

LETTER TO SHAREHOLDERS

BIEL/BIENNE, 22 JULY 2014

HALF-YEAR REPORT 2014: SWATCH GROUP – CONTINUED GROWTH DESPITE SIGNIFICANT NEGATIVE CURRENCY IMPACT

- The Group's gross sales were up 8.5% to CHF 4 535 million at constant exchange rates, or 4.0% to CHF 4 347 million at current rates.
- Gross sales grew over 10% in the Watches & Jewelry segment at constant exchange rates, including Production 8.8%, despite the fire at ETA which negatively impacted sales by approximately CHF 200 million.
- More than 800 new jobs were created in the first six months of the year, of which over 460 in Switzerland.
- As expected, operating profit of CHF 830 million was 8.8% lower than the previous year due to the negative currency situation, the high level of marketing expenses for the Olympic Games in Sochi and the fire at ETA; nevertheless, operating margin reached 20.2%.
- Net income was CHF 680 million, 11.5% below the first half of 2013, with a 16.6% return on net sales.
- Positive outlook for the second half of the year, with a better comparison basis for exchange rates and an already improved situation at ETA as of July, after recovery from the fire.

GROUP OVERVIEW

Group Key Figures

(CHF million)	1st half	1st half	Change in %		Total
	2014	2013	at constant rates	currency effect	
Gross sales	4 347	4 181	+ 8.5%	-4.5%	+ 4.0%
Net sales	4 102	4 006	+ 6.7%	-4.3%	+ 2.4%
Operating profit	830	910			- 8.8%
– in % of net sales	20.2%	22.7%			
Net income	680	768			- 11.5%
– in % of net sales	16.6%	19.2%			
Investments in non-current assets	396	295			
Equity, 30 June	9 832	8 557			
Market capitalization, 30 June	28 733	26 984			
Annualized return on equity (ROE)	14.0%	17.9%			
Basic earnings per share (EPS) – expressed in CHF per share:					
– Registered shares	2.43	2.83			
– Bearer shares	12.14	14.17			

Unaudited figures.

Swatch Group generated gross sales of CHF 4 535 million at constant exchange rates in the first half year of 2014 and thereby grew by a further 8.5%. The already overvalued Swiss franc strengthened further against currencies in all of the Group's important sales regions compared to the first half of the previous year. The extremely adverse exchange rate situation negatively impacted Group sales by CHF 188 million or 4.5 percentage points.

In the Watches & Jewelry segment (including production), Swatch Group recorded gross sales growth of 8.8% at constant rates and 4.3% at current rates compared to the previous year. This growth was generated by the Group's strong brands and broad distribution network. In local currency, all markets except for a small number of European countries remain on a growth course compared to the very high prior-year figures. This is also the case in China. In addition, all brands continued to invest heavily in marketing, particularly Omega during the Olympic Winter Games in Sochi.

Harry Winston made further significant investments in a wider product range and an increased availability of "high jewelry", as well as in the new watch collection which was presented at Baselworld 2014 and which will be available in its retail stores in the second half of 2014. The brand also invested in renovation of its retail stores.

The fire at ETA on 29 December 2013 caused a significant strain on Group production. Although the fire was quickly brought under control, extensive damage and an interruption of business occurred in the electroplating department and the downstream watch movement production. ETA completed cleanup in January 2014, however, due to the long delivery schedules for replacement installations, the burned out electroplating department could not be rebuilt as foreseen in the first half of 2014. Non-deliveries and delivery delays resulting from the fire negatively impacted gross sales by approximately CHF 200 million. In the meantime, production at ETA has been reorganized so that only minor delays in watch movement production are anticipated in the second half of 2014.

The Electronic Systems segment continued to remain exposed to the overvalued Swiss franc, particularly against the USD and JPY, which eroded further compared to the first half 2013 by -5% and -11%, respectively. This segment generated gross sales of CHF 146 million or a decline of 2.0% at current exchange rates, although a return to very positive sales development was reported in the months of May and June.

Despite unfavorable exchange rates and the strain on watch movement production caused by the fire at ETA, the Group continues to follow its long-term defensive pricing policy, which prioritizes market gain over short-term profitability. Under these circumstances, Swatch Group generated an operating profit of CHF 830 million and a net income of CHF 680 million. 800 jobs were also created worldwide since the end of 2013, of which 460 in Switzerland. In total, Swatch Group employed over 34 000 at the end of June 2014. In addition, CHF 396 million was invested in operating assets. The operating cash flow for the first half year 2014 amounted to a total of CHF 1 013 million.

