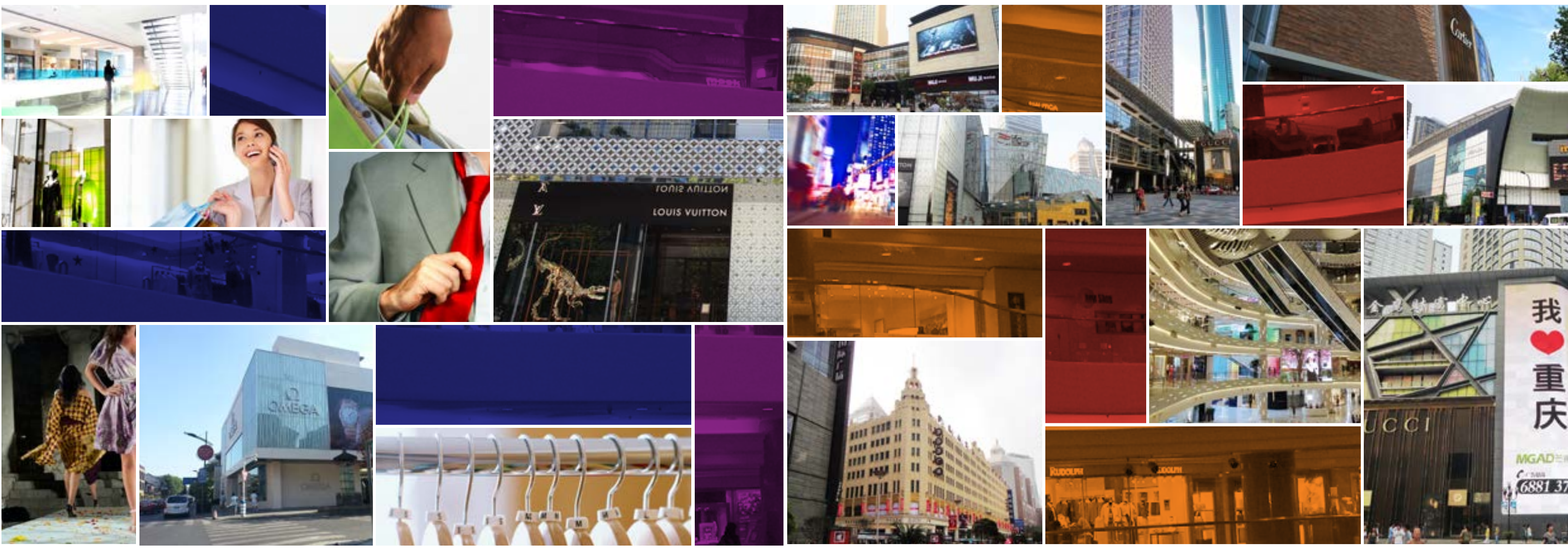
CHINA RETAIL: A CHANGING LANDSCAPE

Part I: Fast Fashion Brand

CBRE


H&M
UNI
QLO
H&M
FOREVER 21
FANCL



A CHANGING LANDSCAPE

Summary

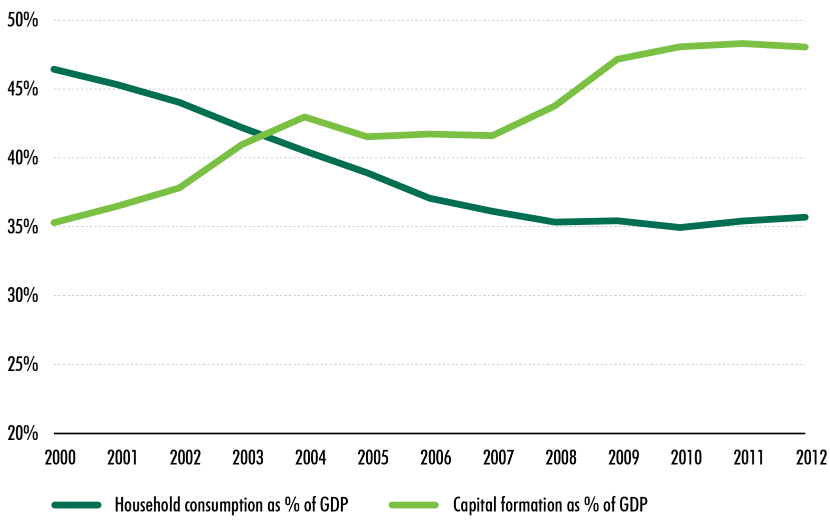
A CHANGING LANDSCAPE IN CHINA RETAIL

After thirty years of rapid economic growth, China has made tremendous achievements in social and economic development. The living standard of Chinese citizens has improved substantially during the same period of time. These developments have opened up a lot of opportunities in the domestic consumption market, which has drawn enormous interest from retailers around the world.

	1978Y	2012Y	Cumulative growth[1]
Gross domestic product (RMB 100 million)	3,645	519,322	141 times
Total retail sales of social consumer goods (RMB 100 million)	1,559	210,307	134 times
Urban population (100 million)	1.72	7.12	539 million people
Per capita disposable income of urban population (RMB)	343	24,565	71 times

Since the turn of the century, China's economic growth has notably been driven by investments (see Chart below). In contrast, the share of household consumption as a percentage of GDP (household consumption ratio) has been declining, from 46% in 2000 to 36% in 2012. The RMB 4 trillion stimulus introduced in 2008/09 further elevated the country's dependence on investment-driven growth. While the stimulus was effective in bringing China back to double-digit GDP growth in the near term, it has created serious issues including excessive liquidity, high inflation, mounting local government debts, redundant construction, and soaring asset prices. In view of this, the new leadership of Mr. Xi and Li has repeatedly advocated the need to transform the current investment-driven economy to a domestic-consumption-led economy. This bodes well for the growth of the domestic consumption market, which we believe will continue to grow at a double-digit pace in the foreseeable future.

