshan airport in Zhejiang Province]

HANGZHOU XIAOSHAN AIRPORT

For example, CDFG is currently building a number of luxury brand duty paid shops and boutiques in Hangzhou Xiaoshan International Airport in Zhejiang Province where the company was selected earlier this year from a group of bidders including Nuance Watson, DFS Group and Dufry as winner of the duty paid retail concession for the airport’s new domestic Terminal 3 which is scheduled to open in October.

The boutiques and shops being built in the luxury boutique area of Hangzhou’s T3 domestic departure hall

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will cover more than 1,000sq m of retail space when completed. CDFG already holds a five-year concession to operate duty free shops and boutiques in international Terminal 2 at Hangzhou Airport, which is located about one hour by rail from Shanghai in eastern China.

“With impeccable service and perfect shopping experience, CDFG will provide the best products for tourists and business people in more airports around the world.”
CDFG

“Our duty free business is large while duty paid is our new growth area in recent years,” said a CDFG source. “In Hangzhou Airport we have duty free and duty paid licenses. We can create a one-stop solution for airport owners. This is our integrated business model for China. They give the whole travel retail business to us and then they do not have to worry. This has happened in Hangzhou and Nanjing airports.”

Other duty paid airport concession opportunities are also attracting CDFG’s attention. The Business understands that the company is now interested in operating duty paid shops in Guiyang Airport’s new domestic terminal, which is currently under-construction. In Guiyang, the capital of Guizhou Province in southwestern China, the new terminal is expected to raise Guiyang Airport’s capacity to 15m passengers a year from 5m at present.

CITS GROUP CORPORATION

Founded back in 1984, CDFG is part of the CITS Group Corporation, which includes China International Travel Service (CITS), the largest travel agency in China. For the uninitiated it is a state-owned enterprise established under China’s ruling State Council and the only state-owned entity authorised to sell duty free goods in China.



Following rapid expansion in recent years, CDFG

now operates more than 190 duty free and duty paid outlets across China. In addition to airport, seaport and border shops, the company runs diplomatic stores, high-speed railway station and bus station travel

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retail shops, a large downtown store in Sanya on Hainan Island, duty free shops on cruise ships, shops to supply ships' crews and manages Chinese airline inflight sales.

[Left: Lobby of duty free Sanya downtown store on Hainan island]

CDFG's revenue has grown at a double-digit rate for the past five years, climbing at a significant 43.6% in 2011 to reach \$660m, up \$200m from almost \$460m in 2010, boosted by last year's opening of the company's downtown duty free store in Sanya, Hainan Province.

"The Chinese duty free market is growing fast because of macro-economic growth and the government wants to maintain profits from duty free sales in China," the CDFG source said, "We can take advantage of the construction and reconstruction of airports and seaports. We are offering to upgrade a lot of space for use in retailing and for luxury brands.

LIQUOR AND TOBACCO

"We are above the international duty free growth average for the past five years. Duty free is our biggest business sector. We will run operations as four regions soon as it is more efficient."

"Our duty free business is large while duty paid is our new growth area in recent years." CDFG source.

Needless to say, the opening of the company's Sanya downtown duty free shop on April 20, 2011, has had a major impact on CDFG's total revenues. Sales revenue in the shop's first year of trading to April 19, 2012 reached \$240m, with average daily sales totalling an impressive RMB.4.64m (\$726,329) being recorded. Around one third of total visitors to the shop make purchases, with an average of 3,857 recorded daily transactions.

"Our Sanya duty free store is growing most quickly this year. We are very happy," the source said. "Several brands in our Sanya shop have hit sales records. Sales of Tissot watches ranked first in the world according to our records; our first day Fossil sales were the highest in Asia. Also, our Lancôme, Christian Dior and Estée Lauder sales for each brand in 2011 ranked in the top five in the world in the global travel retail market according to our records and [those of the] the brands. We are happy and brands are happy as they see the potential of the Chinese travel retail market."