Inventories amounted to CHF 5 729 million at the end of June 2014. The increase of approximately CHF 300 million compared to the end of 2013 can be attributed for the most part to semi-finished and finished products. Over CHF 140 million was invested in the new diamond-studded “high jewelry” collection for the above-mentioned expansion of the Harry Winston brand. The opening of new retail stores, the upcoming launch of the new Omega Master Co-Axial with antimagnetic movement and the worldwide launch of the Swatch Sistem51 in the second half of the year are additional elements contributing to the positive increase in inventory.

Outlook

The outlook for the Group in all regions and segments remains very good and a promising second half of 2014 is expected. Particularly in the USA and Japan, sales continue their very positive development. Also, the stronger sales trend noticed on the Chinese mainland continues. In contrast, the situation in Hong Kong is affected by a number of uncertainties. In the second half of 2014, due to the anticipated lower comparison basis of exchange rates to the Swiss franc, negative currency impact should be less dramatic than in the first half of 2014.

The Group will strengthen its worldwide market presence through investment in marketing, retail and customer service. In addition, ongoing investment will be made in the continuing training of personnel and the professional education. In the second half of 2014, the brands will broaden the existing and sought-after product line with the launch of new products.

The Swatch brand expects robust growth in the second half of the year from the increased availability of the very successful and sought-after Sistem51, and the Omega Master Co-Axial will be a strong catalyst on the sales front. The progress of the Harry Winston brand, acquired last year, has been highly encouraging and with the launch of the new watch collection, it will continue to make a major contribution to the development of the Group during the next six months.

In the production sector, particularly the manufacture of Universo watch hands and production of Rubattel & Weyermann watch dials, the new and modern production facility in La Chaux-de-Fonds will start its operations in August. Delivery delays of watch movements resulting from the fire at ETA will be increasingly resolved.

Swatch Group will continue to consistently follow its long-term strategy to gain market share.

Interim Consolidated Financial Statements

INCOME STATEMENT

	1st half 2014		1st half 2013	
	CHF million	%	CHF million	%
Gross sales	4 347	106.0	4 181	104.4
Sales reductions	- 245	- 6.0	- 175	- 4.4
Net sales	4 102	100.0	4 006	100.0
Other operating income	214	5.2	48	1.2
Changes in inventories	312	7.6	399	10.0
Material purchases	- 1 159	- 28.3	- 1 221	- 30.5
Personnel expense	- 1 175	- 28.6	- 1 069	- 26.7
Depreciation on tangible assets	- 155	- 3.8	- 133	- 3.3
Amortization on intangible assets	- 17	- 0.4	- 14	- 0.4
Other operating expenses	- 1 292	- 31.5	- 1 106	- 27.6
Operating profit	830	20.2	910	22.7
Other financial income and expense	13	0.3	27	0.7
Interest expense	- 1	0.0	- 1	0.0
Share of result from associates and joint ventures	3	0.1	13	0.3
Ordinary result	845	20.6	949	23.7
Non-operating result	0	0.0	4	0.1
Extraordinary result	-	0.0	-	0.0
Profit before taxes	845	20.6	953	23.8
Income taxes	- 165	- 4.0	- 185	- 4.6
Net income	680	16.6	768	19.2
Attributable to equity holders of The Swatch Group Ltd	659		767	
Attributable to non-controlling interests	21		1	
Earnings per share (EPS) – expressed in CHF per share:				
Registered shares				
Basic earnings per share	2.43		2.83	
Diluted earnings per share	2.43		2.83	
Bearer shares				
Basic earnings per share	12.14		14.17	
Diluted earnings per share	12.13		14.16	

Unaudited figures.

