HAINAN
HONG KONG + DUBAI + SINGAPORE?

Oliver Wyman’s Point of View

6 May 2021
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BASIC FACTS

Key statistics of Hainan

- **9 MN** population
  Population of Switzerland or Austria

- **35,354 sq km**
  Size of Belgium

- **EUR 71 BN GDP**
  0.54% of China
  GDP of Luxembourg

Source: Hainan government announcement, Oliver Wyman analysis

Key economic zones in Hainan province

- **HAIKOU**
  Positioned as center of conference and exhibition

- **SANYA**
  Tropical beach; Positioned as tourism destination

Other cities are still comparatively under-developed

1. Excluding Hainan resident travelling in Hainan; 2. As of 2020
A CRITICAL COMPONENT OF PRC GOVT’S DUAL CIRCULATION PLAN

CONSUMPTION & RE-SHORING

• With economic growth slowing down, pushing consumer spending has become even more critical for PRC government
• Dual-Circulation has been set as a key economic driver in the 14th Five-Year Plan
• Multiple programs are developed to accelerate re-shoring of consumption, incl. FTZ, CBEC

HAINAN MASTERPLAN

• As part of the grand plan, Hainan is set to become a full-island free trade port (FTP) with systems in place by 2025, fully matured by 2035

Source: Government announcement
The Grand Masterplan “6+1+4” Policy Framework

Ensure facilitation in:
- Trade
- Investment
- Capital flow
- Access for people
- Transportation
- Flow of data

Constructing Modern Industrial System (medical, finance)

1. Including medical and health, international finance, professional services, etc.
Source: Hainan government announcement, Oliver Wyman analysis

Tourism
Modern service industry
High-tech industry
High-efficiency agriculture

Institutional Construction
- Tax system
- Social governance
- Rule of law system
- Risk prevention and control system
TURNING HAINAN INTO A WORLD CLASS TOURISM HUB

**Duty Free shopping**
- Expansion of offshore duty-free shopping targeting domestic travelers
- Haitang Bay Duty Free Shopping Center as the world’s largest standalone duty-free shop

**Infrastructure**
- Investment in transport doubled over the past 5 years
- 29+ hotel projects ongoing, adding to the 122 hotels\(^1\) in 2020

**Specialty travel**
- Designated destination for medical/aesthetic, rural and cultural tourism
- Positioned as a cultural hub for One Belt One Road

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1. Those 122 hotels are star rated hotels
Source: Chinese Government, National Bureau of Statistics, Oliver Wyman analysis

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HAINAN SAW ~50 MN CHINESE TRAVELERS IN 2020 AND EXPECTS TO WELCOME ~100 MN BY 2025

Chinese travelers to Hainan, 2019 – 2025F

MN trips

Source: Hainan Tourism Board, Oliver Wyman analysis
A WELCOME ALTERNATIVE FOR PAST INT’L TRAVELERS, STUCK IN CHINA BECAUSE OF COVID

Question: How many times have you been to Hainan in the past 12 months?
% Chinese international travelers

1. Chinese aged 18+ who traveled internationally (including Macau, Hong Kong and Taiwan) in 2019
N = 2,000, weighted
Source: Consumer survey, Oliver Wyman analysis
2 YEARS OF ADVANTAGE BEFORE INTERNATIONAL TRIPS RECOVER TO 2019 LEVEL

Number of outbound trips by Chinese travelers
2018-2024F, MN PAX

Source: Chinese traveler recovery dashboard (Apr 26)

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HAINAN IS HERE TO STAY EVEN WHEN INT’L TRAVEL RESUMES

Willingness to travel to Hainan
% respondents

If borders are still closed...
% willing to travel to Hainan as an alternative of international travel

<table>
<thead>
<tr>
<th></th>
<th>Unlikely</th>
<th>Likely</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hainan travelers</td>
<td></td>
<td>98</td>
</tr>
<tr>
<td>Non-Hainan travelers</td>
<td></td>
<td>88</td>
</tr>
</tbody>
</table>

If borders are reopened...
% respondents who ranked Hainan as their top 3 destinations

<table>
<thead>
<tr>
<th></th>
<th>Others</th>
<th>Top 3 destination</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hainan travelers</td>
<td></td>
<td>48</td>
</tr>
<tr>
<td>Non-Hainan travelers</td>
<td></td>
<td>29</td>
</tr>
</tbody>
</table>

Question: If travel ban is still in effect in the foreseeable future, how likely will you travel to Hainan as an alternative to international travel?
Question: Assume the pandemic is fully under control and China has resumed travel with the entire world, what would be your top destination to visit?

