

## Rosefinch Research | 2024 Series # 7

### Consumption Volume and Structure



When it comes to consumption, recovery has been the central topic among everyone. Current consumption is difficult to escape from the macro environment. After hitting a low point in 2022, consumer confidence has not fully recovered. Although the growth rates of discretionary consumption categories such as sports and pets maintained double-digit growth, the growth rate of durable goods such as home appliances and furniture continued to be low. As of the third quarter of 2023, the proportion of Chinese per capita consumption expenditure to disposable income was 66.43%, still lower than the pre-epidemic level.

#### Consumer Confidence Index and Satisfaction Index

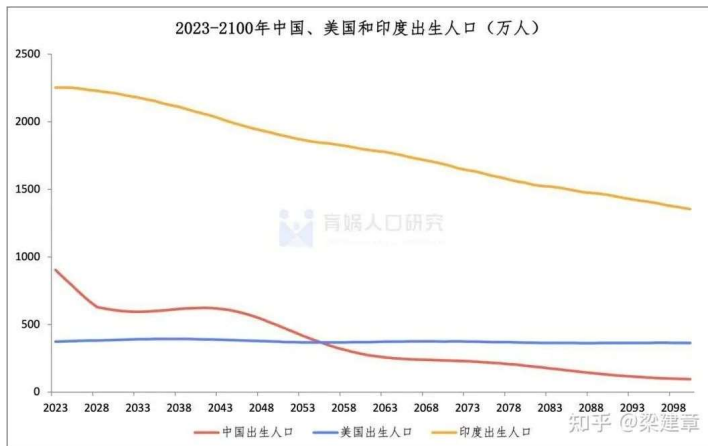


The data comes from the National Bureau of Statistics and Jiangdong Securities.

After the weak economic recovery expectations, consumption sectors had one of the biggest declines in the A-share market. The performance of consumption sectors has also been relatively weak in the past two years.

## 1. Shifts in consumption

The population is the basis of consumption, and its long-term growth is facing challenges. According to the population projection of Yuwa Population Research Institute, the total Chinese population in 2040/2050 will be 1.313 billion/1.23 billion people, among which the labor population will be 835 million/728 million people respectively. By 2050, the proportion of labor age population will decrease by 10 percentage points to 59.14%. According to its central prediction, China's population bonus may end in 2036. (Internationally, people aged 15-64 are generally defined as labor age population. Total dependency ratio refers to the ratio of minor and elderly population to labor age population, which indicates how much non-labor age population are supported by 100 labor age population.)



Data source: Yuwa Population Research Institute, Rosefinch.

We need to recognize the reality that the past growth model of economy, population and consumption has undergone an irreversible change. The previously reliable growth bonus brought by past user numbers multiplied by income growth has reached a certain ceiling.

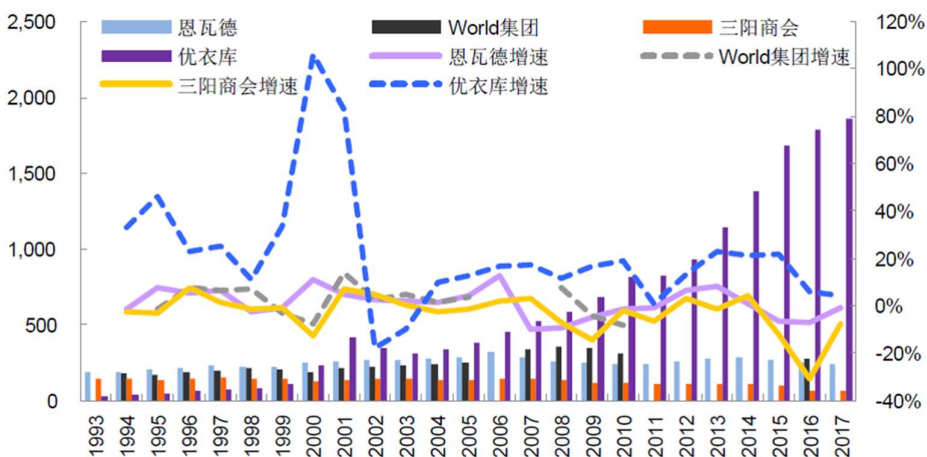
In the past, the consumption industry as a whole had a positive Beta, and the market tended to seek tracks with faster growth and spread the net widely. However, as the market shifts from growing to capped, the critical evaluation factors must also change from penetration rate, sustainable growth rate and PEG in the past needs to consider the ceiling, pattern, and end instead. The changes in market patterns and clearances will gradually accelerate, requiring a shift from spreading the net widely to more selective mining. We must focus our efforts within our own capability circle. We believe that even in a more stable and more complex economic entity, quality companies can still be found at different stages.

## 2. From Uniqlo to “consumption downgrade”

At this time, we often hear the hot topic of "consumption downgrade." Simply put, the logic of consumption downgrade is that under internal and external pressures, consumers tend to shrink spending and choose inexpensive goods. Examples of consumption downgrade include the recent rise of discount retail sales, changes in e-commerce landscape, and price cuts announced by some consumer brands. However, consumption downgrade is not simply about "price cuts". As an asset management institution, we care more about the underlying environment and influencing factors, and how to predict and choose companies that may get through the current environment.