Interim Consolidated Financial Statements

BALANCE SHEET

Assets	30.06.2014		31.12.2013	
	CHF million	%	CHF million	%
Current assets				
Cash and cash equivalents	1 157	9.8	908	7.8
Marketable securities and derivative financial instruments	286	2.4	325	2.8
Trade receivables	975	8.2	1 073	9.2
Other current assets	255	2.2	256	2.2
Inventories	5 729	48.3	5 426	46.6
Prepayments and accrued income	290	2.4	685	5.9
Total current assets	8 692	73.3	8 673	74.5
Non-current assets				
Property, plant and equipment	2 426	20.5	2 272	19.5
Intangible assets	136	1.1	136	1.2
Investments in associates and joint ventures	67	0.6	65	0.6
Other non-current assets	168	1.4	156	1.3
Deferred tax assets	366	3.1	337	2.9
Total non-current assets	3 163	26.7	2 966	25.5
Total assets	11 855	100.0	11 639	100.0

Unaudited figures.

Interim Consolidated Financial Statements

BALANCE SHEET

Equity and liabilities	30.06.2014		31.12.2013	
	CHF million	%	CHF million	%
Current liabilities				
Financial debts and derivative financial instruments	7	0.1	15	0.1
Trade payables	330	2.8	383	3.3
Other liabilities	144	1.2	164	1.4
Provisions	77	0.6	74	0.6
Accrued expenses	708	6.0	702	6.1
Total current liabilities	1 266	10.7	1 338	11.5
Non-current liabilities				
Financial debts	43	0.4	44	0.4
Deferred tax liabilities	606	5.1	576	4.9
Retirement benefit obligations	35	0.3	33	0.3
Provisions	44	0.4	45	0.4
Accrued expenses	29	0.2	29	0.2
Total non-current liabilities	757	6.4	727	6.2
Total liabilities	2 023	17.1	2 065	17.7
Equity				
Share capital	125		125	
Capital reserves	- 1 056		- 1 062	
Treasury shares	- 268		- 268	
Translation differences	- 127		- 115	
Retained earnings	11 077		10 828	
Equity of The Swatch Group Ltd shareholders	9 751	82.2	9 508	81.7
Non-controlling interests	81	0.7	66	0.6
Total equity	9 832	82.9	9 574	82.3
Total equity and liabilities	11 855	100.0	11 639	100.0

Unaudited figures.

Interim Consolidated Financial Statements

STATEMENT OF CASH FLOWS

	1st half 2014 CHF million	1st half 2013 CHF million
Operating activities		
Net income	680	768
Reversal of non-cash items	322	325
Changes in working capital and other items included in operating cash flow	194	- 249
Dividends received from associated companies	2	11
Interest received	26	5
Interest paid	- 1	- 3
Income tax paid	- 210	- 182
Cash flow from operating activities	1 013	675
Investing activities		
Investments in property, plant and equipment	- 329	- 254
Proceeds from sale of property, plant and equipment	3	6
Investments in intangible assets	- 20	- 18
Proceeds from sale of intangible assets	0	0
Investments in other non-current assets	- 47	- 23
Proceeds from sale of other non-current assets	1	6
Acquisition of subsidiaries – net of cash	- 4	- 684
Divestment of subsidiaries	3	-
Investments in associated companies and joint ventures	-	- 14
Divestments of associated companies and joint ventures	-	0
Purchase of marketable securities	- 126	- 88
Sale of marketable securities	173	187
Cash flow from investing activities	- 346	- 882
Financing activities		
Dividends paid to shareholders	- 407	- 366
Dividends paid to non-controlling interests	- 6	0
Purchase of treasury shares	-	- 2
Sale of treasury shares	-	122
Change in non-current financial debts	- 2	- 261
Change in current financial debts	0	- 89
Cash flow from financing activities	- 415	- 596
Net impact of foreign exchange rate differences on cash	- 3	6
Change in cash and cash equivalents	249	- 797
Change in cash and cash equivalents		
– at beginning of year	908	1 520
– at 30 June	1 157	723
	249	- 797

Unaudited figures.

