Blue Book Series

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China's Duty-free Retail Development Report

Blue Book of China's Commercial Sector:

Annual Report on China's Commercial Sector (2021 -2022)

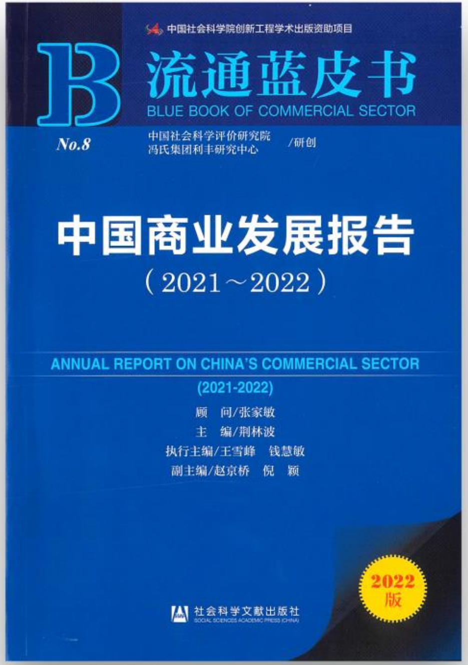
Introduction

As one of the three key drivers of economic growth, consumption remains the biggest contributor to China's development. According to the 14th Five-Year Plan, the central government will promote the development of the duty-free retail as part of its plan to foster international consumption centre.

Meanwhile, restricted global travel and relaxed duty-free shopping policies in Hainan has prompted Chinese consumers to make purchases domestically, which has strongly invigorated the local duty-free retail market. With the introduction of new policies and measures, China's duty-free market has entered a new stage of "orderly competition", showing long-term growth potential.

This report provides an overview of China's duty-free market, the current market landscape, policy impacts, and development trends.

The content in this report is based on the Chinese article published in the Blue Book of China's Commercial Sector (2021-2022).



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Duty-free Goods

Duty-free goods refer to goods that are sold on a duty- and/or tax-free status, normally with the understanding that these goods will be taken out of the country for use. Luxury goods, perfume and cosmetics account for two-thirds of duty-free sales. Alcohol and cigarettes sales have dwindled over the years.

Definition	Duty-free merchandise is sold without duties and tax being applied
Tax exempted	Customs duty, VAT, consumption tax
Items covered	Tobacco, liquor, and other products imposed with duty
Eligible shoppers	Departing visitors

Popular duty-free goods

General goods	Consumables
Electronic products	Cosmetics, perfume
Folk crafts	Vitamins & supplements
Bags, shoes	Confectionary
Watches, jewellery	Tobacco
Clothes	Beverage

Main Categories of Duty-free Shops by Channel

Duty-free shops in China can be divided into four main categories.

Port duty-free shops and offshore duty-free shops are the primary distribution and sales channels of duty-free goods in China.

Source: China Duty Free Group Official Website

Four Main Categories of Duty-free shops in China

1. **Port duty-free shops**
   Airports; Border crossings; Seaports; Railway stations
2. **Downtown duty-free shops**
   Downtown locations and offshore duty-free stores in Hainan
3. **Duty-free shops on means of transport**
   Onboard international flights; Onboard cruise ships
4. **Duty-free shops exclusive for special groups**
   Only for diplomats and crew on outbound vessels

Price of Goods

Goods sold in duty-free shops in China are generally exempt from customs duties, import VAT and consumption tax. The combined tax for imported goods such as luxury goods, perfume and cosmetics are generally in the range of 20-40%, and may be even higher for products such as tobacco and alcohol. Consumers are able to enjoy significant savings on goods bought from duty-free shops as compared to purchasing the same goods from regular offline or online malls.