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SANYA'S DOWNTOWN STORE

Laid out over two levels, CDFG's Sanya downtown store totals 7,000sq m in area and is designed so that customers enter on the ground level passing through the perfume and cosmetics section and then past watches before taking an escalator to the upper level where fashion wear, jewellery and sunglasses are displayed, along with Chinese souvenirs.

[Right: Sunglasses boutique on upper level of Sanya Downtown duty free store, Hainan Island]

Customers then take an escalator back down to the ground floor level where leathersgoods are available. Pay counters are situated throughout the store.

"Our Sanya store is like a 5-star hotel with a luxurious international feel. It's very unusual in Sanya, which is sun, sea and coconuts. We have got Sanya themes like the sea, waves and stars in the decoration and design," the source said, adding that Perfume and cosmetics and boutiques with the same proportion take up over 90% of sales in CDFG's Sanya store.

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LUXURY LEATHERGOODS

Most leathersgoods sold are small items such as wallets and purses. Larger luxury brand products such as handbags are not stocked as their price tags exceed customers' individual shopping allowances.

"Chinese nationals have a RMB.5,000 spending limit per visit to Hainan Island for two visits a year.

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Customers show their ID, plane ticket and register at the entry. They must be over 18 to shop," the source explained. "Operators are not allowed to sell liquor and tobacco in downtown stores on Hainan or elsewhere in China. Our Sanya store is an offshore shop, but it comes under downtown duty free shopping laws."

Designed to handle 12,000 visitors a day, the Sanya store is already operating at near full capacity. To handle further expected growth in Sanya's duty free shopping market, CDFG is building a new downtown duty free shop at Haitang Bay, an expanding resort catering to the tourist and the business conference market, located in another district of Sanya, 45 minutes drive from the existing downtown store.

CDFG estimates that the Hainan Island offshore duty free shopping market is currently worth around \$425m a year, some \$185m more than the company's estimated revenue in its present Sanya shop. However, some of this market is being supplied by Sanya's other downtown shop managed on behalf of a company connected with Hainan Airport by DFS Group.



HAITANG BAY DUTY FREE COMPLEX

"Our Haitang Bay International Duty Free Complex [pictured left] will be the largest duty free store in the world," the CDFG source said. "The complex will open in 2014. It will have a completely different look to our first Sanya store. The interior design theme includes flowers and plants. The store will have a modern international feel."

Planned to comprise a 60,000sq m retail area, the new complex will include a hotel, cinema complex, theme stores and a food centre. "The main reason for this project is there is still a lot of potential under Hainan's offshore duty free policy," the source said. "The new store customer capacity will be really big. This shop will be 10 times our current Sanya shop size.

"We have over a year's experience of our Sanya shop which is the only shop in China that can compare to other downtown shops around the world. It has drawn the attention of international brands and retailers. We are confident of our Haitang Bay project. The main reason is the potential of this market."

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Beach resorts in Sanya and at other locations on Hainan Island are popular holiday destinations for a growing number of middle class Chinese families. Around 90% of customers using CDFG’s Sanya store are Mainland Chinese. Russian and Japanese tourists are the other main groups of shoppers.

SANYA IS LARGEST DUTY FREE OPERATION

“At Haitang Bay we expect mostly Chinese customers ,but we expect more foreign visitors will be coming,” the source said. “Sanya Airport is a domestic airport only. There is no duty free shopping there.”



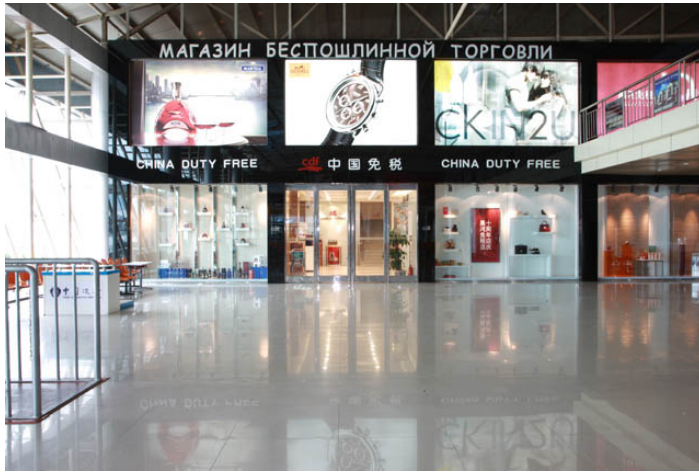
Sanya downtown store is CDFG’s largest duty free

