

“The State of the Industry”

2003 TFWA WE Conference

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Ladies & Gentlemen:

Good Morning and a very warm welcome to Cannes, to the 19th TFWA World Exhibition and to this morning's conference during which we will consider this world in which we trade and our future as an industry.

On behalf of the Tax Free World Association Management Committee and my fellow Board members it gives me great pleasure to welcome you to what looks to be a banner year for the industry's premiere event.

Cannes is where our companies and executives gather from all corners of the globe and this offers us a unique opportunity to assess the overall mood, the pace, the general condition and direction of the business. Each of us will leave Cannes with our own sense of the state of the industry, an assessment arrived at through various meetings we have had, trade press comments we have read - and speeches we have heard...all coloured, of course, by the irrepressible rumour mill.

One travel industry analyst describing the current environment put it best when he said, "It's not good, but it's less bad." - And the same is probably true for the international duty free and travel retail industry. Perhaps not an overwhelmingly hopeful statement, but it acknowledges that the state of our industry could probably be a lot worse than it is.

In spite of the increasing number of international travellers, world-wide duty free sales have been in gradual decline since 1996 - hastened by a drop in spending among key groups such as the Japanese, the abolition of intra-EU duty free sales, and the knock-on effects of global economic malaise.

This gradual decline has been eclipsed by the more shocking developments of the last four years, the awful events on September 11, international conflicts, Afghanistan and Iraq, and the outbreak of SARS - to mention but a few.

The argument that the duty free retail channel operates in a protected, privileged environment, and therefore has a distinct advantage over its domestic counterpart, no longer holds true. Instead of just watching products walk off the shelves, we have had to become highly professional retailers and brand owners whilst regulators continue trying to dilute the business proposition. The abolition of intra-EU duty free in 1999—despite a hard fought battle from our industry—has altered the shape of our business and ushered in a new era in its history.

Again, when the industry's global retailers, the brand owners and all other stakeholders assessed the potential impact of a proposed World Health Organisation ban on duty free tobacco sales it became all too clear what a challenging — rather than privileged — environment we trade in. Such a ban would have dealt a devastating blow to penetration rates and impulse sales which are so key for other categories. Associations and retailers from across the globe joined together to challenge the W.H.O. and managed to negotiate a change in wording that would allow sales to continue and—just as importantly—that would stem a dangerous precedent in regulating our trade.

Where have these battles—some won, some lost—left our industry? Healthier? Perhaps, in the sense that we have been forced to quickly adapt to a development that was inevitable and explore new avenues of growth for our future. Wealthier? So far, these have been painful adjustments. Wiser? Certainly the attacks of finance ministers and regulatory agencies have been a rallying point for our industry to organise a defense against future attacks. In fact, this has led to some important developments which I will come back to at the close of my speech.

Post-abolition pains in Europe pale in comparison to what hit us in the first and second quarter of this year. The triple effect of economic decline, war, and a mysterious deadly virus highlighted just how vulnerable the travel industry has become. Airlines were haemorrhaging from a 20-55% loss in passengers, despite having cut capacity and receiving government subsidies over the previous 12 months. Passenger traffic in key international airports fell anywhere from 30 to 70% in the second quarter. Luxury goods companies which rely on travel spending were also vulnerable, some registering as much as a 97% drop in profits for the period. TFWA's own Asia-Pacific show was one of thousands of casualties of the SARS epidemic. The decision to cancel was painful but responsible.

This unpleasant dose of reality was a lot for our businesses to digest in just six months. Clearly it has ushered in a new era where companies around the world are operating leaner than ever before. September 11 and SARS have taught our industry that trouble on a global scale can spring up without warning and it highlights why some fundamental changes are necessary for the health and survival of our business. Hold that thought because I will return to it in a moment.

The travel industry seemed to turn a corner in June and passenger movements began a gradual climb out of their critically low levels. SARS, war and economic problems were shrugged off as people demonstrated once again how remarkably high travel comes on their list of priorities. But the glass is only half full, Ladies and Gentlemen, and I believe we have to face the fact that while we trade on the back of the remarkably resilient travel industry, recovery in passenger numbers will not be enough to solve the duty free and travel retail sector's fundamental problems.

Aviation analysts agree that further huge structural changes are on the horizon for the airline business. We are told to expect more restructuring, more mergers, a paring down of routes and a range of cost-cutting measures. Alliances are leading the way for a range of deregulations that will restructure the passenger movements in major airports.

Ladies and Gentlemen, in my humble opinion the biggest mistake that our industry could make at this juncture would be to blame all of our problems on recent events

and to move forward under the status quo and simply wait to react to the next crisis. History provides lessons but not paradigms for moving forward.

The types of crises, shocks and developments travel retail has endured in recent history would naturally make any company timorous in its strategic planning. But my core message this morning is that there is every reason for this industry to move beyond its modus operandi of crisis management and set a course for its future, establishing new models of business, planning strategically and setting realistic short-term goals.