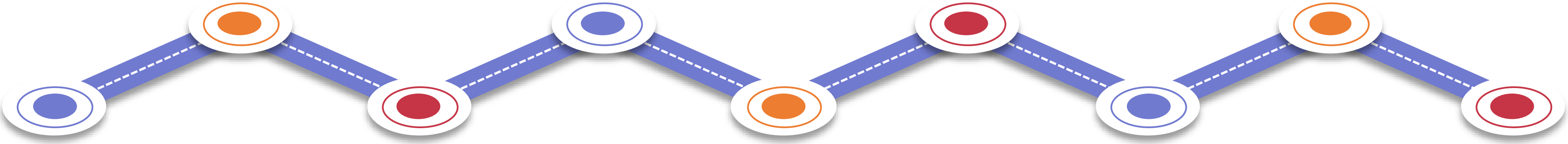
Price Comparison of Goods via Selected Duty-free and Non-duty-free Distribution Channels

	Sunrise Duty Free	CDF Hainan Duty Free	Tmall
 Tom Ford Bitter Peach Eau De Parfum (50ml)	¥1,888	¥1,916	¥2,500
 Giorgio Armani Lip Maestro Lip Gloss 405 (6.5ml)	¥200	¥227	¥310
 Estee Lauder Advanced Night Repair Eye Supercharged Complex (15ml)	¥390	¥385	¥520
 Qeelin Petite Wulu Necklace in 18K Rose Gold with Diamonds and Jade	¥10,500	¥12,950	¥16,200
 Johnnie Walker Black Label Blended Scotch Whisky (1000ml)	¥243	¥236	¥319
 Chunghwa Filter Cigarettes (Hard Pack) (10 Packs)	¥325	N/A	¥450**
 Coach Tabby Shoulder Bag 26	¥3,800	¥3,850	¥4,500
 Longines PrimaLuna L8.111.4.71.6	¥10,200	¥11,400	¥13,100

Source: Tmall, CDFG, Sunrise Duty Free, price quoted online as of May 27, 2021
**Tobacco is not sold on Tmall. The price quoted is the recommended retail price

Tmall CDF Hainan Duty Free Sunrise Duty Free

Development of China's Duty-free Market



1980

Following China's reform and opening up, the first duty-free shop was established in Lo Wu, Shenzhen

1984

China's dominant duty-free market player China Duty Free Company (the predecessor of China Duty Free Group) was formally established with the approval of the PRC State Council

1990

China's first downtown duty-free shop opened in Beijing

1999

Key airport duty-free operator Sunrise Duty Free was established

2000

The first state-level decree on duty-free business, namely the *Regulations on Further Strengthening the Centralized and Unified Management of Duty Free Businesses,* was issued, laying out the regulatory framework for the operation of duty-free businesses in China.

2009

The value of China's duty-free market surpassed US$1 billion

2011

The State Council issued the *Announcement on the Pilot Implementation of Duty-free Shopping Policies for Travelers Leaving Hainan Island.* Tourists leaving Hainan Island by air can purchase goods duty free, subject to certain requirements and limitations.

2014

Sanya International Duty Free Shopping Complex, the world's largest duty-free mall, opened for business

2020

Offshore duty-free policies in Hainan were further relaxed and enhanced to boost consumption

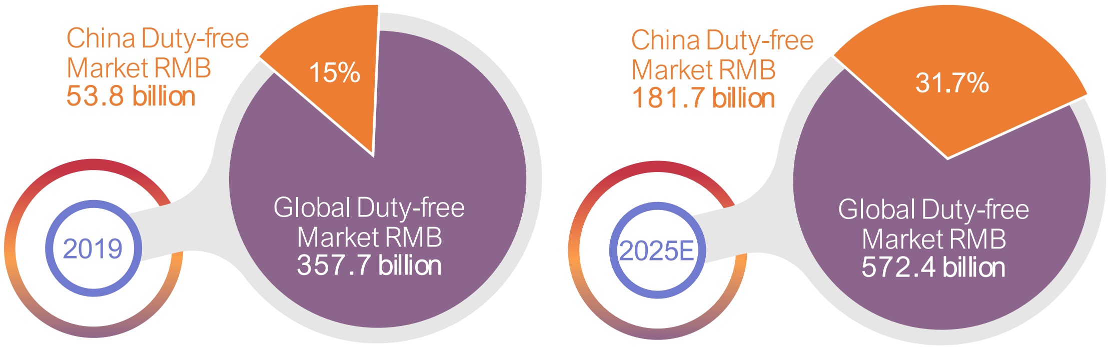
Market Size of China's Duty-free Market

China's rising middle class and the rapid development of the travel industry has fueled duty-free sales over the past decade.

