OLIVER WYMAN

THRIVING IN THE NEW NORMAL

Impact of COVID-19 on apparel sector in China

May 2020

A TURBULENT YEAR WITH STRUCTURAL LONGER TERM SHIFTS

US$ 60 Billion expected to be wiped out of the largest global apparel market, putting most apparel players at risk

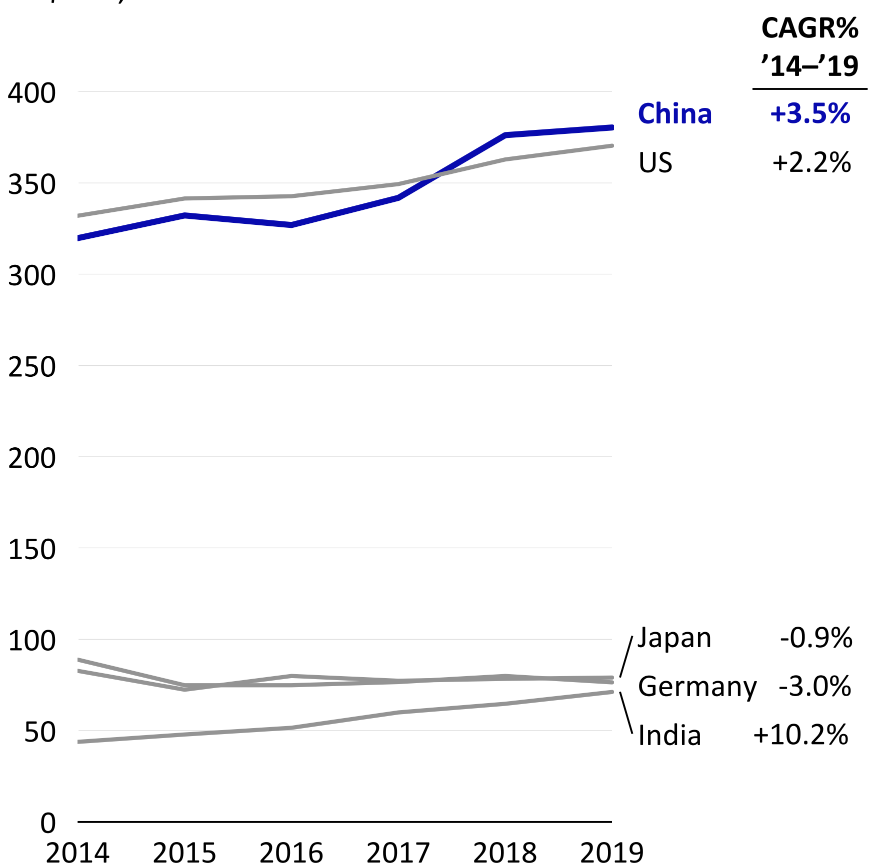
Further growth of e-commerce with accelerated penetration into sub segments such as high income customer groups, requiring further strengthening of online offering to cater to their needs

Offline stores still important but imperative for retailers to re-exam the role and footprint of their offline stores, and fundamentally change the format / offerings / experience in stores

Further polarization of the market (across income levels and city tiers), brands stuck in the middle will need to rethink their positioning to survive in this market: either be truly value for money or have a clear and proven higher quality proposition

COVID-19 PLACES THE LARGEST APPAREL MARKET OF US$ 370BN AT RISK

Global apparel & footwear retail market[1]
US$ BN; 2014–19



China apparel & footwear market[1]
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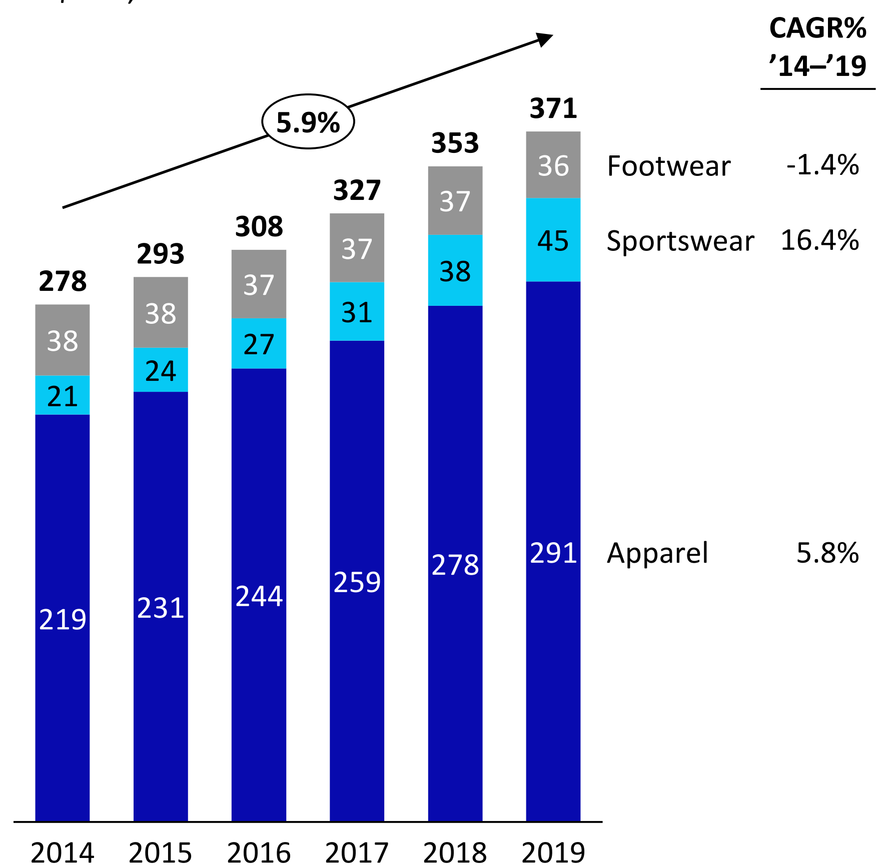
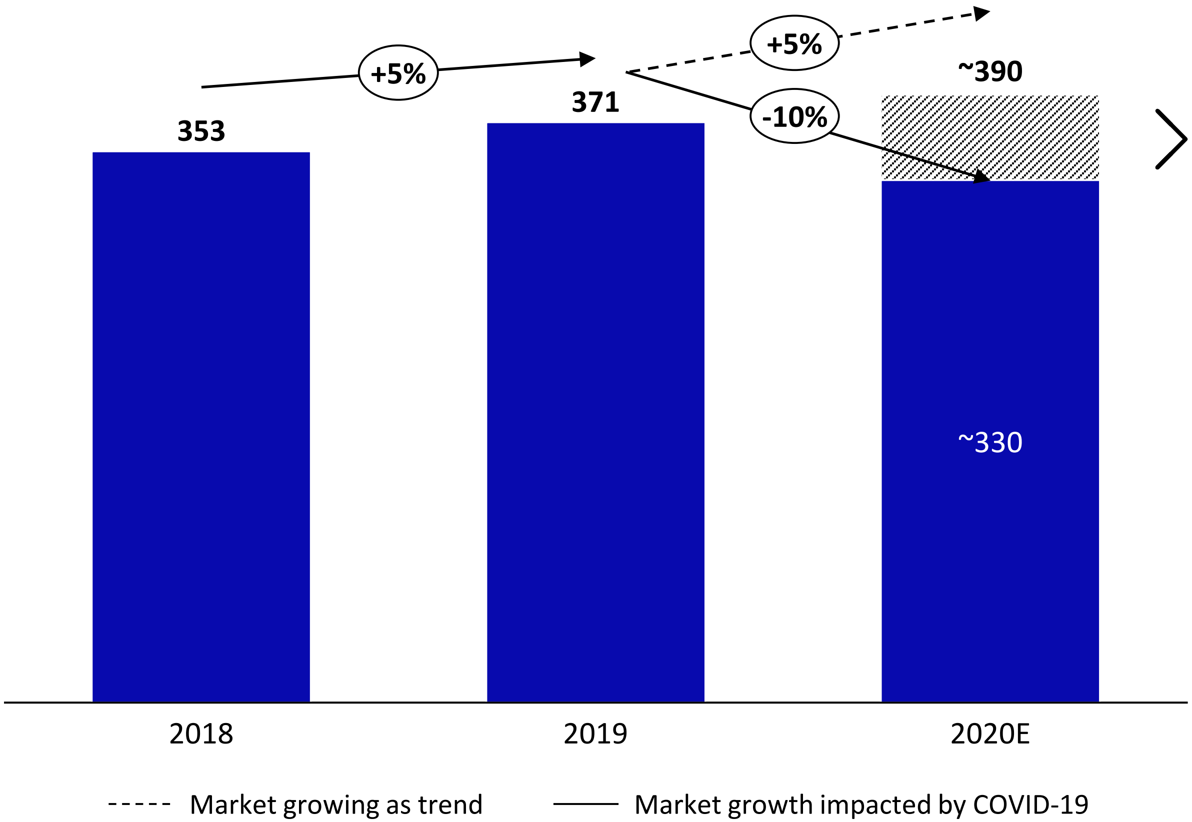


1. Exchange rate: USD/RMB = 7.06
Source: Euromonitor; Statista; China National Bureau of Statistics

WE EXPECT ~US$ 60BN TO BE WIPED OUT OF THE MARKET IN 2020

China apparel market projection[1], 2018–2020E
US$ BN



~15%

market value wiped out because of COVID-19

~25% decline for offline

~15% growth for online

1. Exchange rate: USD/RMB = 7.06

Source: Euromonitor, Financial reports, Oliver Wyman consumer survey and analysis

IMPACT ON PROFITABILITY OF FASHION PLAYERS WILL BE SEVERE AND FAST ACTION IS NEEDED FOR SURVIVAL

Revenue and operating income projection[1] if offline sales drop by 25%

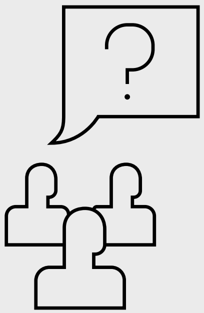
Offline sales percentage
70–90%

Total revenue drop by
19–24%

Operating income drop by
~55%

1. Projection based on 5 Chinese apparel brands' 2019 financial reports
Assumptions: Unchanged COGS as percentage of revenue as last year, unchanged online and offline sales split as last year, unchanged online sales revenue as last year, unchanged operating expenses as last year
Source: Company reports, Financial Reports, Oliver Wyman analysis

WE TALKED TO CONSUMERS TO UNDERSTAND WHAT WILL BE NEXT

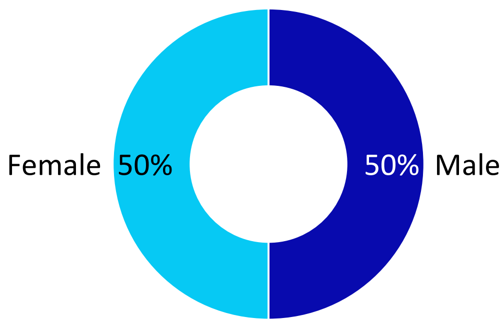


Survey background

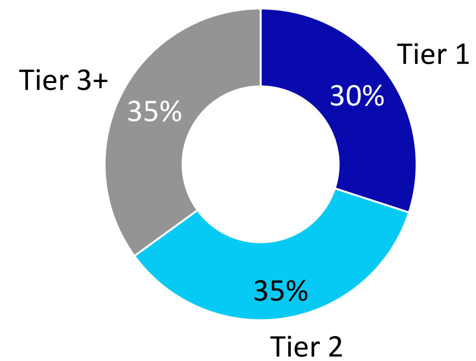
- Conducted between April 30 and May 12
- 1,000 respondents who have purchased apparel and footwear products in 2019
- Key topics
  - Spending changes and expectation in 2020
  - Online/offline shifts
  - Product preference shifts

