LUXURY SEGMENT IN GOOD HEALTH: 5% GROWTH IN 2018

The 17th edition of the Altagamma Monitor provided a snapshot of the situation and perspectives of the luxury segment of the market: despite significant international uncertainty, luxury goods repeated the 5% growth recorded in 2017, thanks in particular to the Chinese market and new generations of consumers.

Milan, 15 November 2018. The luxury sector is still sailing on smoothly above the economic uncertainties, excise duty wars and geopolitical crises that mark the international scene, and has again demonstrated its non-cyclical nature, posting a total market value of around **EUR 1,200 billion in 2018, a growth of 5% based on constant exchange rates.**

The **Personal Luxury** segment recorded even bigger growth of **6%**, and is worth a total of **EUR 260 billion.**

The forecasts for **2019** also point to growth in the **consumption of personal luxury goods**, with an estimated average increase of **5%.**

Despite solid growth, the global picture is marked by ups and downs: China, the major driver of growth in the segment over the last decade, has bolstered and increased domestic consumption, while the growth in purchases in Europe has slowed, due to a drop in tourism. In this context, note should be taken of the increasingly greater weight of the **online channel (10% of the total)** and new generations **(Y and Z)**, the only ones to generate actual growth in consumption.

During the conference held at the National Theatre in Milan, the situation in the luxury industry and markets was illustrated by the **Altagamma Worldwide Market Monitor 2018** (presented by *Claudia D'Arpizio, Bain & Company*), **Tax-Free Consumption in the European Union 2018** (*Pierfrancesco Nervini, Global Blue*) and **Altagamma Consensus 2019** (*Armando Branchini, Altagamma Foundation*) studies.

"The 5% ***growth in*** *global consumption in the luxury market and brilliant news for Italy, which is historically one of the leading countries in the segment",* said **Chairman of the Altagamma Foundation, Andrea Illy**. *"The international competitiveness of our manufacturing is driven by creativity and innovation. Altagamma believes it necessary to strengthen Brand Italy through strong policies, starting with the country's reputation and training, as outlined in the* Altagamma publication. Strategies for Italian Excellence".

Present and future scenarios and prospects were then discussed by *Javier Fernández Andrino* of *El Corte Inglés, Armin Broger* of *B&B Italia, Philippe Plein, Vittorio Radice* of *Rinascente, Pietro Ruffini* of *Archive,* and *Paolo Vitelli* of *Azimut Benetti Group,* in a session of talks moderated by Armando Branchini and Claudia D'Arpizio.

Below are the findings of the studies, in detail.

1. Altagamma Worldwide Luxury Market Monitor. Carried out by *Bain & Company*

The personal luxury goods market recorded a solid performance in 2018, **with a rise of 2% in Euros, and 6% at constant rates**: so growth was unchanged growth in percentage real terms compared to the previous year.

A positive performance was recorded in all **geographical areas**, except for the Middle East, which was stable; China saw a highly positive trend, driven by the repatriation of purchases due to lower Chinese tourist flows to Europe, and in the rest of Asia, sustained by both local consumption and renewed acquisitions by the Chinese in neighbouring countries.

The **online** channels confirmed their acceleration, reaching a 10% penetration of the global market; as regards physical channels, the best performances were reported by airports, retail and outlets.

The new ***generations*** (Y and Z) generated 100% of this year's growth. Younger consumers (Gen Z) demonstrate very specific purchasing behaviour, different from their Millennial "older brothers and sisters".

Jewellery and footwear were again the top growth **categories**, while clothing, after many years of weak but solid growth, dropped by 1%, due mainly to the slowdown in the accessible luxury goods giants, especially in the menswear segment.

The **forecasts**, albeit difficult to make in the current context, remain positive: from now to 2025, an average annual market growth of 3 to 5% in real terms is forecast, driven by solid fundamentals and the attitudes of global consumers to this type of consumption. We can't rule out encountering some minor turbulence in the short-term (including a soft recession in the US, and a slight slowdown in the Chinese economy), which does not deflect from the strong market potential in the future.

2. Tax-Free Consumption in the European Union. Carried out by *Global Blue.*

After a positive 2017, in the first nine months of 2018, Tax-Free Shopping in Europe recorded a downturn in sales (6%), attributable primarily to the appreciation of the Euro against the main currencies, particularly the dollar and the Chinese renminbi. Against a fall in the number of transactions, the Global Blue figures however registered an **increase** of 2% in the value of the **average European receipt**.