operation accounting for around one third of the company’s total revenue. CDFG’s largest border shop is the Hei He River border ferry crossing shop in Heilongjiang Province situated on the border with Russia, where the shop is located in the ferry terminal. Elsewhere, CDFG’s largest airport operations are at Guangzhou and Hangzhou international airports.

[Right: Cosmetics walkthrough store in downtown Sanya]

“Our Cartier watch shop in Guangzhou New Baiyun International Airport opened in 2011. It’s our first airport single brand watch shop,” the source said. “Guangzhou Airport is doing pretty good. It’s our largest airport operation.”

CDFG’s largest duty free operations today reflect a major change that has occurred to the company’s revenue sources within the past five years. In 2009, by contrast, the Hei He River border ferry crossing shop [pictured below right] was CDFG’s largest duty free outlet, along with the company’s Zhuhai and Shenzhen border shops in Guangdong Province.



MARKET RESEARCH

Meanwhile, opening the Sanya downtown store has allowed CDFG to carry out market research on customers' shopping habits which is not possible in the company's other duty free outlets, which serve mostly customers living in surrounding regions while the Sanya store caters to visitors from all over China.

[Right: Hei He River border ferry crossing shop CDFG's largest duty free outlet in 2009]

"Beijing and Shanghai consumer preferences are very similar. We think that is due to their similar level of income and sense of fashion and both are big international cities," the source said. "Elsewhere, Guangdong peoples' preferences are different as they can go to Hong Kong or Macau for shopping. Away from first line cities, consumers from other regions often have different consumption preferences.

"People from northwest China have less preference for perfumes and cosmetics; in fact, this trend is for the China consumer market in general, while consumers in southwest China have more interest in perfume and cosmetics. We also found that more younger people in China buy luxury goods people aged 18 to 30 years old contribute 40% of sales in our Sanya shop in customer numbers and sales ratio. That's really a lot. We are not surprised as we think the Sanya store represents the whole China market. Younger people spend money far more than older people."

According to CDFG's analysis of Sanya store sales, consumers aged 18 to 40 account for 71% of revenue taken at the shop, while 31 to 40 year olds' purchases represent 31% of total sales recorded at the store.

BRAND SWITCHING

Although sales of luxury brand goods are growing quickly, Chinese consumers are prone to switch brands when making purchases on different occasions.

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“The Chinese luxury market is largely undeveloped,” said the source. “According to relevant data the brand loyalty of Chinese consumers is lower than that of American or European consumers. The purchase repetition rate was only 15%, while the frequency of brand change was up to 80%. Consumers of different ages also have different consumption preferences. It’s worth noting that consumption preferences for consumers under 29 years old are in direct contrast to those above 40 years old.”



Luxury goods purchasing trends differ in CDFG’s

airport and border shops as the customer mixes in these outlets is different to the Sanya downtown shop where most customers are Chinese vacationers.

[Right: Luxury brand Salvatore Ferragamo has a standalone boutique at Hangzhou Xiaoshan International Airport in Zhejiang Province]

“Our airport shops have different sales trends as there are many business travellers, while our border shops serve lots of foreigners. So our shops in different regions have different products,” the source said. “In Hei He border shop there are a lot of liquor sales to Russian visitors, so Hei He shop’s strategy is different to our airport shops.”

RUSSIAN VISITORS

“Russian visitors come for shopping, while Chinese businessmen buy gifts to take to Russia. Perfume and cosmetics are over 60% of sales in Hei He. It used to be liquor and tobacco, but perfume and cosmetics sales are growing in Hei He as we pay more attention to selling perfume and cosmetics.”

