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**The Deloitte Swiss Watch Industry
Study 2016**

Navigating through stormy waters

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About the study

This is the fifth annual Deloitte Swiss Watch Industry Study. It is based on an online survey and discussions with executives and a consumer survey which was conducted among 3,000 people living in China, Italy, Germany, Japan, Switzerland and the US by the data collection provider Research Now. The online survey with executives was conducted between May and July 2016. A total of more than 50 watch executives participated.

Key findings



Sharp fall in Swiss watch exports

Exports of Swiss watches fell in the first half of 2016 to **CHF 9.5 billion** from CHF 10.2 billion in 2015. This is the lowest level since 2011. In July and August the decline continued. Both the value and volume of exports have been decreasing for 14 consecutive months.



Negative Outlook

54% of watch executives surveyed are pessimistic about the outlook for the Swiss economy while **65%** are pessimistic about the main export markets for the next 12 months. The number of watch executives who are pessimistic about the outlook for the Swiss watch industry has doubled since 2015, peaking at **82%**.



Weaker foreign demand is biggest risk

According to the survey, weaker foreign demand has become the biggest risk for watch executives overtaking the strength of the Swiss Franc. **79%** consider weaker foreign demand to pose a significant risk to their business over the next 12 months, especially in Hong Kong where **57%** expect fall in exports to continue.



Growing importance of 3D printing

3D printing has gained a foothold in the Swiss watch industry. **64%** of watch executives surveyed use this technology as a concept and prototype tool.



Swiss brands gain visibility in the smartwatch market

Our consumer survey, conducted in China, Germany, Italy, Japan, the US and Switzerland, shows one notable change from last year. Swatch, which was already quoted in the top 3 smartwatch brands in 2015, is now joined by Tag Heuer.



Online shops set to become a more important sales channel

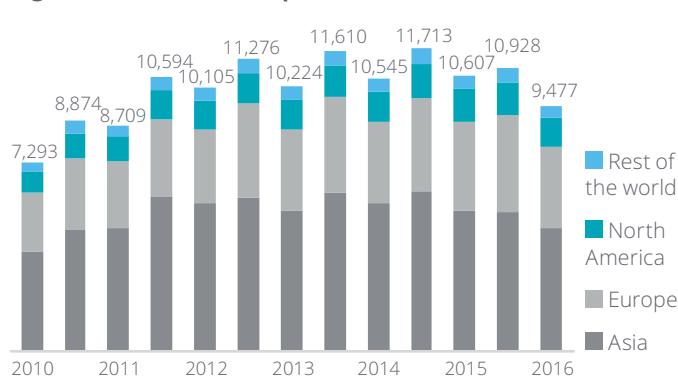
For the first time since our study was launched in 2012, watch executives are planning to focus primarily on online sales channels over the next 12 months. Our consumer survey also indicates that more people are likely to buy their watches online.

Industry overview

Swiss watch exports continue to fall

The Swiss watch industry has been facing difficult conditions since 2015. Exports of watches fell in the first half of 2016 to their lowest level since 2011 (see Figure 1) creating concerns that a return to growth would take longer than expected.¹ After years of tremendous growth between 2010 and 2013 followed by a relative plateau in 2014, Swiss watch exports started to falter in the second half of 2015 primarily due to a sharp fall in sales to Asia. In the first half of 2016, watch exports to Asia were worth CHF 4.7 billion, compared to CHF 5.4 billion in the first half of 2015. Overall, the first half of 2016 showed a decline of 11.3% in volume and 10.6% in value over the same period in 2015. Swiss watch exports have now been declining for 14 consecutive months (as at August 2016), the first time this has occurred since the 2009 global recession. However, the recent decrease is less dramatic than the one recorded in 2009 when volume decreased by 16.9% and value by 22.2%.

Figure 1. Swiss watch exports (CHF m)

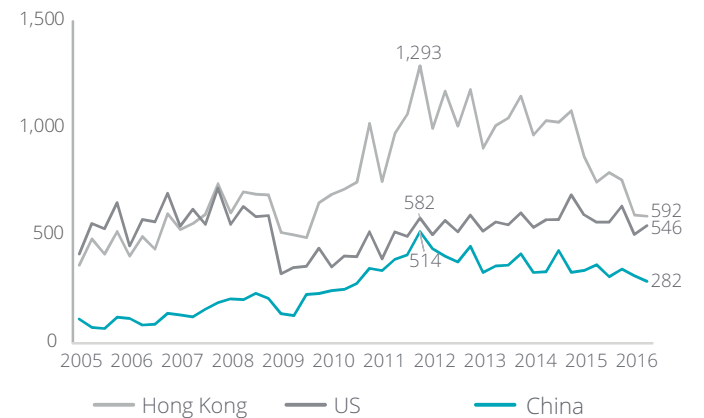


Source: Federal Customs Administration, Deloitte analysis

Plunging demand in Hong Kong

The situation in Hong Kong, the most important export market for Swiss watches, is striking. After a sharp upward trend from 2010 to 2013 and a pause in 2014, watch exports to Hong Kong in Q2 2016 fell almost to the level last seen in 2009 (see Figure 2). In Q4 2011, Swiss watch exports to Hong Kong peaked at CHF 1.3 billion, but in Q2 2016 they dropped to CHF 592 million, a decline of 54%. In July 2016, the US overtook Hong Kong as the number one market. If this downward trend continues, the US is likely to become Switzerland's top market for watches again for the second half of 2016.

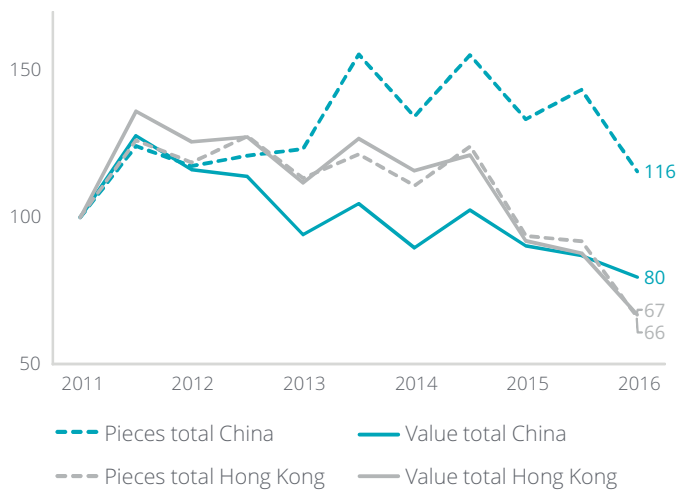
Figure 2. Swiss watch exports (CHF m), top three markets



Source: Federal Customs Administration, Deloitte analysis

The situation in China is not as dramatic as in Hong Kong. Compared to the first half of 2011, Swiss watch exports to China decreased by 20% in value while exports to Hong Kong declined by 33% (see Figure 3). This can be explained by the fact that the product mix is different in China with a larger proportion of quartz and low-end watches and a lower overall price per piece. In contrast, exports to Hong Kong are composed mainly of higher-end watches with an overall higher price per piece. This combined with a sharper decrease in volume led to a stronger decline in Hong Kong.