Uniqlo is often taken as a typical case of consumption downgrade. In retrospect, Uniqlo's "high value-for-money" has at least experienced two cycles before gradually forming its memorable branding in the domestic Japanese market. In the 1990s when Japan's economic bubble burst, it was the beginning of Uniqlo's high-speed growth. At that time, the company's positioning was mainly low-priced, even lower than now. The company achieved rapid growth and launched IPO in five years, with revenue compound growth of 61%, of which 57% was contributed by the increase in the number of stores. However, in the following years, revenue growth slowed down and same-store sales remained almost unchanged, not much different from traditional Japanese apparel companies established in the 1950s-1960s. By 1998, Uniqlo was still a domestic company competing for market share in the low-price market with other brands.

### Sales and growth of Uniqlo vs other brands



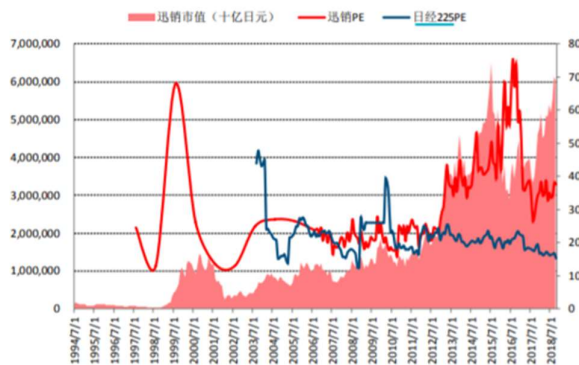
Data source: CICC.

Uniqlo's changes came after 1996, when the company made two adjustments. The first was to clearly upgrade the value-for-money of products. The second was to establish an overseas supply chain.

First of all, Uniqlo dropped many low-end product lines at the time and began cooperating with its core supplier DongLi to develop new fleece fabrics that were very popular in the United States as the core best-sellers. At the same time, the company also opened flagship stores in core commercial areas to match high-value products. From 1999 to 2001, Uniqlo's revenue compound growth rate reached 94%, with same-store sales compound growth rate reaching 64%, and revenue grew from 1,110 billion yen in 1999 to 4,185 billion yen in 2001.

However, Uniqlo then fell into a bottleneck due to over-reliance on single products and inventory issues. Revenue declined continuously in 2002-2003, down to 3,098 billion yen in 2003. During this period, the company's stock price fluctuated greatly following its sales fluctuations, although market share increased, the effectiveness of its international expansion had not yet been reflected, and the outlook for international expansion was still unclear. Uniqlo continued to find and cultivate apparel supply chain companies in China.

It was through such efforts that the company's domestic sales gradually stabilized after 2004, and overseas markets including China began to contribute incremental growth. By 2009, revenue compound growth reached 15%. By 2010, overseas markets led by China took over from the Japanese domestic market as the main growth driver, with revenue compound growth reaching 13% by 2019. During this period, although revenue growth slowed down, valuation and performance both rose, with significantly higher relative returns.



Data source: Changjiang Securities.

Therefore, Uniqlo experienced two cycles of bottlenecks and difficulties, and through product differentiation, competitive edge on raw materials, and forward-looking strategy in China, it formed the well-known global brand we see today.

### 3. New trend and growth area of domestic consumption

Back in China, the market is relatively pessimistic about the current consumer market and there are also significant differences in future developments. We still hope to improve our skills, make forward-looking investments, and strive to achieve solid returns.

For example, in the domestic demand sector, we focus on the food and beverages supply chain sector. In the existing environment, there are fast changes in traditional F&B businesses. The restaurant chain expansion is accelerating and still has significant room for growth in the future. Large F&B enterprises have stronger risk resistance capabilities and are accelerating store expansion. Their supply chain system is also opening up and expanding. Small catering demands are more affected by the external consumption environment, but there are trends towards industrialization and prefabrication. At the same time, under the demands of smaller households and increasing convenience, the prefabricated frozen foods will grow quickly as company supplier and eventually as direct consumer supplier.

In summary, some sub-sectors in the F&B supply chain (such as new frozen rice noodles and prefabricated ingredients) still have good growth potential. It will increase industry efficiency and improve corporate profit. As food industrialization continues, we can see larger growth potential as well as a more concentrated competitive landscape.

China's manufacturing capabilities serve global brands, but brand building and channel penetration have not yet matured. In a more domestic-circulating consumption environment, domestic brands can also produce larger food type enterprises through mergers and acquisitions. This situation has appeared in sports goods, where domestic brands still stand firm through technology and product strength.

Finally, there is service consumption. In the first three quarters of 2023, the per capita service consumption expenditure of China's residents increased by 14.2% year-on-year, accounting for 46.1% of consumption expenditure, an increase of 2 percentage points from the same period in 2022. This recovery in service consumption may be due to reasons such as making up for missed holidays and entertainments after the epidemic, but we believe these marginal consumption tendencies will likely be sustainable even under limited income.

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