China's duty-free sales grew from 8.9 billion yuan in 2010 to 53.8 billion yuan in 2019, recording an average CAGR of 23.7%.

We expect the on-going travel restrictions due to the pandemic and the relaxing of offshore duty-free policies in Hainan will continue to significantly boost duty-free sales in China in the coming years.

According to Frost & Sullivan, China's duty-free market accounted for 15% of the global duty-free market in 2019. The proportion is expected to increase to 31.7% in 2025.



Source: Frost & Sullivan

Source: Qianzhan Industry Research Institute

Key Duty-free Operators

China's duty-free business is a heavily regulated and highly concentrated sector with high entry barriers. Prior to 2020, only 7 duty-free licenses were issued. Current players in the market are all state-owned companies.

The Chinese government has relaxed some of the restrictions to enter the sector in recent years and issued three new licenses, allowing Hainan Tourism Investment, Hainan Development, and Wangfujing Group to operate duty-free shops in 2020. A number of department store operators have also announced that they are currently applying for duty-free licenses in China.

Approved Duty-free Operators in China (as of Aug 2020)

Duty-free Operator	Controlling Shareholder	Location	Region(s) of Operation
China Duty Free Group (CDFG)	China Tourism Group	Airports, borders, downtown, offshore	Nationwide
Sunrise Duty Free	CDFG	Airports	Beijing, Shanghai
Hainan Duty Free	CDFG	Airports, offshore	Hainan
Shenzhen Duty Free	State-owned Assets Supervision and Administration Commission of the People's Government of Shenzhen Municipal (Shenzhen SASAC)	Airports, borders	Shenzhen, Xi'an (Shaanxi province), Ruili (Yunnan province), Horgos (Xinjiang Uygur autonomous territory)
Zhuhai Duty Free	Zhuhai SASAC	Airports, borders	Zhuhai and Tianjin
China National Service Corporation (CNSC)	China National Pharmaceutical Group	Downtown, airports	Nationwide
China Expatriates Overseas-Remittance Tourism Service Corporation	China Tourism Group	Downtown	Harbin
Hainan Tourism Investment	Hainan SASAC	Offshore	Hainan
Hainan Development	Hainan SASAC	Offshore	Hainan
Wangfujing Group	Beijing Tourism Group	Not officially announced	Not officially announced

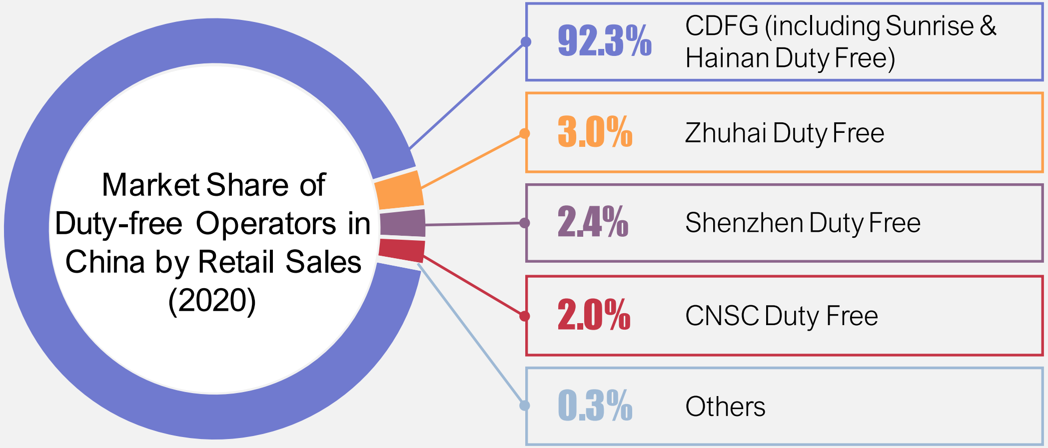
Source: State Council, Ministry of Finance, Ministry of Commerce, duty-free operators' official website

China's Duty-free Market is Highly Concentrated

The Chinese duty-free market is highly concentrated. In 2020, the top five duty-free travel retailers in China accounted for 99.7% of the market share in terms of retail sales.