Figure 3. Growth of Swiss watch exports, H1 2011=100



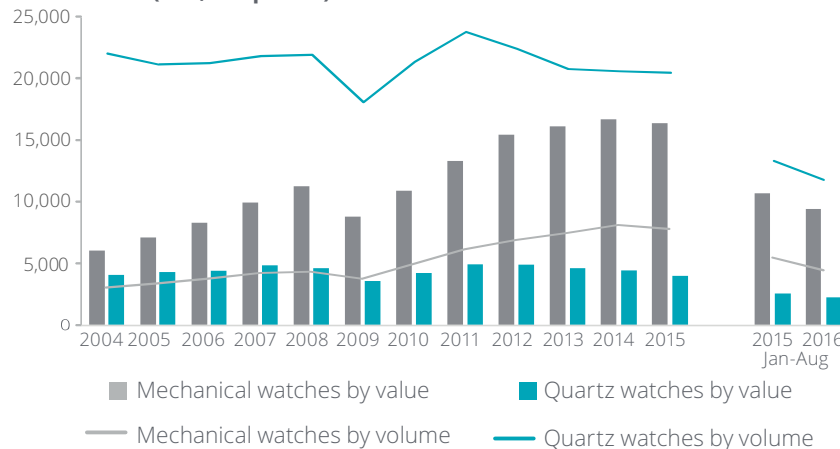
Source: Federal Customs Administration, Deloitte analysis

Slight decrease in mechanical watches

After a steady increase in value and volume since 2009, mechanical wristwatches declined by 2% in value and 4% in volume in 2015 (see Figure 4). In 2016 (Jan-Aug), the decline was even stronger, with value down by 11% and volume by 14% compared to the same period of 2015. Quartz watches continued to decrease further although the first half of 2015 had shown signs of growth returning. Overall, the first eight months of 2016 showed a decrease in value and volume of 10.8% and 11.5% respectively over the same period in 2015.

According to the watch executives surveyed, expectations for volume growth in the next 12 months declined for all price segments compared to 2015. However, expectations remain highest for high-end watches (rating 4.5 on a scale of 1-10, down from 5.6 in 2015), followed by mid-range (4.1 down from 4.7) and low-end (4.1 down from 4.8).

Figure 4. Swiss exports of mechanical and quartz watches by value (in m) and volume (in 1,000 pieces)



Source: Federal Customs Administration, Deloitte analysis

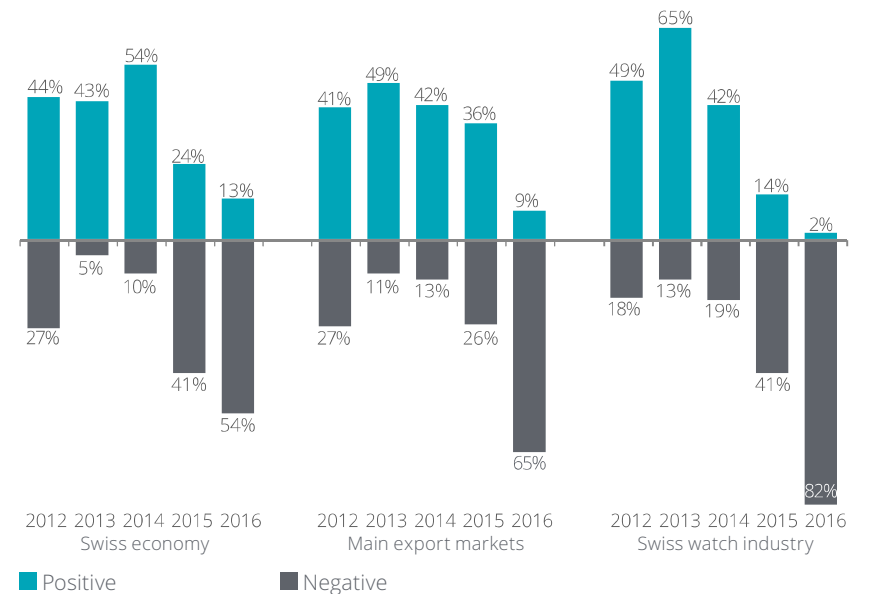
Industry outlook and demand

Negative outlook

According to the vast majority of watch executives surveyed, the downward trend in the Swiss watch industry will continue over the next 12 months. The number of respondents who are pessimistic about the outlook for the Swiss watch industry has doubled since 2015 – and now stands at 82% (see Figure 5). There is also growing pessimism about the outlook for the Swiss economy with only 13% of watch executives having a positive outlook. For the first time since the Deloitte Swiss Watch Industry Study was launched in 2012, the percentage of respondent who have a negative outlook for the main export markets exceeded those who are optimistic.

Figure 5. Outlook for the next 12 months

How do you judge the economic outlook for the ... in the next 12 months



Pessimism about Hong Kong

Hong Kong remains the most negatively viewed market with 57% of watch executives expecting demand for Swiss watches to decline in the next 12 months (see Figure 6). The downturn in the most important export market for the Swiss watch industry therefore seems likely to continue. The situation has not been helped by the inventory built-up in 2015 which should still take time to clear. Richemont announced at its September 2016 annual general meeting that it bought back some inventory, mainly in Hong Kong and Macau, in a move to assist their multi-brand retail partners. According to various interviews, it was also the case for some of the other luxury groups and independent watch brands.² The outlook for China also remains weak although watch executives are not as pessimistic.

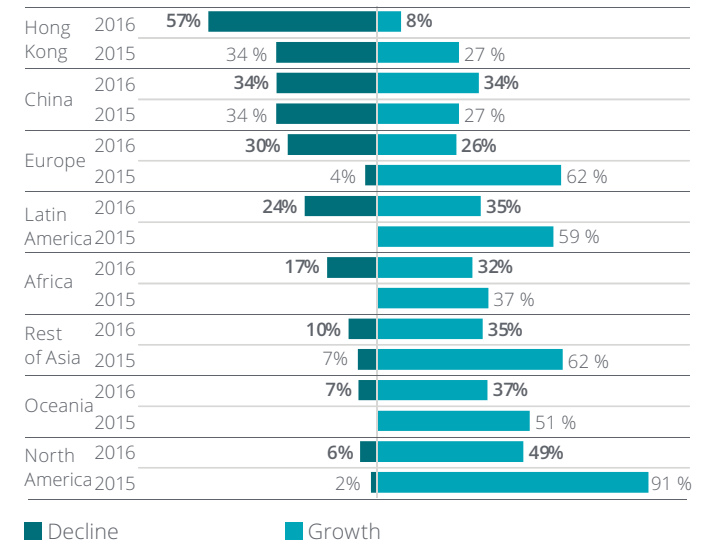
Growing pessimism about the outlook for watch sales in China and Hong Kong is not surprising. As highlighted in the Industry overview, Swiss watch exports have declined sharply since the beginning of 2015 in this region primarily due to the economic slowdown in the region and the anti-corruption and anti-kickback legislation in China which continue to impact sales of luxury products there and in Hong Kong. Hong Kong has also been affected by the drop in Chinese tourists due to changes in visa requirements and increased political uncertainty in the region. In addition, the sharp appreciation of the Swiss Franc in 2015 following the removal of the exchange rate floor by the Swiss National Bank led to a rise in the price of imports from Switzerland, further affecting sales.