Interim Consolidated Financial Statements

STATEMENT OF CHANGES IN EQUITY

(CHF million)	Attributable to The Swatch Group Ltd shareholders					Total	Non-controlling interests	Total equity
	Share capital	Capital reserves	Treasury shares	Translation differences	Retained earnings			
Balance at 31.12.2012	125	- 1 128	- 343	- 41	9 941	8 554	19	8 573
Net income 1st half 2013					767	767	1	768
Currency translation of foreign entities				23		23		23
Compensation of goodwill Group companies					- 569	- 569		- 569
Dividends paid					- 366	- 366		- 366
Share-based compensation:								
– Value of employee services (net of tax)		8				8		8
– Proceeds from sale of shares								
Sale of treasury shares		46	76			122		122
Purchase of treasury shares			- 2			- 2		- 2
Balance at 30.06.2013	125	- 1 074	- 269	- 18	9 773	8 537	20	8 557
Net income 2nd half 2013					1 154	1 154	6	1 160
Currency translation of foreign entities				- 97		- 97	- 1	- 98
Compensation of goodwill Group companies					- 99	- 99		- 99
Compensation of goodwill associated companies and joint ventures							46	46
Dividends paid							- 5	- 5
Share-based compensation:								
– Value of employee services (net of tax)		12				12		12
– Proceeds from sale of shares		1				1		1
Sale of treasury shares		- 1	1			0		0
Purchase of treasury shares								
Balance at 31.12.2013	125	- 1 062	- 268	- 115	10 828	9 508	66	9 574
Net income 1st half 2014					659	659	21	680
Currency translation of foreign entities				- 12		- 12	0	- 12
Compensation of goodwill Group companies					- 3	- 3		- 3
Dividends paid					- 407	- 407	- 6	- 413
Share-based compensation:								
– Value of employee services (net of tax)		6				6		6
– Proceeds from sale of shares						0		0
Sale of treasury shares								
Purchase of treasury shares								
Balance at 30.06.2014	125	- 1 056	- 268	- 127	11 077	9 751	81	9 832

Unaudited figures.

Notes to the Interim Consolidated Financial Statements

1. Basis of preparation and significant accounting policies

These consolidated financial statements cover the unaudited interim results for the six months ending 30 June 2014. They have been prepared in accordance with Swiss GAAP FER (Accounting and Reporting Recommendations). The consolidated interim financial statements for 2014 have been prepared in accordance with FER 31 "Supplementary Recommendation for Listed Companies". This means that the Group already adopted FER 31, published in January 2013 (applicable as of 1 January 2015), as of 1 January 2013. Consequently, the earlier FER 12 "Interim Financial Reporting" is no longer applicable.

These interim financial statements do not contain all the information and disclosures required in the annual consolidated financial statements. They should therefore be read in conjunction with the consolidated financial statements at 31 December 2013. In this interim report, Management has not made any significant changes to the estimates and assumptions compared to the previous period.

2. Changes to Group structure

At 30 June 2014 the Group consolidation structure comprised 179 legal entities (31 December 2013: 185). The decrease was mainly due to mergers and liquidations within the Group. Information on business combinations can be found in Note 5.

3. Key exchange rates

		Average rates	Prevailing rates	Average rates	Prevailing rates	Prevailing rates
		01.01.-30.06.2014	30.06.2014	01.01.-30.06.2013	31.12.2013	30.06.2013
		CHF	CHF	CHF	CHF	CHF
1	CNY	0.1445	0.1437	0.1524	0.1475	0.1543
1	EUR	1.2203	1.2160	1.2319	1.2280	1.2355
1	HKD	0.1152	0.1150	0.1214	0.1152	0.1221
100	JPY	0.8758	0.8800	0.9843	0.8500	0.9610
1	USD	0.8933	0.8915	0.9418	0.8930	0.9475

4. Segment information

1st half 2014 (CHF million)	Watches & Jewelry	Electronic Systems	Corporate	Elimination	Total
– Third parties	4 209	134	4		4 347
– Group	1	12	2	– 15	0
Gross sales	4 210	146	6	– 15	4 347
– Third parties	3 965	133	4		4 102
– Group	1	12	2	– 15	0
Net sales	3 966	145	6	– 15	4 102
Operating profit	889	– 10	– 49		830
– As a % of net sales	22.4%	– 6.9%			20.2%
– As a % of total	107.1%	– 1.2%	– 5.9%		100.0%
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1st half 2013 (CHF million)	Watches & Jewelry	Electronic Systems	Corporate	Elimination	Total
– Third parties	4 038	139	4		4 181
– Group	0	10	2	– 12	0
Gross sales	4 038	149	6	– 12	4 181
– Third parties	3 865	138	3		4 006
– Group	0	10	2	– 12	0
Net sales	3 865	148	5	– 12	4 006
Operating profit	967	– 7	– 50		910
– As a % of net sales	25.0%	– 4.7%			22.7%
– As a % of total	106.3%	– 0.8%	– 5.5%		100.0%
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Total assets at 30.06.2014	10 920	390	4 154	– 3 609	11 855
Total assets at 31.12.2013	10 244	453	3 828	– 2 886	11 639

Unaudited figures.

