

20th July 2016

Luxury & Consumer Goods

The Swatch Group

Price CHF261.30

870bp EBIT margin decline in H1

Fair Value CHF270 (+3%)

SELL

After last Friday' release, The Swatch Group has reported its final H1 2016 results this morning. As pre-announced, net sales declined 11.4% to CHF3.71bn and fell 12.5% at same forex. H1 2016 EBIT was down 54% to CHF353m, implying a 9.5% EBIT margin, down 870bp to 9.5%. We remain at SELL on the stock with a FV at CHF270.

Bloomberg	UHR VX
Reuters	UHR.VX
12-month High / Low (CHF)	432.9 / 261.3
Market Cap (CHF)	14,416
Ev (BG Estimates) (CHF)	12,931
Avg. 6m daily volume (000)	266.8
3y EPS CAGR	-5.9%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-9.0%	-23.4%	-19.8%	-25.4%
Pers & H/H Gds	4.6%	-0.4%	7.6%	1.2%
DJ Stoxx 600	3.5%	-3.4%	1.3%	-7.8%

YEnd Dec. (CHFm)	2015	2016e	2017e	2018e
Sales	8,451	7,760	7,860	8,080
% change		-8.2%	1.3%	2.8%
EBITDA	1,817	1,410	1,510	1,680
EBIT	1,451	1,035	1,130	1,301
% change		-28.7%	9.2%	15.1%
Net income	1,089	790.0	850.0	993.0
% change		-27.5%	7.6%	16.8%

	2015	2016e	2017e	2018e
Operating margin	17.2	13.3	14.4	16.1
Net margin	12.9	10.2	10.8	12.3
ROE	10.0	7.0	7.4	8.1
ROCE	12.2	8.1	8.3	8.8
Gearing	-14.4	-12.6	-10.8	-8.2

(CHF)	2015	2016e	2017e	2018e
EPS	20.11	13.34	14.35	16.76
% change	-	-33.7%	7.6%	16.8%
P/E	13.0x	19.6x	18.2x	15.6x
FCF yield (%)	4.5%	2.3%	2.3%	2.3%
Dividends (CHF)	7.50	7.88	8.27	8.68
Div yield (%)	2.9%	3.0%	3.2%	3.3%
EV/Sales	1.5x	1.7x	1.7x	1.7x
EV/EBITDA	7.0x	9.2x	8.7x	8.0x
EV/EBIT	8.8x	12.5x	11.6x	10.3x

ANALYSIS

- The Swatch Group has issued poor H1 2016 results this morning, harbouring no real surprise, following last Friday's pre-announcement.** Sales fell 11.4% to CHF3.71bn and 12.5% at same forex. Watches & Jewelry sales were down 12.4% at same forex. Sales were fairly resilient in Mainland China (around 15% of sales) with double-digit growth in retail sales and the same trend for Southeast Asian countries. However, they were down significantly (close to -20%) in Hong Kong and Macau (together 14% of sales), where retailers were more than cautious in their orders. According to management, the downturn in retail sales has bottomed out. In Mainland China, the situation has improved for the high-end segment.
- Revenues were also down double digit in Europe, including in Switzerland and particularly in France, as tourists (mainly from Asia and the US) were lacking, due to the terrorists attacks in Paris and in Brussels. Furthermore, we guess that production sales fell sharply as some third parties cancelled or reduced orders.
- H1 2016 EBIT was down 53% to CHF353m. This implies EBIT margin at 9.5%, down 870bp vs H1 2015.** The margin in Watches & Jewelry narrowed 880bp to 11.2%. The EBIT margin decline was due to lower sales, the negative geographical and product mix, lower production capacity utilisation due to lower orders from third parties, a long-term industrial strategy of continued investment in employees, and lastly, investments in new products and marketing. Furthermore, some costs concerning the Olympic Games in Rio were already booked in H1. Globally, the Rio games could prove costly for The Swatch Group. Inventories were increased at end of June (+2% at CHF6.3bn), accounting for 86% of FY 2016 expected sales. The increase was due to further investments for Harry Winston.

Half year results

CHFm	H1 2015	H1 2016	chge %
Net sales	4,192	3,713	-11.4
o/w Watches & Production	4,045	3,586	-11.2
EBIT	761	353	-53.6
o/w Watches & Production	807	402	-50.0
<i>EBIT margin %</i>	<i>18.2</i>	<i>9.5</i>	<i>-870bp</i>

Source : Company Data; Bryan Garnier & Co. ests.

- At this point, management anticipates a better situation in H2, even with the prospect of a sales increase, which should lead to a limited sales decline for the FY. For FY 2016 sales, we expect an 8% decline that should lead to a 4% decrease in H2 alone. In the first days of July, the group reported a clear sales increase in Mainland China especially in the very high-end segment (Blancpain, Breguet, Omega...). Management remains cautious on some countries in Europe and HK (particularly for the wholesale business). Long-term marketing investments will continue in H2 and the period will also shoulder the costs of the Rio OG.

VALUATION

- We remain at Sell on The Swatch Group with a CHF270 FV.

NEXT CATALYSTS

- Conference call at 2pm.

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