Demographics of respondents

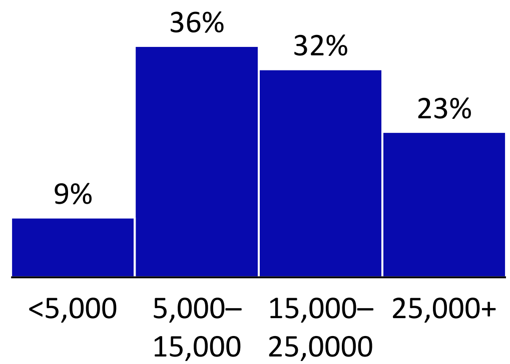
Gender



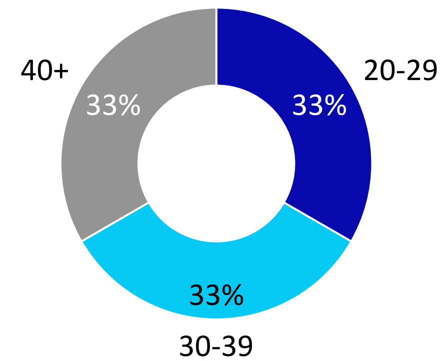
City tiers



Monthly household income in RMB



Age



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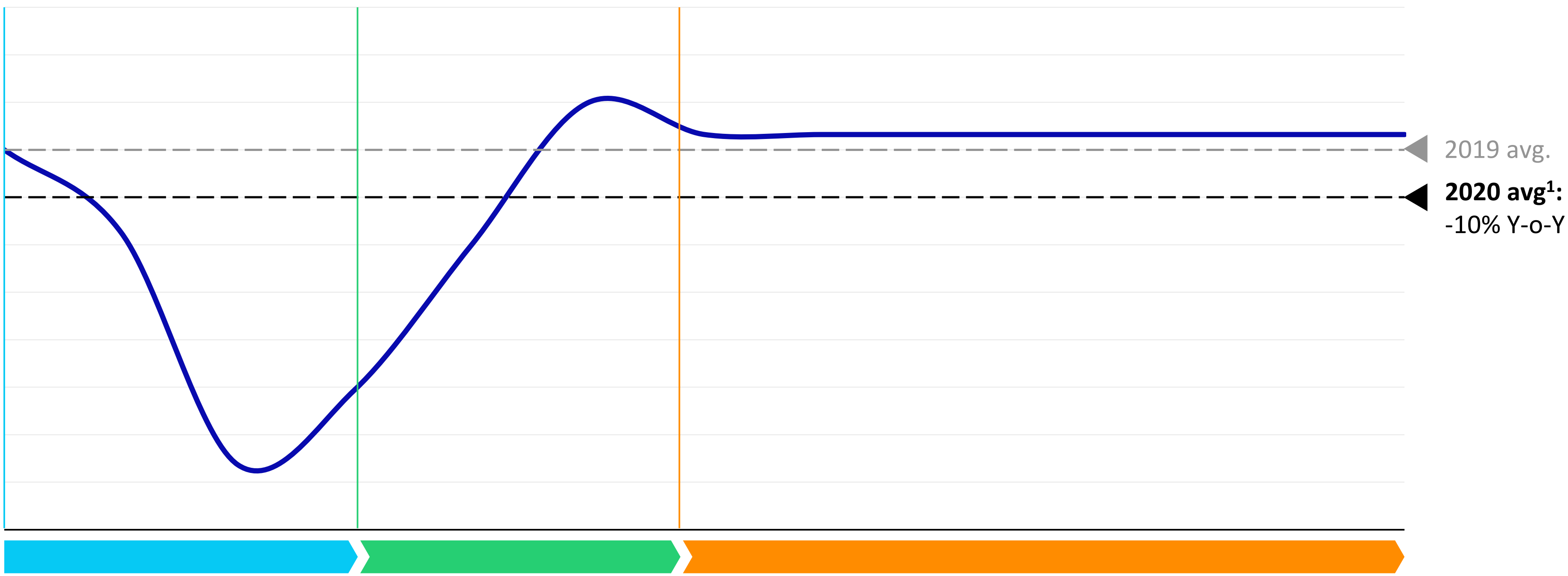
OVERALL 2020 MARKET OUTLOOK

WE LOOKED AT 3 WAVES OF IMPACT OF COVID-19

Indicative performance of China's apparel and footwear market

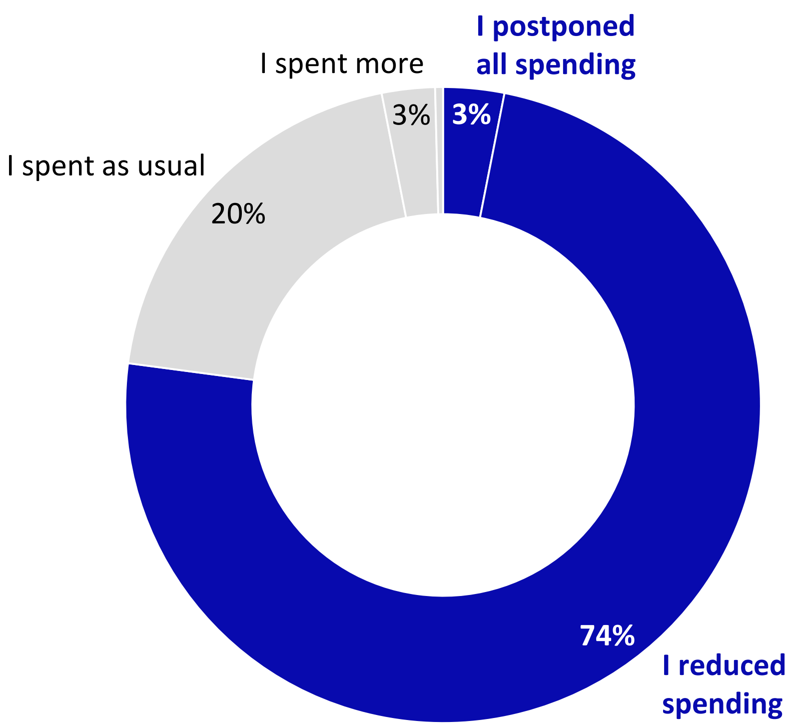


In-COVID *Jan–Mar*	**Recovery** *Apr–May*	**Post-COVID new normal** (with new dynamics and new shopping patterns) *Jun+*
Y-o-Y[2]: -45%	**Y-o-Y[3]**: -5%	**Y-o-Y**: +3%

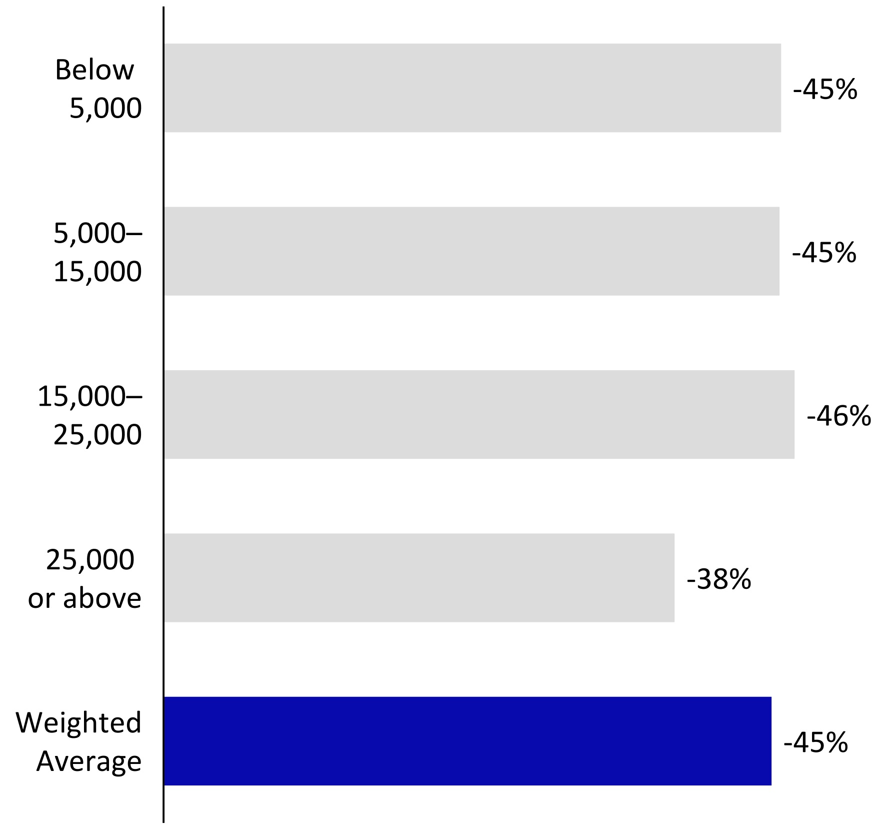
1. Generalized average internalizing seasonal variation including Double 11
2. National Statistics Bureau stated apparel spending (companies with annual revenue over CNY 5MM only) dropped by 32% Y-o-Y in 2020 Q1 and dropped by 18% in April 2020
3. Initial statistics on apparel spending in early May was up 31% comparing to early April. Total e-commerce sales also shows Y-o-Y growth at ~30%

>75% OF CONSUMERS POSTPONED PURCHASES AND TOTAL SPENDING REDUCED BY 45% DURING 2020 Q1

Did you reduce your apparel and footwear spending during coronavirus outbreak?

