

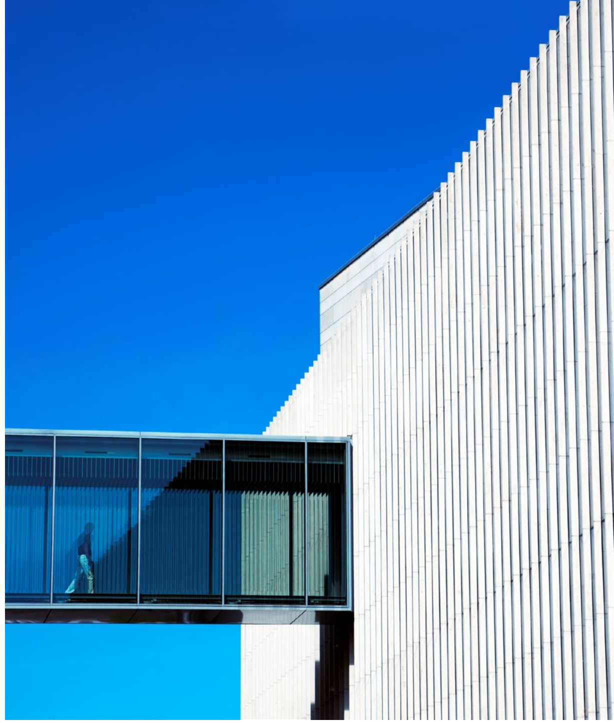

Sector Update
Global Travel Retail

Rising Air Traffic, Shrinking Consumer Budgets

S&P Global
Ratings

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This report does not constitute a rating action

Industry Overview

Key Takeaways

- **S&P Global Ratings expects the travel retail industry will likely grow at 7%-10% in 2024-2025.** This is up to 7%, significantly more than our estimate of global GDP growth of 3.3% in 2024 and 3.2% in 2025. In 2024, traffic will exceed pre-pandemic levels. But sales won't surpass 2019 levels until 2025. Asia-Pacific should lead the growth in traffic in the next two years.

- **Travel retailers are enhancing the customer experience.** This includes working with airports to improve technology and personalization, as well as adding hybrid stores and local brands.

- **Market positions are reshuffling amid structural changes.** The top two global travel retailers have the edge over smaller players due to their long-term supplier relationships. This will aid their global expansion efforts in airports. The drop in the Daigou market (tax-free purchases made for illicit resale elsewhere) from 2022 will permanently hurt China and Korea players.

- **Waning consumer confidence will bite in 2024 and 2025.** Soft consumer sentiment and fewer business travelers could further drive down spending of duty-free products per traveler.

Medium-Term Industry Trends

1

Air traffic to grow above GDP growth, fueling above-GDP growth for travel retailers

- Expanding middle classes in developing countries mostly in Asia-Pacific, and to a lesser extend Latin America, will fuel global air-traffic growth over the next two to four years.
- Increased connectivity and infrastructure enhancement should also boost traffic.

2

Increased digitalization will leave passengers more time for non-aeronautic activities at airports

- The continued streamlining of operations, including remote check-in and bag-drop, will allow travelers more time for retail-related activities.

3

Travel retailers are diversifying their offerings beyond traditional products and enhancing customer experience

- Airports and travel retailers are adding more personalization and technology, and hybrid stores combining duty-free and experimental retail (restaurants and entertainment).
- There will be greater focus on luxury goods, fashion, electronics, and local merchandise, and tailored customer experiences.

4

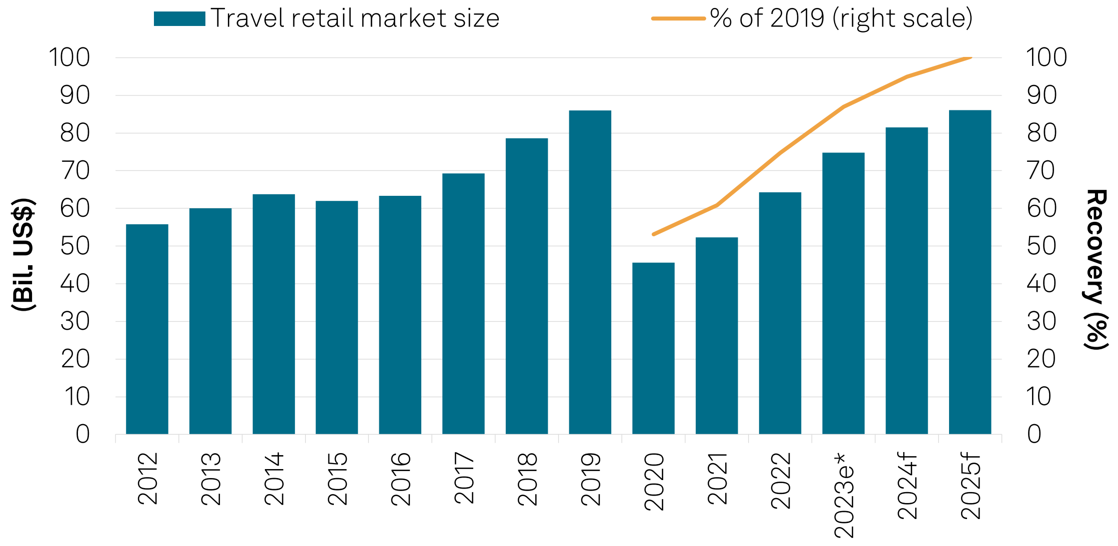
Concession fees to airports play a major role in the profitability and economics of travel retailers

- After the pandemic, concession fees, both fixed and variable, have stabilized at a higher level than before. The margins of the industry will suffer if the rates continue to rise.
- Major Chinese operators, however, may not face significant increases because they have negotiated lower concession rates with airports.