Against a background of economic stagnation and geopolitical uncertainty caused by a series of terrorist attacks, expectations for Europe have also deteriorated. Only 26% of watch executives have a positive growth outlook for Europe, compared to 62% in 2015. Given that our online survey was launched shortly before the decision by the UK to leave the EU (Brexit), the number of executives having a positive growth outlook for Europe could now be even smaller. The UK has become the seventh-ranking export market for Swiss watches in the last two years, overtaking France, Singapore and the UAE. Exports of wristwatches increased by 21% in the first half of 2016 compared to 2014. However, as a result of the Brexit, economic growth is likely to be lower over the next few years, leading to uncertainty about job security which in turn could have a negative impact on watch sales. Brexit has already had an immediate impact with sterling falling sharply. In 2015 sterling was trading around CHF 1.50, but in the wake of the referendum it fell to CHF 1.30 making Swiss watches less expensive unless watch brands raise their prices in the local market to reflect the drop in sterling. Exports of Swiss watches are therefore likely to decline over the next several months. Nevertheless, short-term effects tend to be positive as watch brands need some time to increase their prices. Swiss watch exports to the UK were 13% higher in July 2016 than a year earlier while total watch exports fell by 14% in the same period of time.

The most highly rated market remains North America although the number of survey participants who expect the demand for Swiss watches to grow dropped from 91% in 2015 to 49% in 2016. Exports to the US started to slow towards the end of 2015 and continued to weaken in the first half of 2016.

Figure 6. Growth regions

What are your growth expectations for the Swiss watch industry in the following regions in the next 12 months?



Note: In 2015 Hong Kong and China were not tracked separately.

The next big growth markets: The US and India

According to our survey, the US and India continue to be considered as the markets with the most potential. Asked about the next big growth market for watch exports, 22% of respondents mentioned the US up from 13% in 2015, although exports to the US fell sharply over the first half of 2016. Overall, the US economy appears to be performing well with growth and consumer spending continuing to rise. In April this year consumer spending advanced at the fastest pace in seven years.³ While the reasons for the decrease in exports to the US remain unclear, Swiss watch brands continue to believe in the short-term potential of this market. For example, Tag Heuer recently became an official timekeeper for Major League Soccer and Roger Dubuis opened its first retail shop in New York and is planning to open shops in other US cities.⁴ Other Swiss watch brands, which had focused on Asia over the past four years, are now also planning to expand in the US. A strategy that appears necessary if this market becomes the number one export country again in the short term.

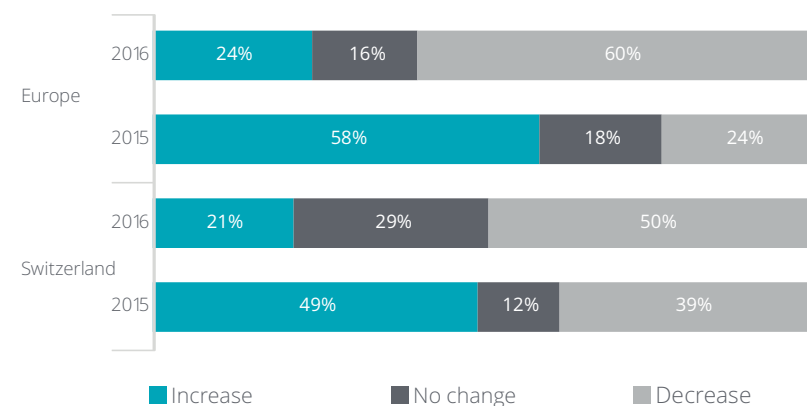
Twenty-two per cent of watch executives consider India to be the next market with strong potential. India's economy has enjoyed strong growth in recent years with GDP growing by 7.2% in 2014 and 7.3% in 2015. The International Monetary Fund predicts that growth will climb to 7.5% in 2016 and 2017.⁵ In addition, India's market for luxury products continues to increase sharply. However, India's economy might be weaker than data suggests as a new methodology for calculating GDP was implemented recently. Some economists think that 5%-6% is more realistic.⁶ It is also worth noting that Swiss watch exports to India account for only 0.6% of total watch exports and have stagnated in the past few years. Therefore, any potential for this market might be more longer term.

Sales to foreign tourists under pressure

With Europe, and Switzerland in particular, being attractive destinations for tourists from South America and Asia, sales to foreign tourists are an important additional export channel for Swiss watch companies. They are estimated to make up 5% of total exports (the Federation of the Swiss Watch Industry only tracks export statistics). However, compared to 2015, watch executives are now much more pessimistic: 21% expect sales to tourists to increase in Switzerland, down from 49% in 2015 (see Figure 7). The increase in pessimism is similar for other European countries.

Figure 7. Outlook for sales

What do you think is the outlook for sales in Europe and Switzerland to tourists from Asia, South America or Russia, for example, over the next 12 months?



This change in sentiment can be attributed to various factors, one of which has been the fear of terrorist attack following the events in France, Belgium and Germany which had a strong impact on tourism in Europe.

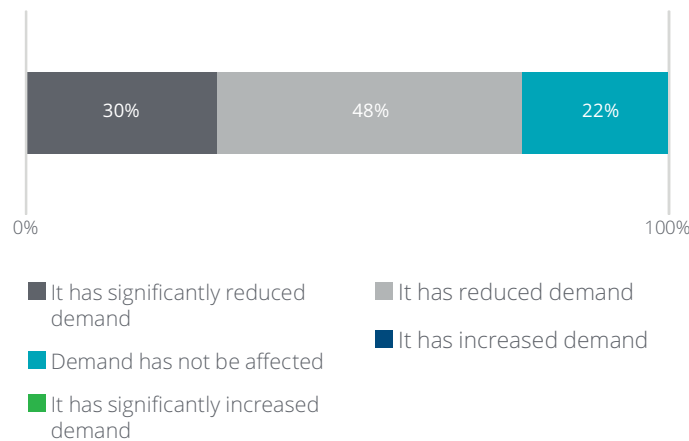
China also recently decided to increase taxes paid on imported luxury goods in a move to cultivate a domestic luxury market. Controls at Chinese customs are due to be reinforced and taxes on imported watches will increase from 30% to 60% which could have a strong impact on sales of luxury watches to Chinese tourists in Switzerland and Europe. The new biometric information collection procedures introduced for visa applications to Schengen countries in October 2015 have also had an impact on Chinese tourists' ability to visit European countries. Rather than simply mailing in an application, visa applicants in China must now personally go to the Swiss Consulate in Beijing, Shanghai, Guangzhou or other major cities to undergo fingerprinting. Nearly 50% of watch executives indicated that this change has reduced demand in Switzerland, while 30% said demand has been reduced significantly (see Figure 8).

The change in visa regulations is likely to be the main factor for the sharp decline in tourists from China. After six years of strong growth the number of Chinese tourists visiting Switzerland was down to 373,000 in 2016 (January-June), compared to 451,000 for the same period in 2015.⁷

As Swiss authorities and the National Tourist Office are looking at ways to simplify the process such as the introduction of mobile biometric station, the negative impact of visa conditions might be reduced quite significantly over the next years.

Figure 8. Visa regulations

How do you rate the impact of the change of visa conditions for Chinese tourists on the watch sales in Switzerland?