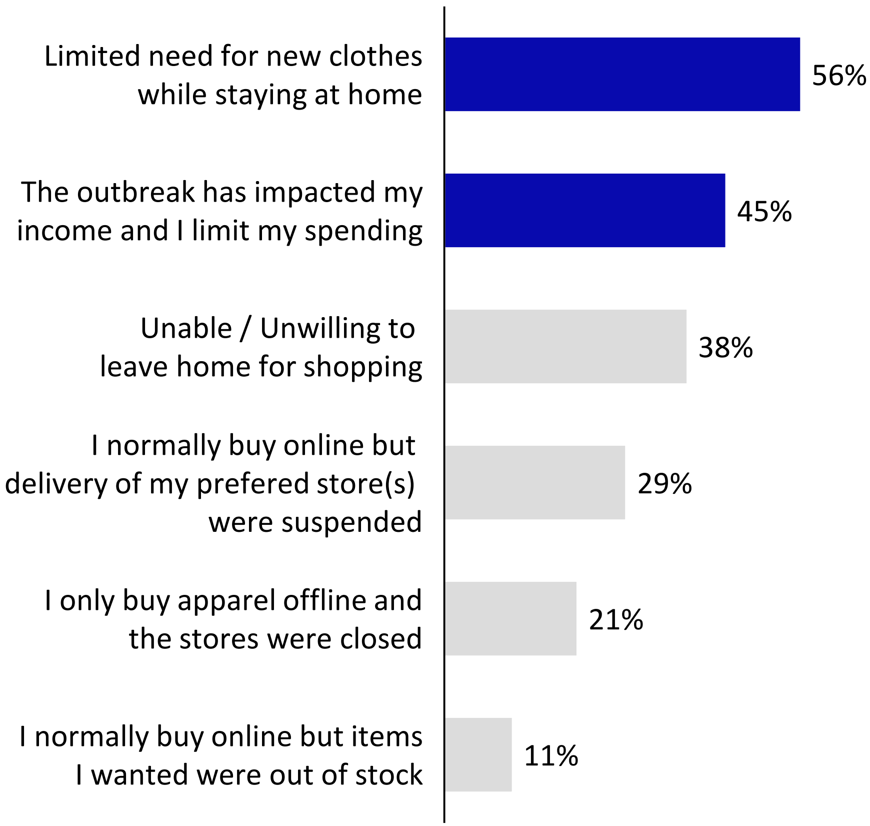


% spending reduced from 2019 average
by monthly household income group (RMB)

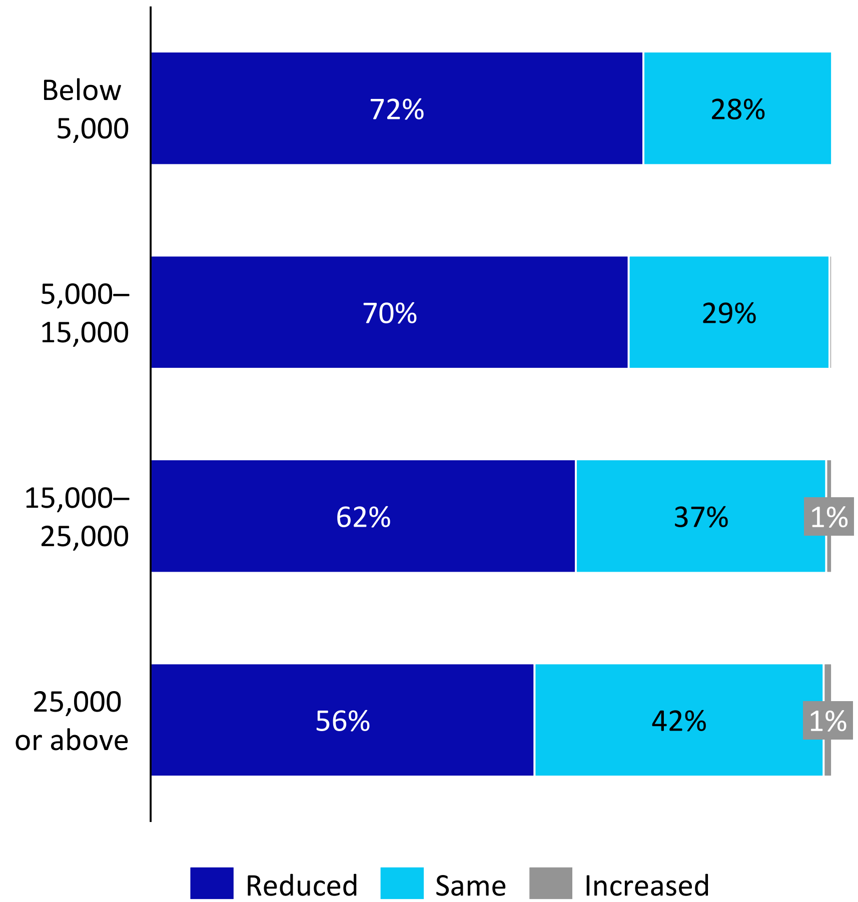


NO NEED FOR NEW CLOTHES AND A LOWER INCOME ARE THE TOP REASONS FOR REDUCED SPENDING

Why did they reduce their spending during the outbreak?
% of maximum score



How was their income impacted?
% respondents by income group



LITTLE RETALIATORY SPENDING IN APRIL AND MAY, AND LOW INCOME GROUP STILL EXPECTS TO SPEND ~15% LESS THAN NORMAL

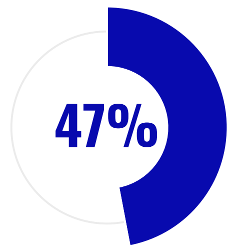
Estimated apparel and footwear spending compared to usual in April and May
% vs 2019 average

Monthly household income (RMB)	Total	Casual and format: Apparel	Casual and format: Footwear	Sports apparel & outerwear
Below 5,000	-14%	-14%	-11%	-19%
5,000–15,000	-5%	-3%	-12%	-6%
15,000–25,000	-5%	-5%	-4%	-3%
25,000 or above	2%	3%	-4%	-3%
Weighted average	-5%	-4%	-7%	-6%

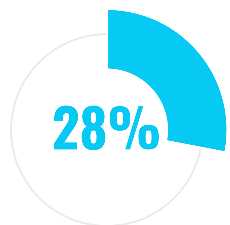
DISCOUNTS ARE A KEY DRIVER FOR RECOVERY IN SPENDING IN APRIL AND MAY, ACROSS ALL INCOME GROUPS

Why are consumers spending more in April and May?
% respondents

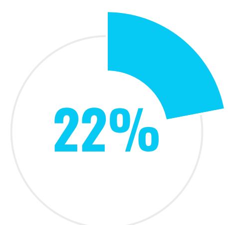
There are steep discounting and promotions which makes it very attractive to buy now



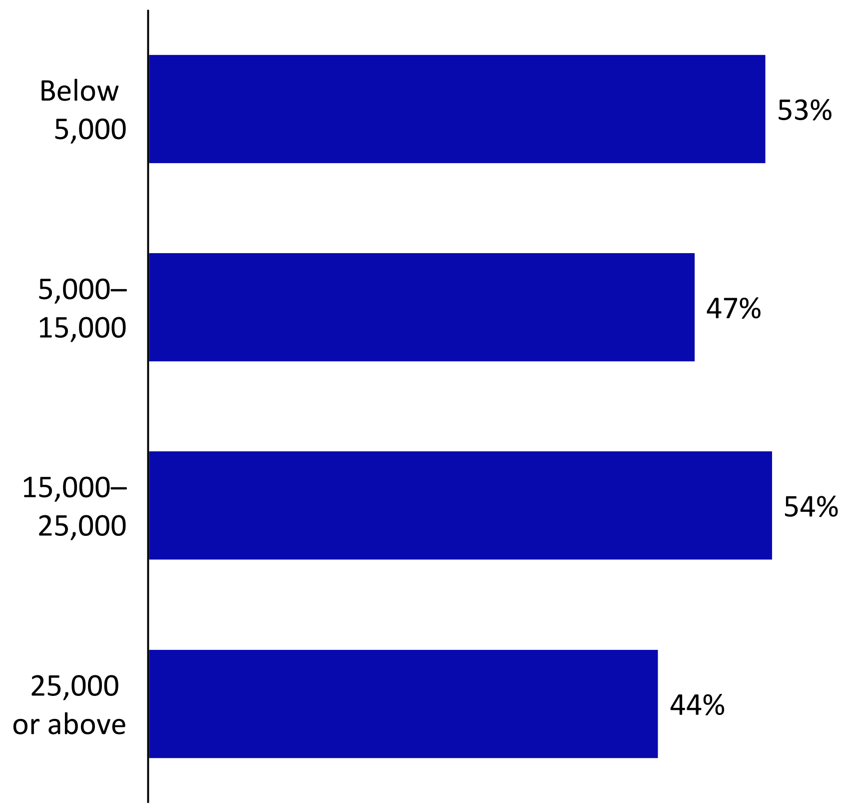
I want to check out some product in offline store but was not able to do that during the outbreak



I have not been purchasing as much during the outbreak so now I need to make up for that