“Our strategy is to increase the selection of products in duty free to meet customer needs and take our stores to a new level with more brands and different products. We sell electronics products in our border shops; also, infant formula milk powder in border and some airport shops.”

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Meanwhile, CDFG sees opportunities to develop downtown duty free shops in other locations in China apart from Sanya, including several of the country’s major cities. At the end of May CDFG announced the signing of a strategic agreement with Chaoyang District government in Beijing to open a downtown shop in the capital’s eastern district where foreign embassies, international hotels and international company offices are located.

While further details are awaited, the Beijing downtown store is expected to target foreign visitors, at least initially. “Now we are looking for a location and making preparations with government agencies,” the source said.



SHANGHAI AND XIAMEN

CDFG previously operated downtown stores in Beijing, Shanghai and Xiamen, a port city in Fujian Province with strong historical connections with Taiwan. The company closed the shops a number of years ago, but is now looking to revive its downtown duty free retail activities due to government support for luxury brand retailing.

[Left: Cartier store operated by CDFG at Hangzhou Xiaoshan airport in Zhejiang Province]

Apart from the agreement signed in Beijing, CDFG has also signed strategic cooperation agreements with city governments in Shanghai and Xiamen to open downtown duty free shops in each city. Once again, the search for suitable locations is now underway.

Meanwhile, CDFG is looking to expand its retail operations by opening shops in various new locations and channels as opportunities present themselves in future. For example, the construction of China’s high-

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speed railway network requires construction of new railway stations, which are being fitted with duty paid luxury brand shops and other upmarket retail facilities.

CDFG already operates duty paid shops in Shanghai's Hongqiao and Nanjing South high-speed railway stations where the travel retail offer includes perfume and cosmetics shops and luxury brand outlets.

HIGH-SPEED RAILWAY RETAIL

"In future, we will examine the consumption characteristics of the high-speed railway retail market and get involved in high-speed railway retail operations through a range of methods to build sales branded by 'CDF High-Speed Rail Retail', focusing primarily on large stations at first and second-tier cities," said the source.

New and renovated airport terminals also offer important growth opportunities in future as more airport owners implement airport terminal expansion projects in future and look to large, experienced travel retail operators to develop modern duty free and duty paid luxury brand shopping facilities.

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CDFG has expanded its airport retail activities in recent years by winning concession contracts in all categories, including perfume and cosmetics, fashion goods and liquor and tobacco.

Airports' plans to develop duty paid luxury brand retailing in their domestic passenger terminals will also offer further opportunities in future.



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[Above: CDFG Headquarters]

GATEWAYS TO THE CITIES

“There is opportunity when airports build new terminals. We have to seize the opportunity at construction of new airports; also, seaports and border check points,” the source said. “Local governments see transport facility expansion as important for their development as airports are gateways to their cities. Airports are windows to cities. People get off their flights and see the airport first. How the airport is [is] how the city is viewed.”

CDFG operates perfume and cosmetics shops and fashion boutiques in about eight airports at present where company’s total airport retail space adds up to around 10,000sq m and total airport duty free sales are worth around \$31m a year.

Airports where CDFG operates duty free outlets and in some cases duty paid shops, include: Guangzhou New Baiyun International Airport and Shenzhen Bao’an International Airport in Guangdong Province; Xiamen Gaoqi International Airport in Fujian Province; Nanjing Lukou International Airport in Jiangsu Province; Changsha Huanghua International Airport in Hunan Province; Dalian Zhoushuizi International Airport in Liaoning Province; Hangzhou Xiaoshan International Airport in Zhejiang Province; and Kunming Changshui International Airport in Yunnan Province.

“Things are looking pretty good. Sales are growing,” the source commented. “Sanya sales continue to grow and Haitang Bay shop is coming up. Also, new airport terminals are to be built. With close relations with the government we will work to open downtown stores. Altogether we think our business is looking pretty good.”