



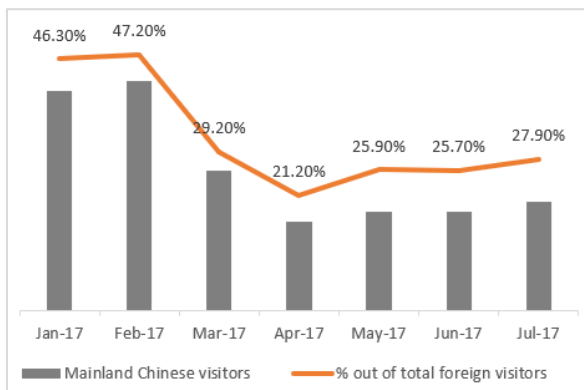
6 months after China's Travel Ban: Situation of the Korean Luxury Market

It's been 6 months since the Chinese retaliation on Korea's deployment of THAAD¹ started in March 2017. Over the past 6-month period, the travel ban on Chinese group tours to Korea has hit strongly on the domestic travel and travel retail industries. Above all, the status of travel retail turned around drastically from a "golden goose" to a "hot potato" as it used to rely on Mainland Chinese travelers for up to 80% of the total sales. Moreover, South Korea has been aggressively expanding the travel retail with entrance of 5 new players between late 2015 to mid-2016 because of the overly optimistic prospects based on this huge spender group.

MAINLAND CHINESE VISITORS REDUCED TO 50% AFTER GROUP TRAVEL BAN

When looking at the total number of Mainland Chinese visitors for the month of July 2017, its decline accelerated to a point of -70% against the same period of 2016. Since March 2017, the total number of Chinese visitors each month has decreased in the range of -40% up to -70% on a year-on-year basis.

Exhibit 1: The evolution of Mainland Chinese visitors to South Korea



Data Reference: Korea Duty Free Shops Association

¹THAAD - U.S. missile defense system, known as Terminal High Altitude Area Defense battery

With the drastic decline for Youker², the dominant player of Lotte Duty Free saw its bottom line decline by -97% in 1st half of 2017 compared to the same period of the previous year³. As of September 2017, Lotte Duty Free initiated a dispute over the current rental rate with Incheon International Airport Corporation. Lotte is threatening to retreat from the Incheon Airport and requesting a fair adjustment of the airport duty free space rental rate. The sudden conflict reflects the changed business position for Lotte, who represents the dominant part of the travel retail for South Korea.

About Lotte Duty Free?

A dominant player for local travel retail as part of the Lotte Group, a major Korean conglomerate. It is also the favorite shopping venue among Mainland Chinese visitors to Korea.

Lotte offered their golf course land as the THADD operation site and has been a direct target of negative sentiments from the Chinese.

Exhibit 2: Lotte Duty Free Downtown COEX Store- Its license expires as of December 2017



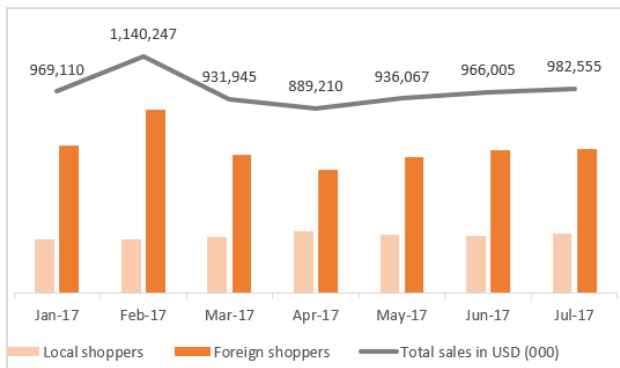
²Youker - refers to Mainland Chinese tourists in Korea

³ Financial Supervisory Service

RECOVERY OF TRAVEL RETAIL SALES PERFORMANCE?

Contrary to the trend for Youker, the total duty-free sales figure is recovering rapidly from the initial shock from early part of 2017. The seemingly paradoxical results can be explained by a combination of reasons such as increased sales value per foreign travelers combined with steady rise of domestic travelers heading for overseas. However, the most important contributor is the group of Daigou (purchasing on other's behalf) who facilitates the Mainland Chinese to still shop at Korean stores despite the travel ban to Korea⁴.

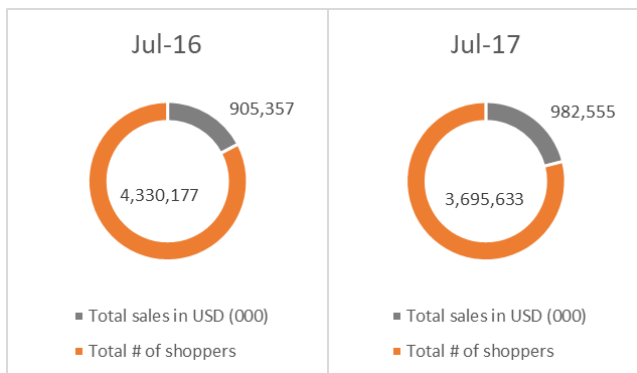
Exhibit 3: Duty Free Sales Trend by traveler type



Data Reference: Korea Duty Free Shops Association

Comparing the latest duty-free sales value in July 2017 with the same month of 2016, total sales value increased 8.5% to reach USD 982.5 million despite the -14.7% reduction in total number of shoppers. The total number of foreign shoppers reduced by -45% in July 2017 against July 2016.

Exhibit 4: Comparison of duty-free sales and number of shoppers (between July 2016 and July 2017)



⁴ The Asia Business Daily (<http://www.asiae.co.kr>)

HOW TO EXPLAIN THE MISMATCHING TRENDS OF YOUKER AND TRAVEL RETAIL SALES?

This result comes as a huge surprise when considering all the negative sentiments around the performance of travel retail industry after THAAD as well as the serious profit decrease for number one player of Lotte Duty Free.

The secret to the obvious paradox lies in the increased role of Daigou in domestic travel retail scenery. In July 2016, average sales/foreign shopper was USD332 but this figure almost doubled to USD654 as of July 2017. At the same time, Mainland Chinese remains to be the top ranking foreign shoppers for Korea's travel retail market. For local shoppers, the average spending has not changed during this period and remains to be at the level of USD110/shopper.

According to the highest sales generating store of Downtown Lotte Duty Free, the Daigou is the high net worth customer after the THADD incident and they make up the place of reduced Mainland Chinese travelers to Korea. On the other side of the increased sales revenue on the surface, the market players are suffering serious losses from the intensified competition and extensive marketing expenses. As seen from the Lotte's threat against the Incheon Airport to reduce their excessive rental fees, the domestic travel retail industry is undergoing a major challenge that can halt their continued success records of the past years and force them to re-design their survival strategy for the future.

NEW OPENING of ACDL Seoul in August 2017!

Since 2008, ACDL has performed numerous projects in Korea in Mystery shopping and training, partnering with luxury brands/groups in cosmetics, watch & jewelry, fashion and wine & spirits for both domestic and travel retail segments. With the opening of the Seoul office in 2017, ACDL strives to expand its presence & bring its HR consulting expertise into the Korean market.