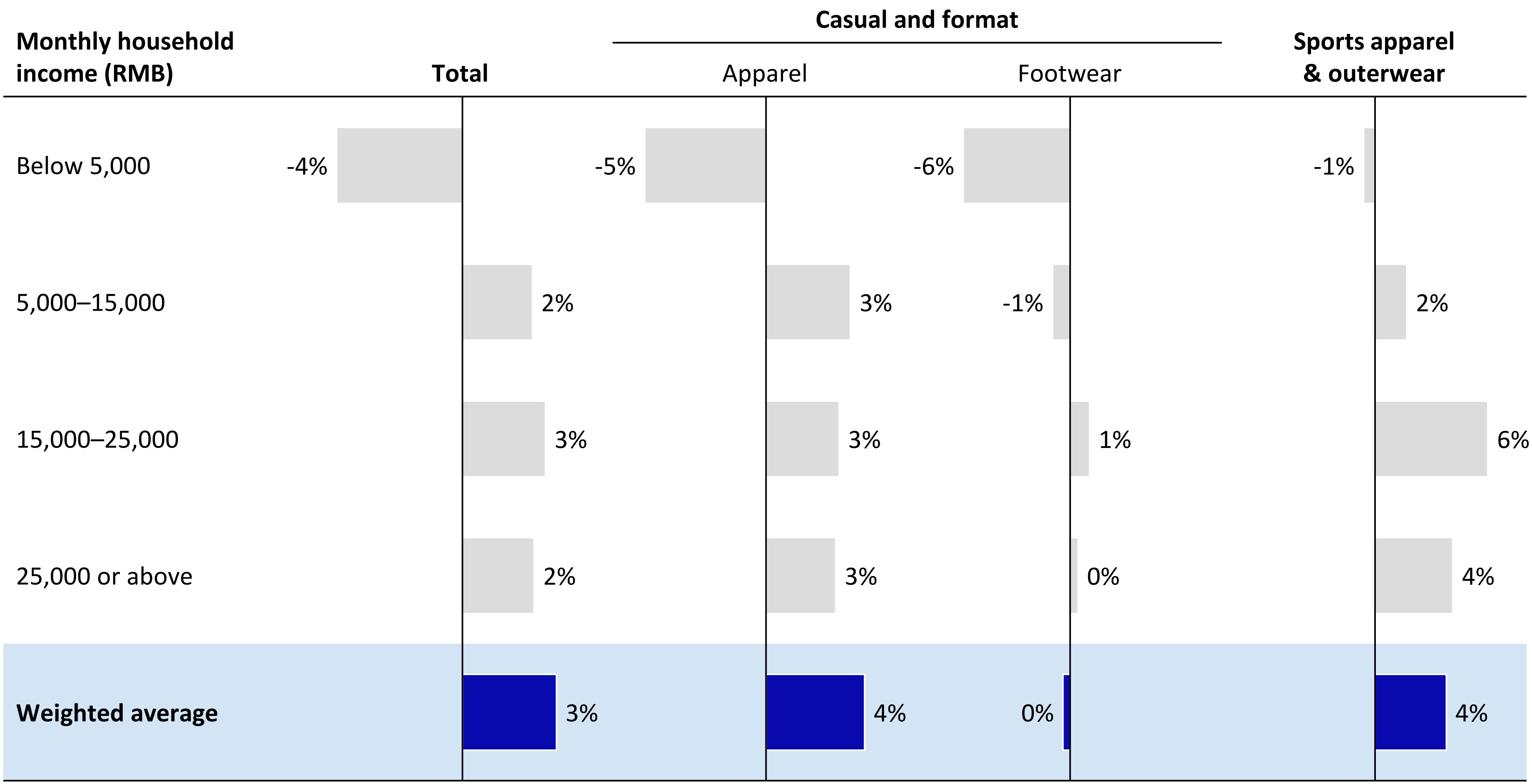


By income group



FOR THE REST OF THE YEAR, MARKET MAY REVERT BACK TO SOME GROWTH, YET STILL LOWER THAN HISTORIC 5%+ GROWTH

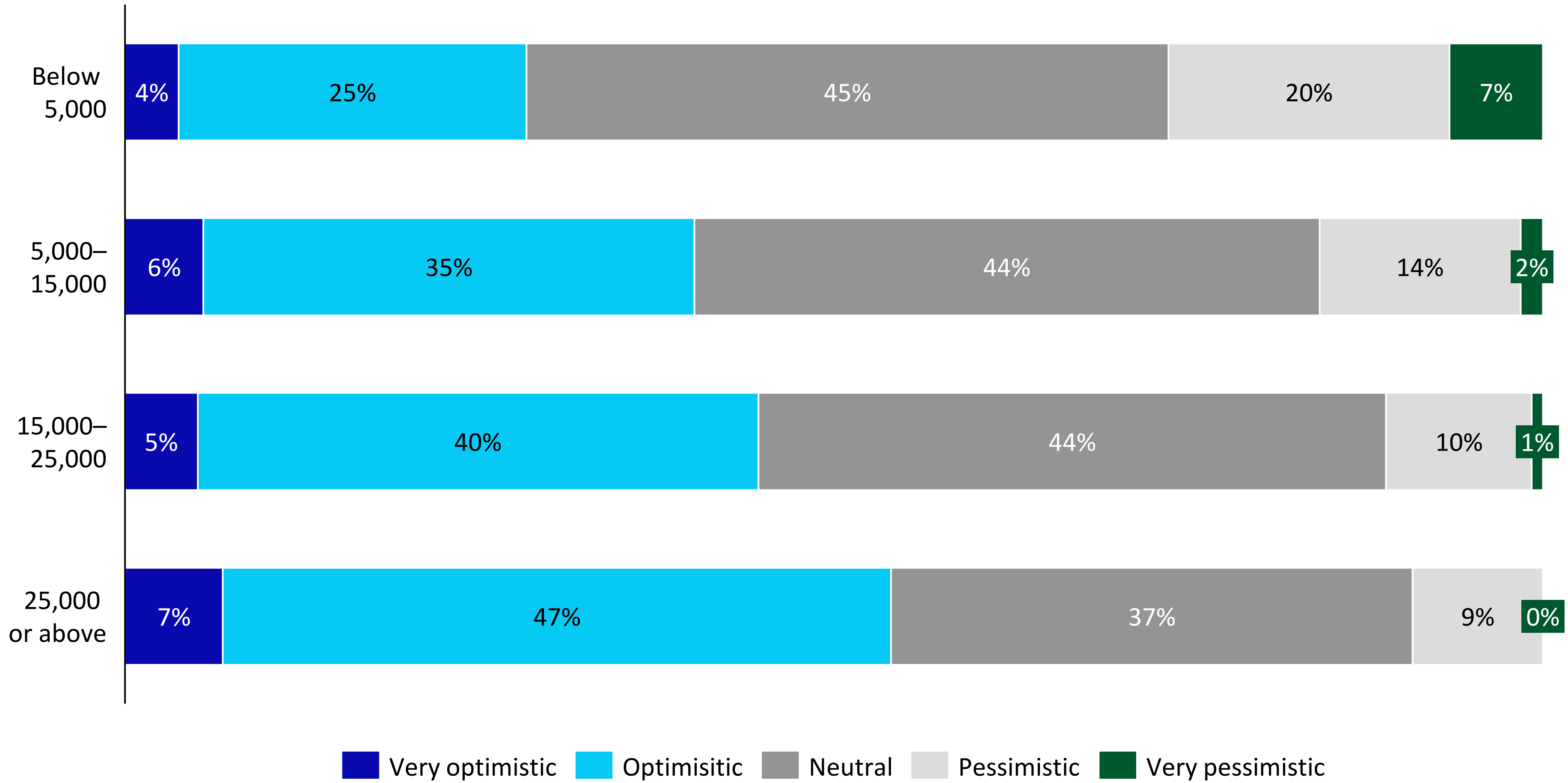
Estimated apparel and footwear compared to usual in the rest of 2020?
% vs 2019 average



CONSUMERS ARE MORE OPTIMISTIC ABOUT THEIR INCOME FOR THE REST OF 2020

Question: What is the outlook of your income for the rest of 2020?

% respondents by income group



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SHOPPING PATTERN SHIFTS IN THE NEW NORMAL

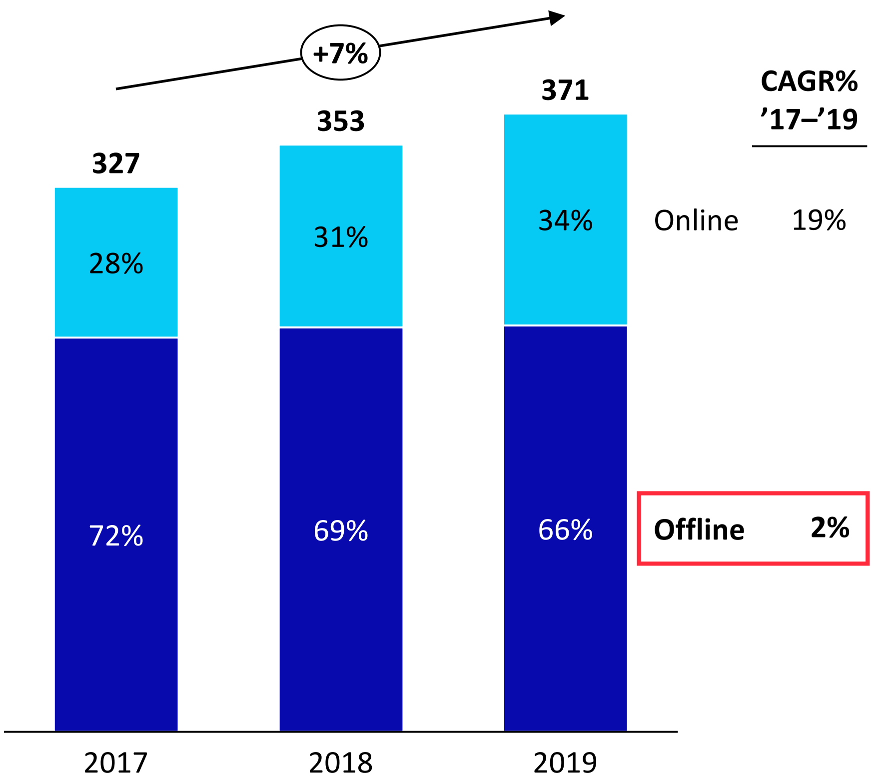
EXPECTED LONGER-TERM SHOPPING PATTERN SHIFTS

		Pre-COVID	Post-COVID new normal
1	**Further shift to online**	• E-commerce represented 34% in 2019, up from 12% in 2014 • A multichannel journey • A small share of pure online shoppers	• The shift to e-commerce is accelerated, expected to be 40-50% in 2020 • High income group will embrace online as a major channel for apparel, surpassing other income groups • Further increase in pure online shoppers, especially for younger age groups • Brand online flagship stores on major platforms will gain even more attention, potential for brand's own app / online store / mini-program remains to be unlocked
2	**Higher bar for offline**	• Offline stores already under pressure, with many players slowing down offline expansion or even closing stores • Some leading players have started to re-invent offline experience	• Offline stores will still have a role to play, especially for sportswear, but the bar to draw in traffic is increasing • Experience and quality will be the major differentiators, especially for middle and upper classes in tier 1/2 cities • Personalized clothing suggestion could be the most wanted service, followed by more digital in-store experience
3	**Further polarization**	• Brands with no clear positioning already suffering and many international brands left China	• Trade-up remains strong in middle and upper classes, while strong trade-down emerges in lower income group • Players with clear value-for-money proposition are more likely to survive • Those without distinctive proposition (e.g. value-for-money, quality) may fall into a tough situation and suffer

① OFFLINE CHANNEL WAS ALREADY UNDER PRESSURE BEFORE COVID-19

Online is the main driver of market growth

China apparel market, 2017–2019
US$ BN



Exchange rate: USD/RMB = 7.06
Source: Euromonitor, Company reports, Oliver Wyman analysis