Growth In Global Travel Retail Sales Will Depend On Asia-Pacific

- Asia-Pacific (about half of global travel retail sales) still lags the sales levels seen in 2019. The rest of the world has largely exceeded pre-pandemic sales levels. We attribute the lag to (1) pandemic restrictions; (2) weaker spending per traveler; (3) absence of Daigou as a channel.
- Global travel sales to reach 2019 levels by 2025. Main drivers: traffic recovery in Asia-Pacific; moderate volume growth in other regions.

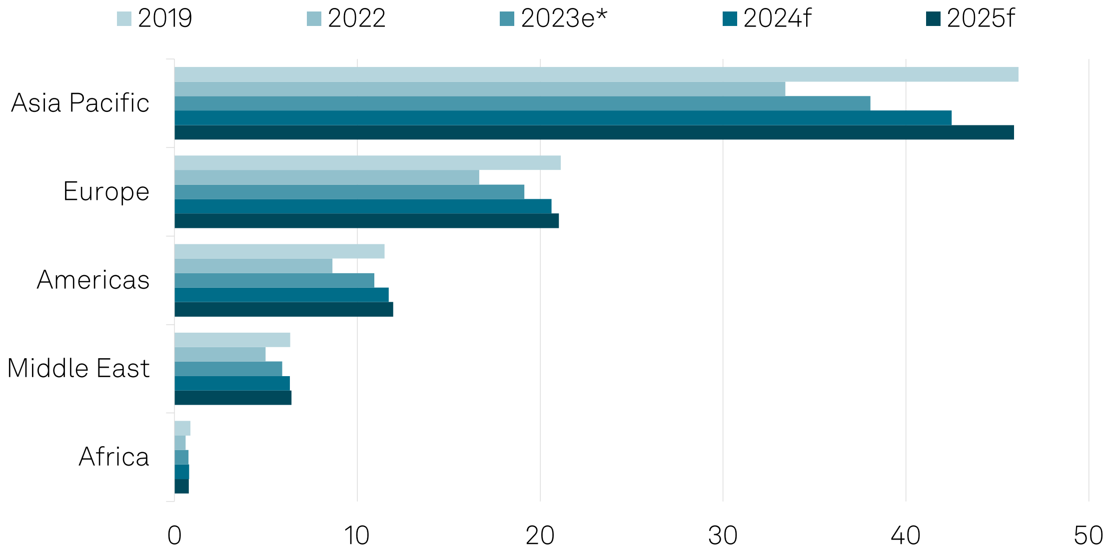
Travel retail sales are slow to recover



*Estimate by Generation Research. e--Estimate. f--Forecast, Sources: Generation Research, S&P Global Ratings.

Asia-Pacific to rebound in 2024-2025

Market size by region (bil. US$)



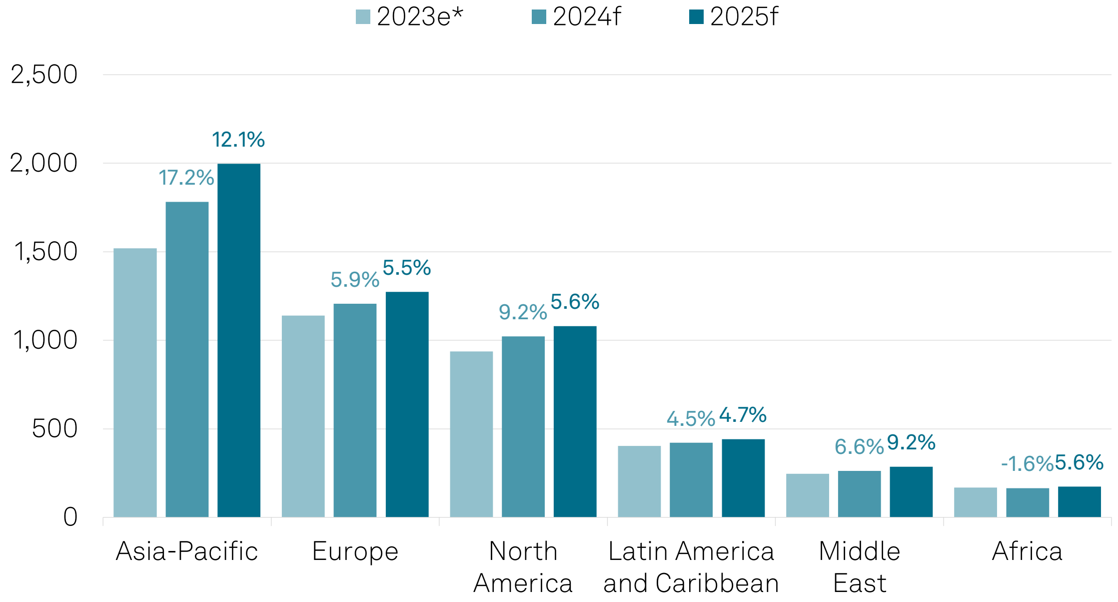
*Estimate by Generation Research. e--Estimate. F--Forecast. Sources: Generation research, S&P Global Ratings.