Analysis of China's economic growth momentum from 2000 to 2012

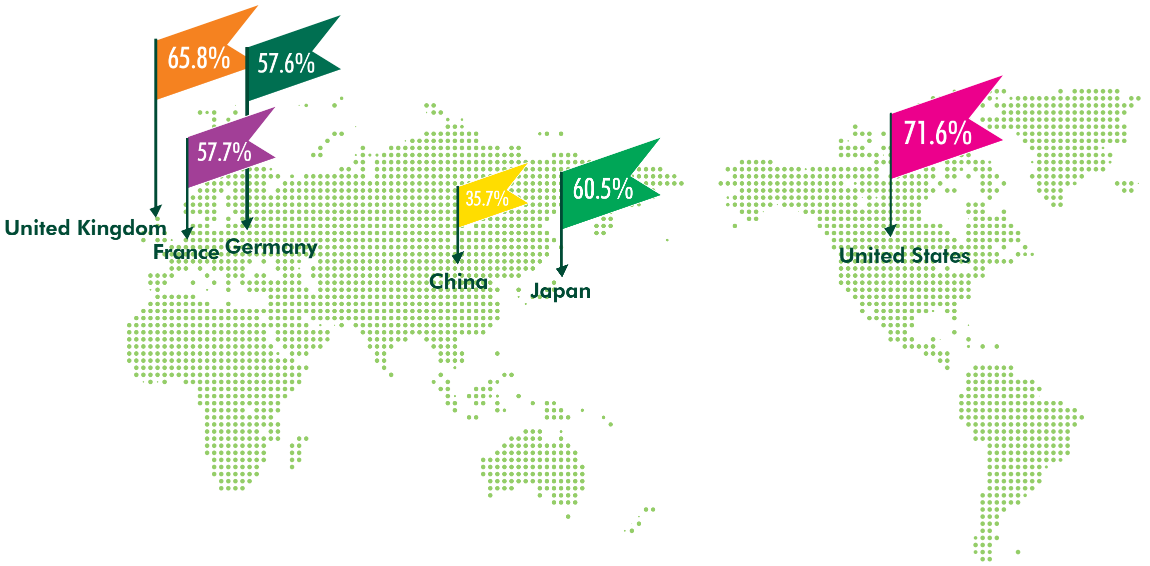


Source: National Bureau of Statistics of China

1. Nominal growth.

Furthermore, both academic research and international experience have showed that domestic consumption will inevitably become the major and more sustainable economic growth driver as a country (including China) enters the later stages of industrialization. Against the backdrop of weakening external demand and continuing appreciation of RMB, it is even more critical for China to further develop the domestic consumption market to sustain its economic growth. In our view, Premier Li Keqiang's "New Urbanization Program" and the government's target to double household income by 2020 will significantly enhance household consumption and the propensity for consumers to spend. Compared to other developed countries, the household consumption ratio in China is extremely low (see chart below), indicating significant room for growth in the coming decades.

Household consumption as % of GDP[2]



Source: WorldBank, National Bureau of Statistics of China

We believe the China retail market has enormous potential to be tapped in the years ahead. Yet challenges do exist at this crucial turning point for the retail industry. For example, we identify competition from e-commerce, homogeneous product offerings, a lack of differentiation, and rising operating costs especially labor costs as primary challenges. In the face of these, the retail industry will go through many changes in order to maximize the opportunities brought by the changing landscape in China's retail industry.

2. Data with asterisk are of 2011 and the rest are of 2012.

Fast Fashion

In 2002, UNIQLO opened its first store in Shanghai, signifying a new era of international fast fashion brands' development in China. Since then, international fast fashion has expanded aggressively over the past 10 years. By June 2013, 4 major fast fashion brands tracked by CBRE have a total of 523 stores in China, primarily located in tier-1 and tier-2 cities. We observe that most fast-fashion retailers have changed their expansion strategy in recent years. In tier-1 cities, the key focus has shifted from core retail areas to emerging suburban hubs (a "decentralizing" trend). From a national perspective, the key battlefield has shifted from tier-1 cities to tier 2 and even tier-3 cities (a "cascading" trend into secondary markets).

The outlook for the fast-fashion brands remains positive in view of rapid growth of the urban middle class and the current low penetration rate still found in China. We expect fast fashion will remain active in expanding their footprint across the nation in coming years. Facing the incoming supply peak of shopping malls, fast fashion brands are expected to be highly sought after by landlords thanks to their ability in drawing foot-traffic as well as their demand for large store space. Such advantage provides fast fashion brands with abundant choices at competitive costs as they expand aggressively in China. However, this might also pose related challenges such as excessive competition and concerns regarding operating sustainability.

Luxury Brands

The growth of China's luxury consumption market has topped the world in the past decade, driven by the rising high income class' aspiration to demonstrate status and success alongside the long-standing etiquette of Chinese gift-giving. During the past few years, international luxury brands were expanding aggressively in various gateway cities and major tier-2 cities, with new stores regularly springing up. However, market sentiment has cooled down since 2012 when sales growth ratcheted down rapidly as a result of slower economic growth and the anti-corruption campaign launched by the new leadership. According to a study by Bain & Company, luxury goods sales were estimated to grow by a mere 7% y-o-y in mainland China in 2012, a sharp decline from the 30% growth found in 2011[3].

Along with decelerating growth of domestic sales, there is a rising trend of overseas shopping for luxury brands. We also find Chinese luxury brand consumers becoming more sophisticated and actively looking for brands that can express their unique status. Against this backdrop, we observe luxury retailers, who already achieved a fairly high penetration in major cities, slowing down their rate of expansion. Instead, their focus has shifted to enhance the performance of existing stores. On one hand, luxury brands are providing more personalized products and services and utilizing the internet as a new way of branding, improving the consuming experience and increasing brand loyalty. On the other hand, they have started to put more resources in developing and acquiring new brands to diversify their product offerings in order to cater to a more diverse consumer group.

Department Stores

Department stores, as a traditional format of retailing, are experiencing pressure from the competition by new retail models such as specialty stores, franchise stores, and shopping centers. Compounded with their own problems such as outdated business models, rising operating costs and a limited choice of products and services, the transformation of traditional department stores appears urgent, particularly considering the challenges and competition brought by flourishing online retailers.

3. Data source: Bain & Company, 2012 China Luxury Study – Bain Point of View December 2012.

Based on CBRE's case study analysis, there are 5 typical models found in traditional department store transformation. These include: converting medium- to large-size department stores into shopping malls, changing small-size department stores in prime locations into specialty shops, increasing the proportion of merchandise direct sales (i.e., decreasing the proportion of concessionaire sales which is the major revenue source traditionally), increasing the ratio of self-owned properties, and integrating online business platforms with physical stores. These transformations have successfully enhanced operating performance for some department stores. Having said that, we note the industry's lingering issues are unlikely to be resolved in the near term. In the transformation process, most department store operators will still face challenges including financial constraints, lack of business connections in upstream and downstream industries and a shortage of qualified, professional talent in adapting to the new business models.

Other Retail Formats (eg. Shopping Centres)

In addition to fast fashion, luxury brands, and department stores, China's retail landscape is transforming into a wider spectrum of formats, models and channels. Some emerging trends are worth our attention, such as the diversification of shopping centers with increasing emphasis on the consumer experience with family entertainment and recreation, the rising demand by brands for multi-level sales channels being expressed in the rapid growth of factory outlets, and the concept of Omni-channel Retailing amidst the collision and integration of online and offline business. All these trends are likely to make a profound impact on the retail market, and inevitably, on the commercial property market, which should not be negligent in taking notice.

In view of this, CBRE Research has launched a report series, "China Retail: A Changing Landscape" to explore and discuss the key challenges, opportunities and emerging trends in the China retail market, along with the implications for the property market.

In Part I of this report series, we will focus on Fast Fashion, followed by subsequent reports on Luxury Brands, Department Stores and other noteworthy retail formats.