N = 2,000, weighted
Source: Consumer survey, Oliver Wyman analysis
**SIMILAR IN POPULARITY AS HONG KONG**

**Question:** Assume the pandemic is fully under control and China has resumed travel with the entire world, what would be your top destination to visit?

**Top 3 locations, % of respondents who traveled internationally in 2019**

<table>
<thead>
<tr>
<th>Location</th>
<th>% of Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong</td>
<td>41</td>
</tr>
<tr>
<td>Hainan</td>
<td>40</td>
</tr>
<tr>
<td>Japan</td>
<td>35</td>
</tr>
<tr>
<td>Western Europe</td>
<td>33</td>
</tr>
<tr>
<td>Singapore</td>
<td>28</td>
</tr>
<tr>
<td>Korea</td>
<td>25</td>
</tr>
<tr>
<td>Macau</td>
<td>25</td>
</tr>
<tr>
<td>Australia / New Zealand</td>
<td>24</td>
</tr>
<tr>
<td>Thailand</td>
<td>21</td>
</tr>
<tr>
<td>North America</td>
<td>14</td>
</tr>
<tr>
<td>Taiwan</td>
<td>12</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>vs. 2018¹</th>
<th>+23%</th>
</tr>
</thead>
<tbody>
<tr>
<td>vs. 2018¹</td>
<td>+21%</td>
</tr>
<tr>
<td>vs. 2018¹</td>
<td>-13%</td>
</tr>
<tr>
<td>vs. 2018¹</td>
<td>-1%</td>
</tr>
<tr>
<td>vs. 2018¹</td>
<td>+13%</td>
</tr>
<tr>
<td>vs. 2018¹</td>
<td>+2%</td>
</tr>
<tr>
<td>vs. 2018¹</td>
<td>+14%</td>
</tr>
<tr>
<td>vs. 2018¹</td>
<td>+18%</td>
</tr>
<tr>
<td>vs. 2018¹</td>
<td>-5%</td>
</tr>
<tr>
<td>vs. 2018¹</td>
<td>+1%</td>
</tr>
<tr>
<td>vs. 2018¹</td>
<td>+3%</td>
</tr>
</tbody>
</table>

N = 2,000; weighted; 1. Except Hainan (2019)
Source: Consumer survey, Oliver Wyman analysis

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THE JOURNEY TO A FULL DUTY-FREE ISLAND

HAINAN DUTY-FREE

Introduction of Offshore Duty-Free
- RMB 5K/year person quota
- 18 product categories

Relaxation of Offshore Duty-Free
- RMB 10K/year personal quota
- Increased to 21 categories
- Removed most product-level quota restrictions

Launch of Resident Duty-Free
- RMB 8K/year personal quota
- Increased to 21 categories
- Detailed to be announced


Full Island Duty-Free (Expected)
- Most products will be duty
- and tax free

1. To be announced
Source: State Council “Master Plan for the Hainan Free Trade Port “, expert interviews, Oliver Wyman analysis

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**DUTY FREE: HOW BIG?**

**Hainan duty free sales forecast**
2019-2025F, BN EUR

Latest gov. target is €8 BN (incl. duty-paid), duty-free est. to be €5-6 BN

2020 sales from 4 DF stores in Hainan is €4+ BN with duty-paid e-commerce

+102%

Bank of America estimate Hainan total sales in 2025 to be EUR 33.34 BN, inclusive of duty-paid channels which amounted to 85% in 2019

Source: Bank of America, Morgan Stanley, Oliver Wyman analysis

Morgan Stanley projection in 2020 Q3

Bank of America projection in 2021 Q1, driven by:

- New licenses and malls
- Entry of international suppliers
- Price advantages
- Potentially brands could operate their own stores when Hainan becomes fully tax-free

30+% of China luxury spending in 2030?