Asia-Pacific To Drive Global Volume

- In 2024, global international traffic should grow and surpass that of 2019. Asia-Pacific should see the highest growth, led by China and India.
- The airport channel will be the main beneficiary of recovery and grow further. The channel mix will likely revert to 2019's mix in 2024.

Regional passenger growth in 2024 and 2025

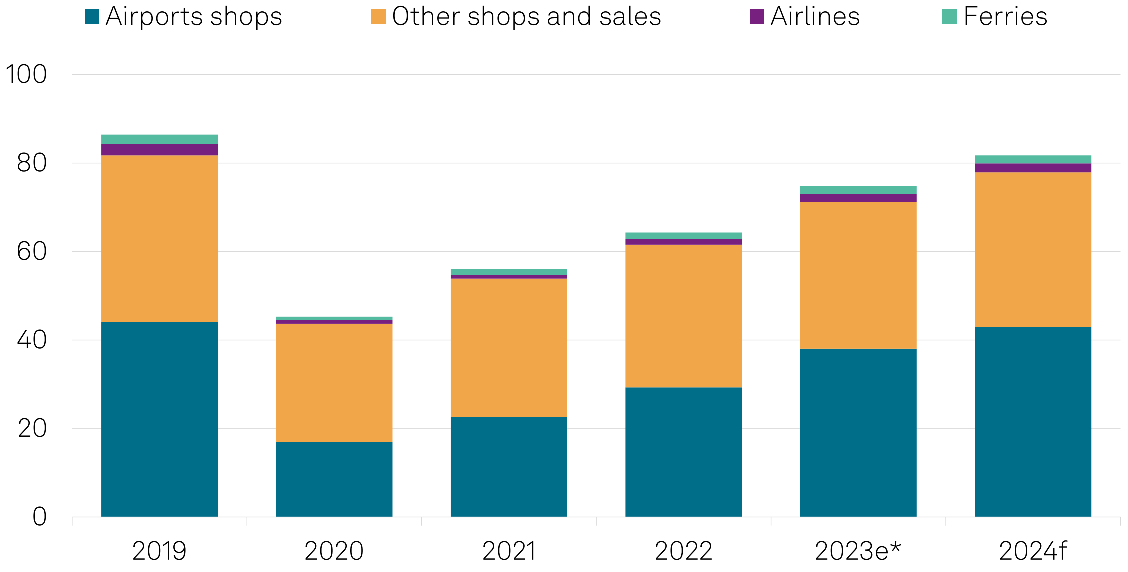
Number of travelers (mil.)



Labels show year over year percentage change. *Estimate by IATA. e--Estimate. f--Forecast. Sources: IATA, S&P Global Ratings.

Airport shops to outgrow other travel channels in 2024

Market size by channel (bil. US$)



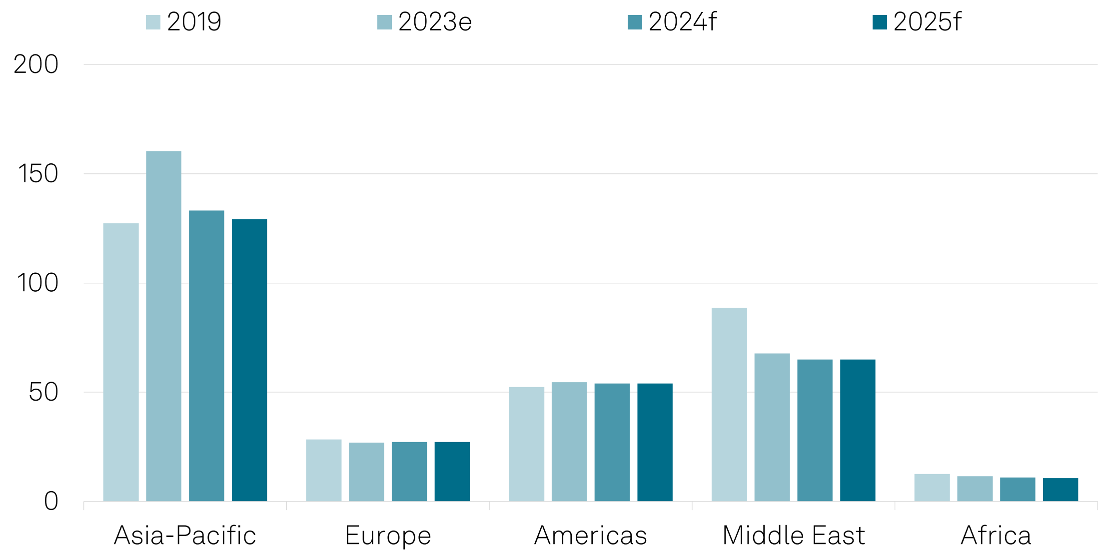
*Estimate by Generation Research. e--Estimate. f--Forecast. Sources: Generation research, S&P Global Ratings.

Spending Per Traveler On Duty-free Products Down With No Recovery In Sight

- Average spending to trend down for duty-free products: (1) weak consumer sentiment; (2) e-commerce being cheaper for some products and more convenient. Food and beverage spending to increase because of inelastic demand.
- Travel retailers are adding more services and categories to enhance customer experience and capture incremental demand for restaurants, second-hand luxuries, and spa treatments. Avolta and Lagadere, the two European giants, have acquired food services companies to enhance hybrid offering.