China Duty Free Group (CDFG) is the largest duty-free operator in China. It acquired a 51% stake in Sunrise China, Sunrise Shanghai, and Hainan Duty Free in March 2017, April 2018, and June 2020, respectively.

CDFG is currently the only retail operator in China covering all duty-free distribution channels. In 2020, CDFG accounted for 92.3% of the market share by retail sales in China. It is also one of the fastest growing travel retail operators in the world.



Source: Frost & Sullivan

II. Duty-free Policies

Key Duty-free Policies and Regulations

Major regulatory authorities for duty-dree operations in China include the Ministry of Finance, Ministry of Commerce, State Taxation Administration, Ministry of Culture and Tourism, and the General Administration of Customs.

2000

Regulations on Further Strengthening the Centralized and Unified Management of Duty-free Businesses

- Laid out the regulatory framework over China's duty-free business
- Strengthened the State's centralized and unified management of the duty-free sector

2011

Announcement on the Pilot Implementation of Duty-free Shopping Policies for Travelers Leaving Hainan Island

2012

Interim Measures for the Administration of Duty-free Shops for Travelers Leaving Hainan Island

- Officially ushered in the concept of offshore duty-free shops in Hainan. Travelers leaving Hainan by air, but not bound abroad, could purchase goods duty free, subject to limitations on purchase amount, quantity and category of goods.

2016

The Interim Measures for the Administration of Duty-free Shops at Ports of Entry

- Resumed and increased the number of duty-free shops at ports of entry
- Enterprises that had been approved by the State Council with an existing duty-free operating license and had a track record of operating duty-free stores at ports or downtown continuously for the past three years were allowed to bid for operation rights of duty-free shops at ports of entry. The restrictions on geographical location and categories of duty-free shops to be operated were relaxed.

2019

The Interim Measures for the Administration of Duty-free Shops at Ports of Exit

- Enterprises that had been approved by the State Council with an existing duty-free operating license and had a track record of operating duty-free stores at ports or downtown continuously for the past five years were allowed to bid for operation rights of duty-free shops at ports of exit. The restrictions on geographical location and categories of duty-free shops to be operated were relaxed.

2020

Notice of Duty-free Shopping Policies for Travelers Leaving Hainan Island

- Raised the annual duty-free shopping quota from 30,000 to 100,000 yuan per person
- Removed the purchase cap of 8,000 yuan per single item
- Expanded the categories of duty-free goods from 38 to 45
- Removed the quantity limit for purchasing products (excluding cosmetics, mobile phones, and alcohol)

Offshore Duty-Free Policies in Hainan

Hainan first received its duty-free status in 2011. In recent years, the government has released a series of policies to support Hainan's reform and opening up, as well as developing the island into an international tourist attraction and consumption centre.

In 2018, the CPC Central Committee and the State Council promulgated the *Guiding Opinions on Supporting Hainan's Comprehensive Deepening of Reform and Opening-up*, strategically positioning Hainan as an International tourism consumption centre.

In June 2020, China released the *Overall Plan for the Construction of the Hainan Free Trade Port ("FTP")* to facilitate trade and investment and build the Island into a globally influential duty-free trading centre. Policies on duty-free shopping for travelers leaving Hainan Island is one of the major achievements in the initial stage of the construction of the Hainan FTP. The government has enhanced duty-free shopping policies such as raising duty-free shopping limits, lessening restrictions on the number of purchases, expanding the variety of duty-free goods offered, as well as increasing the pick-up methods of goods.