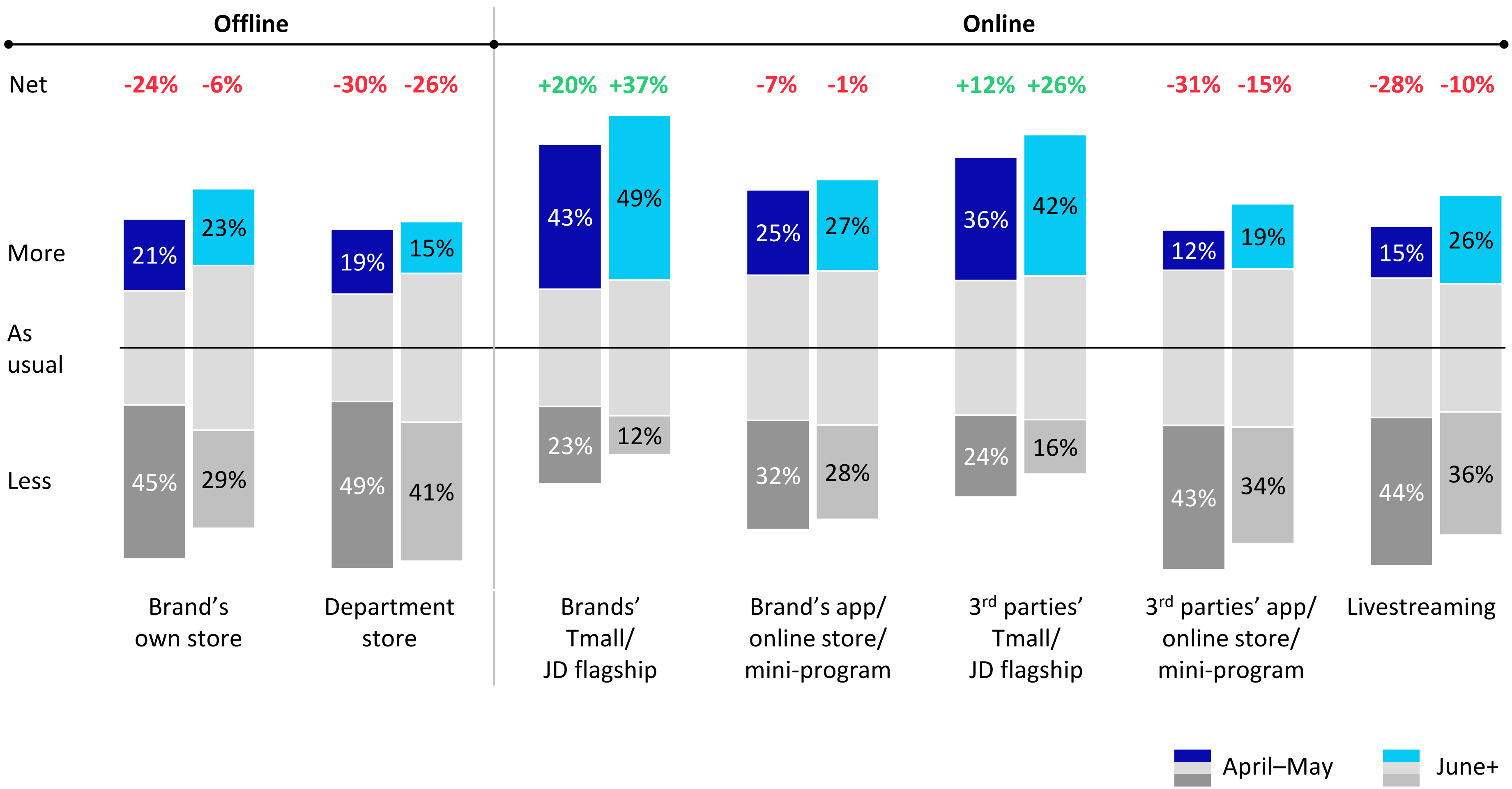
Slow down in offline expansion

# of stores nationwide, 2017–2019

	2017	2018	2019	'17–'18 Growth	'18–'19 Growth
UNIQLO	645	726	807	**13%**	**11%**
LILANZ 利郎	2,410	2,670	2,815	**11%**	**5%**
INDITEX	640	659	655	**9%**	**-1%**
PEACEBIRD	4,251	4,594	4,427	**8%**	**-4%**
都市丽人 COSMO LADY	7,181	7,305	5,970	**2%**	**-18%**
La Chapelle	9,448	9,269	4,878	**-2%**	**-47%**

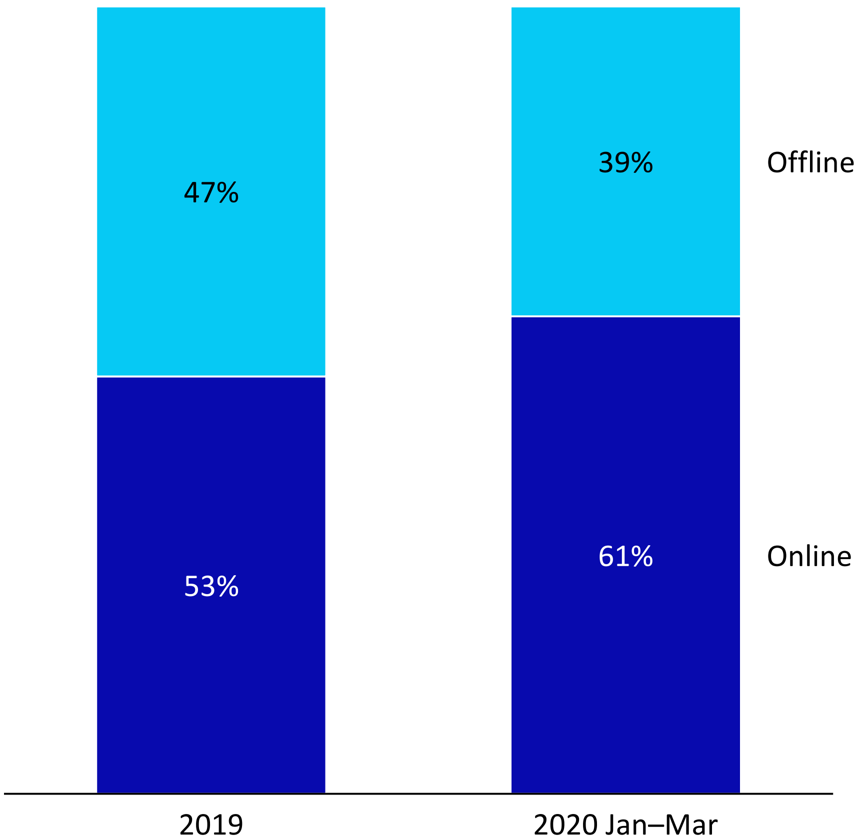
1 INTEREST IN BRANDS' OFFLINE STORE WILL REBOUND, BUT IN LONG RUN THERE CONTINUES TO BE AN INCREASING INTERESTS IN ONLINE CHANNELS

Question: How do you expect your spending to change in the following channels comparing to 2019?

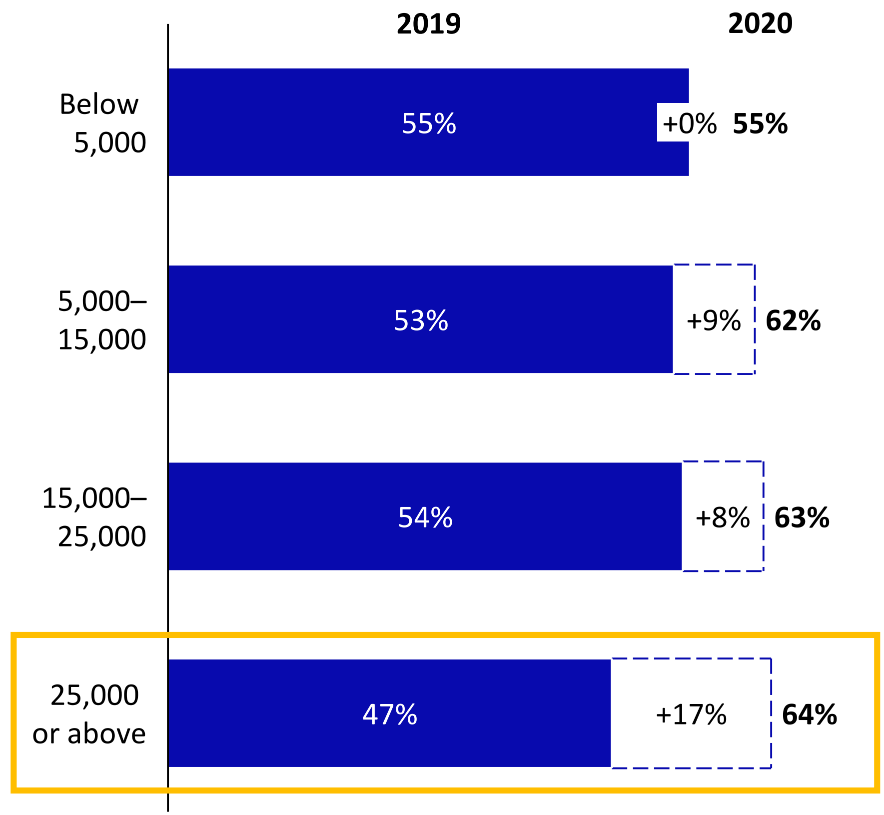


① HIGH INCOME GROUP JUMPS FROM THE LOWEST USE OF E-COMMERCE TO THE HIGHEST DURING COVID-19

Question: What is the % of apparel and footwear spending made online? (best estimate)