Spending per travel to decline in most regions

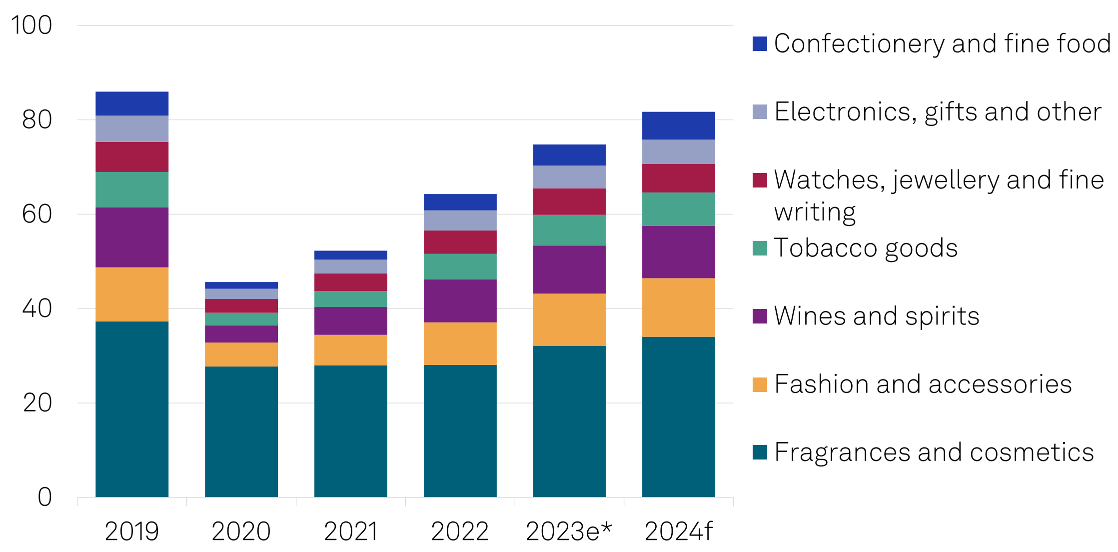
Retail sales per person (US$)



e--Estimate. f--Forecast. Sources: UN Tourism, Generation research, S&P Global Ratings.

Hybrid stores could enhance growth in non-cosmetics

Market size by category (bil. US$)

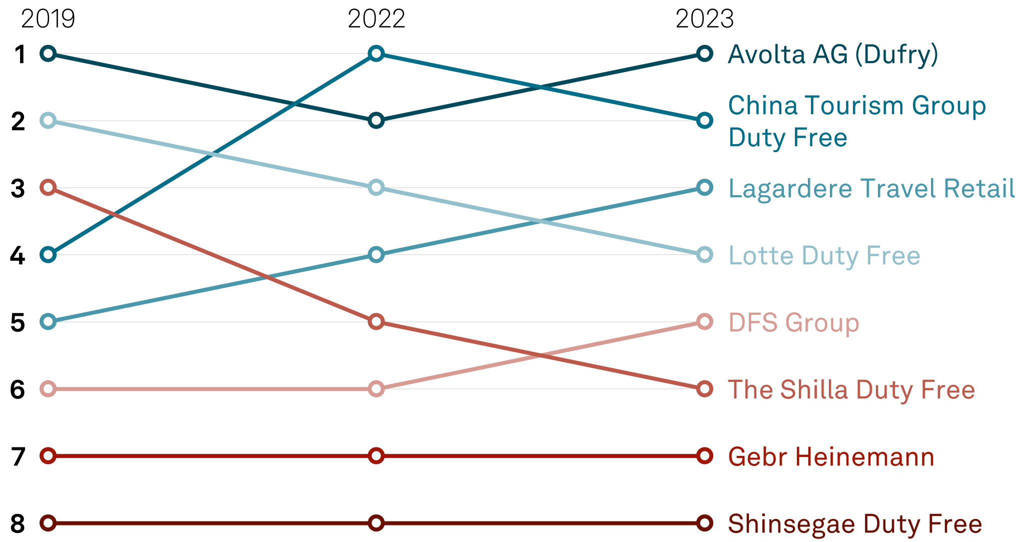


*Estimate by Generation Research. e--Estimate. f--Forecast. Sources: Generation research, S&P Global Ratings.

