

Golden goose is tarnished as Shinsegae's duty free business drags on group results

SOUTH KOREA. There is a saying in Korean, ‘??? ?? ???’ – best translated as pouring water into a sieve, writes *Min Yong Jung**. It is used to describe an impossible situation where someone tries to fill up a vase which has a gaping hole at the bottom.

Shinsegae Department Store's second-quarter results, published yesterday, brought that saying to mind. Despite injecting cash and assets into the duty free business, heavy losses from the channel dragged down an otherwise impressive performance from the company's department stores.

(Billion KRW)

	2Q 2020	2Q 2019	YoY	2020	2019	YoY	
Net Sales							○ Shinsegae DF
ID (F)	311	770	-59.0%	800	1,473	-46.7%	- COVID-19 Neg. Impact on Sales - 2Q [Domestic -51%/YoY] [Abroad -52%/YoY]
(S (D)	287	362	-4.0%	611	668	-8.0%	- Non-operat. -20%/YoY incurred
(Central City)	63	67	-21.0%	108	133	-18.7%	○ Shinsegae International
(Daegu S.)	36	45	-12.7%	73	90	-19.1%	- Due to DF Sales decrease - Cosmos (-28%/YoY)
(Cosmos)	38	35	53.2%	73	52	37.9%	- Expansion in Fashion, Good in CE - Fashion (+8.1%/YoY, Dress, +10%/YoY) - Lifestyle (+12%/YoY)
G. Profit							- Non-operat. +10% (Sales & Interest)
ID (F)	-37	17	-94	-69	30	-100	○ Shinsegae Central City
(S (D)	-3	15	-17	9	44	-34	- Earnings for next increase due to sales recovery of Gangnam Dept.
(Central City)	-3	10	-12	9	31	-32	- CCC sharp drop, now recovering
(Daegu S.)	-1	3	-3	-4	7	-11	- 2Q 20 : 10% (2019: 8%) Months : April, May, July, and October
(Cosmos)	-3	-3	-	-8	-5	-1	○ Cosmos
Net Profit							- Sales increase due to the growing interest in interior design and closing ineffective store - 2Q 20 : 7% (2019 : 32 stores)
ID (F)	-115	3	-118	-159	-1	-157	
(S (D)	18	10	+8	21	33	-12	
(Central City)	-6	5	-10	1	15	-18	
(Daegu S.)	-3	-	-3	-7	3	-8	
(Cosmos)	-3	-3	-	-8	-4	-1	

Footnote : (DF, S, Central City are consolidated basis)

All charts courtesy of Shinsegae (click to enlarge)

II. 2Q 2020 Summary [Consolidated]

✓ Total Sales 1,732bn KRW(-24.5%), OP -43bn(-11bn), Net Profit -106bn(-131bn)

○ Significant loss on DFS (Sales -36% yoy, OP -34bn yoy) impact on Consolidated Performance

○ Due to easing of social distancing measures and revenue spending, Department Store turns around

○ DFS sales recovering slowly aided by government deregulation(third party return, local distribution)

(KRW in Bbn)

	2Q 2020	2Q 2019	YoY	%	2020	2019	YoY	%
Total Sales (Net Sales)	1,732 (1,814)	2,294 (1,508)	-562 (-492)	-24.5% (-32.8)	3,577 (2,217)	4,813 (3,023)	-1,236 (-802)	-25.7% (-26.8)
Gross Profit (%)	839 (21.1)	783 (29.1)	-56 (-7.2)	-7.2% (-2.0)	1,183 (31.2)	1,879 (24.2)	-696 (-37.0)	-37.0% (-2.0)
SG&A (%)	882 (25.5)	715 (29.2)	-167 (-23.4)	-18.8% (2.4)	1,182 (33.3)	1,481 (20.4)	-299 (-20.2)	-14.8% (3.0)
OP (%)	-43 (-2.5)	88 (3.6)	-131 (-14.8)	-152.2% (-4.8)	-43 (-1.2)	178 (2.8)	-221 (-12.4)	-123.6% (-4.8)
EBIT (%)	-135 (-7.8)	33 (1.3)	-168 (-503.9)	-14.2% (-4.2)	-131 (-3.7)	927 (20.1)	-1,058 (-114.7)	-114.7% -
NP (%)	-106 (-6.1)	34 (1.1)	-140 (-408.2)	-17.2% (-7.2)	-106 (-2.9)	719 (16.4)	-825 (-114.7)	-114.7% -

The affiliates' results show the pressure on the duty free (DF) division

Shinsegae Department Store, the parent company of Shinsegae Duty Free, posted a -25% second-quarter decline in sales year-on-year to KRW1.7 trillion (US\$1.46 billion). Operating profit turned to a loss of KRW43.1 billion (US\$36.4 million).



The famed Shinsegae Department Store in Myeong-dong also houses the retailer's main duty free business in Seoul

While the department store business performed well through the COVID-19-affected period (gross sales down just -3%, same store sales growth -2% and operating profit positive at KRW12.9 billion/US\$10.9 million), duty free sales slumped by -58% year-on-year to KRW380.3 billion (US\$321 million).

