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Mobile payment - an essential element for successful retailing

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The retail market shows signs of recovery, with visitor numbers rebounding and combined retail sales in April and May up 0.3% YOY. Tech-savvy shoppers and mainland Chinese tourists' payment preferences are fuelling the expansion of mobile payment. The changing retail environment led by a shift from luxury towards more lifestyle-related consumption is reshaping the high-street retail mix. New mid-tier fashion brands, cosmetics shops and F&B concepts are expanding. We believe high-street rents are now close to bottoming. With new market opportunities ahead, and optimism among retailers rising, we expect retail sales growth of 1-2% for 2017 YOY and have a positive outlook for 2018.

Forecast at a glance

Demand
Focus on lifestyle and health will drive demand for mid-tier brands, affordable luxury as well as new dining experiences.

Rent
We expect high-street rents to remain under pressure over H2, and predict a drop of 5% by year-end 2017. However, we expect rents to pick up next year, with a growth rate of 3-5% in 2018.

Supply
We expect 410,000 sq ft (38,100 sq metres) of new retail space located in core retail districts to come to the market in H2 2017.

Retail Sales
Tourism is rebounding, with an overall retail sales increase of 0.3% in April and May YOY. Declines in electronics and photographic equipment remained high (-16% YOY). Given recent trends, we expect retail sales to rise 3-4% in H2 YOY with total growth of 1-2% for 2017 YOY and a further 3-4% rise in 2018.

2017 High-Street Retail Rental Index Projection

District	Rental Index Q2 2017	2017F
Overall Rental Index*	66	-5%
Central	75	-7%
Causeway Bay	60	-4%
Tsim Sha Tsui	67	-6%
Mong Kok	60	-5%

Index: Nov 2011 = 100. * Street level shops on key street segments
Source: Colliers

Capture of Chinese tourist spending via mobile payment

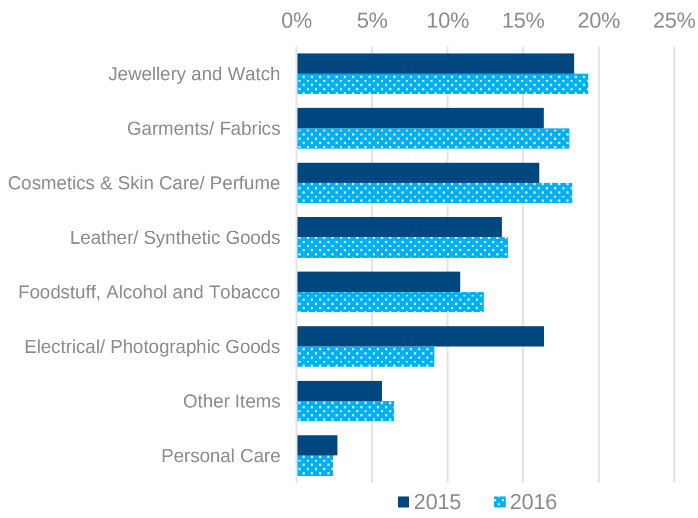
Rebounding tourism, featuring rising visitor numbers from mainland China, has led to an upswing of the local retail market. The sustained positive economic growth in China, a strengthening renminbi and rising household income translated into a 2.8% YOY increase in mainland tourists in April and May combined. Total tourist numbers were up by 2.4% for the same period. However, the deepening challenge of continuous spending decline of Chinese tourists in Hong Kong and changing consumer demands must be tackled. China has a mature mobile payment market and is intensely developing online-offline-integration, indirectly creating competition for Hong Kong retailers.