Despite a difficult 2018 in Europe, Tax-Free consumption in the last seven years, from 2011 to 2018, has been one of the main drivers of growth in the luxury segment, **with its volume doubling**.

A detailed look at the purchase trends in Europe between **January 2018 and September 2018** shows that Tax Free Shopping slowed in **Italy (-8%), United Kingdom (-8%), Spain (-8%)** and **Germany (-13%). France** bucked the trend, the only European country in which tax-free sales rose (1%) in the first nine months of 2018 with respect to the same period of the previous year, thanks in particular to the purchases of Globe Shoppers belonging to the "*Elite*" (2.2%) and "*Frequent*" (17.7%) segments, which are less sensitive to currency fluctuations.

3. Altagamma Consensus 2019. Carried out by the Altagamma Foundation with the contribution of the leading international expert analysts.

The forecasts for 2019 confirm a solid 5% growth: higher growth for leather, footwear and accessories (7%) and for perfumes and cosmetics (5%). Healthy growth for Hard Luxury, lower growth for clothing (2%). Art de la Table stable. Markets: Asia is expected to be the market with the most rapid growth (10%), also due to the lowering of excise duties in China. Followed by Japan (5%) and North America (4%), the latter in the first half in particular. Good prospects also for Europe (3%).

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Tax-Free Consumption in the EU 2018

In the last seven years, from 2011 to 2018, Tax Free Shopping has been one of the key driver of growth for the "Luxury" industry in Europe, representing a doubling in its market volume;

From January 2018 to September 2018 tax-free sales decreased in Europe (-6%) compared to the same period of 2017 but despite the lower amount of transactions the average spending increased by 2%;

From January 2018 to September 2018 in Italy Chinese tourists were still the first nationality in terms of tax free shopping, representing the 30% of the market.

Milano, November 15th 2018

During the 2018 edition of the Altagamma Monitor Conference, figures from Global Blue, the worldwide industry leader in Tax Free Shopping services, showed that in the last seven years, from 2011 to 2018, Tax Free Shopping has been one of the key driver of growth for the "Luxury" industry in Europe, representing a doubling in its market volume. On the occasion, Global Blue also outlined the main market trends in the first nine months of 2018.

«It is a pleasure to be here again this year» said Pier Francesco Nervini, Global Blue Chief Operating Officer of North & Central Europe and Global Accounts. «In the first three quarters of 2018 Tax Free Shopping in EU slowed (-6%), after a positive performance market in 2017. The phenomenon, largely expected, is mainly due to the euro appreciation against other major world currencies. Although, it is interesting to notice the increase in the average spending per transaction, confirming the lower exchange rate elasticity of the high spender Globe shopper. I would like to underline that, despite the negative market performance in 2018, the figures are higher than in 2016 and the Tax Free market is still one of the key driver of growth in the luxury sector».

In the first three quarters of 2018, tax-free sales decreased in Europe (-6%) compared to the same period of 2017. The main cause of this contraction is linked to the strengthening of the euro against the other currencies, in particular towards the dollar and the Chinese renminbi. Despite the lower amount of transactions, Global Blue data showed that the average spending per transaction increased by 2% in Europe.

In detail, from January 2018 to September 2018, Tax Free Shopping slowed in Italy (-8%), Great Britain (-8%), Spain (-8%) and Germany (-13%). On the contrary, tax free consumption in France increased by 1% in the first three quarters of 2018 compared to the same period of the previous year, thanks to the "Elite" (2.2%) and "Frequent" (17.7%) Globe Shopper, whose purchases are less sensitive to currency fluctuations.

However, Global Blue figures underline another increasing trend: in 2017 the "Millennials" powered the increase of Tax Free Shopping in France. Globe Shopper between the ages of 18 and 34 years represent 31% of the total of tourists with a purchasing power that in 2017 increased by 17% compared to 2016. In 2017 the annual tax-free expenditure of the Millennials belonging to the "Infrequent" category of shopper was about 1,700 euro (+10% vs 2016). The amount of purchases of the “Frequent” segment was over 4,000 euro (+ 17% vs 2016) while the expenditure of the “Elite” one reached more than 51,000 euro (+ 10% vs 2016).
In conclusion, for this kind of tourists a personalized and "digital" shopping experience is fundamental, representing the first generation grown up with Internet and smartphones.