Challenges and risks

Widespread worries about foreign demand

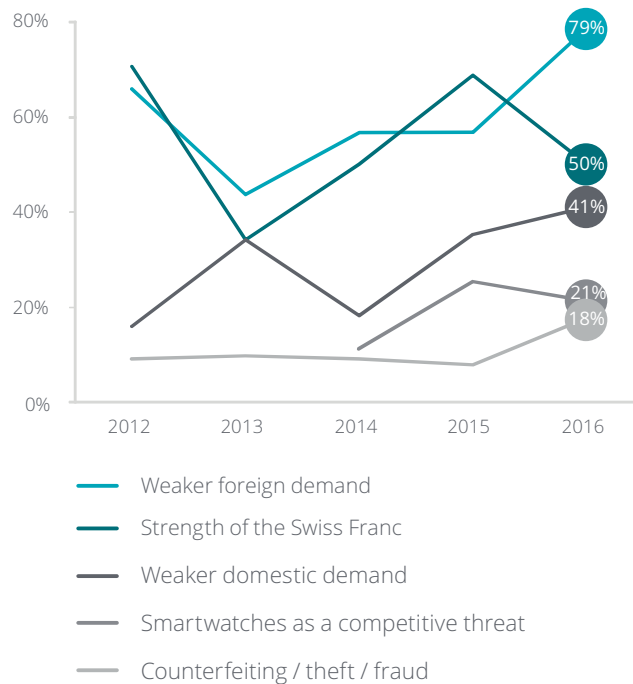
Compared to last year, there is one significant change regarding risk factors. Unsurprisingly, weaker foreign demand has become the biggest risk for watch executives, mainly due to the sharp drop in Swiss watch exports to Hong Kong and China in the past few months, as highlighted earlier. Nearly 80% of respondents expect this to pose a significant risk to their business over the next 12 months, compared to 57% in 2015 (see Figure 9).

The strength of the Swiss Franc remains a top concern even though it is considered less important than in 2015 as the exchange rate has remained relatively stable over the last 12 months. The same is true for smartwatches with 21% of watch executives expecting them to pose a significant risk to their business, compared to 25% in 2015. This change can be attributed to the fact that there is still no concrete sign that this category poses a significant threat to the Swiss watch industry, although smartwatch sales have increased dramatically.

Some companies had already decided to lower prices to counter weak foreign demand and the strength of the Swiss Franc. For example, IWC Schaffhausen and Baume & Mercier decreased prices for some mid-level collections two years ago.⁸ Blancpain has also recently lowered prices for some steel models. The decision to cut prices seems to reflect the view that above inflation price increases are no longer sustainable even for high-end brands. Time will tell if this is a good strategy or not.

Figure 9. Outlook for sales

Which of the following factors are likely to pose a significant risk to your business over the next 12 months (multiple answers possible)?



The threat of counterfeiting and grey market

For the first time since the Deloitte Swiss Watch Industry Study was launched in 2012, counterfeiting ranks among the top five risks.

According to the Federation of the Swiss Watch Industry (FH), 40 million fake watches are produced each year, compared to 30 million genuine Swiss watches.⁹ With the growing importance of online sales, the distribution of fake watches has become easier. Counterfeiters can offer their products anonymously. Moreover, the quality and design of counterfeit watches have improved with progress made both in mechanical movements and external watch parts.

Besides counterfeiting many watch executives are also worried about genuine watches being sold at a discount in the grey market without their authorisation. The strong growth and record sales of recent years which were followed by a growth plateau and more recently a decline created a flood of new Swiss timepieces and a massive surplus of stock in some regions. This overproduction is driving the grey market with numerous dealers forced to sell stocks to discounters to free-up cash and buy new collections. Many wristwatches are turning up on the grey market – especially in China and Hong Kong. More than 50% of watch executives surveyed consider the grey market as the biggest reputational risk, an increase of 18 percentage points compared to 2015.

Procurement problems easing

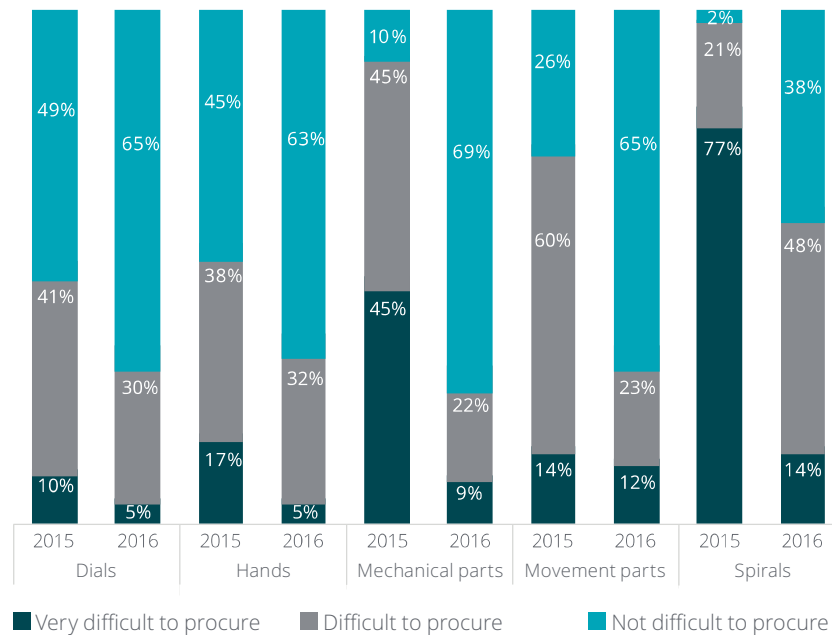
According to watch executives, procurement problems overall have fallen (see Figure 10). This change can be attributed to the difficult current economic situation and the decline in watch sales. In 2015, 77% of respondents indicated that spirals were very difficult to procure. This year this number declined to 14%. Nonetheless, spirals still remain the most difficult parts to procure.

Overinvestment in production facilities

With concerns about the weaker foreign demand and decreasing sales of Swiss wristwatches, investment in production capacity is likely to fall. The number of watch executives who consider the amount of investment capacity as too high increased from 21% in 2015 to 63% in 2016 (see Figure 11). Only 8% rate the amount of investment capacity as too low.

Figure 10. Outlook for sales

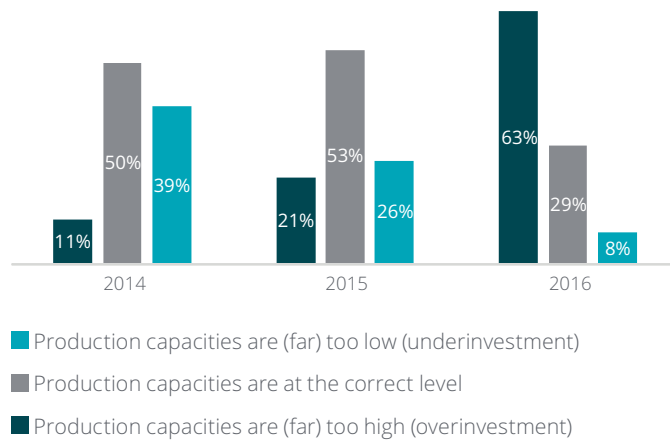
In your view, what parts (internal and external) are the most difficult to procure?



Considering the decrease in exports over the last 12 months, this overinvestment sentiment does not come as a surprise as a number of watch brands from Richemont (Jaeger-LeCoultre, Vacheron Constantin, Piaget) and from LVMH (Louis Vuitton and Hublot) had recently substantially increased their production facilities. For example, Richemont has inaugurated its long awaited 45,000 square meter campus housing nine entities. Patek Philippe has also announced its intention to invest CHF 450 million to expand its Plan-les-Ouates manufacturing facility which will include a 50,000 square meter extension and take four years to complete. Although the production capacity of the industry might appear too high in the current environment, the Swiss watch industry has an overall track record of growth and these investments should be measured in the long term. The main downside of the rapid expansion of some of the Swiss watch brands remains the layoffs and partial unemployment that some of them had to implement over the last year. Since the beginning of 2015 the unemployment rate in the watch industry increased from 7% to 9%.¹⁰

Figure 11. Amount of investment in production facilities

How would you rate the amount of investment in production facilities in Switzerland?