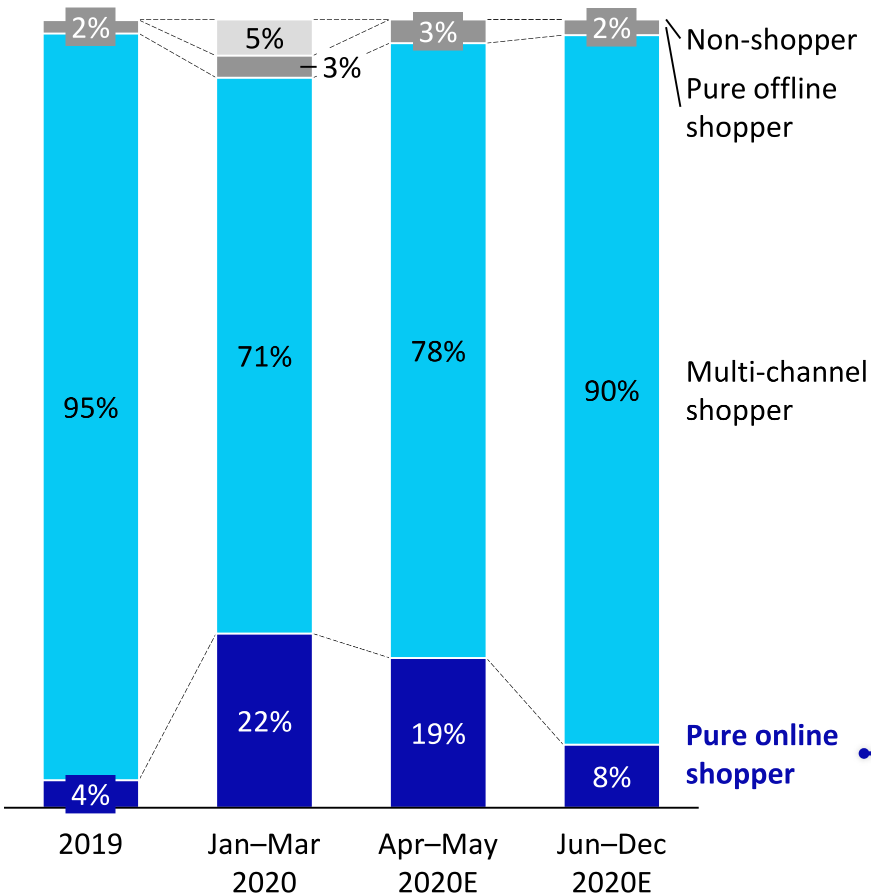


By monthly household income

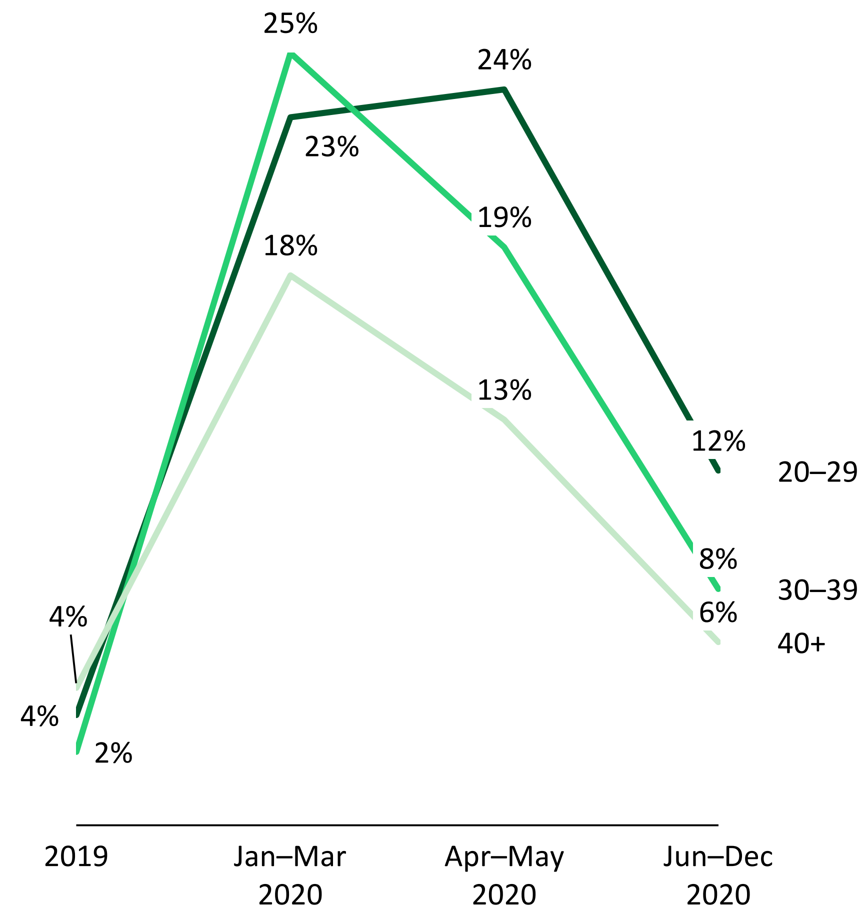


① MAJORITY REMAINS A MULTI-CHANNEL SHOPPER, THOUGH SOME GROWTH IN SHARE OF PURE ONLINE SHOPPERS

Shoppers by shopping channels
% respondents



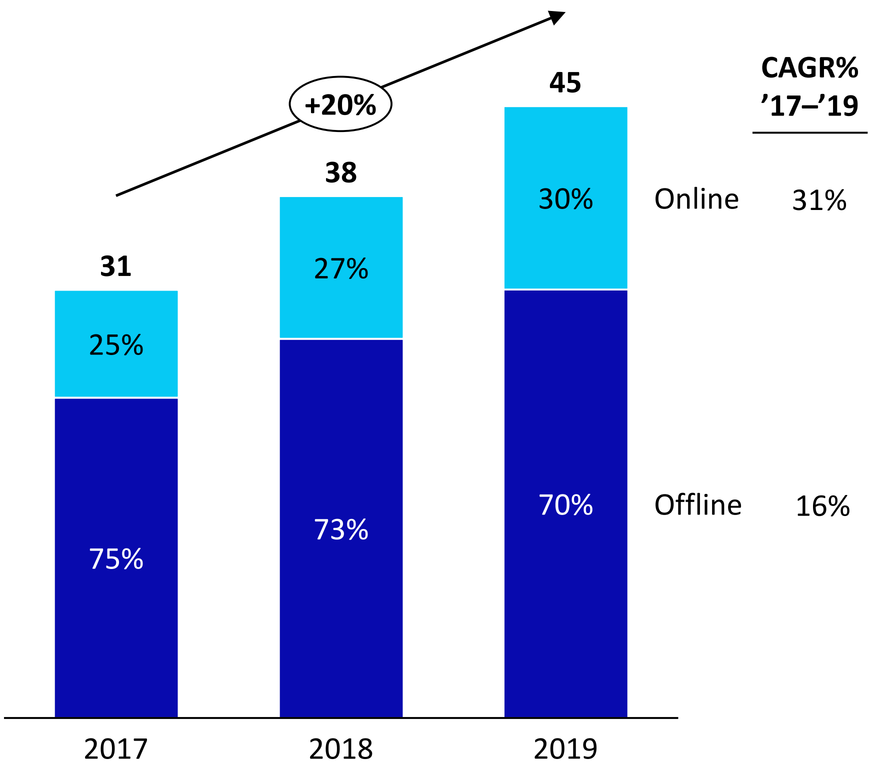
Pure online shoppers by age group
% respondents



1 SPORTSWEAR SECTOR ENJOYED A FASTER GROWTH THAN GENERAL APPAREL, AND OFFLINE STORES HAVE BEEN MORE RESILIENT

Both online and offline are driving the market growth

Sportwear market value by channel, 2017–2019
US$ BN



Exchange rate: USD/RMB = 7.06
Source: Euromonitor, Company reports, Oliver Wyman analysis

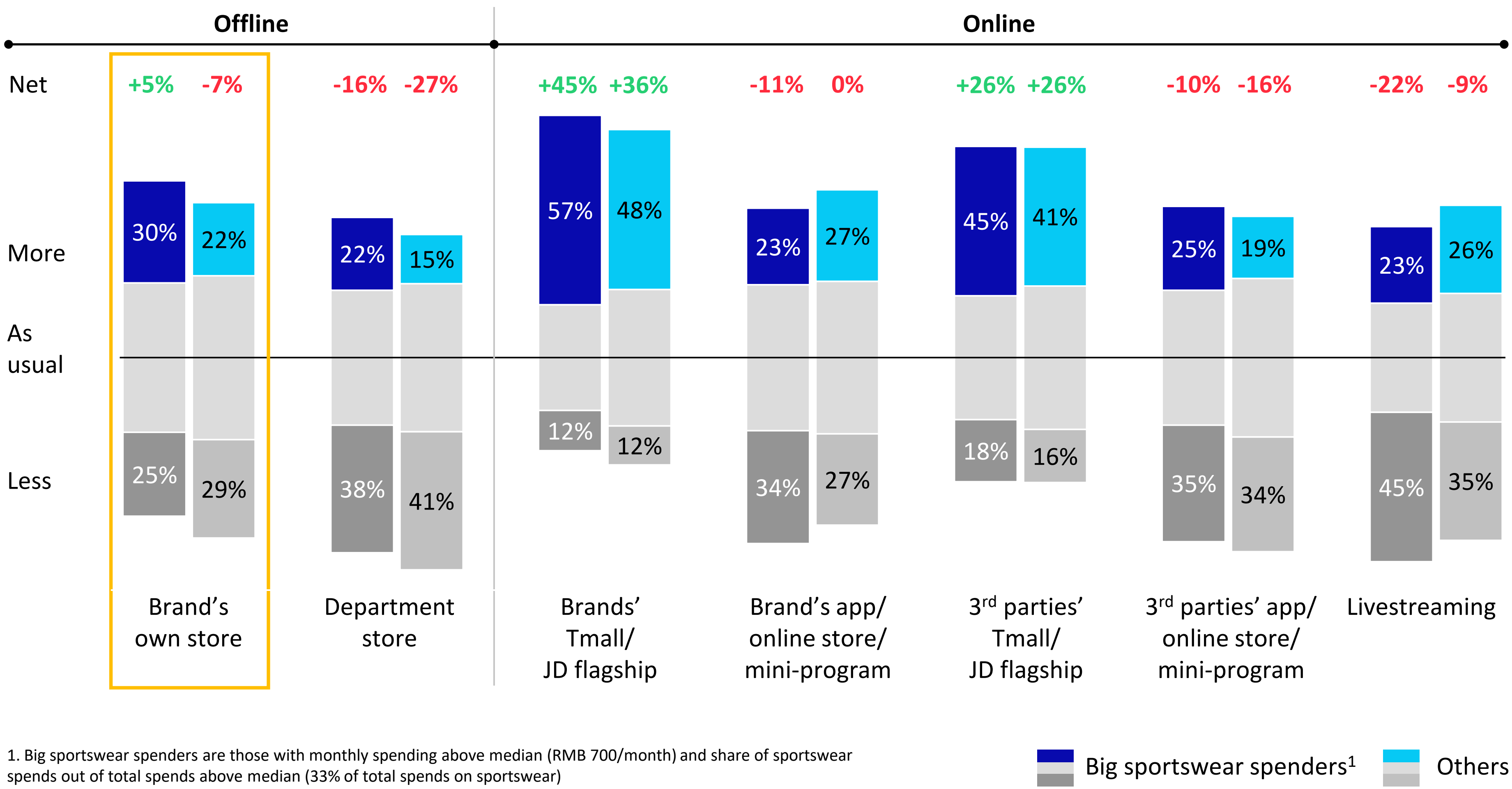
Still expanding their offline store footprints

# of stores nationwide, 2017–2019

	2017	2018	2019	’17–’18 Growth	’18–’19 Growth
SKECHERS	165	174	204	**5%**	17%
ANTA	10,617	12,188	12,943	**15%**	6%
LI-NING	6,262	7,137	7,550	**14%**	6%
X特步	~6,000	6,230	6,379	**4%**	2%
361°	5,808	5,539	5,519	**-5%**	0%

① SPORTSWEAR CUSTOMERS APPRECIATE BRANDS' OWN STORES MORE

In the next 1 to 2 years, do you think you will shop in the following channels?



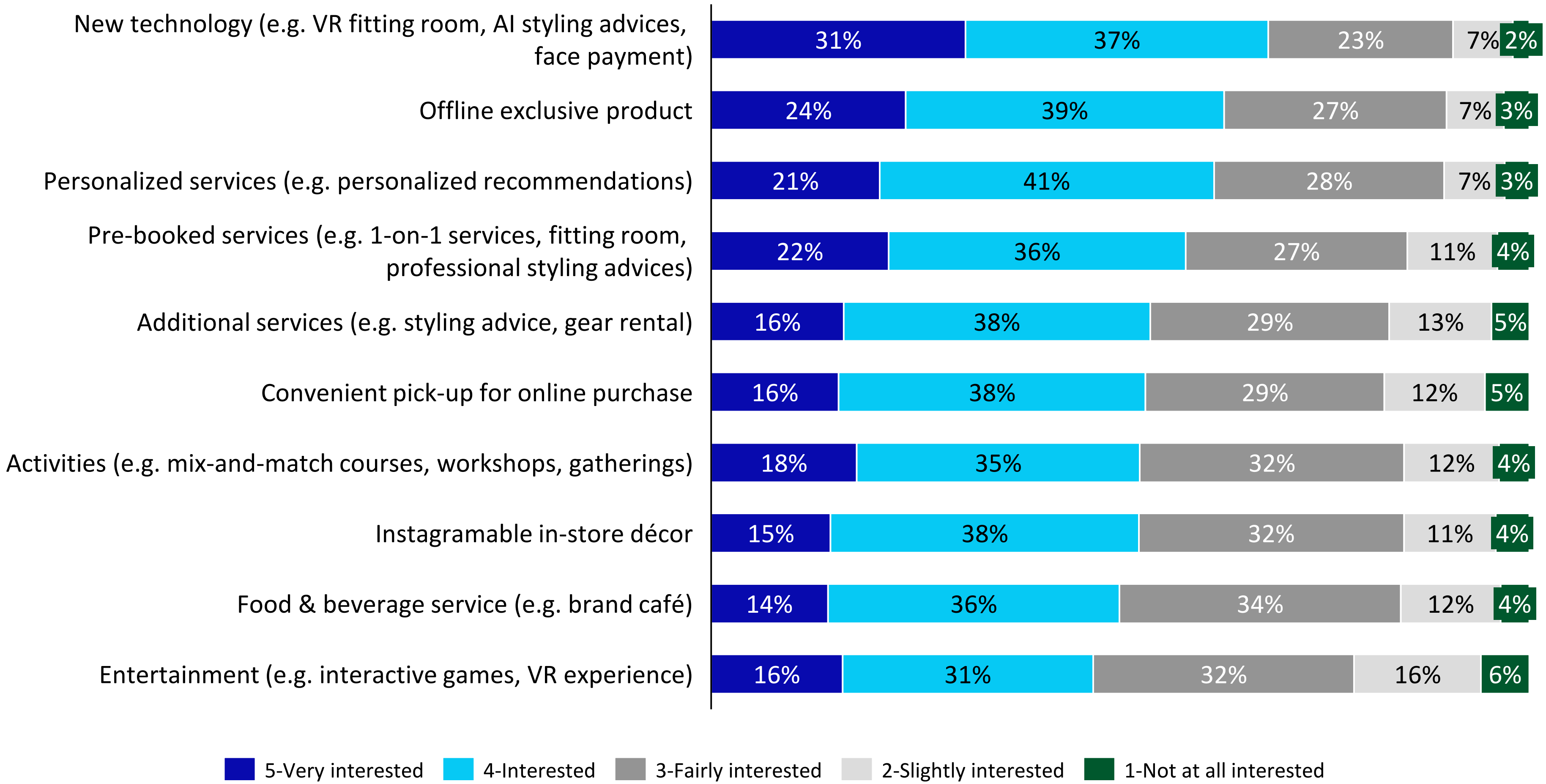
1. Big sportswear spenders are those with monthly spending above median (RMB 700/month) and share of sportswear spends out of total spends above median (33% of total spends on sportswear)