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1. Bank of America estimate Hainan total sales in 2025 to be EUR 33.34 BN, inclusive of duty-paid channels which amounted to 85% in 2019

Source: Bank of America, Morgan Stanley, Oliver Wyman analysis
### ComPELLING OFFERINGS IS THE BIG UNKNOWN. PENETRATION IS KEY

**Breakdown by key drivers**

2019–2025F

<table>
<thead>
<tr>
<th># of travelers in Hainan (MN trips)</th>
<th>Penetration of Hainan duty free</th>
<th>Average spending (EUR)</th>
</tr>
</thead>
<tbody>
<tr>
<td><img src="#" alt="Graph showing percentage changes" /></td>
<td><img src="#" alt="Graph showing percentage changes" /></td>
<td><img src="#" alt="Graph showing percentage changes" /></td>
</tr>
</tbody>
</table>

- **# of travelers in Hainan**
  - 2019: 67
  - 2020: 54
  - 2021: 62
  - 2022: 74
  - 2023: 83
  - 2024: 91
  - 2025: 97

- **Penetration of Hainan duty free**
  - 2019: 6%
  - 2020: 8%
  - 2021: 12%
  - 2022: 16%
  - 2023: 17%
  - 2024: 19%
  - 2025: 21%

- **Average spending (EUR)**
  - 2019: 450 EUR
  - 2020: 790 EUR
  - 2021: 1,030 EUR
  - 2022: 1,120 EUR
  - 2023: 1,200 EUR
  - 2024: 1,280 EUR
  - 2025: 1,360 EUR

**FX:** EUR/RMB = 7.8: 1

1. Based on Morgan Stanley forecasts.
2. The tourists number includes only tourists from outside Hainan (Hainan local tourist is ~20% of total tourists) which are unqualified for duty-free.
3. Number of purchases as a % of number of travelers, multiple purchases in one trip are counted separately.

Source: Ministry of Commerce, Hainan tourism board, Morgan Stanley, Euromonitor projection, Oliver Wyman analysis.
MANY AFFORDABLE MODE OF TRANSPORT ALLOWING PEOPLE OF VARIOUS INCOME TO VISIT WITH EASE

Hainan travelers by arriving transportation, 2019

% of travelers

- Flight: 11%~19%
- Ferry & train: 22%~25%
- Self-driving & bus: 58%~65%

Train is carried by ferry through the Qiongzhou Strait (between Hainan and Guangdong)

5 trains (Departure station: Harbin [northeast], Changchun [northeast], Shanghai, Beijing, Zhengzhou)

Travel time and costs

- Beijing: 3 hr 45 min (EUR 250)
- Shanghai: 2 hr 50 min (EUR 250)
- Guangdong Province:
  - 1 hr 20 min from Guangzhou (EUR 230)
  - 6+ hr from Zhanjiang (EUR 9)
  - 1 hr from Xuwen (EUR 5)

Source: Ctrip, Hainan Tourism Bureau, Oliver Wyman analysis

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Question: Do you think you would substitute your overseas shopping with Hainan when travel resumes? 1. Weighted
Source: Consumer survey, Oliver Wyman analysis
THE REAL SIZE OF HAINAN IS STILL DEPENDENT ON BRANDS’ SUPPORT

Comparison of Sanya CDF Mall and Hong Kong Harbour City¹

<table>
<thead>
<tr>
<th>Sales Area</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Sanya CDF Duty Free Mall</td>
<td>72K sqm</td>
<td></td>
</tr>
<tr>
<td>Hong Kong Harbour City</td>
<td>185K sqm</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Sales Value</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>10.4 BN RMB (2019)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>33.6 BN RMB (2018)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th># of Beauty Brands</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>58</td>
<td></td>
<td></td>
</tr>
<tr>
<td>323</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th># of Fashion &amp; Accessories Brands</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>196</td>
<td></td>
<td></td>
</tr>
<tr>
<td>335</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Selected Brands</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>BVLGARI</td>
<td>Tiffany &amp; Co.</td>
<td></td>
</tr>
<tr>
<td>PRADA</td>
<td>HERMES</td>
<td></td>
</tr>
<tr>
<td>CARTIER</td>
<td>GUCCI</td>
<td></td>
</tr>
<tr>
<td>TIFFANY &amp; CO.</td>
<td>HERMES</td>
<td></td>
</tr>
<tr>
<td>GUCCI</td>
<td>DIOR</td>
<td></td>
</tr>
<tr>
<td>CHANEL</td>
<td>GIORGIO ARMANI</td>
<td></td>
</tr>
</tbody>
</table>