Looking at the nationalities of the Globe Shopper, in the first three quarters of 2018 Chinese were the top spender, representing 29% of total Tax Free Shopping purchases in Europe. Even though the expenditure was slightly lower than in 2017 (-4%). The Old Continent continues to be a shopping destination also for travellers from the Gulf Countries (11% of total tax-free sales), and for those arriving from Russia (8% of total tax-free

sales). The Global Blue data shows that, in 2018 between January and September, France was the favourite "shopping destination" for the main nationalities of Globe Shopper, except for the Russian ones. In the UK Chinese Tax Free purchases decreased by 8%, as well as those of the Americans (-8%); while in Italy the expenditure of travellers from Middle East fell by 16%.
The outlook for the next three months confirms this trend, except for Spain and the UK.
In order to analyse the buying behaviour of non-EU tourists, also in 2018 Global Blue and Bain & Company worked together to define the evolution of tax free transactions in the three main buyers categories of reference: "Luxury", "Premium" and "Mass". In the first three quarters of this year there was a downturn in the "Luxury" (-8%) and in the "Premium" categories (-10%) in line with the dynamics related to the arrivals and the profile of the Globe Shopper, while the "Mass" segment remained unchanged from the last year.

TAX FREE SHOPPING IN ITALY
January-September 2018

In the first nine months of 2018 in Italy, the Tax Free Shopping market decreased by 8% compared to the same period in 2017, due to the strengthening of the Euro against the other currencies, causing a negative impact on tax free sales in our country. Chinese tourists purchases were 5% lower than in the first three quarters of 2017, even if they follow to represent around the 30% of the market. Also the shopping tax free of Russian travellers decreased (-15%), even though they represent the second nationality in terms of expenditure in Europe (13% of the total). In this case, the decline is due to the weakness of the Russian ruble toward the other currencies, the embargoes and the international tension. In Italy, tax free shopping slowed down. The data show a decrease in the purchases of travellers arriving from the United States (- 4%), from South Korea (-15%) and also from the Middle East (-16%). About this latter, tourist flows are strongly affected by the economic condition and the strong geopolitical tension among the countries of the area.
Global Blue outlook confirms this trend over the next three months, predicting just an increase by 16% in tax-free purchases by US tourists.

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ALTAGAMMA
CREATIVITÀ E CULTURA ITALIANA

PERSONAL LUXURY GOODS: GROWTH FORECAST IN 2019

November 15, 2018. The ALTAGAMMA CONSENSUS 2019, the forecasting report on the worldwide luxury goods industry in 2019, carried out by Altagamma with the collaboration of the main international analysts, were presented today in Milan, at the 2018 Altagamma Monitor Conference.

PRODUCTS	2019
Apparel	2,0%
Art de la Table	0,0%
Jewelry, Watches, Pens and Lighters	4,0%
Leather, shoes and accessories	7,0%
Fragrances and cosmetics	5,0%

MARKETS	2019
Europe	3,0%
North America	4,0%
Latin America	1,0%
Japan	5,0%
Asia	10,0%
Middle East	2,0%
Rest of the World	2,0%

	2019
EBITDA	6,0%

According to Armando Branchini, Deputy Chairman of Altagamma "with a 5% growth forecast for next year, personal luxury goods consumption are confirmed in constant growth, regardless a series of political and economic exogenous factors that has become more threatening in the second half of 2018 and may have a further impact at the end of next year."

Altagamma Consensus 2019 is carried out by Altagamma in collaboration with BAIN & CO. ITALY, BANCA AKROS, BRYAN GARNIER, BCG, DELOITTE, DEUTSCHE BANK, EQUITA SIM, EY, EXANE BNP PARIBAS, FIDENTIIS EQUITIES, INTERMONTE SIM, INTESA SANPAOLO, J.P. MORGAN, KEPLER CHEVREUX, MAIN FIRST BANK, MCKINSEY&COMPANY, MEDIOBANCA, MORGAN STANLEY, ORTELLI.COM, RAYMOND JAMES, ROYAL BANK OF CANADA, SOCIÉTÉ GÉNÉRALE, VONTOBEL.