Enhancement of Duty-free Shopping Policies in Hainan

Date	Regulation	Issuing Authority	Key Highlights
27 Nov 2018	Announcement on Further Adjusting the Duty-free Shopping Policy for Travelers Leaving Hainan Island	Ministry of Finance, General Administration of Customs, and State Taxation Administration	Raised the duty-free shopping limit and increased the variety of duty-free goods
29 Jun 2020	Announcement on the Policy of Duty-free Shopping for Travelers Leaving Hainan Island	Ministry of Finance, General Administration of Customs, and State Taxation Administration	From 1 July 2020, the duty-free shopping quota will be raised to 100,000 yuan per person
2 Feb 2021	Announcement on Introducing New Methods of Picking up Goods for Duty-free Shopping by Travelers Leaving Hainan Island	Ministry of Finance, General Administration of Customs, and State Taxation Administration	Apart from picking up the goods at designated areas at airports, railway stations or port terminals, travelers leaving Hainan may also choose to receive the goods by post or collect their goods upon their return to the Island.

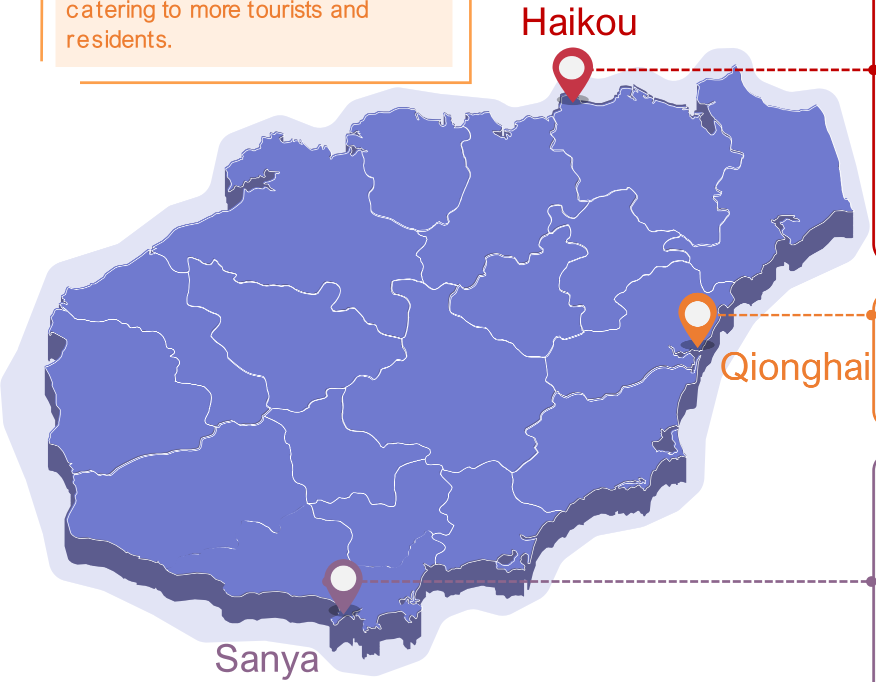
Source: Ministry of Finance, General Administration of Customs, and State Taxation Administration

Key Improvements to Offshore Duty-free Policies in Hainan effective 1 July 2020

Before 1 July 2020	Duty-free policies in Hainan pre & post 1 July 2020	After 1 July 2020
30,000 yuan per person	Annual duty-free shopping quota	100,000 yuan per person
8000 yuan (need to pay extra personal postal articles tax if a single product costs over 8,000 yuan)	Duty-free limit for a single product	Unlimited
38 categories	Products categories of duty-free items	45 categories
All products were subject to a limit on purchase quantity	Products subject to limit on purchase quantity	Removed the limit on purchase quantity, except for the following items: • Cosmetics: 30 pieces per person per time • Mobile phones, hand-held (vehicular) radiophone: 4 pieces per person per time • Liquor: Not exceeding 1,500 ml per person per time
Only offshore duty-free operation license holders, such as CDFG and Hainan Duty Free, are allowed to run duty-free shops in Hainan	Eligible operators	All operators that are qualified for the operation of duty-free goods in China can participate in offshore duty-free operations in Hainan

Duty-free Shops in Hainan

The number of offshore duty-free stores will continue to increase, covering a wider geographical area catering to more tourists and residents.



