TFWA World Exhibition 2006

Opening Speech

Erik Juul-Mortensen – President

• Ladies and Gentlemen,

Good morning and welcome to Cannes and to Tax Free World Association World Exhibition at yet another defining moment in the industry's history.

I am delighted to welcome to this morning's conference two most distinguished speakers: Gerhard Schroeder, the former Chancellor of Germany, and Madame Christine Lagarde, French Minister with responsibility for Foreign Trade – we are honoured to have two such distinguished speakers and look forward to hearing from them later.

• Before August 10, I had two themes in mind for this morning's opening address

- **growth and**
- **credibility.**

As a firm believer in the long-term resilience of our industry, I still intend to address those two subjects, but I want to start by commenting on the impact on our industry of the alleged plot to blow up transatlantic flights, revealed on August 10.

The effect on our industry has been material. And not just in Europe but across the world to varying degrees in the wake of increased security.

• Restrictions have hurt many sectors of the airport retail industry – the liquor and beauty industries have felt the strongest impact with restrictions on carrying liquids, pastes and gels on board US-bound flights, worsened in some countries by restrictions on transferring passengers or restrictions bringing these same items through from landside to airside.

There are few businesses which have not been affected in some way by reduced dwell time as a result of increased security checks, or simply as customers, stressed and delayed by the longer check-in queues and security procedures, have lost the time – or simply the will - to shop.

Their confusion has been compounded by some airlines who have unilaterally - and in some cases regardless of even the remotest logic of destination - refused to allow passengers to take their purchases on board.

• So as an industry, how have we responded? What have we achieved? Where do we stand now? Ladies and gentlemen, in circumstances where security was – and is - at the very top of every government's agenda, the industry has done, I would claim, a magnificent job in securing support for protecting airside retail in the new order of things.

• Within 7 days of August 10 a small group of us met at World Duty Free's Heathrow offices – on the doorstep of one of the worst hit airports - with others joining by conference call. Less than a week later ETRC and Schiphol hosted a meeting at Schiphol where 40 leading figures from the beauty and liquor industries, retailers and airports agreed a common way forward, shaped a proposal to put to the authorities, appointed a lobbyist and swung immediately into action.

Led by ETRC, the European Travel Retail Council, national associations contacted government and regulatory bodies, the beauty and liquor industries mobilised their sector associations, position papers were drawn up and circulated, and regular updates on progress were emailed not only to the participants of the Amsterdam meeting, but to the wider industry, through the national associations to the European businesses, and to the other Duty Free World Council members – APTRA for Asia Pacific, the IAADFS for the Americas, MEDFA for the Middle East and TFWA.

The position papers recognised the reality of the security situation and brought workable solutions to the table which would allow the industry to trade. This resulted in unprecedented access to key officials and policy makers who have worked in close co-operation with us and sought our input into key proposals presented to stakeholder groups and the EU member states.

This whole exercise has yet again been run and co-ordinated by a relatively small group of people who all have day jobs. They are not paid to work on behalf of the industry, but they do so with energy and passion and the results speak for themselves.

The EU, working in close co-operation with the US, ensured that the requirement to gate deliver to US-bound flights was lifted on September 26 by the TSA.

On October 5 the European Union adopted a new range of airport security measures, which set the framework for our business in the new situation. Whilst this does not completely return us to pre – August 10 trading, it is a huge leap forward from the decimation of the perfume and liquor business at airports which we originally feared.

However, the work is not finished. Until these regulations are recognised outside the EU and the US, passengers coming from outside those countries and transferring within the EU and US will not be able to keep their duty-free liquid goods.

This poses a problem which is of truly global concern for our industry. The potential for customer confusion is massive, and unless solved it could turn out to be as damaging as - or more - than the abolition of intra-EU duty and tax-free sales in 1999.

The industry outside the EU and US now needs to work with the same vigour that ETRC has shown to ensure alignment and a solution which works worldwide. The alternative is huge customer confusion and lack of confidence in duty free purchasing.

I shall refrain from going into more detail here, • but would urge you all to attend the workshop on Wednesday morning at 10 o'clock, in Auditorium A, led by Frank O'Connell, the President of ETRC, to whom – once again – this industry owes an enormous debt.

• Back now to the two themes of my original agenda, which I believe are even more relevant in the wake of the current trading environment:

Growth and Credibility.

Self-congratulation has never been in short supply in this industry, some of it well-deserved as over the years the passenger experience has been significantly improved in airports, on ferries and cruise lines, and some of the downtown and border duty and tax free stores are up there amongst some of the best in the world.

But isn't it time we looked at the hard facts?

***Look at the growth chart 10 years a la Generation* •**

We are, of course, all familiar with the sales achieved by this industry – and particularly with the 27 billion US dollars achieved in 2005, up 8% on the previous year.

But is this real growth?

In other words are we growing the business through our own efforts or are we just riding on the back of passenger growth? At the very least we should want our sales percentage growth to be in line with passenger growth.

In the absence of robust data other than for air passengers, let us look at the global sales evolution slide just for airports. •

It shows a powerful upswing in sales from 2002, and particularly over the last two years – from 10 billion US dollars to 14 billion US dollars.

Now I want to share with you a different view of life: year-on-year percentage change in sales, compared with year-on-year percentage change in passenger numbers. •

Ladies and gentlemen, in the mid to late 90s the year on year percentage growth in sales fell short of the year on year percentage growth in passengers, but since 2001 we have seen the reverse – a very positive development. However, the 2005 figures, which look so good on the global airport sales chart you just saw, do not look quite so healthy viewed from the point of growth rates – they suggest that for 2005 at least we did not maximise the potential that passenger growth offers.