THE PERSONAL LUXURY GOODS MARKET DELIVERS POSITIVE GROWTH IN 2018 TO REACH €260 BILLION – A TREND THAT IS EXPECTED TO CONTINUNE THROUGH 2025

The 17th edition of Bain & Company's annual luxury study identifies seven trends that will define the future of luxury

Milan – Nov. 15, 2018 – The luxury goods market continues to shine. The overall luxury market – encompassing both luxury goods and experiences – grew by 5 percent at constant exchange rates in 2018 to an estimated €1.2 trillion globally, with overall positive performance across all segments. Personal luxury goods outperformed the market, posting 6 percent growth at constant exchange rates to reach €260 billion, affirming the ongoing era of a "new normal." Looking ahead, this positive growth trend is expected to continue in the range of 3-5 percent per year through 2025 – a result of favorable market fundamentals – to reach €320-365 billion. However, socio-political issues, commercial policies, and potential short-term soft recessions could make this road to growth a bumpy one in the short term.

These are the top-line findings from the 17th edition of the "Altagamma Worldwide Market Monitor 2018", released today in Milan in collaboration with Fondazione Altagamma, the

"Last year, we saw the global luxury market return to healthy growth, albeit at a more moderate pace than in the past," said Claudia D'Arpizio, a Bain partner and lead author of the study. "That trend continues in 2018, reinforcing the 'new normal' we predicted, led by flourishing luxury demand from Chinese consumers, the continued rise of online channels, and increasing influence from younger generations of consumers."

Chinese consumers' luxury dominance remained unrivaled in 2018

Chinese consumers are leading the positive growth trend around the world. Between 2015 and 2018, their purchases in **Mainland China** contributed twice as much growth as their spending abroad. Their share of global spending has continued to rise (now estimated at 33 percent of global luxury spend, up from 32 percent in 2017), while the share of Mainland China has also risen to 9 percent (up from 8 percent in 2017). In Mainland China, luxury sales grew 18 percent at current exchange rates to €32 billion (20 percent at constant exchange rates), driven by rising demand rather than by price increases.

Luxury purchases in **Japan** softened slightly, pushing brands to find new solutions to bring consumers back to stores. However, retail sales still grew at 3 percent at current exchange rates to €22 billion. Increased consumption from tourists in Japan is prompting brands to rethink their distribution models.

Across the **rest of Asia** retail sales grew 7 percent at current exchange rates to €39 billion, due to dynamic growth in South Korea, driven by strong local consumption. Brisk growth in other Asian countries – Singapore, Thailand and Taiwan – also contributed. Hong Kong and Macau benefitted from Chinese purchases.

Europe lagged in 2018 due to a strong Euro that impacted tourists' purchasing power. Local consumption was positive overall, despite mixed country performance, helping to boost retail sales 1 percent at current exchange rates to €84 billion.

The **Americas** grew 5 percent at current exchange rates to €80 billion. A positive U.S. economy boosted disposable income and overall luxury spending from locals, even as brands remained wary of continued economic prosperity. However, the strong dollar impacted tourists' spending from Asia and Latin America. Canada and Mexico were strong players in the region, while political uncertainties derailed Brazil's performance.

In **other areas**, growth was 0 percent at current exchange rates, holding at €12 billion, mainly due to stagnation in **Middle East** brought on by a recent government spending restriction.

Consumers are increasingly shopping for luxury online

The retail channel grew 4 percent in 2018, with three-quarters coming from like-for-like sales growth. Wholesale channels grew at only 1 percent, brought down by high-end department stores still trying to recover, and a slow-down among specialty stores facing tough competition from online.

Luxury shopping online continued to accelerate in 2018 compared with physical channels, growing 22 percent versus 2017 to €27 billion. The U.S. market made up close to half of online sales – 44 percent– but Asia is emerging as the new growth engine for luxury online, slightly ahead of Europe. Accessories remained the top category sold online, ahead of apparel; beauty and hard luxury (jewelry and watches) were both on the rise. Brands are catching up to other online players, comprising 31 percent of sales, compared to e-tailers (39 percent) and retailers (30 percent).