¹ As of December 2020
Source: Bank of America, Meituan App, Harbour City Website, Oliver Wyman analysis

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A HIGH RISK OF DEFLATION AND UNCONTROLLED CBEC

Retail price comparison

<table>
<thead>
<tr>
<th>Product</th>
<th>Tmall flagship</th>
<th>Hainan duty-free</th>
<th>Percent off</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estee Lauder Advanced Night Repair 50ml</td>
<td>900</td>
<td>448</td>
<td>(\downarrow 50%)</td>
</tr>
<tr>
<td>Lancôme Advanced Genifique 100ml</td>
<td>1,720</td>
<td>740</td>
<td>(\downarrow 47%)</td>
</tr>
<tr>
<td>Dior J’adore Eau de Parfum 75ml</td>
<td>1,520</td>
<td>1,072</td>
<td>(\downarrow 29%)</td>
</tr>
<tr>
<td>La Mer Moisturizing Cream 30ml</td>
<td>1,520</td>
<td>1,192</td>
<td>(\downarrow 22%)</td>
</tr>
<tr>
<td>La Prairie Firming Foundation Concealer 30ml + 2g</td>
<td>2,100</td>
<td>1,717</td>
<td>(\downarrow 18%)</td>
</tr>
</tbody>
</table>

Brand offering discounts beyond tax and duty deductions (25\%) – Brands taking advantage of tax & duty savings savings

1. As of 5th May, 2021; 2. Converted to the same unit size; 3. 13% VAT and 15% consumption tax for premium beauty products, i.e. 33% of import duty and tax on pre-tax price, equivalent to 25% of post-tax price

Source: CDFG, Tmall, Oliver Wyman analysis
A NEW DAIGOU HUB

Key drivers for switching focus to Hainan

• Same or even lower prices
  Combining membership discount and frequent promotion could achieve prices lower than HK/Korea

• Reduced travel effort
  Travel expense (flights and hotels) to Hainan is much lower + no visa requirements

• Lower perceived customs screening risks
  Daigous are under the impression that customs screening in Hainan is less stringent

• Easier to resell with full packaging
  Packaging need not to be removed for efficient shipping from overseas, hence easier to resell

Source: Daigou interviews, Oliver Wyman analysis

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Pre-COVID Daigou flow
In-/Post-COVID Daigou flow
## HAINAN IS VERY ATTRACTIVE FOR BEAUTY PRODUCTS DAIGOU

**Profit simulation of Hainan Offshore Duty-free and Resident Duty-Free** Daigou (C2C)

### RMB/person/year

<table>
<thead>
<tr>
<th>Quota</th>
<th>Offshore Duty-free</th>
<th>Resident Duty-Free</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Max. # of products under the quota&lt;sup&gt;4&lt;/sup&gt;</td>
<td>Max. purchase under 30K RMB quota</td>
</tr>
<tr>
<td></td>
<td>120 units of Lancôme Genifique 100ml (30 units × 4 trips)</td>
<td>40 units of Lancôme Genifique 100ml</td>
</tr>
</tbody>
</table>

| Sales |  |  |
|-------|  |  |
|       | Assume 20% lower than Tmall<sup>1</sup> |  |
|       | =30×4×(1,720×80%) RMB | =40×(1,720×80%) RMB |
| - Purchase cost |  |  |
| Pre-order price after promo<sup>1</sup> | 88,800 | 29,600 |
| =30×4×740 RMB | =40×740 RMB |
| - Commission fee<sup>2</sup> | 3,600 | 1,200 |
| Based on expert interview | =30×4×30 RMB | = 40×30 RMB |
| - Delivery cost | 1,560 | 720 |
| Assume from GZ to SZ using SF | =30×4×13 RMB | = 40×18 RMB |
| = DAIGOU PROFIT | 71,160 | 23,520 |

1. As of March 4th, 2021; 2. Assume Daigou paying commission fee to buy quota from others; 3. to be announced; 4. Max. # of product under each trip is 30 units, with a yearly purchase quota of 100K RMB.