② OFFLINE STORES WILL ALWAYS HAVE A ROLE TO PLAY, WITH EXPERIENCE AND QUALITY BEING THE MAJOR DIFFERENTIATORS

Why consumers prefer going to offline stores?
% of maximum score

② BUT THE BAR TO DRAW IN TRAFFIC IS INCREASING

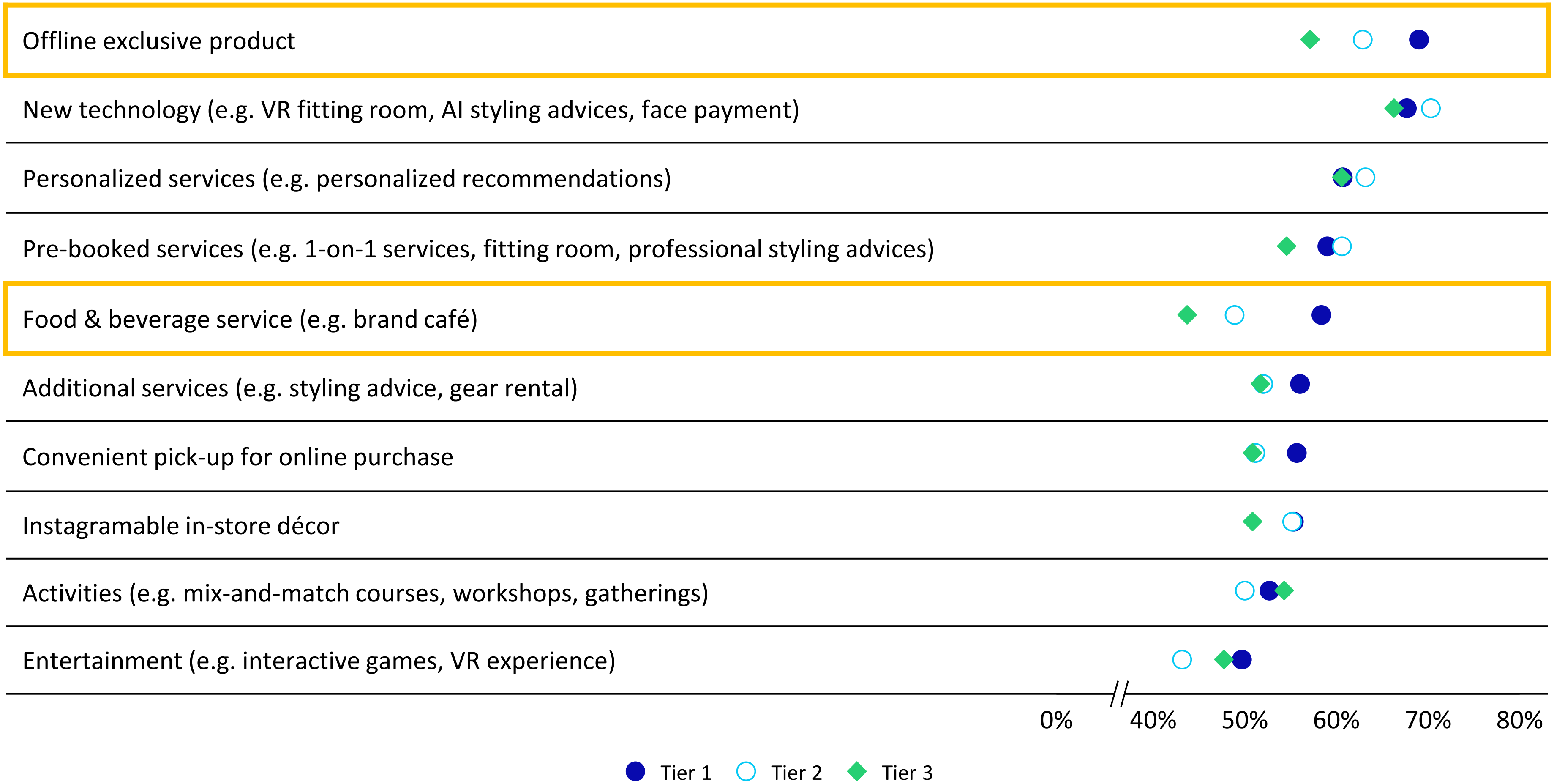
What features will attract you to visit and/or make a purchase in an offline store in the future?
% respondents



② TIER 1 CONSUMERS ARE MOST DEMANDING; OFFLINE EXCLUSIVE PRODUCTS AND ADDITIONAL SERVICE COULD HELP GAIN MORE TRACTION

Preferred features for offline stores by city tier

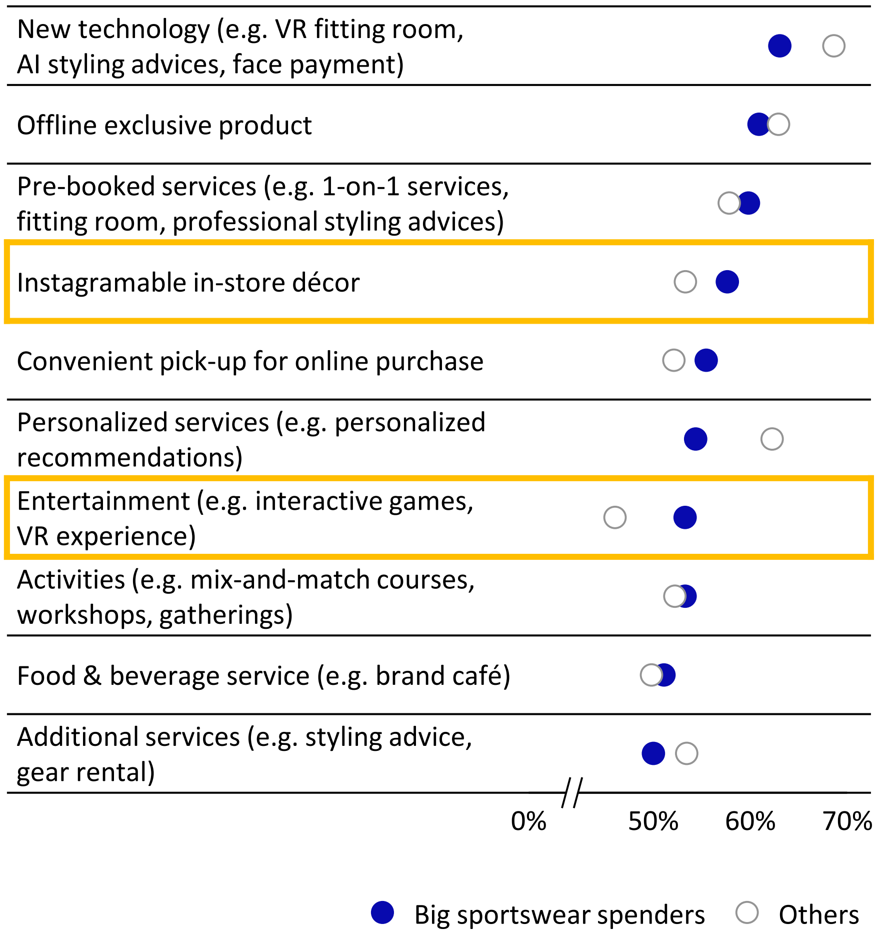
% respondents indicated attractive or very attractive



② FANCY IN-STORE ENVIRONMENT AND EXPERIENCE IS EVEN MORE IMPORTANT FOR SPORTSWEAR CONSUMERS

Preferred features for offline stores

% respondents indicated attractive or very attractive



Global example – PUMA NYC Flagship

- PUMA's first flagship store in New York City opened in Aug 2019 focus on immersive entertainment experience
- Professional Formula-1 simulators were installed for visitors' trial to advertise its lesser-known motorsports wear product line
- Basketball and soccer simulation and gaming sections are included to push its lines of functional sportswear

② # PERSONALIZED CLOTHING SUGGESTION COULD BECOME THE MOST WANTED EXPERIENCE, FOLLOWED BY MORE DIGITAL IN-STORE ELEMENTS

What type of personalized experience would you like in an offline store?
% respondents replied (open question)

38% want personalized clothing suggestion

“ 挑选搭配试穿都有搭配师指导，可以根据客人的身材和脸型，推荐适合的衣服。自己不怎么会穿衣服。

Would be great that stylist could guide and assist customers in choosing apparel based on their body shapes and face shapes. I personally do not know much how to choose apparels. ”

14% want more digital in-store experience

“ 想有新科技试衣间，或者能使用虚拟现实来看到服装搭配上身的效果，这样更方便，有更好的购物体验。

Would like to have new technology for fitting rooms, or have virtual reality to see how it looks when I wear new clothes. It would offer more convenient and better shopping experiences. ”

13% want personalized tailored apparel design

“ 希望可以有个性化的定制服务，量体裁衣。

I wish I could have personalized tailor service, design apparel based on my personal characteristics. ”

12% want VIP 1-on-1 service in store

“ 希望能够得到一对一的服务，就我看中的商品可以和其他品牌或样式的商品进行介绍对比以便我更好的做出选择。

I would like to get 1-on-1 service, such as helping me to compare the product with similar products or brands for me to make better decisions. ”

Observed key difference across different customer groups / city tiers

Tier 1&2		Tier 3
35%	vs	**43%**

Age ≤30		Age >30
16%	vs	**10%**

Male		Female
16%	vs	**10%**

Tier 1&2		Tier 3
13%	vs	**8%**

② FOREIGN PLAYERS ARE RECOGNIZED AS LEADERS IN CUSTOMER EXPERIENCE

Which brand do you think offers the best offline store experience? Why?
% respondents replied (open question)

#1	UNIQLO	17% of respondents
#2	Nike	16% of respondents
#3	adidas	12% of respondents
#4	HLA 海澜之家	8% of respondents

Selected comments

Personalized recommendation

"阿迪达斯。品种比较齐全，可选择性強，每次我一进店，销售员是询问我的需求后再向我推荐产品。

Adidas. Product range is comprehensive and easy to choose form. Every time I shop there, staff always ask for my needs and then recommend products to me."