"New technologies are at once enriching the online and mobile shopping experiences, while potentially putting role of physical channels at risk," said Federica Levato, a Bain partner and co-author of the study. "The luxury store-opening path is slowing down, leading to channel consolidation in the future. Brands must therefore re-think their physical channels and evolve their role from point-of-sale to point-of-touch, and use new technology to enhance customers' in-store experiences."

Today's luxury consumer is getting younger…and more diverse

It is becoming increasingly more difficult for luxury brands to deny in the influence of younger generations. In 2018, Generations Y and Z contributed 100 percent to total luxury market growth, compared with 85 percent in 2017.

In response, the luxury market is evolving and innovating to adapt to their preferences when it comes to product offerings, communications channels and their engagement with media. For example, Generation Z, despite being a smaller proportion of the market (2 percent in 2018, but increasing to 10 percent in 2025) is already demonstrating highly differentiated preferences from previous generations. They are more "individualist;" more willing to shop in physical stores (but expect a digitally enhanced experience); and more logo-driven, though they exhibit less brand loyalty.

The industry is also increasingly acknowledging culture and size preferences. Modest-accepted fashion accounted for approximately 40 percent of luxury womenswear in 2018, inclusive of Muslim-specific garments as well as other "naturally" modest clothing. "Inclusive" fashion represented about 20 percent of women's ready-to-wear as luxury brands are producing more one-size garments, targeted to curvy or plus-sized consumers, larger sizes, and clothing with looser, more inclusive fits.

In 2018, the second-hand market for luxury goods surged as a result of strong growth in Europe, which made up more than half of this market, as well as growth of highly specialized platforms online. Hard luxury (watches and jewelry) led second-hand purchases.

Overall, shoes and jewelry were the top luxury growth categories at 7 percent each, followed by bags and beauty. Watches remained flat while apparel suffered mainly due to lackluster sales in the menswear segment.

<u>Luxury in 2025 – 7 Macro Trends</u>

1. **More Chinese-driven purchases…happening in China –** Chinese consumers will make up at least 45 percent of the market (up from an estimated 32 percent in 2018), and they will make half of their luxury purchases at home in China.

2. **Ecommerce, online digital will permeate every single purchase –** Bain & Company expects that by 2025 online will represent 25 percent of market value – up from 10 percent today – cannibalizing more "traditional" channels, and 100 percent of luxury purchases will be influenced by online. Further, 50 percent of luxury purchases in the future will be digitally enabled as a result of new technologies along the value chain, such as virtual reality and mobile payments.

3. **Footprint consolidation will reshape the store of the future –** The reduction of foot traffic in physical stores, induced by digital, will drive a footprint consolidation, similar to what has already happened in other retail sectors (e.g. music, books). Consequently, the role of the store as it is today will inevitably change: from a simple point of sale to a true "touch point" with consumers.

4. **A more youthful market will disrupt luxury's growth path –** New generations will be the primary engine of growth in the coming years. Generation Z and Millennials (i.e. Gen Y) will represent approximately 55 percent of the 2025 market and will contribute 130 percent of market growth over the period.

5. **Cultures and subcultures will take over consumption trends** – Evolving cultures (religion, ethnicity) and subcultures (minorities) will shape fashion and luxury in 2025. Cultural and subculture groups will increasingly gain influence over consumer trends. Luxury brands will have to acknowledge and address them to remain relevant.

6. **One market to serve markets of one –** Brands in 2025 will experience a cross-over of typical competitive boundaries. The standard model where brands grow to become either the specialist in a category or diversified towards lifestyle positioning will be taken to the extremes.

7. **Nimble is the new black –** This year confirmed the recent trend of higher profitability – from 19 percent EBIT margin in 2017 to 20 percent in 2018. However, the digital disruption will continue to shift the profiles of key expenditures in brands' P&L. Profitability will stabilize assuming brands adopt a more "nimble" approach across the value chain.

"All signs point to significant changes afoot for luxury brands over the next several years," said D'Arpizio. "They can weather these disruptions by keeping in mind three key strategies: be proactive in developing approaches to serve new customers and address market trends; be distinctive in designing a winning formula; and be next-gen minded. The underpinning of all of these strategies is the emergence of new technologies, which will play a crucial role as a fundamental enabler for brands through 2025."

Editor's Note: To arrange an interview, contact Katie Ware at katie.ware@bain.com or 1 646-562-8107

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