Top Two Retailers Are Gaining Market Share

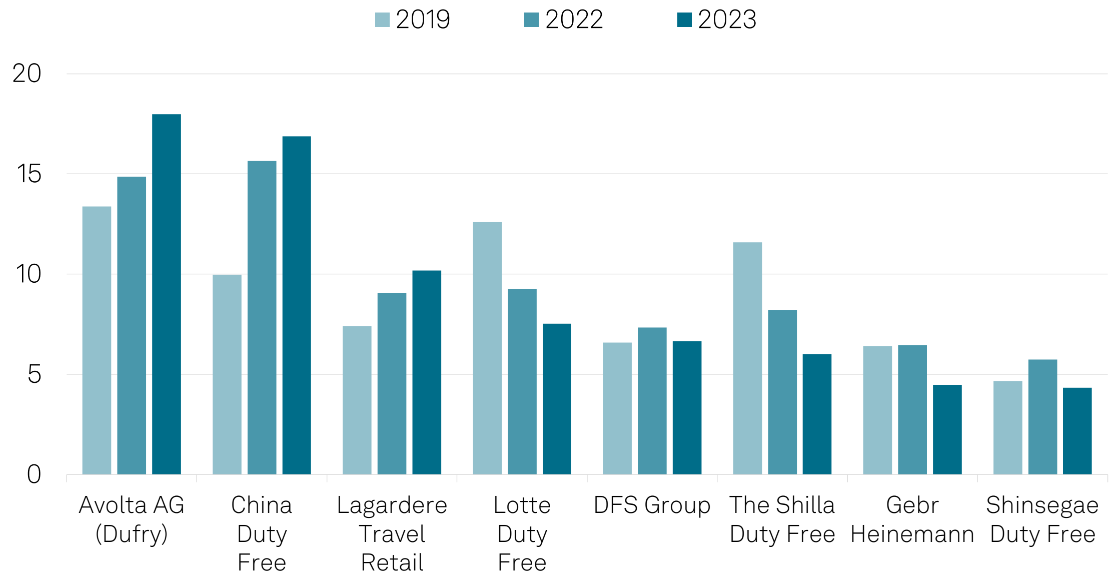
- China Tourism Group Duty Free Co. (CTGDF) gained the most market share during the pandemic. Other players suffered from disruptions to airport travel whereas CTGDF benefited from the Hainan market. Increasing traffic in European airports helped Avolta gain No. 1 place in 2023.
- Korean travel retailers lost market share because of a decline in travelers. Near-term recovery is uncertain because of a local government ban on Tao-Daigou since 2022 and new limits on purchase volume limits in Feb. 2024.

Ranking of top eight travel retailers



*Only includes Avolta's travel retail business and excludes its food and beverage segment.
Sources: Moodie Davitt Research, S&P Global Ratings.

Top 8 players' market share (%)



Sources: Generation research, Moodie Davitt Research, S&P Global Ratings.

Key Regional Specificities

Asia-Pacific
Volume up but average spending down

- Travel volume in Asia-Pacific is on track to fully recover by 2025 from its pre-pandemic level.
- Spending per passenger will fall amid weak consumer sentiment for discretionary duty-free purchases.
- Downtown stores could have more hybrid models, while the focus in airports will remain typical duty-free retailing.

North America
Tough economic conditions could cause more volatility

- North America relies on domestic traffic. Domestic traffic in the U.S. could grow slower with increased recession risk following weak jobs data over the summer.
- Air transportation to remain strong due to lack of other infrastructure (e.g. high-speed railways, etc.)

Europe
Robust international tourist flow despite challenging regulations

- Robust growth in medium term, driven by several European countries remaining in the top 10 global tourist destinations (e.g. France, Italy, Spain, etc.).
- Business travel lower than pre-pandemic levels in the near term, eroding average spending.
- Regulations on traffic and CO2 emissions to toughen over the medium term.

Latin America
A slowdown but normalized air-traffic growth

- In the medium term, traffic growth will slow to about 3x the region's GDP growth rate after an impressive recovery from the pandemic.
- This includes strong demand from the U.S., especially for tourism, with top destinations being Mexico, Brazil, Chile, and Peru.

Key Risk Factors For Travel Retailing Regions

What are the downside risks?

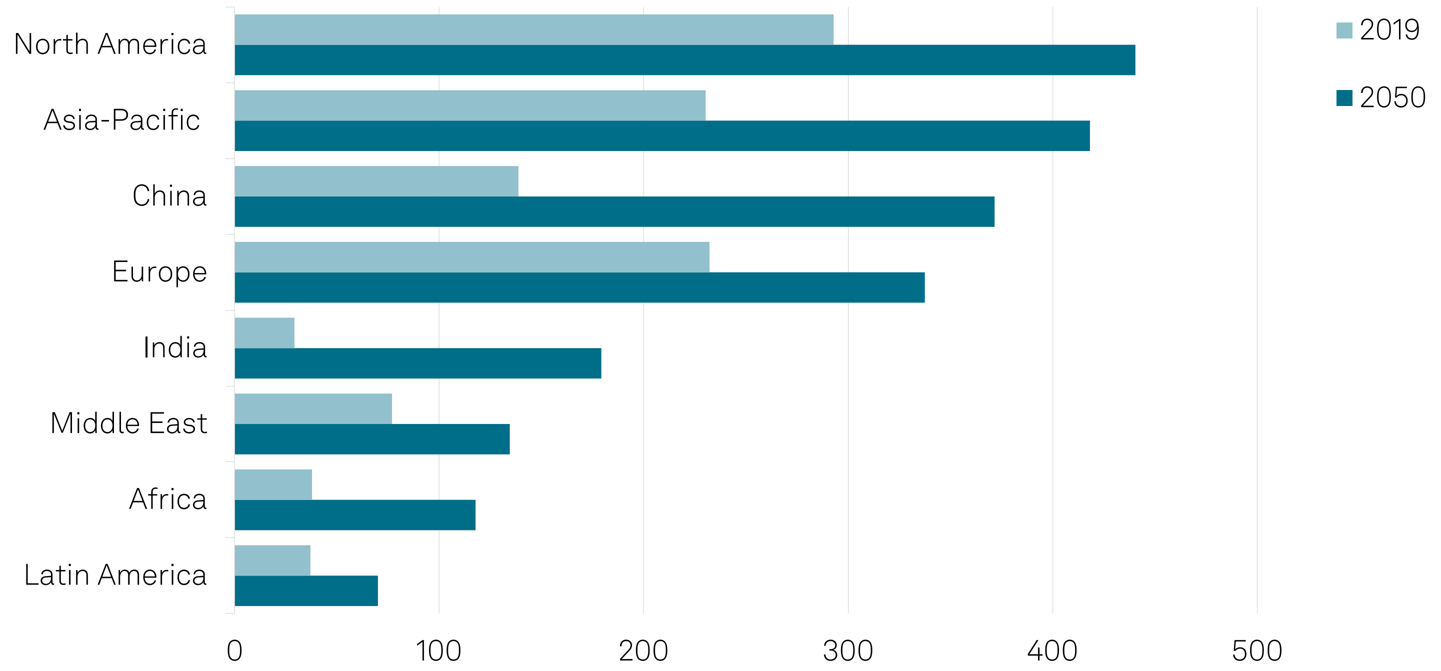
Asia-Pacific	• Weak consumer spending could hurt duty-free spending and international travel volume. • Regulatory risks in Korea are higher than in other countries in the region in 2024. In February, Korea capped certain total duty-free purchase volumes for travelers. • Geopolitical tensions in Europe (Russia-Ukraine) may lead to reduced international flight traffic operated by non-China airlines, which could hurt travel volume to Asia-Pacific.
Europe	• Tough macroeconomic conditions and post inflationary squeeze on disposable income could limit household spending on leisure and thus on travel retail products. • Geopolitical tensions in Europe (Russia-Ukraine) and Middle East could lead to reduced tourist traffic, especially coming from the U.S. and Asia-Pacific. • Regulatory risk around limits on CO_2 emissions could lead to restrictions on capacity and traffic.
North America	• Challenging macroeconomic conditions, a weak job market, and decreasing disposable income should lead to a decline in domestic traffic.
Latin America	• Inflation of about 250% in Argentina will squeeze disposable income and pressure duty-free consumption. • Security concerns could reduce tourist traffic. • Lack of investment in airport infrastructure may lead to reduced capacity.