Downtown sales fared better, falling a comparatively modest -31% thanks to strong resilience in the daigou market. But airport duty free sales plummeted -92% year-on-year in the face of a near total collapse of passenger traffic.



A collapse in passenger traffic has led to a disastrous trading situation at Incheon International Airport, exacerbated by punitive rents

Duty free operating losses reached KRW37 billion (US\$31 million), compared to a profit of KRW17.3 billion (US\$14.6 billion) in the comparative quarter last year.

This year's sharp quarterly loss came despite the duty free arm no longer paying rent to the parent company and a KRW72 billion (US\$60.8 million) rent relief package from Incheon International Airport Corporation (IIAC).

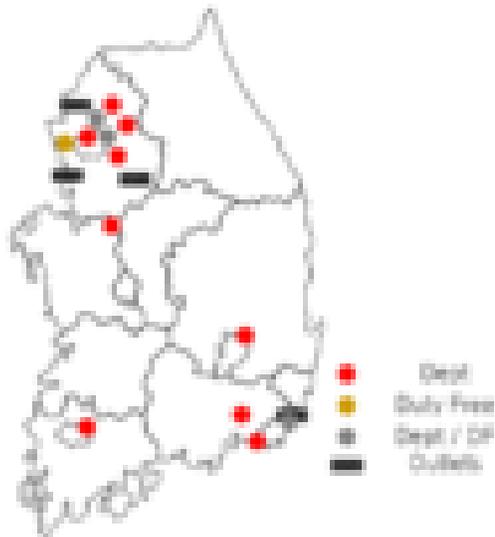


Shinsegae Duty Free in Gangnam, Seoul: Downtown business has fared much better than airports but that was due to daigou traders not traditional shoppers as pictured here

Shinsegae Department Store had shown strong resolve to grow its travel retail operation by injecting KRW195.9 billion (US\$165.5 million) in assets (seven floors of space at the famed Shinsegae Myeong-dong department store occupied by the travel retail division) and KRW100 billion (US\$84.4 million) in cash to Shinsegae Duty Free in April.

Factoring in the KRW72 billion rent that was unpaid this quarter, the operating loss of the duty free business would have actually been KRW109 billion (US\$92 million). And allowing for the fact that the company is only paying 50% of the MAG that would have been owed under normal circumstances, losses could have climbed to KRW163 billion (US\$137.6 million).

DOMESTIC PRESENCE



Location	#	Location	#	Location	#
Department store		Duty Free Store		Premium Outlet	
Seoul	3	Seoul	2	Yeosu	1
Metropolitan	3	Incheon	1	Paju	1
Busan	1	Busan	1	Busan	1
Daegu	1			Silong	1
Others (Gwangju)	3				
Total	11	Total	4	Total	4

TOP 10 DEPARTMENT STORES NATIONALLY

Ranking 1H20	Stores
1	SHINSEGAE Gangnam
2	LOTTE Flagship Store
3	SHINSEGAE Busan
4	LOTTE Jamsil
5	HYUNDAI Pangyo
6	LOTTE Busan
7	HYUNDAI Flagship Store
8	HYUNDAI Trade Center
9	SHINSEGAE Flagship Store
10	GALLERIA Flagship Store

* TOP 1-20 : Shinsegae 2, Hyundai 5, Lotte 5 stores

(Source : Moodie Davitt)

The sale of excess duty free inventory via third party exports and domestic market channels is helping and Shinsegae Duty Free will attempt to boost such efforts. Combined sales of third party exports and unsold inventory amounted to KRW24 billion (US\$20.2 million) and KRW25 billion (US\$21.1 billion) in June and July, respectively. The Moodie Davitt Business Intelligence Unit estimates this accounted for 18% of total Q2 duty free sales.