Personalized apparel design

"耐克做的非常好，因为它产品可以定制手绘个性图案。

Nike do better on in-store experience because you can personalize the products with hand-drawn patterns."

Good fitting experience & services

"优衣库，因为它有试衣改衣服务，不合适可以改。

Uniqlo's in-store fitting and alteration services are very convenient."

Good customer services

"海澜之家的服务员很热情，会推荐个性化的搭配技巧。

HLA, staff are very warm-hearted, will give you personalized matching recommendations."

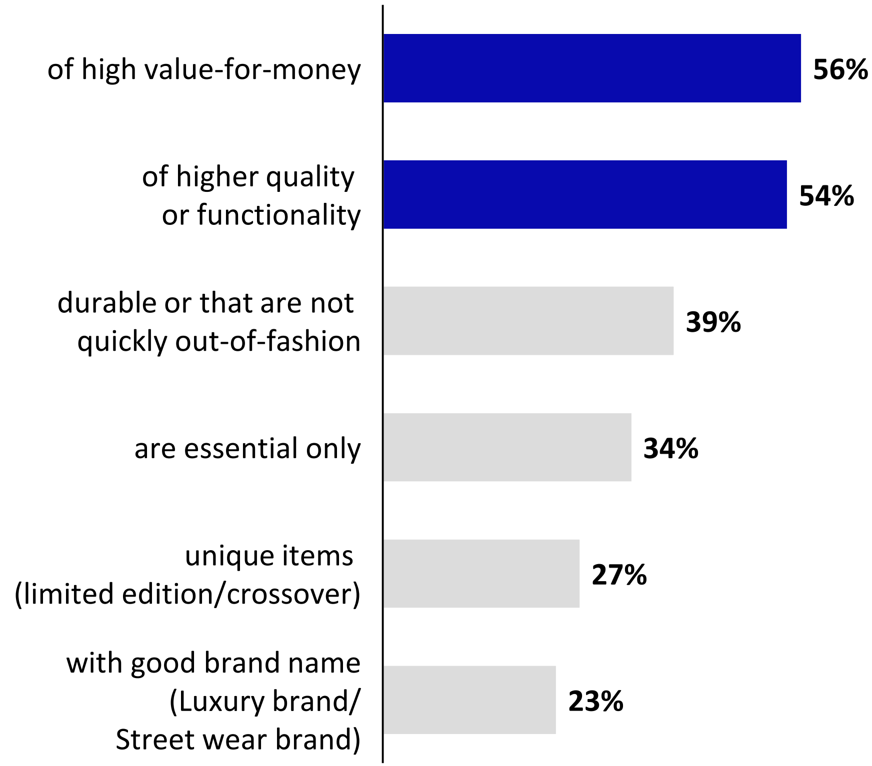
③ HIGH INCOME CONSUMERS STILL TRADE-UP AND GO FOR BOTH VALUE AND FUNCTIONALITY

High income group

Monthly household income ≥ 25,000

Product preferences

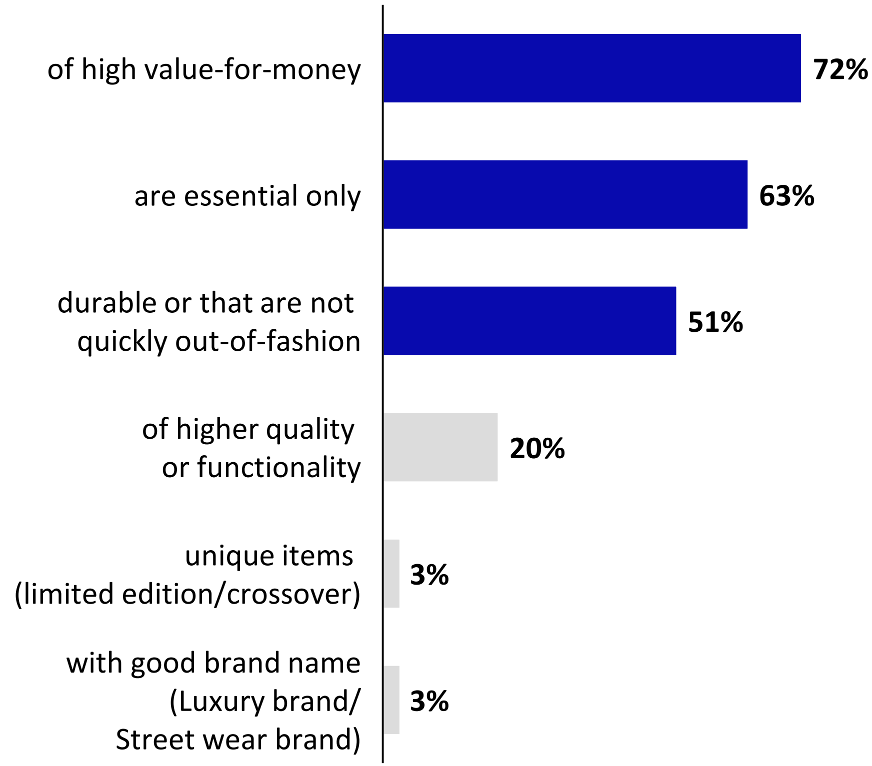
% respondents will likely buy more products which are…



③ # LOW INCOME CONSUMERS WILL TRADE-DOWN FOR ESSENTIALS

Low income group
Monthly household income < 5,000

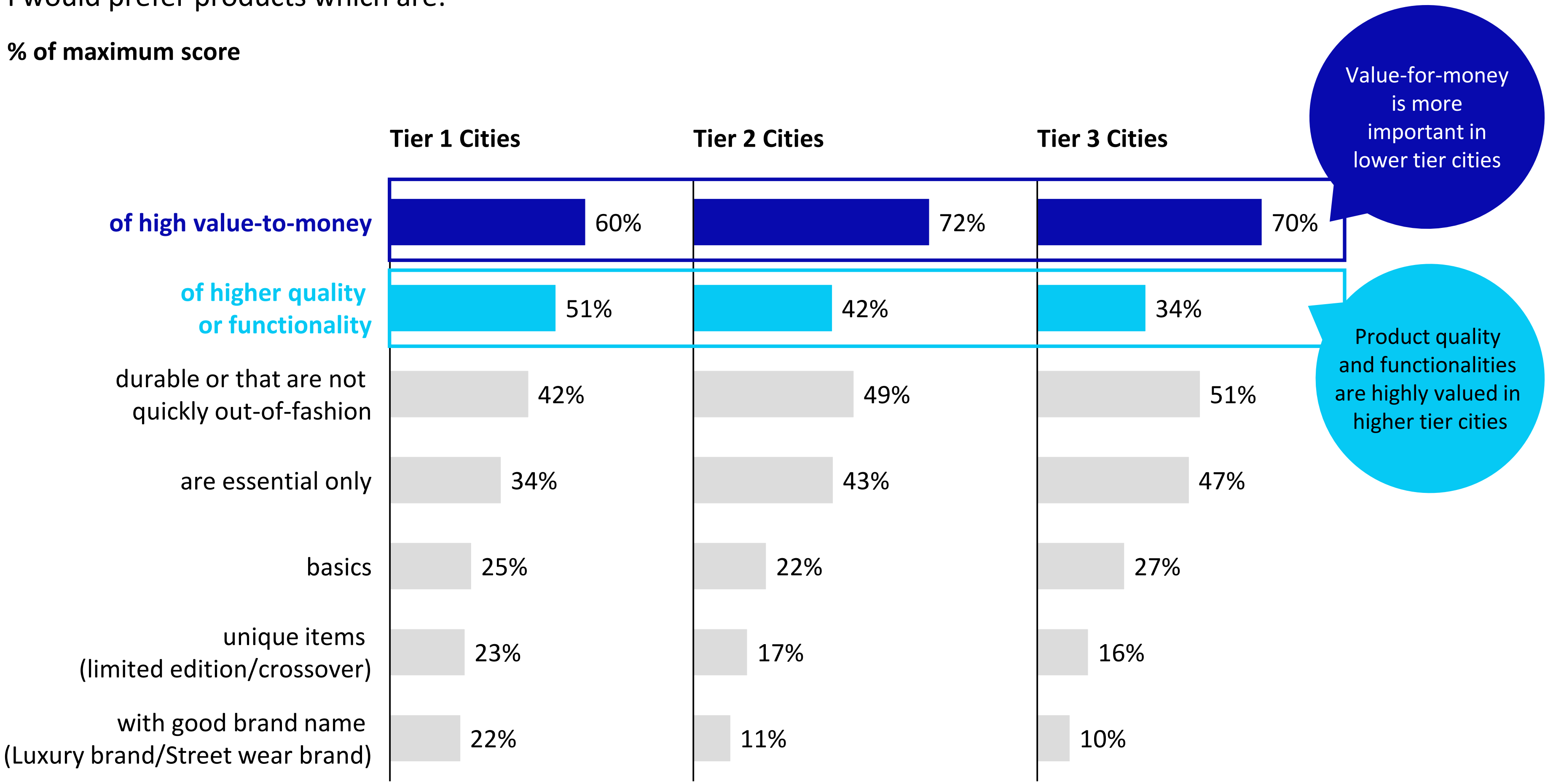
Product preferences
% respondents will likely buy more products which are…



③ TIER 1 CONSUMERS CARE MORE ABOUT QUALITY & FUNCTIONALITY, WHILE VALUE-FOR-MONEY IS MORE IMPORTANT IN LOWER TIER CITIES

In the upcoming months, which of the following describe your product preference better?
I would prefer products which are:

% of maximum score



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HOW TO MINIMIZE 2020 LOSSES WHILE PREPARING FOR THE NEW ERA

WINNERS WILL FOCUS ON MINIMIZING 2020 LOSSES WHILE ALSO PREPARING FOR THE FUTURE

Key levers	What to do to minimize 2020 financial impact	What to do to prepare for the new normal
Adjust proposition to fit with changing consumer needs	• **Be smart about prices and markdowns** to address clear value-for money preference while preventing excessive and unneeded markdowns • **Simplify and adjust collections** by focusing more on core products and re-using some excess stock	• Decide **which part of the market to play in** and develop a **distinct proposition** to win • **Adjust store format, product offering, service, and consumer experience** for both online and offline stores to fit with customers' new shopping preferences
Rationalize store network	• **Close loss making stores** in non strategic locations • Re-negotiate for loss making stores in strategic locations	• **Redefine the roles** between offline stores and online • Develop longer term offline **store network rationalization strategy** to strengthen your footprint • Prioritize investment for **service and experience enhancements** in most competitive locations
Take active cost management initiatives	• **Manage short-term cash** • Implement **one-off cost optimization** program • Put **rapid COGS reduction** methods into place (product profitability review, supplier management) • Optimize **inventory management/ markdowns**	• Strategically **redesign operating model** • Launch rigorous **fact-based assortment planning** • Strengthen long term **supplier strategy** • Adopt **leaner store operations** • **Redefine longer term markdown strategy** via structural and analytical levers

QUALIFICATIONS, ASSUMPTIONS, AND LIMITING CONDITIONS

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