Let us take a closer look at the growth in airport sales in each product category.

• Spirits and wines – characterised by some retailers as a 'dying' category – has fought its way back, outperforming passenger growth consistently since 2001, suggesting that a concerted new approach from brandowners and retailers is bringing results.

• Perfume and cosmetics business has consistently shown the greatest percentage increases over the decade and performed magnificently since 2001 – but watch those columns heading towards convergence.

• Tobacco struggled, rallied between 2001 and 2004, but has since felt the effect of a series of trading restrictions.

• Confectionery and gourmet foods – the smaller of the core categories has the best growth track record and continues to do well.

Finally, • a volatile performance from luxury goods sales in airports.

• What do the figures tell us? For me these charts suggest that we need to take a tougher look at how we evaluate our performance. Simply looking at year-on-year sales figures in isolation is too simplistic and in a sense can lull us into a false sense of achievement. So whilst the long term trend for travel is positive and we need to challenge ourselves to at least match annual passenger growth – and to aim to exceed it.

The reality is that our business is dependent on people travelling and travel is so inextricably linked with geo-political reality that our business will always – to some extent – be at the mercy of bigger, sometimes shocking, events way outside our sphere of control.

2006 has been a challenging year. The Israeli occupation of Lebanon brought not only the closure of Beirut duty free but inevitably affected travel plans with hoteliers also here in Cannes reporting widespread cancellations. The alleged plot to blow up transatlantic airliners had its epicentre at Heathrow and in the UK, but has affected our business across the world. 2006 is unlikely to be a vintage year for our business.

Quite apart from the impact of terrorism there are also underlying trends towards liberalisation and globalisation which mean that we cannot stop the decreasing differential between prices arising from lowering of domestic market taxes.

The charts I showed previously would suggest that despite some really challenging crises, we have had some success in driving growth, which exceeds passenger growth. What the figures do not tell us is whether this was achieved by increasing penetration, or tempting the same passengers to spend more.

However, those converging columns in 2005 should be sounding an alarm bell for us all, and we should be focusing on the things we <u>can</u> do to influence our business in an ever-changing world:

- Achieving a real shift in balance from a predominantly price-driven business to a business which focuses on giving passengers an unrivalled product range and a truly memorable shopping experience, whilst delivering value

- Working hand in hand with airports and ports to increase the time that passengers have to shop. That is a difficult task in today's world where passenger security must be the overriding priority and security measures are slowing passenger flows.

Ladies and gentlemen, I believe we are again at a point where we need to summon every bit of our energy and imagination if we are to drive those sales.

And that means taking a close look at ourselves and our credibility – my final theme

• Credibility in terms of the offer – simply selling products or brands which deliver the highest margin is NOT the way to tempt and excite an increasingly savvy customer

• Credibility of pricing – if retailers want brandowners to invest in building brands that are must haves for passengers – and brand owners DO want to - then retailers should understand that overdoing the 'buy one get one free' and other rock-bottom promotional deals can harm brand integrity and are unsustainable in the long run - and as

brandowners we should resist anything that harms the integrity of our brands. Instead we should jointly invest in creating exciting, innovative and irresistible promotions, which draw customers into the store and which help converting the browser into a shopper. Yes, everybody loves a bargain and there will always be a place for price promotion – but within limits. Trying to compete with the big supermarkets and internet brand for brand is just not sustainable.

• Credibility in terms of the origin of our goods – we must ensure that we always deliver the best, the most authentic products – it is a hallmark of our business that we should be proud of.

• Credibility in terms of controlling the flow of products on to other markets and credibility of we, the producers, not allowing it to happen.

• Credibility of tenders….and awarding them. There has been so much talk around this subject but has anything really changed? - or have we reaching the point where retailers will simply not invest in bidding for some contracts unless they are sure that the field is truly open for the best retailer with the best all-round offer to succeed?

I say again: bidding which results in the winner squeezing supplier brand margins, so that the retailer can make his numbers, has to be a thing of the past.

• Credibility in judging ourselves – where superlatives seem to be the order of the day and critical comments sometimes seem to have all but disappeared - except perhaps on trade associations which somehow always seem to be fair game!

• Credibility in the eyes of governments and regulators. In the last months the ETRC, by its response to August 10, has earned credibility in Europe in regulatory circles, very much akin to IAADFS in the USA. Never has the need for the four regional bodies, APTRA, MEDFA, IAADFS and ETRC and the many national associations been so clear.

And finally, and above all, • credibility in the eyes of the customer, the travelling consumer. • As Peter Brabeck of Nestle argued in his much quoted speech at the first Trinity Forum "this industry will never be entirely credible if it believes it can operate in some parallel universe into which

the gullible customer steps once they have entered the world of travel retail".

Customers do not leave their standards and expectations behind them and somehow passively accept another set of values. The customer knows about value for money and the service levels he or she expects.

So, ladies and gentlemen, • let us work together, retailer, supplier and landlord to ensure our world of duty free and travel retail is compelling and credible. Without that credibility, we will not change a passenger into a shopper. Without turning passengers into shoppers we will not be maximising the true opportunity that rising passenger numbers give us. We have proved that we can outperform passenger growth. So it is up to us pull out all the stops and ensure that it happens every year – without exception, and against all the odds.

I trust you will find the rest of our conference today stimulating and I wish you an productive and enjoyable TFWA World Exhibition 2006.

• Thank You!

___________END________________________