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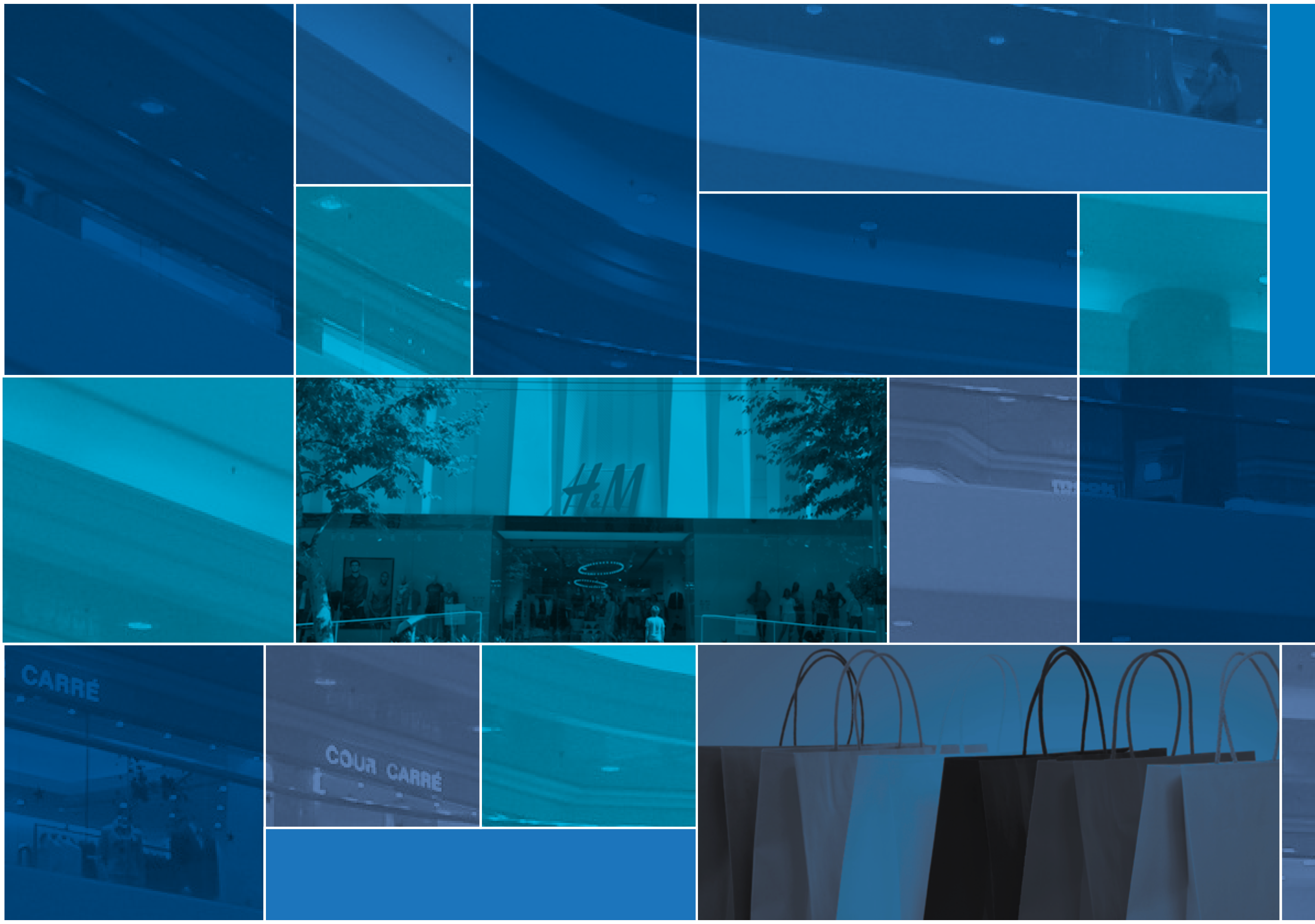
H&M
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Max Mara

FAST FASHION BRAND

INTRODUCTION

The opening of UNIQLO's first store on Shanghai's Huaihai Road in 2002 signified a new era of the development of international fast fashion brands (FFBs) in China. Over the past decade, riding on China's 1.3 billion population and continuous growth of income, FFBs have been expanding rapidly and have become more aggressive since 2012. According to CBRE Research's data, the total store number for 4 major FFBs, including UNIQLO, ZARA, H&M and C&A, amounted to 523 by June 2013. Of which, 40% were opened in the past 18 months. In terms of store number, China has already become the most important international market now for major FFBs – the largest international market for ZARA and UNIQLO, and largest international market in Asia for H&M and C&A. With their branding characterized as having the appeal of "quick trend adoptability, fashionable design, reasonable price labeling, high quality and limited edition product lines", FFBs have quickly gained increasing popularity among Chinese consumers, in particular the younger generation. Thanks to their infrastructure set-up and control of design and production, "Fast" fashion is most renowned for their capability to bring in the latest trends to the stores – from a design to production to shop floor - in a matter of weeks. By frequently introducing new products, usually once per quarter, FFBs have enabled their consumers to keep pace with global fashion trends at affordable price points.

2002
- UNIQLO'S first store in China unveiled at Shanghai Huaihai Road
- MANGO'S first China store opened in China World Shopping Mall

2006
- ZARA entered China and unveiled its first and flagship store at Shanghai West Nanjing Road

2007
- H&M entered China and unveiled its first store at Shanghai Huaihai Road
- C&A entered China and unveiled its first store in Shanghai Super Brand Mall

2009
- Bershka entered China and unveiled its first store at Beijing RafflesCity

2012
- Forever 21 entered China and unveiled its first store at Beijing APM
- Monki, the sister brand of H&M launched the first China store in Nanjing Wonder City

Based on the current development of FFBs in China, CBRE Research expects FFBs will continue their fast expansion in the foreseeable future. However, we believe FFBs will shift their expansion strategy and we expect to see the two emerging trends we have noted: “Cascading” development from tier 1 into tier 2/3 cities and “Decentralized Development” in tier 1 cities from core city locations to suburban hubs.

“Cascading” Development

With rising purchasing power as well as increasing brand awareness in tier 2/3 cities, more and more FFBs have shifted their growth focus toward tier 2/3 cities following successful launches in tier 1 cities. This is evident in the increasing number of new stores in tier 2/3 cities in recent months with the trend set to continue in the foreseeable future.

“Decentralized” Development

Core retail hubs in tier 1 cities, such as Beijing and Shanghai, have always been the top destinations for FFBs when they enter the China market. Facing a limited supply of retail facilities, soaring rents and intensifying competition in core areas, most FFBs have slowed down their expansion in such locations. Furthermore, once well represented in the core areas, most FFBs would move to ‘decentralized areas’ to avoid cannibalization in the core and to reach a greater number of consumers/ potential consumers. Existing stores in core locations are more likely to be positioned as flagship stores as a way to promote their brand. On the other hand, most FFBs have been active in setting up new stores in the emerging suburban hubs of tier 1 cities. The movement of population from city center to decentralized suburban hubs has allowed FFBs to expand their networks further afield, a course of events which became more viable with the fast development of improving infrastructure and connectivity in those decentralized suburban hub locations.

Exhibit 1: Fast Fashion Brands' store location in China

Brand	Number of stores as at end of Jun 2013			Number of new stores in past 18 months			
				Tier 1 city			
	Tier 1 city	Tier 2/3 city	Total	Core area	Decentralized area	Tier 2/3 city	Total
UNIQLO	92	119	211	5	27	63	95
ZARA	39	86	125	3	6	29	38
H&M	40	95	135	4	8	42	54
C&A	14	38	52	1	1	18	20
Total	185	338	523	13	42	152	207

Source: Corporations’ information, CBRE Research

"CASCADING" DEVELOPMENT

As noted, by June 2013, the total number of stores for 4 key FFB brands reached 523. Of which, 35.4% are located in tier 1 cities, a drop of 5.8 percentage points compared to December 2011. In contrast, the proportion of stores in tier 2 and tier 3 cities expanded by 1.9 and 3.9 percentage points to 36.7% and 27.9%, respectively. More importantly, the total number of stores in tier 2 cities has surpassed that in tier 1 cities as of June 2013.