With Chinese visitors representing up to 86% of retail-related tourism spending (overnight and same-day visits) and 35% of overall retail sales in 2016, Hong Kong's heavy reliance on Chinese retail spending makes strategy changes inevitable. Notably, Hong Kong retailers must consider the high number of tech-savvy Chinese millennial shoppers, and their preference for digital media, ecommerce and mobile payment. According to the Hong Kong Tourism Board (HKTB), the share of millennial visitors from mainland China was 49% in 2016 with the majority female (59%). The HKTB report suggests that cosmetics, ready-made clothes, snacks and confectionery were the most popular shopping goods among all overnight visitors. Although Hong Kong's rating on value for money on shopping and on shopping remains highest from mainland tourists, the score (max. 100) dropped by 3.1% to 78.4 and 1.1% to 81.1 (overnight visitors), respectively from 2015 to 2016.

Numerous retailers across different retail sectors in Hong Kong have already started to respond to the challenge and are improving the overall shopping experience by increasingly offering diverse mobile payment options in their shops. In particular, the e-wallet Alipay, one of the most widely used mobile payment options in mainland China, has been very successful in expanding its local network of merchants. According to local newspapers, the number of local shops offering Alipay has risen from 6,000 to 8,000 since July last year, and WeChat Pay is catching up, now being available in 1,500 shops from 200 brands.

E-wallets such as WeChat Pay and Alipay enable convenient in-shop payment through the scanning of a QR code by the customer or by letting the cashier scan a bar-code on the customer's phone. However, offering mobile payment is more than the pure payment transaction. The apps, in which the mobile payment is embedded, are a new way of interactive customer engagement with a brand. Retailers in Hong Kong are increasingly implementing online-offline strategies (O2O) via mobile payment apps, for instance by drawing customers into physical shops by offering product discounts for certain outlets online. Last year, the drug store Bonjour achieved a surge in sales of HKD1 million (USD129,000) on a single day in one of its branches by partnering with Alipay to launch a promotion. Driven by retention of their own competitiveness, more companies are investing in areas such as digitisation of retail, including mobile payment. The A.S. Watson retailing group for instance, has announced that it will invest USD160 million (HKD1.24 billion) in the coming three years in new technology such as mobile payment and data analytics to stay competitive.[1]

Retail Spending of Overnight and Same-day Mainland Chinese Tourists

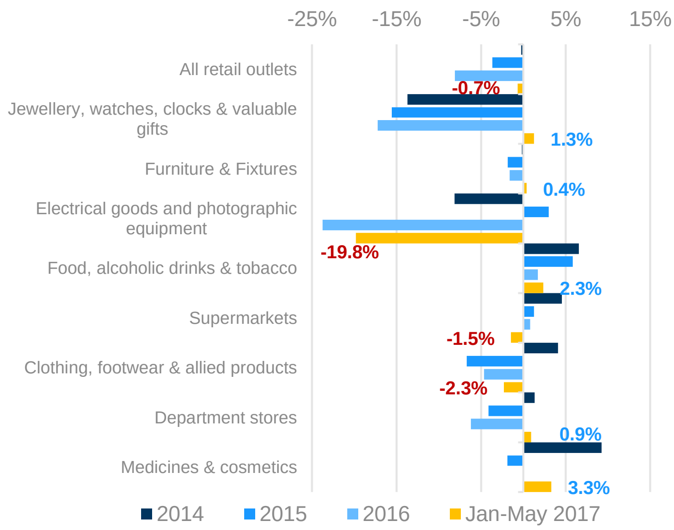


Source: Hong Kong Tourism Board, Colliers

Signs of recovery for the jewellery and watch sector amid return of Chinese tourists

The jewellery, watches, clocks and valuable gifts sector is showing signs of recovery as further declines have halted. The improving wealth effect in China has helped to bring back tourists. This factor, together with positive local consumer sentiment, led to 0.8% higher sales of this sector in April and May combined YOY. If the upturn continues, the jewellery market has a good chance of stabilisation. Retail sales for medicines, cosmetics and food rose by 3.7% and 3.1% YOY, respectively in April and May combined. The shifting consumer interest towards lifestyle-related consumption is fuelling demand for cosmetics, personal care products and health foods as well as new dining concepts. In contrast, the electrical goods and photographic equipment sector continued its downturn, dropping by 16.2% YOY in the same period.