Business strategies

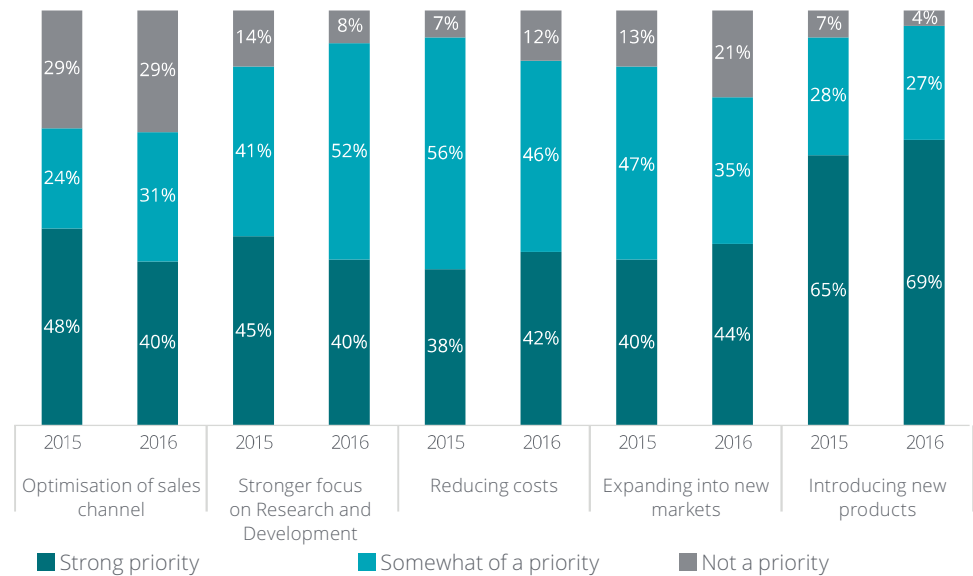
New products continue to be top priority

The introduction of new products remains the most important business strategy for watch executives over the next 12 months with 69% of respondents considering this a strong priority, up 4 percentage points compared to 2015 (see Figure 12).

This year saw the release of the long awaited new steel version of the Rolex Daytona inspired by vintage versions with a black cerachrom bezel. Some brands have introduced new colors or materials to existing lines such as the Hublot Big Bang Sapphire with a translucent case, the Tudor Black Bay Bronze with its case made of an aluminum bronze alloy or the Breitling Avenger Hurricane

Figure 12. Top five business strategies

To what extent is each of the following business strategies likely to be a priority for your business over the next 12 months?



with a case made of a new proprietary ultralight polymer called 'Breitlight'. Some brands introduced completely new lines such as Cartier's Driver line, while others revamped existing lines like Jaeger-LeCoultre's Reverso line which is now offered in three sub-lines (Tribute, One and Classic) with personalisation possible in boutiques and soon online.

Several independent watch producers have started to use crowdfunding to launch new products. A fifth of watch executives surveyed see crowdfunding as an important tool to launch new brands, revive old brands or finance specific products. Thanks to crowdfunding products can not only be financed, but also brought to the market with watch companies getting immediate feedback from buyers.

In 2015, Pebble, yet already well established in smartwatches, raised more than USD 20 million when launching its smartwatch 'Pebble Time' on a crowdfunding platform. Swiss watch manufacturer Czapek & Co was able to raise more than CHF 1 million in only three months. Swiss watch brand DuBois et fils has been using crowdfunding as well. However, crowdfunding is not always successful and the increasing number of watch-related crowdfunding projects tends to make it more difficult for new brands/products to succeed.

Besides introducing new products, expanding into new markets remains important. The increasing interest in new markets reflects a strategy to find different growth channels to compensate for the decline in watch sales to important export markets such as Hong Kong. A number of brands that had heavily invested in Asia are now focusing their development in the US hoping it will grow in the short term.

The rise of 3D printing

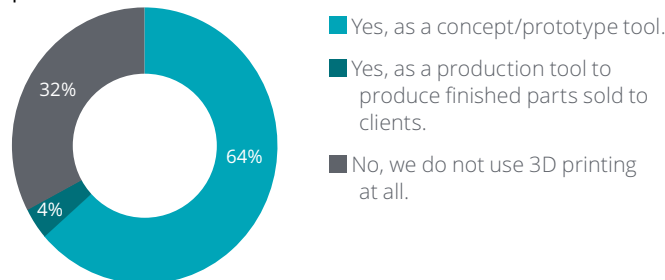
Many Swiss watchmakers have implemented 3D printing to create new models and case designs. This new computer-controlled technology builds objects from the bottom up by layering material until a three-dimensional object is created.

3D printing enables watchmakers to create prototypes in a short period of time without the need to order parts or manufacturing tools. This technology has become important not only for small companies and watch component manufacturers but also for big brands such as Patek Philippe, Vacheron Constantin and TAG Heuer.¹¹

According to our survey the use of 3D printing is widespread among Swiss watch companies: 64% of respondents indicated that they already use 3D printing as a concept or prototype tool (see Figure 13).

Figure 13. Use of 3D printing in the Swiss watch industry

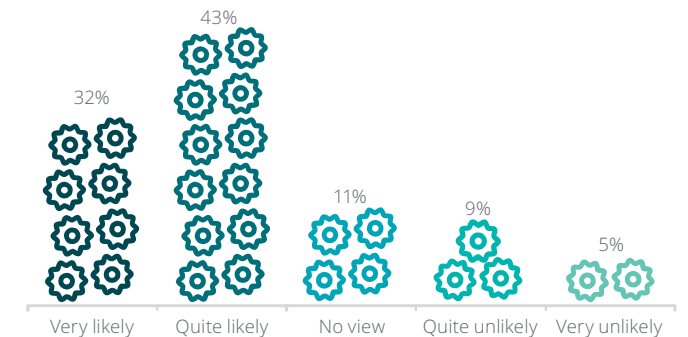
Do you use 3D printing in your conception and/or production process?



In 2016, Christoph Laimer, a Swiss engineer, designed a tourbillon watch that is almost entirely 3D printed. Although the watch is much larger than usual ones and only runs for 30 minutes, it shows the long-term potential of 3D printing for the watch industry. While the technology might not yet be precise enough to create complex mechanical movements or finish off external watch parts it is clear that precision and quality can only improve. According to our survey, 75% of watch executives believe that 3D printing is likely to play an important role for Swiss watch manufacturers over the next five years (see Figure 14).

Figure 14. Role of 3D printing over the next five years

How likely is it that 3D printing will play an important role for Swiss watch manufacturers over the next five years?



Smartwatches: A booming market but growth potential to be confirmed

The release of the Apple watch in 2015 marked the beginning of a new era for the smartwatch industry with sales rising dramatically since then. In Q4 2015, smartwatches overtook Swiss wristwatches in terms of total units: 8.1 million smartwatches were shipped compared to 7.9 million Swiss watches, according to the research firm Strategy Analytics.¹² In Q4 2014, the number of smartwatches was only 1.9 million units. Gartner forecasts that 50 million smartwatches will be sold worldwide in 2016, an increase of 67% from 30 million in 2015.¹³

Although the number of shipped smartwatches is likely to exceed Swiss wristwatches, they are far behind in terms of sales value. In 2015, Switzerland shipped wristwatches worth USD 22.5 billion, nearly double what the smartwatch market could earn in 2017. At its September 2016 Keynote, Apple however claimed they became the second largest watch brand in the world in terms of sales behind Rolex. Although these two brands are not comparable, the progression of Apple in such a short term is impressive.