Exhibit 2: Fast Fashion Brands' change in number of stores across different cities

City	Dec 2011		Jun 2013	
	Number of stores	Proportion	Number of stores	Proportion
Tier 1 city	130	41.1%	185	35.4%
Tier 2 city	110	34.8%	192	36.7%
Tier 3 city	76	24.1%	146	27.9%
Total	316	100.0%	523	100.0%

Source: Company information, CBRE Research

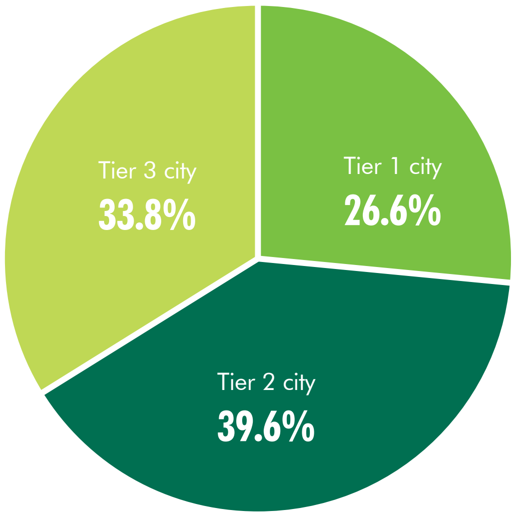
Provincial capital cities (excluding tier 1 cities) are the focus for new store openings

As illustrated in the chart below, tier 2 cities have become the new key battle field for international FFBs. Over the past 18 months, international FFBs opened a total of 207 new stores in China, of which, around 40% are located in tier 2 cities. The proportion for tier 1 cities declined to 26.6%, with the remaining 33.8% coming from tier 3 cities[1].

"Tier 2 cities have become the new key battle field for international FFBs."

1. Tier 1 cities refer to Beijing, Shanghai, Guangzhou and Shenzhen; Tier 2 cities refer to Tianjin, Dalian, Qingdao, Shen yang, Hangzhou, Nanjing, Ningbo, Chengdu, Chongqing, Wuhan, Xi'an, Changsha and Xiamen; The remaining cities that the 4 key FFB have stores refer to Tier 3 cities.

Exhibit 3: Distribution of New Fast Fashion Brands stores over the past 18 months



Source: Corporations' information, CBRE Research

From another perspective, provincial capital cities[2] have been the favorite destination for new store expansion during this period of expansion. Over 69.7% of new stores were located in China's provincial capital cities.

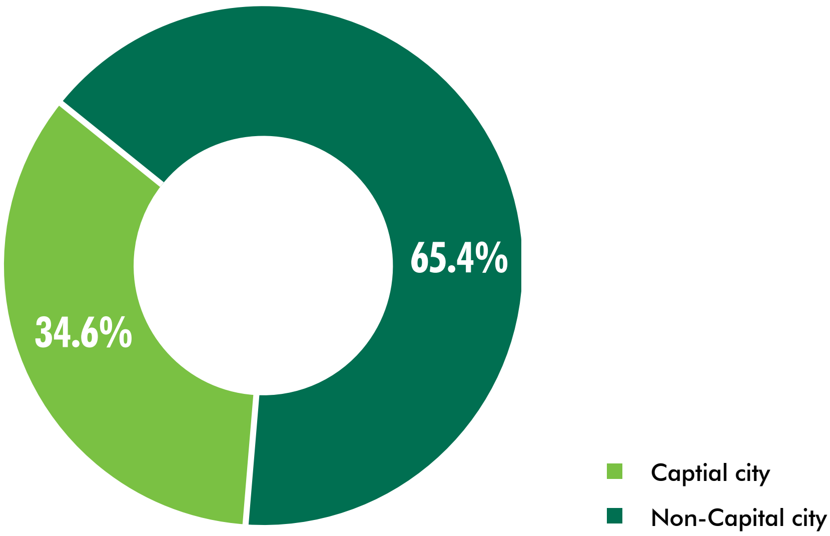
Non-provincial capital cities are the focus for new market penetration

In terms of new market expansion, non-provincial capital cities have been the key focus for international FFBs. During the period between Jan 2012 and Jun 2013, international FFBs expanded their footprint into 52 new cities. Over 65% of new locations were found in non-provincial capital cities. Our study shows that most of these non-capital cities are located within the geographical sphere of regional hub cities. For example, in East China, FFBs entered new markets like Hangzhou, Suzhou, Wuxi and Changzhou, all of which are within an hour or 2 by train or car from Shanghai. In South China, FFBs entered new markets including Foshan, Zhongshan, Huizhou and Zhuhai, which are situated around the geographical hubs of Guangzhou and Shenzhen. We believe this regional expansion strategy will enable FFBs to leverage their regional management and operational resources, thus reducing operating costs for new stores and making distribution logistics easier to manage.

2. Provincial Capitals refer to capital city in each province plus four cities (Dalian, Qingdao, Ningbo and Xiamen) that enjoy status as provincial capital cities. Tier 1 cities are excluded from the list.

> “Competition is intensifying in tier-1 cities and availability of retail properties is tight.”

Exhibit 4: Fast Fashion Brands' new market penetration during Jan 2012 to Jun 2013

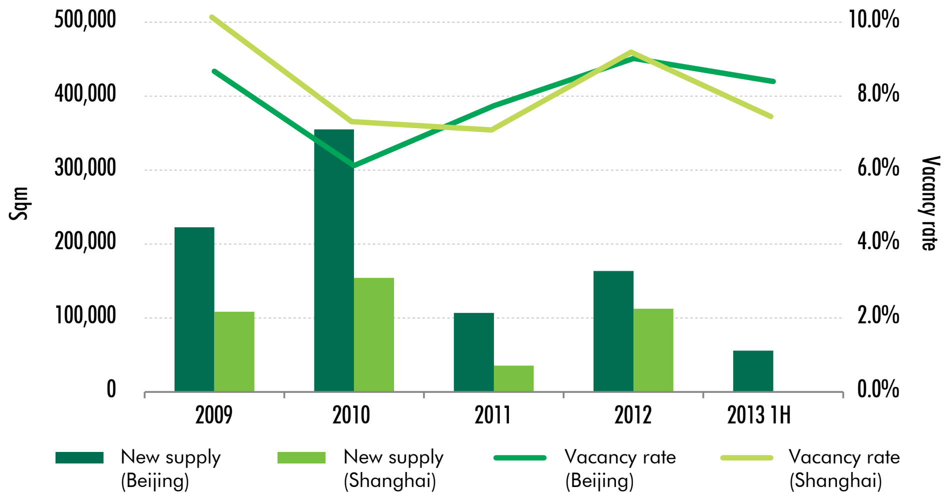


Source: Corporations’ information, CBRE Research

Rationale for moving into tier 2/3 cities

1) **Intensifying competition and tight availability of retail properties in tier 1 cities**. According to CBRE Research’s statistics, almost every major FFB has set up stores in core locations in tier 1 cities. The competition in gateway cities like Beijing and Shanghai are most intense with the majority of FFBs having multiple stores in core locations. On the other hand, the lack of new supply and low vacancy rate of retail properties have made it more difficult to identify new store sites at reasonable costs. As shown in Exhibit 5 below, there was a significant drop of new supply in the core areas of Beijing and Shanghai in recent years. In 2013, Beijing has only one new project in its traditional core area while Shanghai has no new supply on the market. By the end of Q2 2013, the vacancy rate in the core areas of Beijing and Shanghai were 8.4% and 7.4%, respectively.