Retail Sales Growth by Subsector (% YOY)



Source: Census and Statistics Department, Colliers

[1] According to A.S. Watson Group during the MoneyBack 10th Anniversary Celebration Ceremony on 26th June 2017, published in South China Morning Post

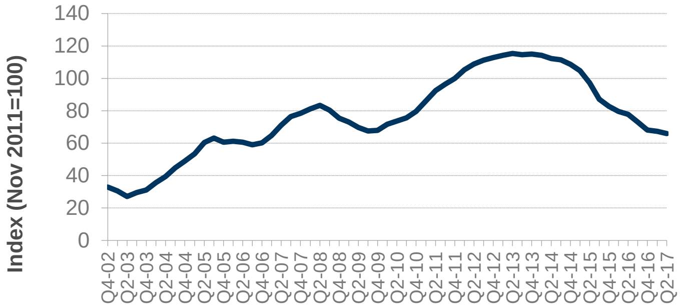
Further pressure on high-street rents

During Q2 2017 the decline in high street retail rents continued, with high-street rents falling by 12.5% on average compared to last year. The rental decline was highest in Mong Kok where rents dropped by 17.4%, followed by Causeway Bay with a 14.1% decrease in Q2 2017 YOY. Rents in Tsim Sha Tsui and Central fell 12.7% and 10.1% YOY, respectively. However, the rental decline in high-street retail locations has been slowing down and we believe it is close to bottoming.

Mid-tier brands increasingly replace luxury labels in high-street shops

The high-street retail mix continues to change in the light of ongoing shift of consumer needs away from high-end luxury towards more affordable and casual fashion and goods. Prime-street shops vacated by luxury retailers are being taken up by new and less-known brands from the mid-tier and mass market segment. New brands enter the market as landlords are accepting offers from new fresh labels in expansion mode, while, based on Colliers data rents are down by about 40% from the prevailing levels of three years ago. Moreover, shops from secondary retail streets are taking up high-street shops as they make use of the adjusted rentals. Other existing high-street retailers are opting for renewal of their leases after renegotiating terms.

Hong Kong High-street Retail Rental Index



Source: Colliers

Pop-up stores continue to thrive as they offer a great tool for new and established brands to explore market potential, while avoiding long-lease terms. For example, the local athleisure brand Caelum Greene which designs casual clothing with functional elements, has opened a pop-up shop in Landmark; Marni Market, an Italian luxury label, has a presence in Harbour City; and Chanel's Coco Café has offered a beauty pop-up concept on Yiu Wah Street in Causeway Bay. Reflecting rising retail sales for cosmetics and F&B, both sectors have been very active in the leasing market in Q2 2017.

Despite the uptake of high-street retail shops, vacancy of large shops in prime locations persists. Additionally, relocations from secondary to prime retail streets have led to more vacancy in secondary retail streets. Given the strong economic figures, together with the market bottom in sight, we expect positive market sentiment to persist with conditions set to improve from 2018.

Selected Lease Transactions in Q2 2017

District	Tenant	Building	Address	Floor/ unit	GFA (sq ft)	Lease Type
Mong Kok	J.Co Donuts & Coffee	Righteous Centre	585 Nathan Rd	G/F, shop 1-2	1,849	New lease
Tsim Sha Tsui	Wonderland Club HK	BCC Building	25-31 Carnarvon Rd	G/F and B/F	8,890	New lease
Tsim Sha Tsui	Itacho Sushi	East Ocean Centre	98 Granville Rd	G/F, shop 7-9	2,761	Renewal
Causeway Bay	Prince Jewellery & Watch	16 Kai Chiu Rd	16 Kai Chiu Rd	G/F - 2/F	3,600	Renewal
Causeway Bay	Calzedonia	Fortune Plaza	48 Yun Ping Rd	G/F	796	New lease
Central	Puyi Optical	Central Building	1-3 Pedder Street	G/F and M/F	2,063	New lease

Sources: EPRC, Colliers

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