5. Business combinations

In the first half of 2014, Swatch Group acquired all the shares of René Clémence S.A. in La Chaux-de-Fonds (Switzerland). The company is a watch glass manufacturer.

The Group also acquired 100% of the shares of the Canadian company H.W. Protection Inc, Toronto, in the first half of 2014. This company provides services solely to other Group companies.

The net cash outflow from both acquisitions totalled CHF 4 million. The accumulated goodwill from both acquisitions which was recognized in equity amounted to CHF 3 million.

On 26 March 2013, Swatch Group acquired 100% of the shares in the US company HW Holdings Inc., the owner of Harry Winston Inc., New York. The Group took over the brand and all the company's activities in connection with jewelry and watches, including its production company in Geneva (Switzerland). The activities of Harry Winston Diamond Corporation – now Dominion Diamond Corporation – in Toronto (Canada) were not affected. As a result of this acquisition, a total of eleven companies were added to the Group's consolidation structure. The acquired balance sheet values mainly reflected inventories, trade receivables and property, plant and equipment. The net outflow of funds for the acquisition amounted to CHF 929 million, including the takeover of CHF 27 million in cash and cash equivalents and CHF 245 million in net debt. Goodwill recognized directly in equity amounted to CHF 569 million.

At the beginning of April 2014, Swatch Group sold its entire participation in Oscilloquartz AG, Neuenburg (Switzerland) to ADVA Optical Networking SE, Munich (Germany). The net assets sold amounted to CHF 12 million. The net cash inflow from the sale amounted to CHF 3 million.

There were no divestments of companies in the first half of 2013.

6. Investments in associated companies and joint ventures

In the period under review, there were no changes in investments in associated companies and joint ventures.

In the first half of 2013, the participation in the associated company Belenos Clean Power Holding SA was raised from 42% to 49% by an increase in capital. The Group contributed CHF 14 million to this capital increase.

7. Goodwill

Goodwill is recognized directly in equity at the time of purchase of a subsidiary or an investment in an associated company. The theoretical capitalization of goodwill, based on a useful life of 5 to 10 years, would have the following impact on equity and net income:

Theoretical impact on equity

(CHF million)	30.06.2014	31.12.2013	30.06.2013
Equity, per balance sheet	9 832	9 574	8 557
Theoretical capitalization of net book value of goodwill	938	996	953
Theoretical equity including net book value of goodwill	10 770	10 570	9 510

Theoretical impact on net income

(CHF million)	30.06.2014	31.12.2013	30.06.2013
Net income, per income statement	680	1 928	768
Theoretical amortization of goodwill	- 61	- 97	- 41
Theoretical net income after amortization of goodwill	619	1 831	727

8. Treasury shares

In the period under review, the Swatch Group neither purchased nor sold treasury shares.

In the previous period, the Swatch Group sold treasury shares in the amount of CHF 122 million. The gain of CHF 46 million from the sale of the shares was recorded in capital reserves. In addition, the Group repurchased treasury shares in the amount of CHF 2 million in the previous period.

9. Dividend

The Company pays one dividend per fiscal year. For fiscal year 2013, the dividend agreed at the Annual General Meeting on 14 May 2014, with a value date of 21 May 2014, was distributed as follows:

Dividend per registered share	CHF	1.50
Dividend per bearer share	CHF	7.50
Total dividend paid	CHF million	407

Based on the decision of the Annual General Meeting, the dividend due on treasury shares held by the Group was not paid out.

10. Seasonality of operations

Due to the somewhat seasonal pattern of the Watches & Jewelry segment, slightly higher revenues and operating profits are usually expected in the second half of the year in local currency. This is mainly due to stronger-than-average monthly sales from September to December related to the holiday and Christmas season.

11. Significant events and business transactions

During the period under review, no material events or business transactions occurred that might have an impact on the critical estimates, appraisals and assumptions to be found in the consolidated financial statements at 31 December 2013. Also, there were no further material events or business transactions that might impact upon other positions in the consolidated financial statements (such as, for example, changes to contingent liabilities and receivables or business transactions involving associated enterprises and persons).

12. Events after the closing date

At the publish date of this press release, the company is not aware of any significant new event that would affect the half-year figures at 30 June 2014.

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