Source: Daigou interviews, Oliver Wyman analysis

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BRANDS SHOULD CLOSELY WATCH OUT FOR MARGIN EROSION

Profitability in Hainan (Taking a luxury example for illustrative purpose)
European price indexed as 100

Mainland China

<table>
<thead>
<tr>
<th></th>
<th>Retail price</th>
<th>Retailer margin</th>
<th>Brand’s revenue</th>
<th>COGS</th>
<th>Gross profit</th>
<th>Operating cost</th>
<th>EBIT</th>
</tr>
</thead>
<tbody>
<tr>
<td>European price</td>
<td>124</td>
<td>17</td>
<td>107</td>
<td>17</td>
<td>90</td>
<td>47</td>
<td>43</td>
</tr>
<tr>
<td>Mainland China</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Hainan

<table>
<thead>
<tr>
<th></th>
<th>Retail price</th>
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<th>Brand’s revenue</th>
<th>COGS</th>
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<th>Operating cost</th>
<th>EBIT</th>
</tr>
</thead>
<tbody>
<tr>
<td>European price</td>
<td>107</td>
<td>64</td>
<td>43</td>
<td>17</td>
<td>26</td>
<td>4</td>
<td>22</td>
</tr>
<tr>
<td>Hainan</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Lower margin in Hainan than that in mainland China

Source: Bank of America, Oliver Wyman analysis
## NEW FORMS OF RETAIL ARE EMERGING AROUND HAINAN DUTY-FREE

<table>
<thead>
<tr>
<th>Example</th>
<th>Hainan Offshore Duty-free</th>
<th>CBEC by Duty-free operators</th>
<th>Hainan Offshore Duty-free</th>
<th>Duty-free by local retailers</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Pre-order, Click &amp; Collect</td>
<td></td>
<td>Home delivery</td>
<td></td>
</tr>
</tbody>
</table>

| Launch time | 2014 | 2020 | 2021 | Expected at 2021H1 |

<table>
<thead>
<tr>
<th>Target consumer</th>
<th>Hainan traveler</th>
<th>Online consumer</th>
<th>Hainan traveler</th>
<th>Hainan resident</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Consumer journey</strong></td>
<td>• Order online/offline</td>
<td>• Order online at duty-free price</td>
<td>• Order online/offline</td>
<td>• Shop at local resident duty-free stores</td>
</tr>
<tr>
<td></td>
<td>• Pick up before leaving the island</td>
<td>• Receive parcel at home</td>
<td>• Check before leaving the island</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Receive parcel at home</td>
<td></td>
<td>• Receive parcel at home</td>
<td></td>
</tr>
</tbody>
</table>

| **Taxation** | Duty and tax free | Duty free but 70% tax paid | Duty and tax free | Duty and tax free |
|              | RMB 100,000 per year | RMB 26,000 per year | RMB 100,000 per year | Pending |

Source: CDF, WFJ, Oliver Wyman analysis

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RETAIL GIANTS ARE HEAVILY INVESTING IN HAINAN

New investment by Alibaba in Hainan

- Alibaba invested 10% stake in Dufry, with a strategic JV formed between Alibaba and Dufry
- The JV facilitates the cooperation with Hainan Development Holdings (HDH) to operate the **Global Duty Free Plaza** in Haikou
  - Dufry: Procurement and operations
  - Alibaba: Digital tech and consumer insights
  - HDH: Duty-free License
- Alibaba also obtained a Hainan Resident Duty-Free license

**Source:** Company announcements, news articles

Additional freighter flights to **meet surging demand** for luxury goods

New warehouse in anticipation of the **new duty-free malls** in Haikou

- 3,000 sqm
- Holds 200,000+ SKUs, mostly cosmetics and electronics
- Expects to increase to 500,000 SKUs
HUGE OPPORTUNITY EXISTS – NOT A QUESTION OF “WHETHER” BUT “HOW”

Big long-term opportunities enabled by many factors

- **Strong government mandate**
  to develop Hainan to rival Asian tourism and business hubs

- **Under steroids from COVID**
  benefits from international travel restrictions for the next 2 years

- **Strong consumer sentiments**
  to continue travelling to Hainan even after COVID

- **Repatriation of Daigou**
  From South Korea and Hong Kong via attractive pricing

Businesses have to embrace this opportunity; but how and when to approach are the key questions

- **Strengthen risk controls** to ensure pricing risks and margin erosion are under control

- **Enhance internal governance** to balance strategic objectives and profit optimization

- **Take proactive actions** to prepare for potential tax and importation benefits
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