Duty-free shop	Operator	Opening Date
Haikou Meilan Airport Duty Free Shop 海口美兰机场免税店	CDFG (Hainan Duty Free)	2011.12
Haikou Duty Free Shop 海口日月广场免税店	CDFG (Hainan Duty Free)	2019.1
Haikou Global Duty-Free Plaza 海控全球精品（海口）免税城	Hainan Development Holdings (Dufry responsible for the supply of global brands)	Phase 1: 2021.1 Phase 2: 2021.8
Times Duty Free Mission Hills 深免海口观澜湖免税城	Shenzhen Duty Free in partnership with DFS Group	2021.1
Haikou International Duty Free Shopping Complex海口国际免税城	CDFG	2022.10E

Duty-free shop	Operator	Year of opening
Qionghai Boao Duty Free Shop 琼海博鳌免税店	CDFG (Hainan Duty Free)	2019.1

Duty-free shop	Operator	Year of opening
Sanya International Duty Free Shopping Complex (CDF Mall) 三亚国际免税城	CDFG	Phase 1: 2014.9 Phase 2: 2020.1
CNSC Sanya International Duty Free Plaza 中服三亚国际免税购物公园	CNSC	2020.12
Hainan Tourism Duty Free Shopping Complex (HTDF) 三亚海旅免税城	Hainan Tourism Investment in strategic partnership with Lagardère Travel Retail	2020.12
Sanya Phoenix Airport Duty Free Shop 三亚凤凰机场免税店	CDFG	2020.12

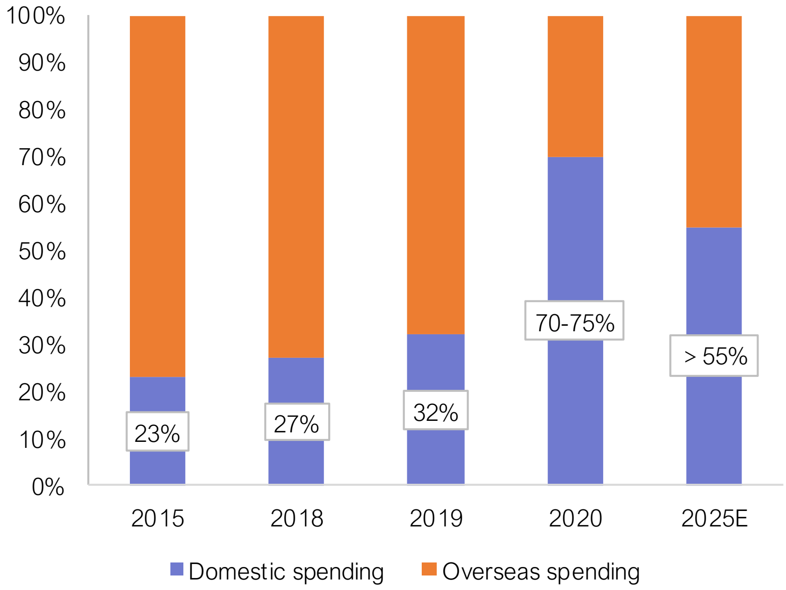
Source: Company websites, as of 15 June 2022

III. Development Trends of Duty-free Retail

(1) A Shift to Domestic Spending from Overseas Spending

With the reduction of import tariffs and the narrowing price difference between goods purchased overseas and domestically, an increasing number of Chinese consumers now choose to make purchases, especially those of luxury goods, back at home. This trend has been further exacerbated by the pandemic due to outbound travel restrictions.

The duty-free industry is expected to experience significant growth due to this backflow of overseas consumption in the years ahead.



