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## China Retail Sector - Macro Trends

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January 2011

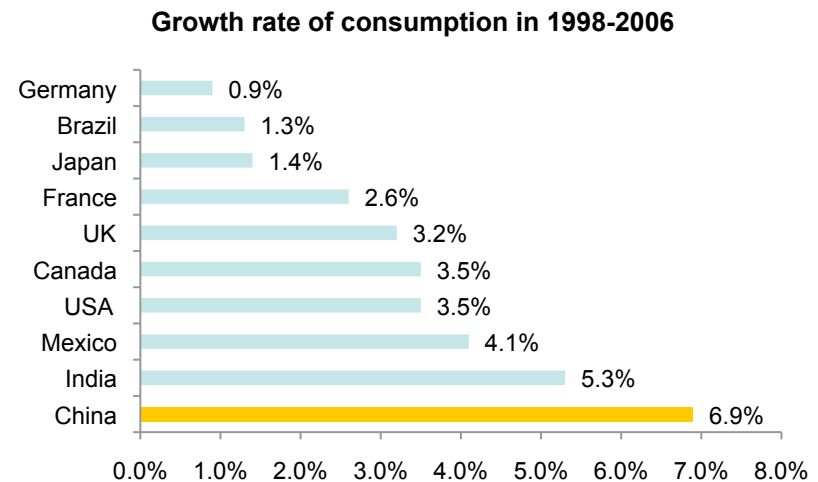
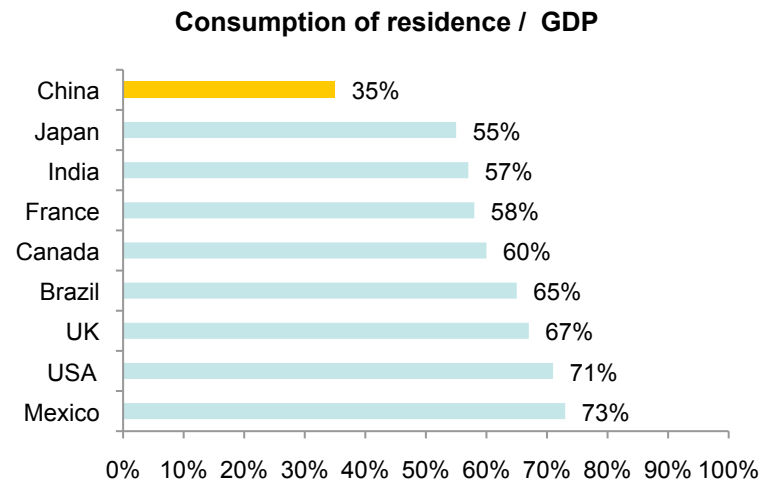
# Extensive Room in Retail Sales Growth in China



## ➤ Development prospects of China retail market

China's personal consumption will increase in a rapid yet stable manner in the next 5-10 years. Tables below show that, the percentage of consumption / GDP of China is only 35% which is the lowest compared with other developed countries. Meanwhile, the growth rate of consumption of China is 6.9% from 1998-2006 which is the highest in the world.

China still has extensive room for market growth.



(Data source: CICC research report, 2009)

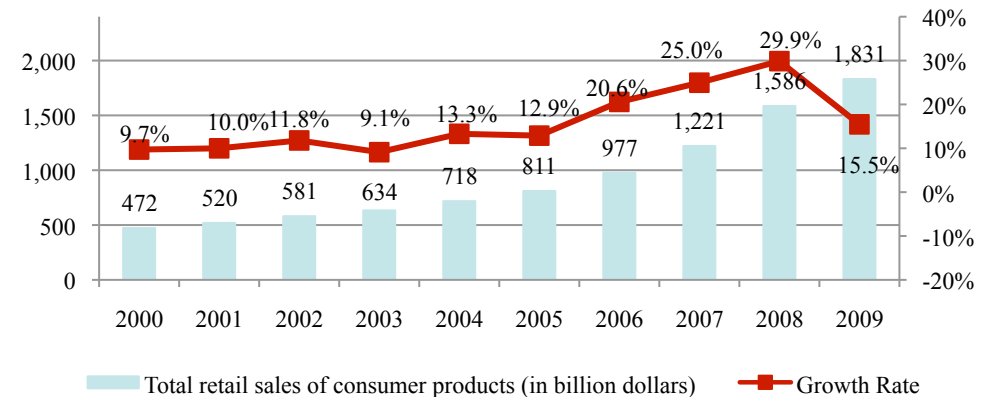
# Development Prospects in China's Retail Industry