Tighter Curbs On Emissions Could Reshape Travel In The Long Run

- Under the Paris Agreement, EU countries are committed to making the area's climate-neutral by 2050. To achieve this, by 2030, the EU will reduce its economywide net greenhouse gas emissions by at least 55% from 1990 levels and will continue to progressively cut emissions to 2050.

Aviation emissions to skyrocket by 2050

Carbon emissions from aviation by world region (mil. metric ton CO2e)



*Scenario with no further intervention to clean up the sector's environmental footprint.
CO2e--CO2 equivalent. Sources: Bloomberg, Statista.

Several initiatives to limit air traffic

- The European Commission and member states are seeking to "green" the aviation industry, mostly by developing biofuels (which will come at a cost) and limiting the recourse to aviation and favoring railways.
- Germany has launched a €50 monthly pass for unlimited national rail services use.
- Schiphol airport in the Netherlands has indicated it will decrease its traffic by 20%.
- France has prohibited short domestic flights where a rail alternative in less than 2.5 hours exists.

Selected Rated Entities

China Tourism Group Corp. Ltd.

Issuer credit rating: **A-/Negative/--**

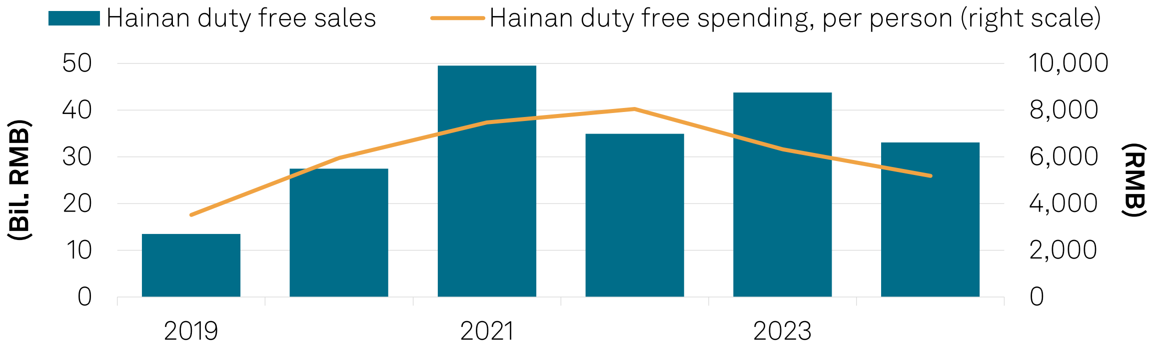
Stand-alone credit profile: **bbb**

Business risk: **Satisfactory**

Financial risk: **Intermediate**

Outlook:

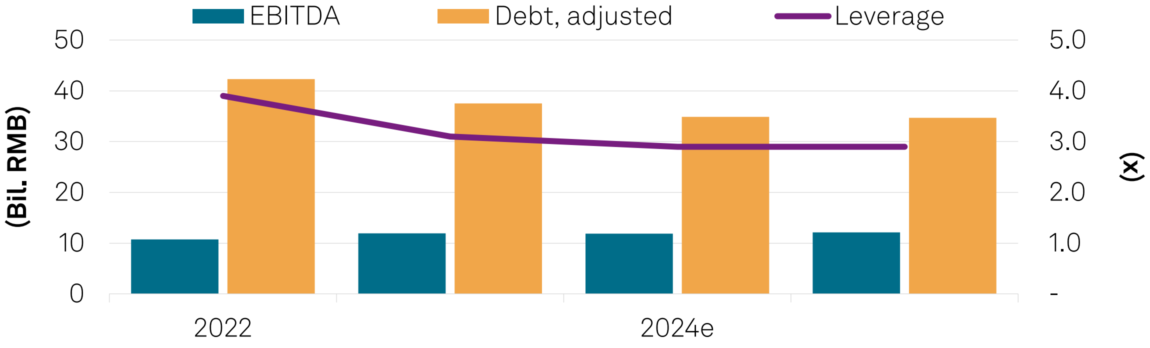
The negative rating outlook on CTG reflects the likelihood that the company's Hainan business could face further downside over the next 12-18 months. Our base case expects Hainan's pace of sales decline will drop over the coming months, and sales will stabilize in 2025. This should bring leverage down to less than 3.0x in 2024, from 3.1x in 2023.



Sources: Haikou Custom, S&P Global Ratings.

Key watch points:

- Hainan duty free market recovery.
- High spendings on property construction or acquisitions.
- Overall concession fee rates and relevant impact on profitability and leverage metrics.



Sources: Company financials. S&P Global Ratings.

S&P Global Ratings

Avolta AG

Issuer credit rating: **BB+/Stable/--**

Stand-alone credit profile: **bb+**

Business risk: **Satisfactory**

Financial risk: **Significant**

Outlook:

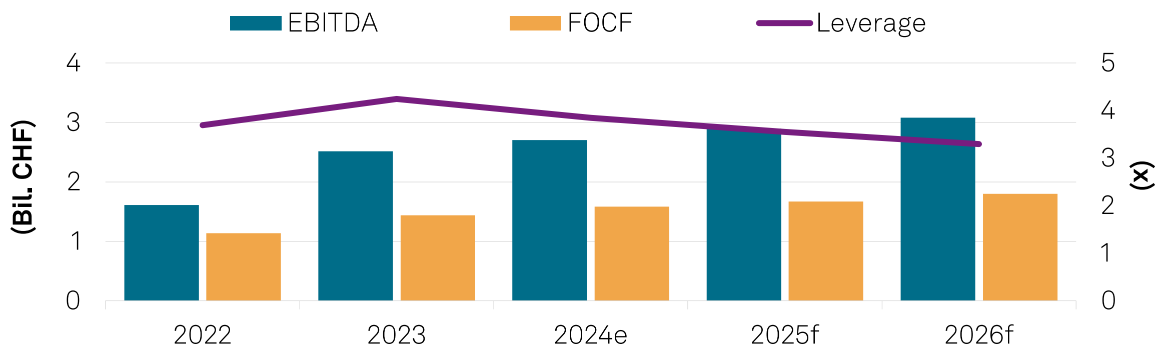
We expect Avolta to deliver strong credit metrics on the back of continued sound operating performance thanks to air traffic recovery and solid execution of its group strategy.

We assume Avolta will reduce S&P Global Ratings–adjusted debt to EBITDA to less than 4.0x by the end of 2024.

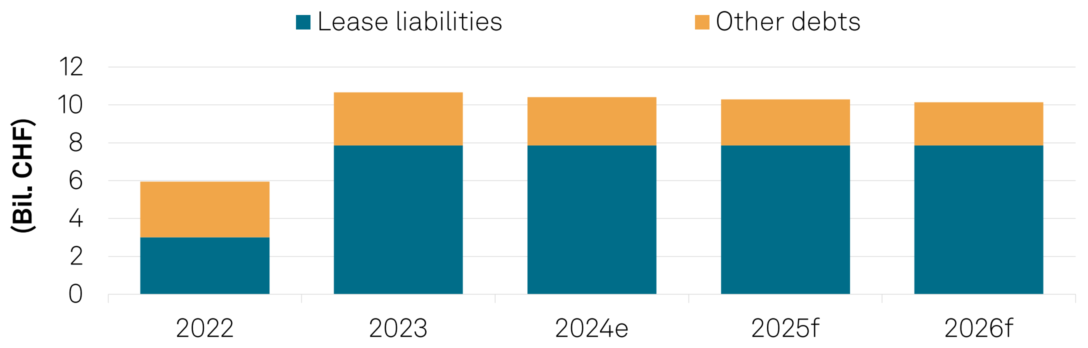
We forecast Avolta's return to its target reported net leverage of 1.5x-2.0x (equivalent to adjusted leverage of 3.2x-3.8x) in the next 12 months.

Key watch points:

- Further integration synergies and performance improvements following the strengthening of its business model through the acquisition of Autogrill.
- Volatility in lease liabilities, which could translate into higher than anticipated leverage metrics.
- Financial policy – dividend distribution and additional M&A.



e--Estimate. f--Forecast. FOCF--Free operating cash flow. Sources: Company financials, S&P Global Ratings.



e--Estimate. f--Forecast. Sources: Company financials, S&P Global Ratings.