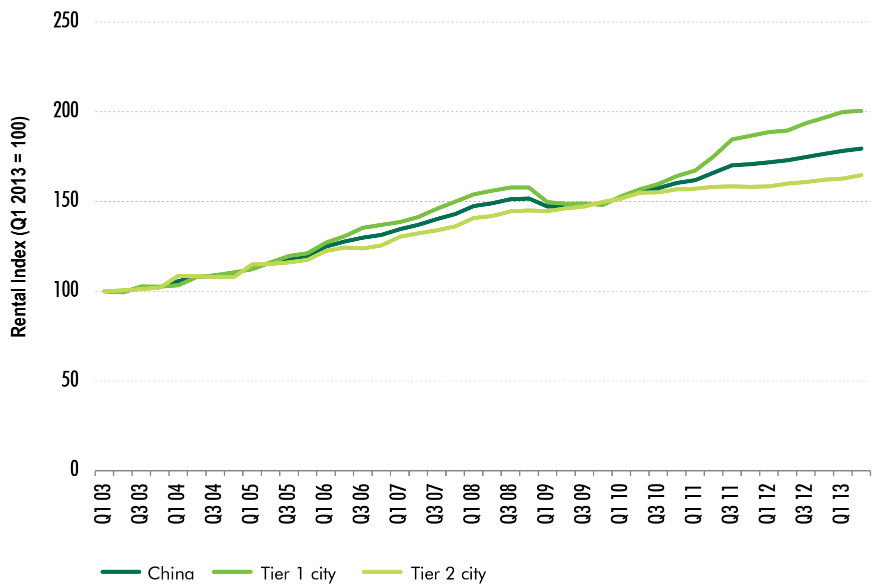
Exhibit 5: New supply and vacancy rate of retail properties in Beijing and Shanghai core locations



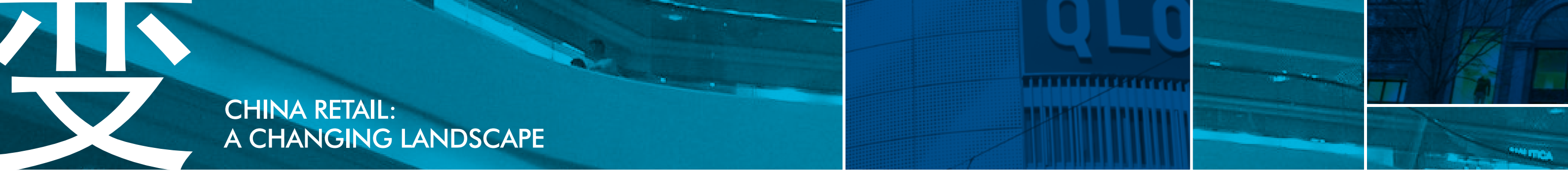
Source: CBRE Research

2) **Soaring retail rents in tier 1 cities**. Consequent to the lack of new supply and tight availability, retail rents in traditional core areas rose steadily in recent years. According to CBRE Research statistics, national retail rental rates increased by 20.5% (on an accumulative basis) over the last 5 years. During this same period, average retail rent in tier 1 cities increased by 28.5%, significantly ahead of the 16.1% increase recorded for tier 2 cities. The rental hikes in tier 1 cities are particularly challenging for FFBs in the sense that these brands usually require a larger store size for their locations.

Exhibit 6: China's Retail Rental Index



Source: CBRE Research



3) **Growth of household income and purchasing power in tier 2/3 cities**. According to statistics from the National Bureau of Statistics of China, retail sales in the 10 tier 2 cities that CBRE covers increased by 18.1% per annum over the last five years, compared to 15.8% in tier 1 cities. At the same time, urban household disposable income in tier 2 cities increased at 12.4% per annum compared to 10.8% in tier 1 cities. The substantial improvement in purchasing power in tier 2 (and tier 3) cities has attracted more and more FFBs to explore these previously untapped markets.

Exhibit 7: Total retail sales of social consumer goods and disposable income in China's major cities

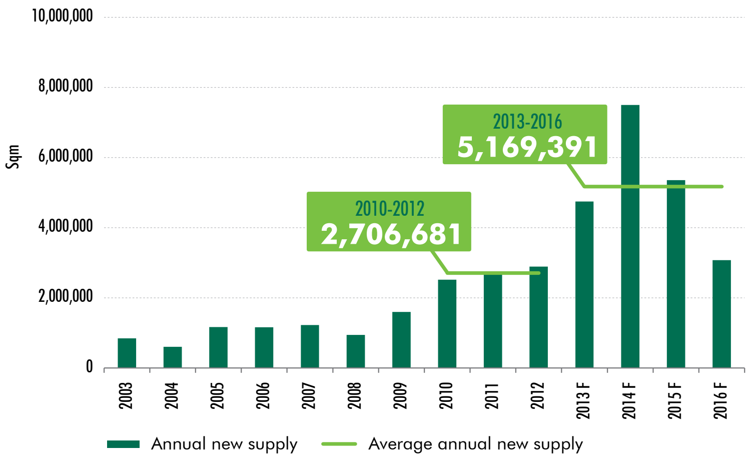
City	Growth rate of total retail sales (%)	Growth rate of disposable income (%)
Beijing	15.2%	10.6%
Shanghai	13.9%	11.2%
Guangzhou	18.2%	11.1%
Shenzhen	15.9%	10.4%
Average in Tier 1 city	15.8%	10.8%
Tianjin	19.6%	12.6%
Chengdu	19.6%	12.9%
Chongqing	19.0%	12.6%
Shenyang	17.9%	12.6%
Hangzhou	17.8%	11.6%
Dalian	17.7%	12.8%
Wuhan	17.7%	13.5%
Ningbo	17.6%	11.2%
Nanjing	17.4%	12.3%
Qingdao	16.4%	12.5%
Average in Tier 2 city	18.1%	12.4%

Source: National Bureau of Statistics, CBRE Research

4) **Rising brand awareness among consumers in tier 2/3 cities**. With steadily improving purchasing power, consumers have correspondingly higher aspirations to keep up with international fashion trends in tier 2/3 cities, particularly among the younger generation. In line with their expansion into the China market, most FFBs have stepped up their marketing and advertisement level across the country, thus raising their brand's exposure and awareness among a wider group of consumers.

5) **Abundant choice for expansion in tier 2/3 cities**. According to CBRE Research's statistics, on average there was approximately 2.7 million sqm of new retail facilities delivered in tier 2 cities in the last 3 years. Based on the current development schedule, this number is expected to increase to close to 5 million sqm per annum over the next three years. This trend will certainly provide additional choices for international FFBs as they expand into new markets in the coming years.

Exhibit 8: Annual new supply and forecast of prime retail space in tier 2 cities



Source: CBRE Research

6) **Low rents in tier 2/3 cities will enable FFBs to expand with controllable costs**. Soaring rents in tier 1 cities have limited FFB's capability to expand aggressively in those cities. Compared to tier 1 cities, retail rents in tier 2/3 cities are far more affordable. According to CBRE Research, the average retail rent in tier 2 cities was RMB25.6/sqm/day at the end of Q2 2013, representing a 43% discount compared to rents in tier 1 cities which averaged at RMB45.1/sqm/day. Most FFBs are able to lease shops in prime locations in tier 2/3 cities at attractive rents, which are comparable to rents in the newly emerging suburban hubs of tier 1 cities.

7) **More attractive leasing terms**. FFB retail normally occupies hundreds or even thousands of sqm of retail space in a shopping mall. Thanks to their high profile and appeal to young customers, the presence of FFBs typically can attract more foot traffic to a shopping mall. Hence, FFBs are considered to be an important tenant, or even regarded as an anchor tenant for a new mall. Most landlords are happy to offer competitive leasing terms in order to attract FFBs. To a certain extent, this state of affairs will further propel the expansion of FFBs in China's tier 2/3 cities.

Against the backdrop of the sustainable growth of consumer purchasing power in tier 2/3 cities, we expect such "cascading" development into secondary markets to continue in the foreseeable future with tier 2/3 markets the key battlefield of strategic market importance to all FFBs.