➤ **China's retail industry has reached a stable and high-speed development stage**

Since the beginning of the 21st century, China's retail & consumer products industry has enjoyed high-speed development with an annual average growth rate of over 10%. In the future, China's retail market will continue to share the benefits from the fast development of China's economy and increasing personal consumption. The following factors have contributed, and are expected to continue to contribute, to the growth of the retail industry in China:

**China Total Retail Sales of Consumer Products and Growth Rates**



- Rapid Urbanization**
- Increasing Middle-Class Population and Improving Social Security System**
- Inflation Pressure Helps Retail Sales Growth**
- Government Policies Encourage Increase in Consumption**

Urbanization has led to higher income for the urban population, which drives higher retail sales

A bigger middle-class and an improving social security system boost consumer confidence higher and foster mid to long term consumption

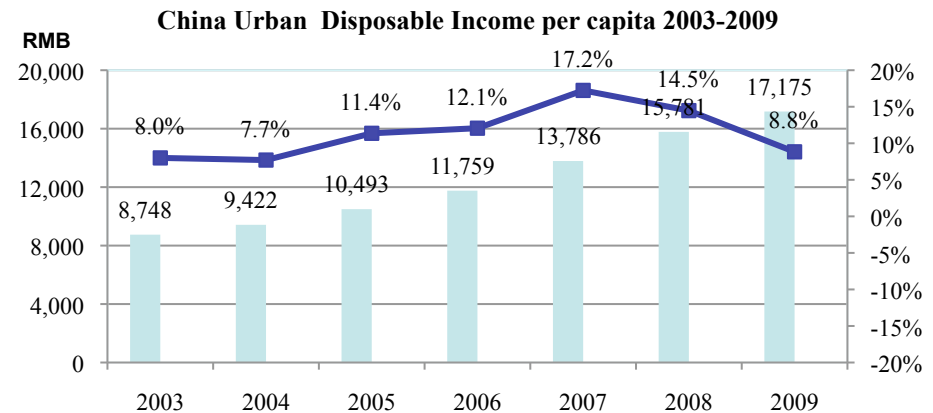
Moderate inflation will be beneficial to retail sales growth

Government policies are directed towards increasing domestic consumption to replace investments as the top driver in economic growth

# Increasing Disposable Income and Rapid Urbanization

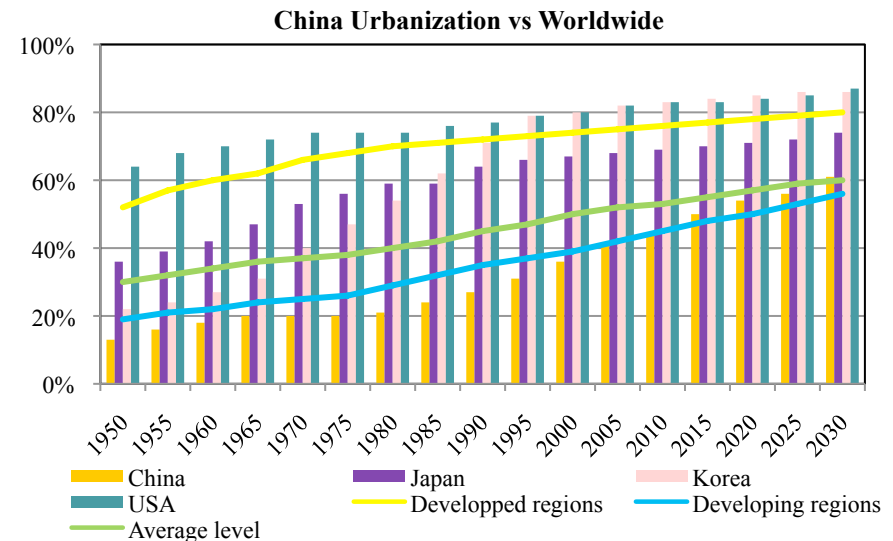
## ➤ Increasing Disposable Income

According to the National Statistics Bureau Report, the annual average growth rate of China's urban disposable income per capita is 13%. A majority of economists believe this rate shall be above 12% for the next 5-10 years. Increasing disposable income is beneficial to strengthen "marginal consumption" and increase the consumption of non daily necessities and luxury products.