PAX Midco Spain (Areas)

Issuer credit rating: **B-/Positive/--**

Stand-alone credit profile: **b-**

Business risk: **Fair**

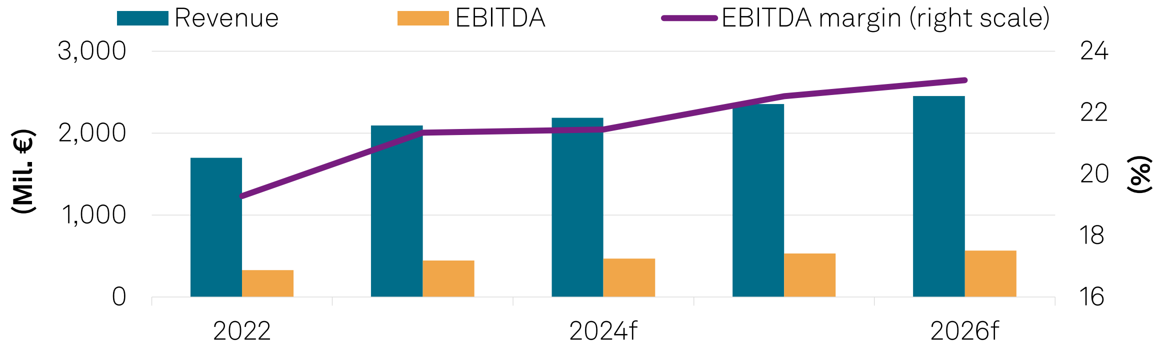
Financial risk: **Highly leveraged**

Outlook:

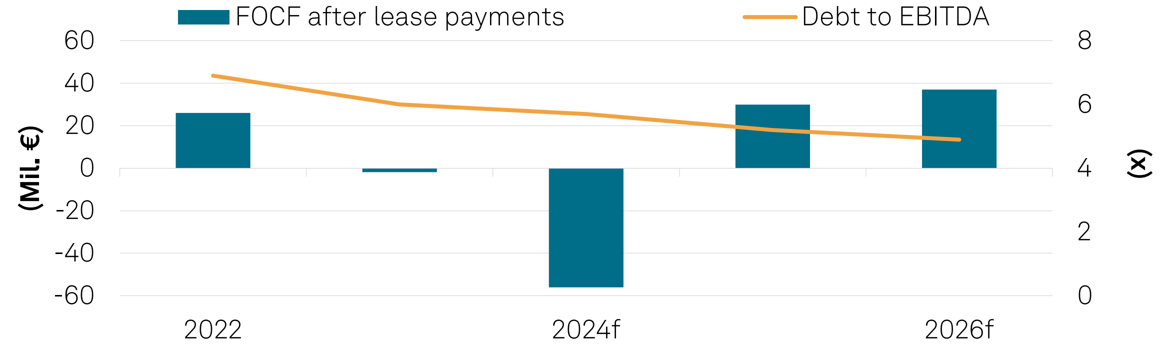
We expect Areas will keep on improving its top-line and EBITDA base in fiscal 2024 (ending September 2024). This will lead to an S&P Global Ratings-adjusted leverage declining toward 5.0x, with free operating cash flow (FOCF) after lease payments turning positive by €20 million in fiscal 2025 after a dip in 2024 on high capex and interest costs.

Key watch points:

- Ability to increase absolute EBITDA generation to continue the deleveraging trajectory.
- FOCF trajectory with expectations of positive contribution starting fiscal 2025.



Note: All figures adjusted by S&P Global Ratings. f--Forecast. Source: Company financials.



Note: Calculated as financial debt divided by EBITDA (pre-IFRS-16). FOCF--Free operating cash flow. f--Forecast. Source: Company financials.

S&P Global Ratings

Selected Rated Entities

	China Tourism Group Corp. Ltd.	Avolta AG	PAX Midco Spain (Areas)
Country risk	Moderately high	Intermediate	Low
Industry risk	Intermediate	Intermediate	Intermediate
Competitive position	Satisfactory	Satisfactory	Fair
Business risk profile	Satisfactory	Satisfactory	Fair
Financial risk profile	Intermediate	Significant	Highly leveraged
Anchor score	bbb	bbb-	b
Modifiers			
Diversification	Neutral	Neutral	Neutral
Capital structure	Neutral	Neutral	Neutral
Financial policy	Neutral	Neutral	FS-6
Liquidity	Adequate	Adequate	Adequate
Management and governance	Neutral	Neutral	Moderately negative
Comparable rating analysis	Neutral	Negative (-1 notch)	Negative (-1 notch)
Likelihood of government support	High (+2 notches)	N/A	N/A
Issuer credit rating / outlook	A-/Negative	BB+/Stable	B-/Positive

Recent Publications

- China Tourism Group Corp. Ltd. And Hong Kong Subsidiary Outlook Revised To Negative; 'A-' Ratings Affirmed, Sept. 16, 2024
- China Retail: 2024 Review And 2025 Outlook The Downside Risks To Revenue Multiply, Aug. 6, 2024
- Air Traffic Takes Off In Latin America, Fueling Investment Needs, June 28, 2024
- European Airports Trundle Along, May 14, 2024
- GMR Hyderabad International Airport Upgraded To 'BB' On Higher Tariffs And Robust Traffic; Outlook Stable, May 7, 2024
- Avolta AG Upgraded To 'BB+' On Strong Operating Performance And Integration of Autogrill; Outlook Stable, April 3, 2024
- PAX Midco Spain's (Areas') Proposed Partial Capital Structure Refinancing Strengthens Group's Credit Profile, March 14, 2024
- Concession Catering Operator Pax Midco (Areas) Outlook Revised To Positive On Continued Deleveraging, Affirmed At 'B-', Jan. 29, 2024

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