"DECENTRALIZED" DEVELOPMENT

The rapid expansion into tier 2/3 cities doesn't mean FFB brands will completely hold with respect to their expansion in tier 1 cities. Instead, they have shifted their expansion focus in tier 1 cities from traditional core areas to decentralized suburban hubs, particularly in Beijing and Shanghai. According to CBRE Research's statistics, over three-quarter of the 55 new FFB stores in tier 1 cities since 2012 were located in emerging suburban hubs. This decentralization trend is particularly obvious in Beijing and Shanghai, where new FFB stores located in decentralized suburban hubs account for 94.4% and 77.3%, respectively.

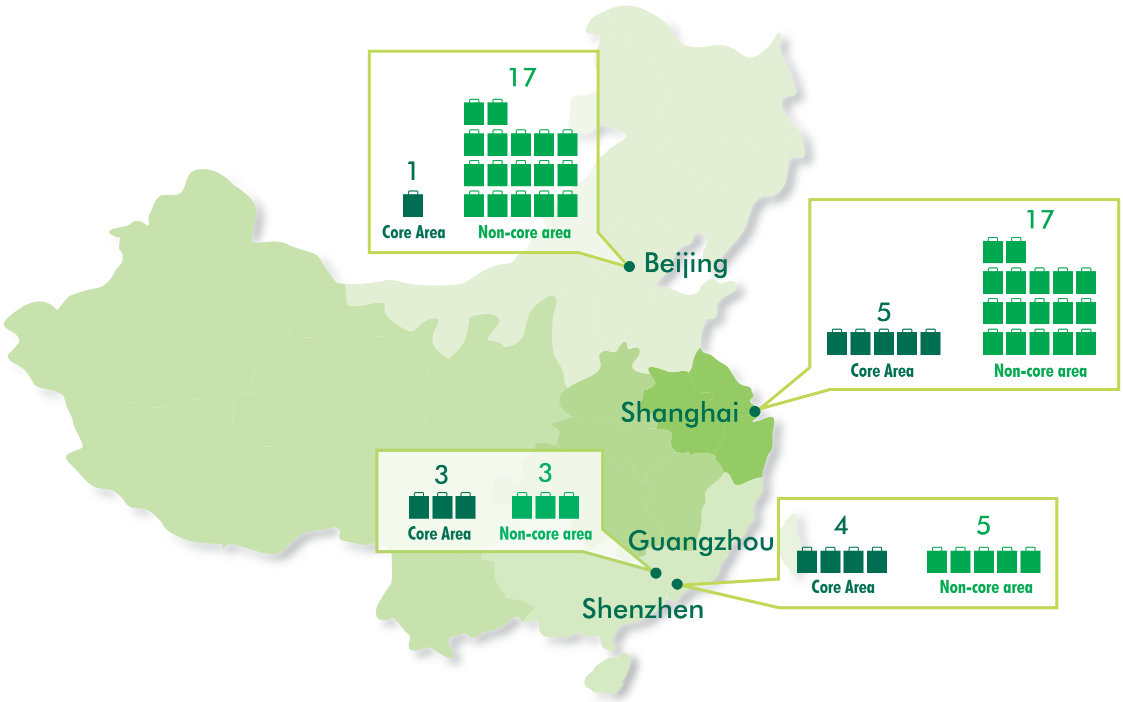
Rationale for the decentralized development

1) **Urban population moving from central to decentralized areas**. From 2007 to 2011, Shanghai and Beijing both experienced a population wave moving from central to decentralized areas, according to demographic data released by the statistics bureaus of the two cities. By comparing the population density in central and decentralized areas (see definition below), we observe that population growth in decentralized areas has far outstripped that found in central area. In 2007, the population density of Shanghai's central area[3] reached 24,200 people/sq km. This ratio has changed only slightly over the last 5 years. Given the high population density in central areas, naturally most of the incoming population will have to settle in decentralized areas[4] of the city. As a result, the population density increased rapidly from 6,000 people/sq km in 2007 to 7,100 people/sq km. The rapid development of infrastructure including new subway lines in particular, found in decentralized areas has certainly improved the connectivity, feasibility and appeal of living in decentralized areas. Beijing[5] shares a similar trend in population growth, although to a lesser extent. The growing population generates a huge amount of potential purchasing power for decentralized areas[6], leading more and more FFBs to focus their expansion on those areas.

"The growing population generates a huge amount of potential purchasing power for decentralized areas, leading more and more FFBs to focus their expansion on those areas."

3. According to the coverage in CBRE's Shanghai Retail Database, Shanghai's central area refers to Huangpu, Xuhui and Jing'an.
4. According to the coverage in CBRE's Shanghai Retail Database, Shanghai's decentralized area refers to Pudong, Changning, Putuo, Zhabei, Hongkou, Yangpu and Minhang.
5. According to the coverage in CBRE's Beijing Retail Database, Beijing's central area refers to Dongcheng, Xicheng and Chaoyang.
6. According to the coverage in CBRE's Beijing Retail Database, Beijing's decentralized area refers to Fengtai, Shijingshan and Haidian.

Exhibit 9: New store location in tier 1 cities (since 2012)



Source: CBRE Research

Exhibit 10: Change in population density in Shanghai and Beijing

CITY	DISTRICT	2007	2008	2009	2010	2011
Shanghai	Central Area	2.42	2.48	2.43	2.43	2.44
	Decentralized area	0.60	0.52	0.59	0.70	0.71
Beijing	Central Area	0.93	0.94	0.97	1.04	1.06
	Decentralized area	0.62	0.64	0.67	0.73	0.76
Unit: 1,000 people/sqkm						

Source: Municipal Bureau of Statistics, CBRE Research

2) **Emergence of new shopping malls in decentralized areas.** Rising retail rent and tight availability of retail space found in central areas, along with new retail projects in decentralized areas has driven more and more FFBs to look beyond the core retail areas of tier 1 cities for expansion. As shown in Exhibit 5, new retail supply found in the new suburban hubs of Beijing since 2009 amounted to 2.3 million sqm, compared to 0.9 million sqm of retail space found in the central area during this period. In Shanghai, there was only a total of 0.4 million sqm of new supply in central areas, while in new suburban hubs, new supply has more than doubled to around 0.9 million sqm. The rental gap between core retail areas and emerging suburban hubs is enormous. For example, in Shanghai the average rent in core retail areas is at a 130% premium in comparison to decentralized areas. And this rent rate gap has been widening over the past 5 years.

