

The Swatch Group

Price CHF334.30

2016 EBIT lowered by 4% after 2015 results

Fair Value CHF410 vs. CHF420 (+23%)

NEUTRAL

Bloomberg	UHR VX
Reuters	UHR.VX
12-month High / Low (CHF)	445.7 / 313.9
Market Cap (CHF)	18,410
Ev (BG Estimates) (CHF)	17,257
Avg. 6m daily volume (000)	248.0
3y EPS CAGR	-3.5%

Following poor 2015 results, we are lowering our FY 2016 EBIT estimate by 4%. In view of this we have reduced our FV from CHF420 to CHF410. Neutral recommendation unchanged.

ANALYSIS

- In 2015, The Swatch Group did not change its historical pricing policy remaining very cautious concerning price increases**, particularly in the entry-segment brands such as Swatch and Tissot as competition in this segment is quite severe, especially from brands with non-CHF production costs and therefore not affected by the strength of the Swiss currency. The CEO's main objective is to increase brand volumes and to gain market share. Beyond lower production capacity utilisation, the negative product and geographical mix also explained the profitability decline (EBIT margin lost 300bp of which -380bp in H2). In 2015, The Swatch Group opened 100 own stores of which 40 for the Swatch brand and seven for Omega. Retail accounts for 25 to 30% of Group sales. In 2016, it expects to open 60 to 80 stores.
- Negative product mix in 2015.** While sales were down 3% at same forex, volumes were well oriented but with a negative product mix. Sales of gold watches were down even in volume terms and the luxury Breguet brand suffered due to its Russian exposure. On the other hand, Blancpain sales grew in volumes and were strong in Mainland China, while the mix was lowered thereby implying a sales decline in value terms and in CHF. In the high-end segment again, Omega sales grew slightly in volumes but there again with a lower average selling price. Lastly, even Tissot suffered in value (negative mix) with more quartz watches sold than mechanical ones. On the other hand, Longines did very well both in volume and in value, and this trend is continuing, with for instance a 16% sales increase in Mainland China in January 2016 (at same forex).
- Negative geographical mix:** in 2015, sales momentum was under pressure in Mainland China (around 20% of sales) with no more than low single digit sales growth (at same forex) and an even tougher situation in Hong Kong (15% of sales) with a 20% sales decline. In HK wholesale sales declined by 40 to 50% depending on the brand names while retail sales were down close to 12%. These two regions are very profitable. In HK, negotiations with landlords, for lower rents were more successful than a year ago. US sales were also down last year, clearly affected by the negative wholesale trend. France sales were up 25% (+30% on 9m but decline in November and December). UK sales were up 10%.
- Furthermore, The Swatch Group continued to invest in marketing in 2015** with a higher amount spent than in 2014, particularly with the Tissot agreement with the NBA (CHF25m per year over seven years) that should have a positive impact on brand awareness both in the US and also in Mainland China (basket-ball is the most popular game in MC with more than 300m people practising). The Swatch Group spent almost 12-13% of sales on marketing/communication in 2015. In 2016, management expects to spend almost the same amount despite the cost of the Olympic Games in Rio in August. Nevertheless, it is clear that if there is an interesting opportunity in terms of marketing or communication, Mr Hayek will not hesitate to invest.
- Following 2015 results, we adjust our 2016 sales and EBIT. We are lowering our EBIT by 4%.** We expect sales to rise 5% and margin to widen slightly (+90bp to 18.1%), as marketing costs should be under control despite the Rio OG. Furthermore, the Swatch brand (sales estimated at CHF700) is close to signing an agreement with an eyewear manufacturer to launch a range of glasses.

VALUATION

- Given our new 2016 estimates, **our FV is reduced to CHF410 vs CHF420**. Neutral recommendation unchanged. The stock is trading in line with sector average.

NEXT CATALYSTS

- Mid July 2016: H1 results

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Analyst :
Loïc Morvan
33(0) 1 70 36 57 24
lmorvan@bryangarnier.com

Sector Team :
Nikolaas Faes
Antoine Parison
Cédric Rossi
Virginie Roumage

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London	Paris	New York	Geneva	New Delhi
Beaufort House	26 Avenue des Champs Elysées	750 Lexington Avenue	rue de Grenus 7	The Imperial Hotel
15 St. Botolph Street	75008 Paris	New York, NY 10022	CP 2113	Janpath
London EC3A 7BB	Tel: +33 (0) 1 56 68 75 00	Tel: +1 (0) 212 337 7000	Genève 1, CH 1211	New Delhi 110 001
Tel: +44 (0) 207 332 2500	Fax: +33 (0) 1 56 68 75 01	Fax: +1 (0) 212 337 7002	Tel +4122 731 3263	Tel +91 11 4132 6062
Fax: +44 (0) 207 332 2559	Regulated by the	FINRA and SIPC member	Fax+4122731 3243	+91 98 1111 5119
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