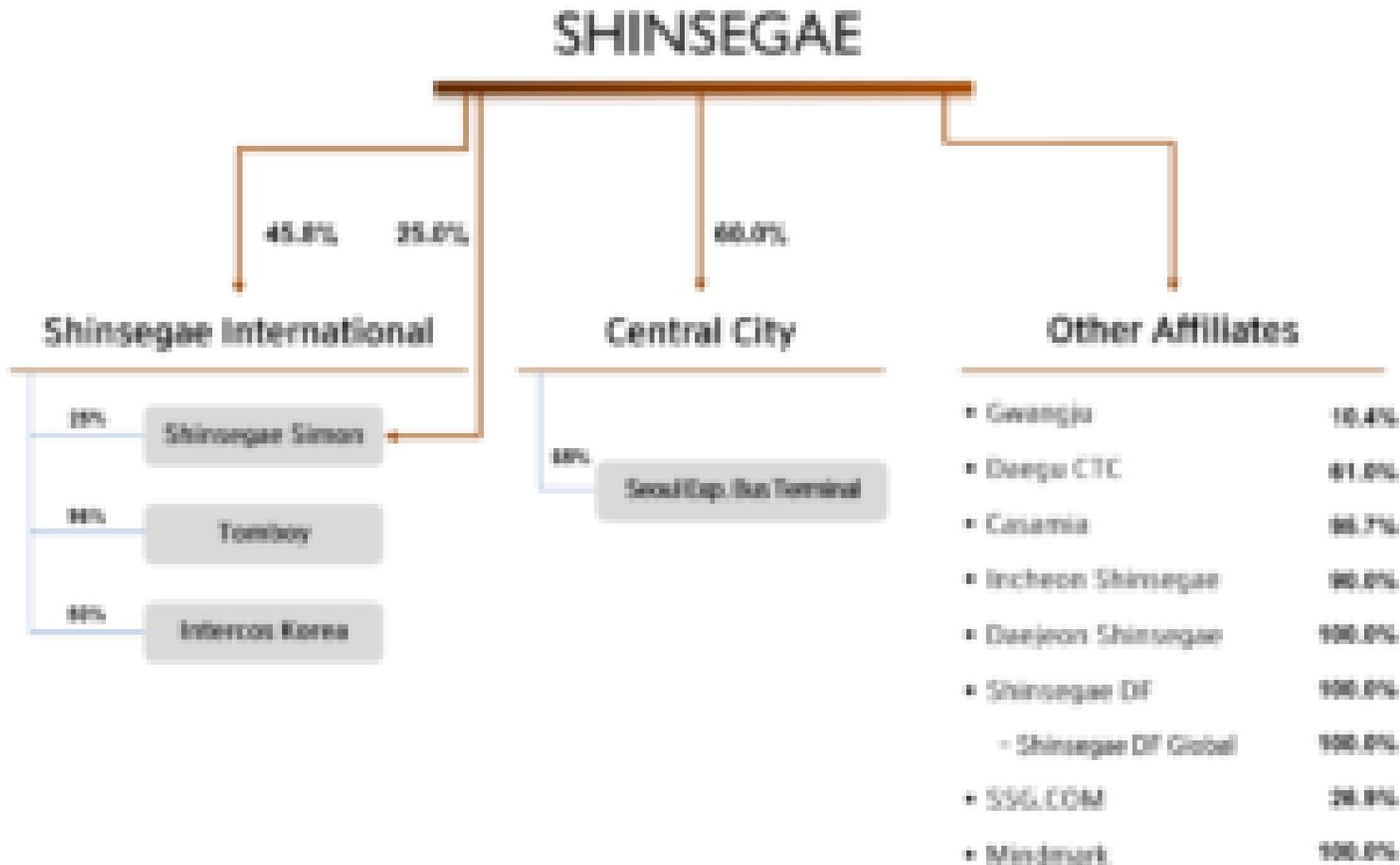
Need to renegotiate airport terms

One of Shinsegae Duty Free's most pressing needs is to renegotiate its existing Incheon International Airport concession to pay rent as a variable percentage of sales instead of the current MAG structure.

Competitors Lotte Duty Free and Shilla Duty Free have that revised formula in place for their respective Incheon T1 concessions after agreeing to temporary rolling contracts until new retailers are determined. The current IAC relief measures which allow Shinsegae Duty Free to pay 50% of its MAG expire at the end of this month. From next month the retailer will in theory need to pay the full amount unless the relief package is extended or terms renegotiated as seems logical.

While Shinsegae Duty Free remains adamant that its rent model should be as per its competitors, IAC so far remains steadfast and has told The Moodie Davitt Report that there has been no progress on this front. Shinsegae Duty Free tells us that it has little interest in bidding on the upcoming tender without the current

situation being resolved.



While the traditional ‘golden goose’ status of duty free in Korea has been badly tarnished, the department store sector and the consumer appetite for luxury goods remain strong. While same store sales growth (SSSG) based on IFRS accounting declined, SSSG by total gross sales of management accounting turned to a positive -3% in Q120, after a heavy -11% fall in Q1 (SSSG by month: April -4%, May +4%, June +9%, July +9% and August MTD +9%).

The duty free sector will in time recover in line with any travel revival – particularly between South Korea and China. But the vast disparity between downtown and airport profitability continues to place a question mark over the sustainability of travel retail at Incheon, the world’s biggest airport duty free location.

One leading analyst maintained its Buy on Shinsegae, arguing that the worst of the department store and duty free earnings worries were over. The continued strength of the daigou market and the sell-off of previously undepleted stock will also help duty free, the source said, with likely extended rent relief at Incheon another boon.

But any real improvement in duty free trading conditions may still be some time off. The hole in that vase needs the water is poured into it.



is Senior Retail and Commercial Analyst at The Moodie Davitt Report. His appointment in June 2019 was the first of its kind in travel retail media. It marked the creation of the Moodie Davitt Business Intelligence Unit, a new division designed to provide a previously unseen level of research and analysis for the travel retail channel.

Do you have research needs related to the Korean and Asia Pacific travel retail and luxury markets? Min Yong Jung can be contacted at minyong@moodiedavittreport.com