The 2016 edition of IFA (a large international electronics show taking place every year in Berlin) saw the introduction of new models by Samsung, Asus, Sony and Whittings amongst others. Although these watches introduced designs that are more elegant and a few new features, one of the most interesting facts

was that a Swiss watch designer, Yvan Arpa, collaborated to the design of the Samsung Gear S3. Although the watch remains very big at 46mm, it is a new confirmation after last year's introduction of the Gear S2 that Samsung is clearly targeting traditional watch consumers.

Shortly after IFA 2016, it is Apple yet again, which paved the way for a further increase of the market with the introduction of its Series 2 Apple Watch, bringing some significant updates to the previous model. The new model is now waterproof thanks to an innovative new speaker which itself ejects water from holes at the end of the workout through sound vibrations. Other important updates are a new display twice as bright as the previous one and an on-board GPS to allow running and other activities without a phone. Apple also announced a new ceramic model (in lieu of the gold version), the renewal of its partnership with Hermès and a new collaboration with Nike with a dedicated Apple Watch Nike+. Overall, the updates to the Apple Watch showed a clear trend towards more fitness oriented tech and content. This does not come as a surprise considering real benefits of smartwatches beyond fitness and health tracking are still lacking for many customers.

After Apple decided to discontinue the gold versions of its watch (which started at CHF 10,000), it seems clear that the current most important target market for "high-end" smartwatches is rather between CHF 1,000 and 2,000. A price range in which we find the Ceramic and various Hermès versions of the Apple

Watch, but also the Tag Heuer Carrera Connected. Future will tell whether much more high-end "Swiss Made" models, like the Breitling Exospace B55, with fewer functions but with a price tag above CHF 8,000, also find their place in the market.

Despite the dramatic sales growth of the smartwatch segment, it remains unclear whether it poses a significant threat to the Swiss watch industry. As explained above, the decrease in exports of Swiss watches in recent months was mainly caused by the decline in Hong Kong and China, a strong Swiss franc and uncertainty in the global environment. There is no sign at this stage that sales of Swiss wristwatches have been impacted by smartwatches especially since the entire Swiss watch industry is currently suffering, regardless of the price range.

Swiss brands gain visibility in the smartwatch market

So far, Swiss brands have not played a very important role in the smartwatch market. Our online consumer survey, which included consumers in China, Germany, Italy, Japan, the US and Switzerland, shows that Apple remains the most popular brand ranking first in five of the six countries (see Figure 15). Samsung also remains one of the most popular brands. One notable change from to last year is that TAG Heuer is now present alongside Swatch (who introduced its payment-enabled watch Bellamy in 2015) in the top 3 smartwatch brands favoured by consumers in Switzerland, Germany, Italy (Swatch) and Japan (Tag Heuer).

Figure 15. Brands

Which brands of smartwatches are you most likely to buy?

| | Switzerland | US | Germany | Italy | China | Japan |
|----|--------------------|---------|---------|---------|---------|-----------|
| 01 | Apple | Apple | Apple | Samsung | Apple | Apple |
| 02 | Samsung/ Swatch | Samsung | Samsung | Apple | Samsung | Sony |
| 03 | Sony | Garmin | Swatch | Swatch | Sony | TAG Heuer |

Building on the success of the sale of over 50,000 pieces of its smartwatch in 2016, TAG Heuer will launch mid-2017 a complete family of smartwatches with the ambition to sell more than 100,000 units that year. According to Jean-Claude Biver, CEO of the brand, this product family will fit into the current collection and offer different colors, materials, sizes and price ranges.¹⁴ At the 2016 edition of Baselworld, Tissot also revealed its Smart Touch, available late 2016, which will be rolled out as a product evolution of its Touch collection. Several positive signs that should push other Swiss brands to venture into the segment or enhance their current offering. The recent announcement of the spin-off of the subsidiary of Frédérique Constant, Swiss MMT Connect, responsible for the development and commercialisation of smartwatch modules but also dedicated smartphone apps, could support this development.¹⁵

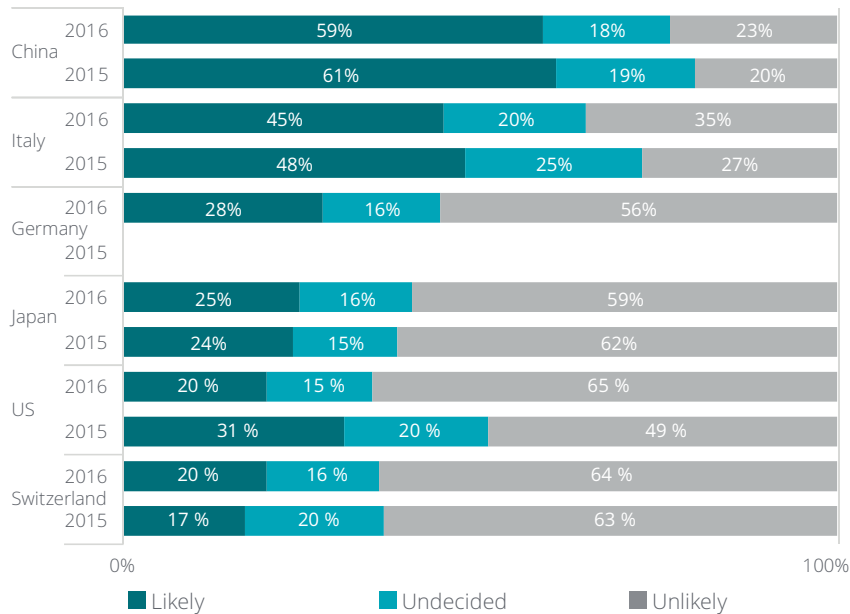


Young people more likely to buy a smartwatch

The results of our consumer survey, representative in terms of age, gender and region, show that interest in smartwatches remains high with the proportion of people intending to buy a smartwatch highest in China and Italy (see Figure 16). Compared to 2015, the proportion of consumers in the US likely to buy a smartwatch declined slightly from 31% to 20%.

Figure 16. Intentions to buy a smartwatch

Proportion of consumers likely to buy a smartwatch in the next 12 months

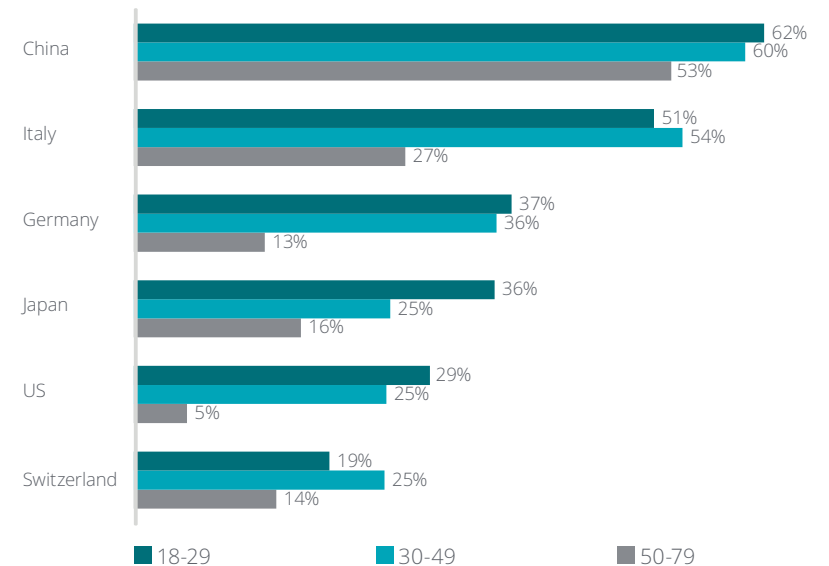


It should be noted that the high number in China has to be treated with caution as the online panel tends to be biased in favour of higher income groups. Lower income groups rarely have access to the internet.