Prior to the pandemic, Chinese consumers' share of luxury spending domestically was typically around 20-35%.

In 2020, due to the disruption of outbound travel, Chinese consumers' global luxury spending within the country significantly increased to around 70-75% of their total luxury spending worldwide.

By 2025, it is expected that more than 55% of global luxury spending by Chinese consumers will be made domestically.

Source: Bain & Company

(2) “Online + Offline” Service Model

Online shopping of duty-free goods has become increasingly popular since the outbreak of the pandemic, as airports were shut down and physical stores were closed. Duty-free operators have been actively boosting its online activities and regularly enriching and expanding their online product offerings.

Consumers can pre-order the goods online within a certain period before departure and then have the goods picked up at the airport upon departure.

In March 2020, the government approved a new scheme allowing offshore duty-free shops in Hainan to offer an online replenishment service, allowing visitors who have departed the island by air (some airlines are excluded) to spend their personal unused duty-free yearly quota online within 180 days of leaving the island and have the goods couriered to their home. Passengers who have left the island by boat or train and have purchased duty-free goods on the island can also enjoy this service.

CDF Online Shopping Mall

HTDF Online Shopping Mall

The online replenishment service has significantly boosted duty-free sales as travelers have more time to decide what to buy

(2) “Online + Offline” Service Model (Cont’d)

In addition, some duty-free operators introduced direct mail services. Both Sunrise Duty Free Shanghai and Sunrise Duty Free Beijing launched direct mail services in 2020, allowing registered members to purchase duty-paid goods online via its own app.

Goods sold online are either imported via cross-border e-commerce model or via the general import model. Sunrise is responsible for paying all the relevant taxes on the goods.

Although additional costs for taxes are incurred, the pricing online is similar to that of its offline duty-free stores and is extremely competitive, as Sunrise does not need to pay commission to the airport for its online transactions. Also, given Sunrise’s strong partnerships with brands, it is able to obtain favorable sourcing prices.

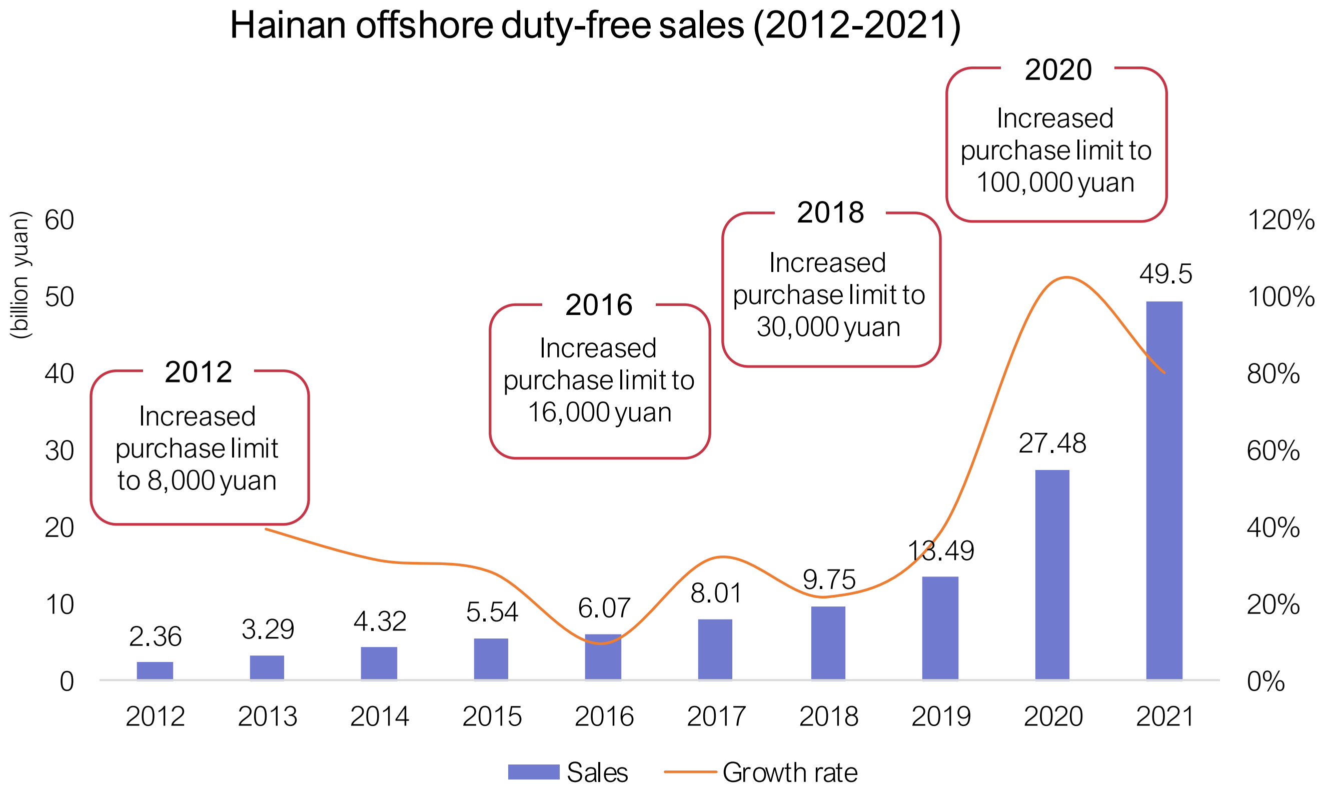
CDFG‘s 2020 annual report showed that the company’s duty-paid sales increased by 1,612.7% year-on-year, mainly attributable to its successful online duty-paid business. The duty-paid sales continued to increase in 2021, posting a yoy growth of 21.8%.