## ➤ Rapid Urbanization

Due to the huge differences in consumption ability between urban and rural populations, urbanization shall lead to a fundamental change in China's consumption volume and types. According to China's current statistics, a 1% increase in urbanization shall increase the ultimate consumption by 1.6%. In recent years China's urbanization has increased rapidly and urban consumption has increased accordingly.



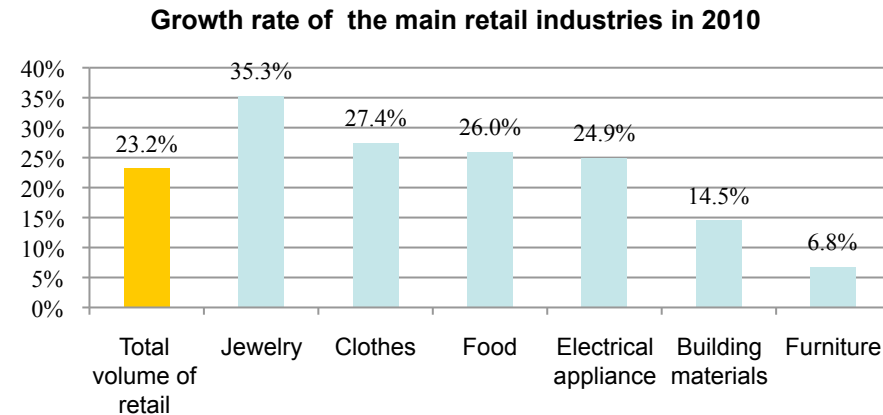
# A Bigger Middle-Class and An Improving Social Security System

## ➤ Increasing Middle-Class Population

From 2009 to 2015, 75M China urban families will be categorized as middle class (annual household income RMB50,000-120,000). China's consumption per capita is projected to increase from RMB14,300/year in 2009 to RMB 17,000/year in 2015. Total consumption of the urban population increased to RMB13,300 billion/year (USD1,940 billion) by 2015. The middle class population will become a major driver of future consumption. Major consumption demand on daily products shall grow to other non- necessity products such as brand name clothing, cosmetics, jewelry and other non-essential goods.

## ➤ Improving the Social Security System

From 2008-2010, government fiscal investment in social securities was 249.1 billion, 290.6 billion and 318.5 billion respectively. The improving social security system shall benefit stable consumption and stimulate the long-term consumption.



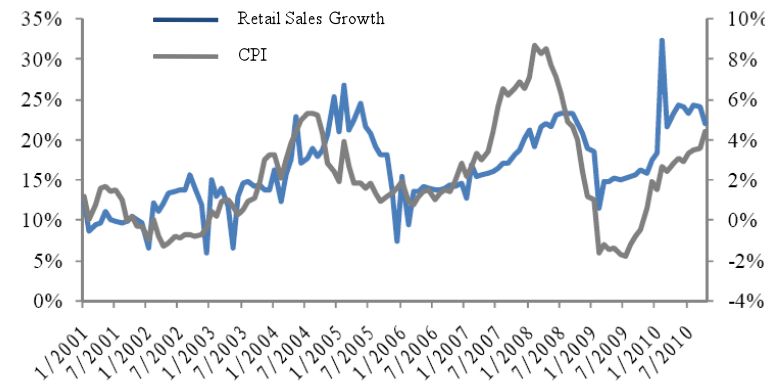
Source: National Development and Reform Commission,