When looking at the age of consumers, there is a huge difference in purchasing intentions. In every country surveyed people under the age of 50 are much more likely to buy a smartwatch over the next 12 months (see Figure 17). By entering the smartwatches market, Swiss watch brands could offer young buyers an entry point to their brand in hopes they will convert to more high-end mechanical timepieces once attached to the brand image.

Figure 17. Intentions to buy a smartwatch by age

Proportion of consumers likely to buy a smartwatch in the next 12 months



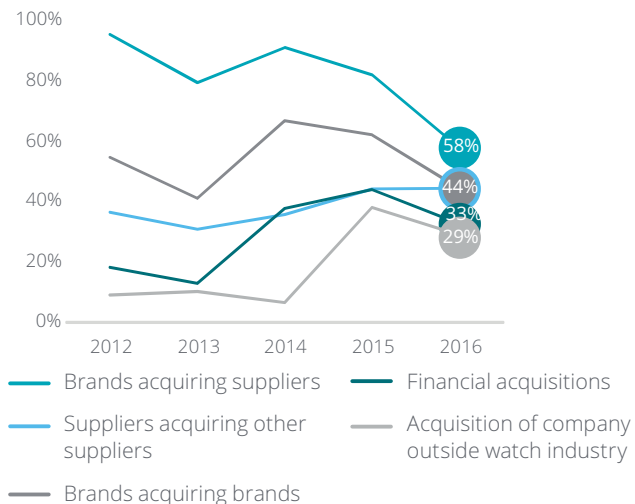
Consolidation of watch component suppliers set to continue

Overall, watch executives expect lower M&A activity than last year. Around a quarter (26%) of all respondents believe that the level of M&A activity in the Swiss watch industry will decrease over the next 12 months, compared to only 8% in 2015. The number of watch executives who expect an increase in 2016 (50%) is similar to the previous year (52%).

Despite a decline from 82% to 58%, vertical integration remains the most commonly expected type of M&A activity followed by horizontal integration at supplier level which has increased steadily since 2013 (see Figure 18).

Figure 18. Most important M&A activities

In your view, which types of acquisitions are most likely to happen (write out three)?



Asked in a separate question, 75% of watch executives also expect that further consolidation among suppliers is likely, i.e. formation of larger supplier groups, up from 57% in 2015. This is illustrated by the addition of four new companies to the Acrotec Group in 2016: Petipierre, Mu-Dec and Precipro in Switzerland and DJC in France. Due to the ongoing slowdown in the industry, a number of watch component suppliers, that generally suffer more than watch brands and over a longer period, are currently looking at ways to merge to achieve economies of scale and potential synergies at the operational and commercial levels.

Recent notable deals include the acquisition of Frédérique Constant by Citizen and Groupe Acrotec by Castik Capital. As seen in previous years, Asian groups such as Japan’s Citizen and China’s Citychamp are the most likely to expand their respective portfolio whereas large French and Swiss based groups like LVMH, Kering, Swatch Group or Richemont are less likely to do so. The acquisition of Frédérique Constant is a strategic move for Citizen as part of their plan to strengthen and diversify their brand portfolio with cross synergies on the distribution side.

The acquisition of Groupe Acrotec by Castik Capital was another landmark transaction in 2016 with an enterprise value of CHF 280 million confirming the strong appetite of financial buyers for watch component manufacturers even in difficult times. Even though this sector is cyclical by nature, financial buyers continue to see it as attractive mainly due to the high margins generated and a large number of private equity houses are looking at acquisitions in the sector again this year.

Digital sales channels to grow in importance

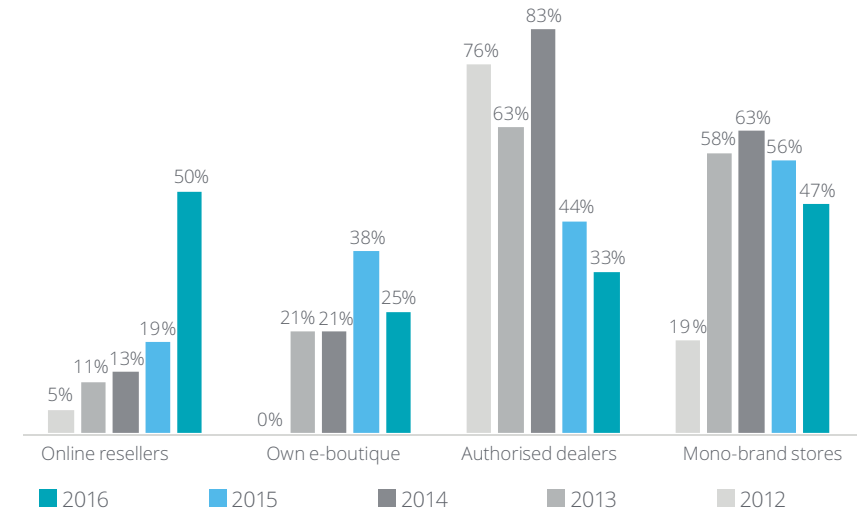
In the past, Swiss watch brands tended to be reluctant to adopt online sales channels as the internet was not seen as a proper place to sell prestigious watches due to counterfeiting and the grey market. Many brands also believed that the in-store experience delivered through excellent customer service could not be recreated digitally. It also is still important for most customers to try the 'real' product on before making their final decision.

Although online sales remain marginal for now, the situation could be set to change. For the first time since 2012, online resellers are viewed as the most important sales channel (see Figure 19). Half of the watch executives surveyed indicated that they will be putting the most emphasis on online resellers in the next 12 months, compared to only 19% in 2015. Another 25% consider that having their own e-boutique will be the most important sales channel. Tag Heuer for instance announced an exclusive e-commerce partnership with Jingdong Grou, china's largest online direct sales company.¹⁶ Other brands like Cartier or Jaeger-LeCoultre which had started opening e-boutiques in the US only are now offering online purchase in most European countries and in Asia.

According to our survey, 47% of watch executives will be putting the most emphasis on mono-brand stores. Asked in a separate question, 49% are likely to open a new mono-brand store in the next 12 months, compared to 58% in 2015. The majority of those brands still plan to open a mono-brand store in Asia (46%), followed by Europe (36%) and North America (25%).

Figure 19. Sales channels

On what sales channels will you be putting the most emphasis in the next 12 months? (multiple answers possible)



Putting more emphasis on online sales channels could be a good strategy. According to our consumer survey, the vast majority of people in the six countries surveyed are likely to purchase a watch online (this includes both smartwatches and traditional watches buying intentions). In Switzerland, the US and Germany online comes first, while in Italy and China it is second (see Figure 20).