Price Comparison of Duty-paid Goods on Sunrise Shanghai and Tmall

Sunrise Shanghai		Tmall
¥215	 Givenchy Le Rouge Luminous Matte Hydrating Lipstick 3.4g	¥360
¥1869	 La Mer Crème de la Mer 60ml	¥2800
¥993	 Guerlain Abeille Royale Night Cream 50ml	¥1490

Source: Tmall and Sunrise Duty Free, price quoted online as of 27 May 2021

(3) Rise of Offshore Duty-free Shopping in Hainan



Morgan Stanley forecasts that China's duty-free market is expected to reach US$16.5 billion (approx. 110.15 billion yuan) by 2025, with Hainan accounting for nearly 50% of the total sales.

KPMG China and Moodie Davitt forecast that Hainan is expected to become the world's largest duty-free market in the next few years.

Source: Haikou Customs

(4) Opening of More Downtown Duty-free Shops

The development of downtown duty-free in China has been slow compared to other types of duty-free channels. Internationally, duty-free stores in downtown areas is the second-largest duty-free shopping channel after airport duty-free stores.

In 2020, to further strengthen the duty-free sector and spur domestic consumption, the National Development and Reform Commission along with 22 authorities jointly announced that the country will further enhance and promote the development of downtown duty-free shops. A number of operators have already opened or rolled out plans to set up duty-free stores downtown. Wangfujing Group, who owns over 40 department stores nationwide, obtained a duty-free license in 2020. It is reported that Wangfujing plans to open downtown duty-free stores in Wuhan and at Universal Beijing Resort.

Compared to other channels, downtown duty-free stores are usually conveniently located, have a lower rent-to-sales ratio compared to airport outlets, and offer more variety of products and flexible shopping hours.

It is expected that the downtown duty-free channel will continue to expand in China, with further policy relaxations in the future.

CDF Beijing Downtown Duty Free Shop

CDF Shanghai Downtown Duty Free Shop

Source: CDFG official website

Contact

Helen Chin

Vice President
Email: helenchin@fung1937.com

Fung Business Intelligence

11/F LiFung Tower

868 Cheung Sha Wan Road

Kowloon, Hong Kong

T: (852) 2300 2470

F: (852) 2635 1598

E: fbicgroup@fung1937.com

W: http://www.fbicgroup.com