# Inflation Pressure is Beneficial to Retail Sales Growth

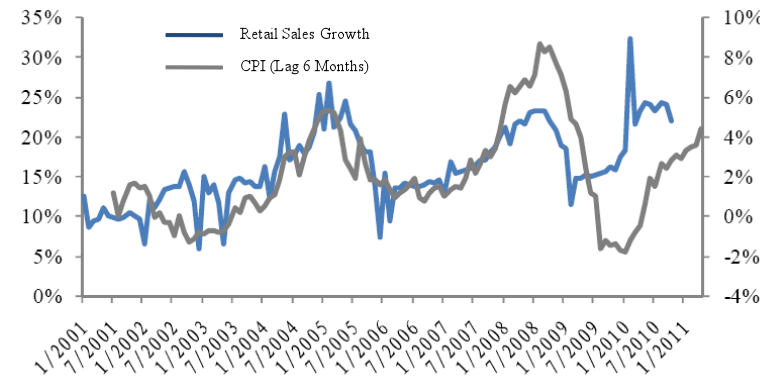


- Retail sales have always had a strong correlation with CPI, especially with the CPI 6 months lagging data.
- China's CPI grew to a 28 month high of 5.1% in November 2010.
- 2010 inflation was 3.3%, 2011 expected CPI will be around 4%, and retail sales growth will increase to 18.6% in 2011 from 18.4% in 2010.
- Inflation results in higher goods prices and will directly drive up the sales amount of retail enterprises. The level of inflation will determine the how suppliers, retailers and consumers are affected as a result of inflation.
- Generally, for general merchandise, it is difficult to pass all the change in costs to consumers because of the availability of substitutes and competition among retailers.
- Retailers that have good distribution channels will have stronger bargaining power with suppliers and apply pressure to keep costs low.
- Moderate inflation is usually the most beneficial to department stores operators. Luxury goods are not subject to price control like necessities and can raise their prices even with inflation.

CPI vs Retail Sales Growth



CPI (Lag 6 Months) vs Retail Sales Growth



## 12<sup>th</sup> Five Year Plan – Boosts Internal Consumption and Improves Living Standards

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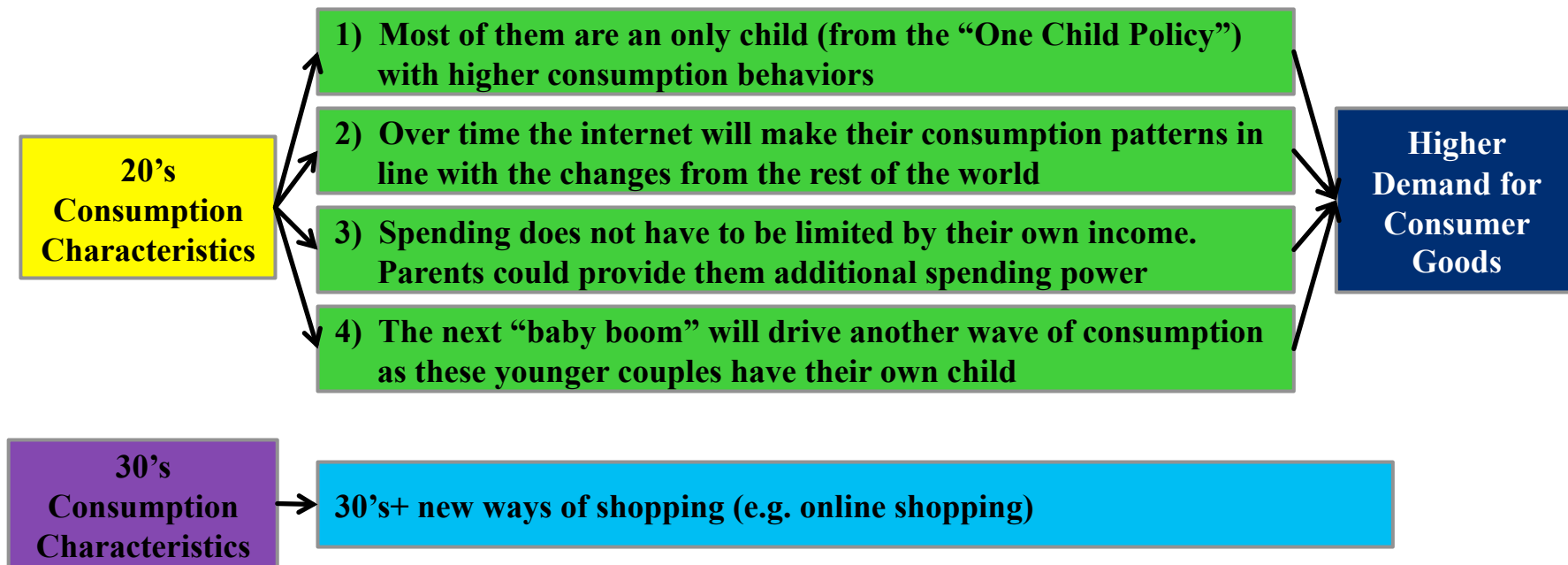
- In the 12<sup>th</sup> Five Year Plan, China's government is committed to increasing the proportion of household income in the national income and wage / salary income in total income and will seek to reduce the proportion of national income that accrues to the government and large corporations while substantially and continuously increasing wages and salaries.
- To boost domestic household consumption, China's government is implementing unprecedented policy initiatives to raise Chinese residents' disposable income, build a well-developed social safety network, push the development of economic housing, and promote consumer finance.
- Disposable Income – China has already implemented policies this year to raise the minimum wage in a dozen provinces by 12-29% with more to come in 2011. There is also a plan to lift the threshold of income tax payment, which is currently at RMB 2,000 per month, and to increase the salaries of civil servants.
- Consumer Finance – One of the major bottlenecks in boosting consumption in China lies in the under-developed consumer finance industry. Notably, consumer loans outstanding per capita in China by the end of 2009 only amounted to US\$608, less than one-tenth of \$7,934 in the US. This presents significant room for this sector to grow to boost the consumption of many consumer discretionary products.
- Over recent years China has indeed encountered an imbalance between consumption and investment, with the investment to GDP ratio rising from 35% in 2000 to 48% in 2009 and the consumption to GDP ratio falling from 46% to 36% during the same period, the Chinese government's aggressive and unprecedented measures should, along with several favorable macro-trends, result in substantial increases in domestic consumption as a percentage of GDP over the next 5 years.