I am not talking about implementing the latest management fad or staging a revolution. I think all of our companies are much more interested in getting the basics right than in chasing the next rainbow. It has been said over and over, but the duty free and travel retail business is based on a flawed financial model, which in some cases makes little economic sense for retailers and suppliers. Retailers who pay illogical fees or guarantees to win airport concessions, often pass that burden on to suppliers who are forced to extend – in some cases - unhealthy terms. One need only examine the performance of the first two quarters to see how vulnerable such thin margins leave you.

Airport authorities need to realise that taking the biggest cheque is no guarantee of a vibrant retail offer and retailers must realise that with the market at full stretch, each new crisis just encourages more brand owning company owners and boards to question the viability of investing in such a volatile market.

In discussing the downturn of business in Asia, DFS chairman Ed Brennan said in a recent trade magazine interview, “I think one thing it is teaching all of us is that we need to be much more cautious and realistic with our investments.” - I don’t think there is one company in this industry that would disagree with Mr. Brennan, and this was echoed in June during the Trinity Forum of landlords, retailers and suppliers in London. Out of that forum a task force was formed to produce a “white paper” that will offer Landlords an alternative to the current business model.

I hope that when we meet again in Singapore for the TFWA Asia Pacific show, our discussions will revolve around “how” this new business model is being implemented, rather than whether it will be implemented.

There are other pressing reasons to cast aside the mantle of crisis management. Key emerging markets could breathe new life into our battered business — the outbound Chinese traveller and the over-50 traveller are perhaps the most significant example. But we must be prepared to meet the special demands of these groups and this requires information and planning. Our next three-year research plan will see a sizable investment in consumer research in western markets as well as in Asia-Pacific.

At tomorrow morning’s Travel Executive Forum titled “Prospects for Asia Pacific”. TFWA has lined up four top authorities from the global and regional travel business to discuss the recovery and realistic projections for growth and development of the region. It represents an ideal opportunity for you to gain a new and better perspective on the region and to walk away with a wealth of actionable information.

That discussion will be followed by a top conference programme during TFWA Asia Pacific next May in Singapore where the industry will take up all the key issues facing the region.

Finally, I will state the obvious: being proactive rather than reactive places our industry on a better footing for the future. The most vocal and active proponents of the duty free and travel retail industry admit that the industry has lacked a single, unified body to fight the powerful regulatory bodies that have challenged and will again challenge our livelihood.

To that end, TFWA is throwing its full support behind the development of the Duty Free and Travel Retail World Council. Late last year, national and regional associations from the industry agreed to form a World Council which will provide a key international support network and a forum in which policy on industry-relevant topics can be formed. Until this industry has a single voice, it will not be recognised by legislators and regulators and therefore not invited or permitted to sit at any table where its future may well be at stake. At a global level, the industry has no presence and could thus be considered invisible to legislators or any regulatory body. Some 22 trade associations are involved in developing the World Council and they will be meeting this week in the hope of turning the concept into a reality.

Ladies and Gentlemen, I began this morning by suggesting the state of our business is not good, but it's less bad. We all recognise the impact of uncalculated, uncontrollable events. However, our industry can realistically influence growth, challenge inefficient models of business and head off future threats to our livelihood. We will take a look at what you feel are the key issues for the future of the business at the close of this morning's programme. TFWA Conference and Research Director Linda Hopkins has assembled a range of commentary from industry figures and polled the trade on key issues affecting our future.

This morning we have an honoured guest with us, who is uniquely qualified to explain the background, the outcome and the future implications of geo-political developments. Richard Holbrooke will be remembered as one of America's premiere statesmen for his ability to negotiate the momentous Dayton agreement which ended the war in Bosnia. It was after that success that President Clinton made Mr. Holbrooke US Ambassador to the United Nations where Mr. Holbrooke played a central role in the development of US policy toward the United Nations, the Balkans, Africa, Asia and the Middle East. It almost seems that Ambassador Holbrooke had spent his entire career preparing for that role, having previously served as Assistant Secretary of State for Europe, Ambassador to Germany, Special Envoy to Kosovo and Cyprus and Assistant Secretary of State for East Asian and Pacific Affairs.

I believe it is fair to say that US foreign policy is not merely a consideration for heads of state, but also for heads of industry and business around the world. We often hear whispers of a "new world order" ushered in since September 11. We have asked Ambassador Holbrooke to help us make sense of geopolitical events and economic structures that are shaping the future of global business and key sectors such as travel and aviation. Following his address we will have an opportunity to chat with him informally in a Q&A session.

Tax Free World Association is pleased and honoured to welcome as our keynote speaker this morning, Former US Ambassador to the UN, Richard Holbrooke.

Ladies and Gentlemen, I wish you a successful week. Thank you for your attention and please join me in welcoming Mr. Richard Holbrooke.

Thank you.