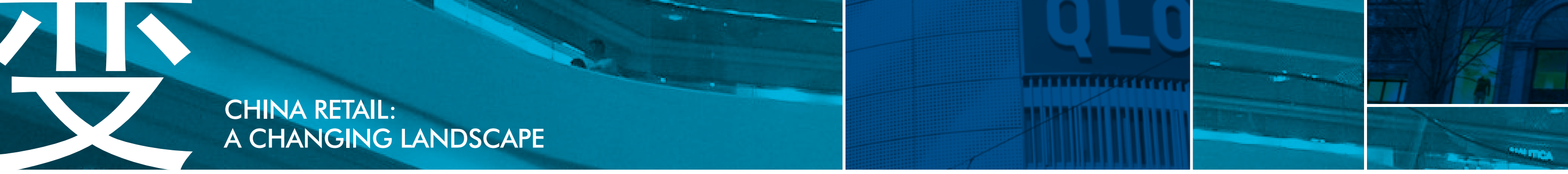
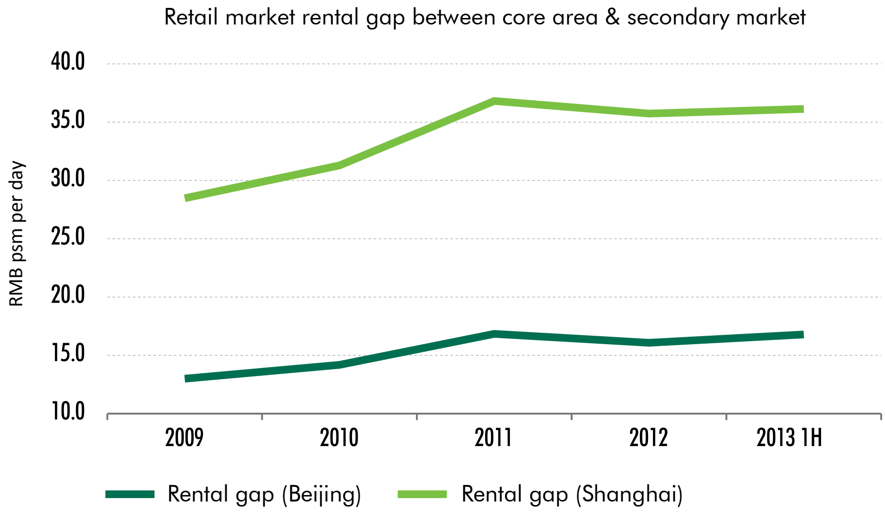


Exhibit 11: Retail market rental gap between core area & secondary market

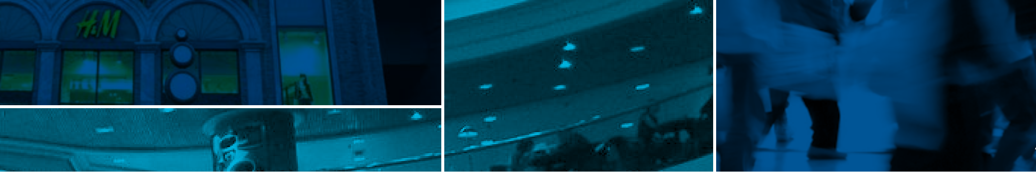


Source: CBRE Research

Mindful of such issues, the FFB sector has been selective in this trend of "decentralized" development. Most FFBs only chose decentralized suburban markets with a high population density to set up new stores. Taking Shanghai as an example, from Jan 2012 to Jun 2013, new stores are found predominantly concentrating in Baoshan, Wujiaochang, Zhoupu, Dahua, Lianyang and North Sichuan Road. Secondly, most FFBs were inclined to cooperate with experienced landlords such as Wanda, CapitaLand, COFCO, AEON, and CR Land, with confidence that doing so will further increase their probability of success.

3) **Flagship stores in the core areas:** As noted, the decentralization trend by FFBs doesn't mean that they abandoned competing in the core areas of tier 1 cities. Instead, they have adopted a different strategy in the core retail areas. Finding the right opportunity, FFBs are more likely to open new flagship stores at superior locations, aiming to strengthen and enhance their brand images. UNIQLO, for example, just opened an 8,000 sqm flagship store on Huaihai Road, a prime retail location in Shanghai. In addition to offering UNIQLO's products, the flagship store will also include other products and brands under Fast Retailing, the parent group of UNIQLO. These brand names include GU, Comptoir des Cotonniers, Princesse, tam.tam and PLST. We observe a similar trend in Beijing. Forever 21 opened their first store in China, with total GFA of 3,000 sqm, at Beijing APM Mall along Wangfujing Street, while H&M will unveil a new flagship store of 1,100 sqm in the same mall.

"The decentralization trend by FFBs doesn't mean that they abandoned competing in the core areas of tier 1 cities. Instead, they have adopted a different strategy in the core retail areas by opening flagship stores."



OUTLOOK

Though China has already become a major market for international FFBs, according to CBRE Research's statistics, the market penetration rate of FFBs generally remains low in China compared with that of their country of origin. Among China's cities, the market penetration of FFBs in Beijing and Shanghai leading that of other cities significantly.

Exhibit 12: International fast fashion brands' market penetration in China and home country

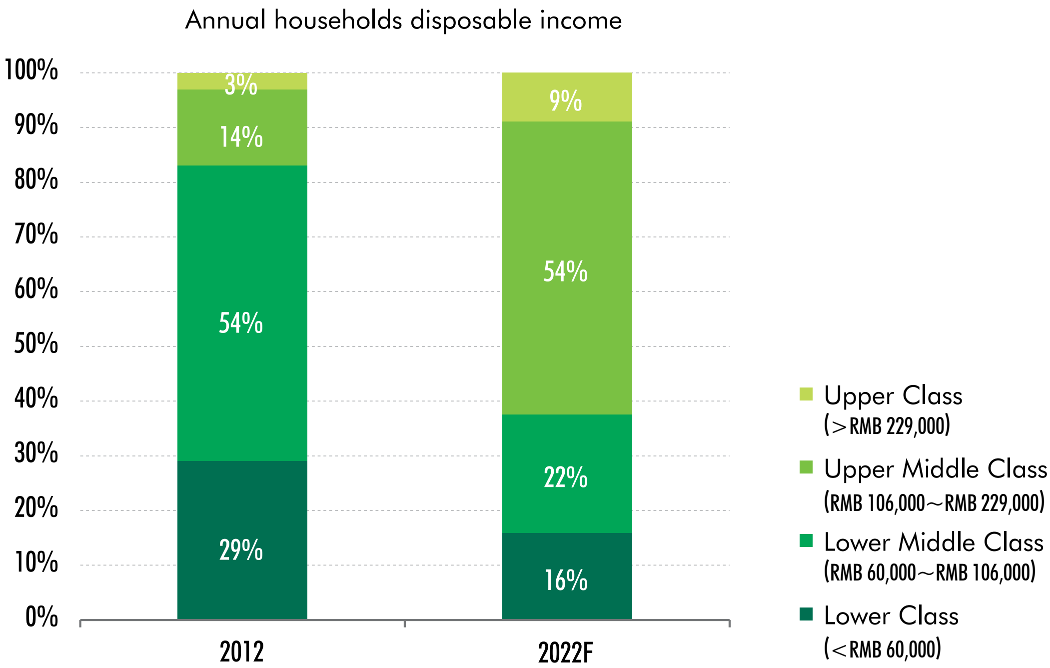
UNIT: NUMBER OF STORE/POPULATION IN MILLION	UNIQLO	ZARA	H&M	C&A	AVERAGE
Home country[7]	6.53	6.94	15.49	6.11	6.78
China	0.16	0.06	0.10	0.04	0.09
World's major gateway cities	**UNIQLO**	**ZARA**	**H&M**	**C&A**	**AVERAGE**
Paris	1.35	9.03	4.52	1.81	4.18
Tokyo	8.80	1.29	0.68	0.00	2.69
Seoul	3.70	1.61	0.66	0.00	1.50
Hong Kong	2.51	1.53	1.81	0.00	1.46
London	0.61	1.84	2.57	0.00	1.25
Singapore	2.31	1.16	0.96	0.00	1.11
Shanghai	1.89	0.67	0.67	0.38	0.90
Beijing	1.30	0.63	0.63	0.24	0.70
New York	0.36	0.84	1.32	0.00	0.63
China's major cities	**UNIQLO**	**ZARA**	**H&M**	**C&A**	**AVERAGE**
Shenzhen	1.14	0.57	0.47	0.00	0.55
Dalian	0.45	0.60	0.45	0.45	0.49
Wuhan	0.59	0.30	0.59	0.49	0.49
Shenyang	0.12	0.61	0.61	0.49	0.46
Chengdu	0.71	0.42	0.49	0.14	0.44
Hangzhou	0.68	0.34	0.57	0.00	0.40
Ningbo	0.65	0.26	0.39	0.13	0.36
Nanjing	0.61	0.25	0.49	0.00	0.34
Qingdao	0.46	0.23	0.46	0.23	0.34
Guangzhou	0.63	0.24	0.47	0.00	0.33
Tianjin	0.42	0.21	0.42	0.07	0.28
Chongqing	0.27	0.07	0.20	0.10	0.16