Figure 20. Sales channels

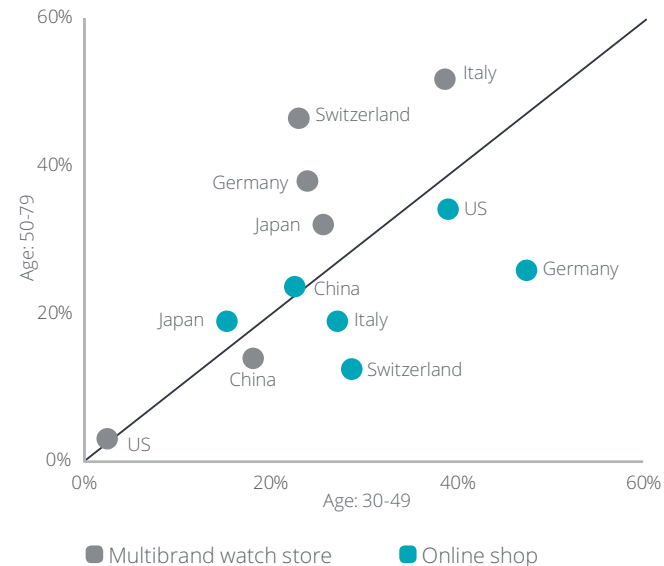
Where will you most likely purchase a watch?

| | Top answer | Second best answer | Third best answer |
|--------------------|---|---|---|
| Switzerland | Online shop | Multibrand watch and jewellery boutique | Department store |
| US | Online shop | Department store | Mono-brand store |
| Germany | Online shop | Multibrand watch and jewellery boutique | Department store |
| Italy | Multibrand watch and jewellery boutique | Online shop | Mono-brand store |
| China | Mono-brand store | Online shop | Multibrand watch and jewellery boutique |
| Japan | Multibrand watch and jewellery boutique | Department store | Online shop |

Online shops are important sales channel for younger people in particular. The share of people aged 30-49 who are likely to buy watches online is clearly higher than it is for those aged 50-79 (see Figure 21). The opposite is true when it comes to watch stores. This is an important finding to consider for Swiss watch brands trying to gain market share in the smartwatch market. As discussed earlier (see Figure 17), younger people are much more likely to buy smartwatches which makes online shops a key sales channel for this particular product category.

Figure 21. Sales channels

Where will you most likely purchase a watch?



Growing importance of online marketing

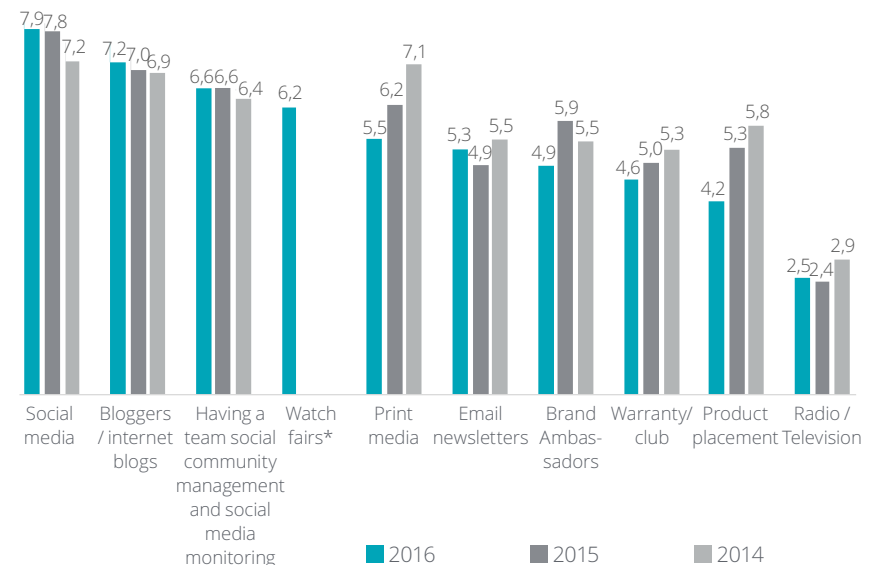
The use of digital media has become an essential part of the marketing campaigns of Swiss watch companies. According to watch executives, social media is the most important element of their marketing strategy, followed by internet blogs (see Figure 22). In contrast, traditional marketing channels such as print media have become less important over the past few years.

Watch fairs ranked fourth, illustrating the importance of events such as the SIHH or Baselworld as essential marketplaces and trendsetting shows. After welcoming 9 independent watch brands in 2016, the SIHH will welcome 5 new ones in 2017 as well as Girard-Perregaux and Ulysse Nardin. It will also for the first time open its doors to the general public on the Friday. Fairs are able to attract consumers, collectors, retailers and the press simultaneously and some watch brands achieve up to 80% of their annual sales at these events.

The importance of brand ambassadors has decreased quite strongly. However, it remains an important form of communication. Canadian actor Ryan Reynolds recently became Piaget's new brand ambassador, while Carl F. Bucherer named Chinese actress and singer Li Bingbing as its global brand ambassador in order to expand its presence in the Asian market. Frédérique Constant also announced its new global charity ambassador Gwyneth Paltrow at Baselworld 2016.

Figure 22. Marketing channels

How important are the following elements for your marketing strategy? Please indicate on a scale from 1 to 10, with 1 indicating very low importance and 10 indicating very high importance.



* first asked in 2016

Social media still represents an important reputational risk for watch executives. However, after increasing for four years it fell for the first time this year with 26% of respondents considering it the biggest reputational risk, compared to 52% in 2015.

This is probably due to the fact that many brands are now much more active in the digital domain and in control of their online presence which is used as a powerful communication tool. This year, reputational risks from the grey market are considered far more important (55%).

Brands such as Rolex, Jaeger-LeCoultre, IWC, Hublot, Omega, MB & F, RJ Romain Jerome, Audemars Piguet and others are now very active on social networks. The brands use these platforms to discuss their products by focusing on their heritage, their ambassadors, technical aspects and prestigious events they support. Watch brands now have a much more integrated online presence than a few years ago and take better advantage of the many opportunities offered by online channels to communicate with their potential customers and ultimately attract them into shops.

Our consumer survey indicates that social media and bloggers have the greatest influence on young people’s watch buying decisions in all countries surveyed except for China (see Figure 23). Print media remains an important marketing channel in Switzerland and Germany among people aged 30-79, while the same is true for radio and television in the US, Italy and China.

Figure 23: Marketing channels

In general, which marketing channels influence your decision to buy a watch the most?

| | Top answer 18-29 | Top answer 30-49 | Top answer 50-79 |
|--------------------|------------------------|------------------------|--------------------|
| Switzerland | Social media/ bloggers | Print media | Print media |
| US | Social media/ bloggers | Radio / Television | Radio / Television |
| Germany | Social media/ bloggers | Print media | Print media |
| Italy | Social media/ bloggers | Radio / Television | Radio / Television |
| China | Brand Ambassadors | Radio / Television | In-store events |
| Japan | Social media/ bloggers | Social media/ bloggers | In-store events |

These results indicate that companies should continue to focus on social media and bloggers to attract Generation Y and therefore potential future customers. However, it is also essential to have a marketing strategy that consists of different elements including print media as well as radio and television channels to broaden the audience of target customers.



Endnotes

1. According to the Federation of the Swiss Watch Industry, the value of exports account for 90% of the Swiss watch production.
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11. 3D printed watches add new dimension to time-telling, Financial Times, 16 May 2016.
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15. MMT Spins Off From Frederique Constant As Its Own Combination Smartwatch/Software Company, Hodinkee, 6 septembre 2016. Voir aussi: <https://www.hodinkee.com/articles/mmt-spin-off-independent-company>
16. TAG Heuer announces e-commerce partnership with JD.com, press release, TAG Heuer 28 September 2015.

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