# Besides Macro Economic Conditions, Other Social Factors Are Also Favorable to the Retail Markets



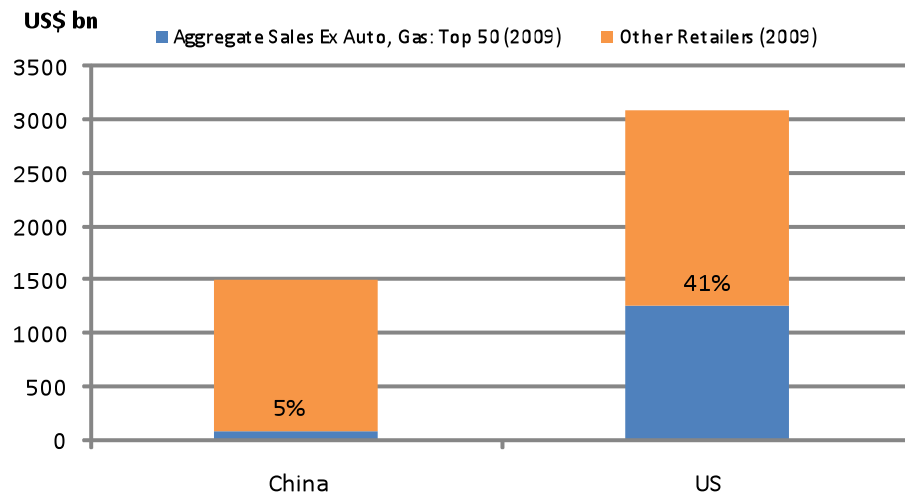
**Changes in Population Structure and Consumption Patterns**

➤ 20 and 30 years old will become the main consumers with a stronger desire for consumer goods



# China's Retail Markets are Highly Fragmented

**The highly fragmented retail markets in China provide a compelling opportunity for investors to create new market leaders**



资料来源: Bloomberg, industry research

Industry	Key Players	Market Share (as of '09)
Petro	Top 2	99+%
Telecom	Top 3	97%
Bank	Top 5	49%
Auto	Top 10	66%
Ready to Drink Tea	Top 4	92%
Instant noodles	Top 4	83%
Diapers	Top 5	75%
Retail	Top 50	5%

Source: Industry research

**China's retail sector is very fragmented**