Source: Company information, CBRE Research

7. Home country refers to UNIQLO in Japan, ZARA in Spain, H&M in Sweden and C&A in German.

Mindful of that backdrop, the China retail market still holds huge potential for future growth. The 18th National Congress Working Report in 2012 declares that the government is striving to double the household income by 2020. In addition, as the FFB's primary consumer group, the upper middle class population will continue to expand rapidly over the next ten years. As forecasted by McKinsey & Company , the proportion of China's urban upper middle class as a percentage of total urban population will climb from 14% in 2012 to 54% in 2022.[8]

Exhibit 13: Upper Middle Class to be major social group



Source: McKinsey Quarterly – Mapping China's middle class

8. McKinsey & Company Insights: "Mapping China's Middle Class".

CBRE expects that, benefiting from promising fundamentals of China's retail market, deployment of further resources toward China by FFBs is well indicated in their global strategic view including further market penetration into China's major cities. UNIQLO reportedly plans to open 1,000 stores in China in the coming 10 years, with 100 stores each year focusing on tier-2 and tier-3 cities. Additionally, Inditex, the parent group of ZARA, declared that, due to the declining prospects of the Spanish domestic market, it would continue its speedy expansion into the China market as well as further enhancing its e-commerce business across international markets. Concurrently, more and more brands are making efforts to execute brand extension strategies in order to fulfill the consumers' changing demands, in terms of differentiation and uniqueness, i.e., Zara Home and Oysho under ZARA, and brands other than UNIQLO under Fast Retailing group.

In terms of the expansion structure, CBRE expect that FFB's expansion in China will follow trends of "cascading" development into tier 2/3 markets and "decentralized" development into the new suburban hubs tier 1 cities. Beijing and Shanghai, for their unique importance, will continue to be the first choice destination of new FFBs landing in China. While planting flagship stores in core retail areas to further promote brand image, we will see more stores opening in decentralized areas of the two cities riding on the back of a synchronized population trend. Tier-2 and tier-3 cities will remain the key battlefield for FFB's expansion into China. Supporting the need to optimize the costs of labor, management and logistics, a geographical focus following the "Hub and Spoke" model will continue to be the preferred expansion strategy adopted by FFBs. Therefore, **we expect to see regional centers, such as Chengdu and Wuhan along with their satellite cities become a prime focus for future expansion in China.**

OPPORTUNITIES AND CHALLENGES

With respect to the role of landlords, given the capability of FFB stores to generate foot traffic and their need for a large space, landlords are expected to maintain their strong desire for the presence of FFBs to their properties, offering attractive leasing incentives accordingly. **In increasing cases, landlords are using FFBs as quasi-anchors to replace traditional less-productive anchors such as department stores and supermarkets, while at the meantime leveraging FFB's strong reputation and appeal to attract other tenants who are willing and able to afford higher retail rents.**

In order to enhance their competitiveness, landlords need to have a thorough understanding of the FFBs' basic criteria in site selections for new stores. Based on CBRE's experience in dealing with these FFBs, we observe most brands have selected sites based on the following criteria:

1. Retail submarkets with high concentration of FFBs, which is likely to attract more foot traffic.
2. Space requirement: net floor area of 500 – 2,000 sqm within a shopping mall, or major high street.
3. Lower floors of a property or underground space with direct link to subway stations.
4. Stores with desirable exposure for brands and products.
5. Properties developed or operated by experienced developers or landlords, particularly by those with experience in operating multiple retail projects.

Concerns arise, however, about aggressive competition among landlords for FFBs in light of a huge pipeline of retail projects in the coming years. According to a published report by CBRE, the total GFA of worldwide shopping malls currently under construction are 32 million sqm; of which, 16.8m sqm, more than 50% of the total, are located in China[9]. Soaring new supply will force landlords to offer relatively more attractive tenancy conditions.

With respect to FFB brands, substantial new supply of retail space now offers plenty of choice for new store locations and establishes a precondition for their fast expansion strategy in China. Our statistics show that from 2013-2016, nearly 50% of the new supply in tier-2 cities will be found in emerging suburban hubs, which in terms of property supply, might drive FFBs to execute their 'decentralization' development in those markets too hastily or rapidly. As some emerging suburban hubs found in tier-2 cities are far from maturity, still lacking necessary infrastructure, they are not yet able to support a cluster of FFB stores with a large enough population of target consumers in the short term. Such type of expansion might not be viewed as efficient utilization of an FFB's resources in China particularly considering constraints on skilled managerial and sales force and logistics network on a track of rapid growth. In a worst case scenario, this issue may even undermine the brand's image as well as its sustainable growth in the country.

In conclusion, CBRE sees a very active development and expansion market in the near future. FFBs can look forward to a good selection of new markets in which to generate sales, and landlords that have done their Shopping center planning well will be opening their doors to FFBs anchoring their projects.

9. CBRE Global ViewPoint: Shopping Centre Development – The Most Active Cities Globally, April 2013

TO BE CONTINUED...

We believe the rise of FFBs in China reflects a trend for retailers to cut down the sales intermediates in the distribution process. This has significant impact on other retail formats such as department stores, which remains very much dependent on conventional distribution channels. So, how will department stores respond in the face of challenges including distribution channel change, rising costs and out-dated operation model? This will be our focus in Part II of our report series.

APPENDIX

THE FOUR KEY FFBS' MILESTONE IN CHINA

Sep 2002	UNIQLO's first store in China unveiled at Shanghai Huaihai Road
Feb 2006	ZARA entered China and unveiled its first and flagship store at Shanghai West Nanjing Road
Apr 2007	H&M entered China and unveiled its first store at Shanghai Huaihai Road
Apr 2007	C&A entered China and unveiled its first store in Shanghai Super Brand Mall
Apr 2008	UNIQLO launched online sales service in China
Sep 2008	ZARA unveiled its first store of South China in Shenzhen Yitian Holiday Plaza
May 2010	UNIQLO unveiled its fourth global flagship store at Shanghai West Nanjing Road
Oct 2010	H&M unveiled its first store of Southwest China at Chongqing Paradise Walk
Sep 2011	ZARA's first flagship store of 5,000 sqm in China unveiled at Changchun
Sep 2012	ZARA launched online sales service in China

Source: Company information, CBRE Research

TOP 10 DEVELOPERS IN STORE NUMBERS OF THE FOUR KEY FFBS

RANK	DEVELOPER	PROPERTY BRAND	FAST FASHION BRANDS' NUMBER OF STORES (by June 2013)
1	Wanda Group	Wanda Plaza	104
2	CapitaLand	Raffles City, CapitaMall	17
3	COFCO	JoyCity	13
4	New World Group	New World Department Store, Printemps Department Store	11
5	SZITIC	Incity Plaza	10
6	Bailian Group	Bailian Shopping Center & Department Store	9
7	CR Land	MIXC, Dreamport	8
8	Intime Group	Intime Shopping Center & Department Store	7
9	Pengxin	Aqua City	7
10	SM Group	SM Shopping Mall	6

Source: Corporations' information, CBRE Research

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