Consumer Electronics
Industry Outlook

VERSION 02 | YEAR 13

OUTLOOK: ☁️ Signs of Weakness

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Industry growth is being limited by a lack of revolutionary products and a consumer focused on “value-seeking” and prioritization of essential spending.

Demand for smartphones and tablets is expected to remain strong while PC and notebook sales will remain challenged due to substitution by lower-priced tablets.

Continuing declines in average selling prices of flat-panel TVs will more than offset the gradual trend to upgrade to larger, more expensive screens.

Price remains the most critical competitive factor. The traditional consumer electronics retailers will continue to lose share to the mass merchandisers and online retailers. Those retailers that are able to provide an effective multi-channel offering and optimize their pricing, sales mix and inventory management will be most successful in fending off competition.

Overall, the U.S. consumer electronics market is mature, with most product categories at or near saturation. A lack of revolutionary new products coupled with longer replacement cycles is expected to keep a lid on demand in the face of a modestly improving macro-environment.
The U.S. economy continued its weak recovery in 2013. Consumer confidence has been increasing due to improvement in the housing and the stock markets. However, the consumer continues to face headwinds in the form of persistent high unemployment, minimal increases in disposable income and concerns regarding rising interest rates which are starting to curtail the home sale resurgence that occurred earlier this year. Even as the U.S. economic recovery remains intact, consumers continue to prioritize their spending on essentials. Consumer electronics manufacturers and retailers remain challenged by the weak environment in a number of core product categories such as TVs and computers, and are competing on price in an effort to maintain market share.

Mobile-connected devices, particularly smartphones and tablets, have driven recent growth in the consumer electronics industry while eroding demand for other portables such as notebooks, netbooks, camcorders and digital cameras. The much anticipated release of Windows 8, Microsoft’s new operating system optimized to take advantage of touchscreen technology and new processors from Intel, has done little to change consumers’ preference for iPad and Android based mobile devices.

Current Situation

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Table: Personal Computer Shipments By Product Category

<table>
<thead>
<tr>
<th>Year</th>
<th>Tablet</th>
<th>Notebook/Netbook</th>
<th>Desktop</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>34%</td>
<td>24%</td>
<td>42%</td>
</tr>
<tr>
<td>2009</td>
<td>33%</td>
<td>24%</td>
<td>43%</td>
</tr>
<tr>
<td>2010</td>
<td>22%</td>
<td>57%</td>
<td>21%</td>
</tr>
<tr>
<td>2011</td>
<td>15%</td>
<td>39%</td>
<td>46%</td>
</tr>
<tr>
<td>2012</td>
<td>11%</td>
<td>26%</td>
<td>63%</td>
</tr>
<tr>
<td>2013P</td>
<td>8%</td>
<td>21%</td>
<td>71%</td>
</tr>
<tr>
<td>2014P</td>
<td>7%</td>
<td>19%</td>
<td>74%</td>
</tr>
</tbody>
</table>

Source: Consumer Electronics Association
The continued rise of smartphones is accelerating the demise of digital cameras, camcorders, GPS navigators and MP3 players, due to the convergence of functions into a single device. In addition, the prevalence of tablets and the industry’s shift toward streaming and downloadable media are supplanting the need for DVD players. The proliferation of smartphones is also changing consumer shopping habits, facilitating the perceived show-rooming threat and forcing brick-and-mortar retailers to adopt aggressive pricing strategies.

The market for flat-panel televisions has reached a saturation point. In order to drive the replacement cycle, manufacturers are producing TVs with larger screens and more features. However, prices continue to drop steadily. While TVs can now be purchased at attractive price points, the gradual decline in average unit selling prices is offsetting the impact of growing demand for the larger, more expensive screens. In addition, there is still relatively little interest in the latest technologies such as ultra HD, 3D and OLED TVs, given their price points.

Pure play consumer electronics retailers are facing pressure from the general big box discounters such as Walmart and purely online competitors like Amazon. Wide product availability of increasingly commoditized offerings, online price transparency and a customer focused on value has enabled the online channel to take share from traditional brick-and-mortar retailers. According to ComScore, online sales grew by 13% in the third quarter of 2013. Many consumers are also now using mobile devices to comparison shop and make purchases, a trend that is expected to continue. In response, many traditional consumer electronics retailers are enhancing their online systems and have implemented price matching policies to better compete.
The fundamental outlook for consumer electronics in the U.S. is neutral with some signs of weakness.

Relatively weak consumer spending, a lack of revolutionary products, increasing substitution of PCs by lower-priced tablets and smartphones, and declining selling prices of TVs will lead to flat sales for the consumer electronics industry in 2013. The Consumer Electronics Association (CEA) is now predicting flat overall U.S. industry revenue growth, with total revenue of $202.6 billion for 2013. This is a downward revision from their 2.7% growth estimate made earlier in the year.
Tables and smartphones will continue to drive industry growth and will make up approximately one-third of industry revenue in 2013. While the U.S. smartphone market is approaching saturation, smartphone revenues are still expected to increase 14% while tablet sales are expected to achieve double-digit growth through 2014, even though prices will continue declining. The growing demand for mobile devices will also continue to have a knock-on effect for accessories such as headphones, wireless speakers and sound bars.

There has been little interest in the latest technologies such as ultra HD, 3D and OLED TVs, given their current price points. However, adoption is expected to gradually pick up as manufacturers strive to make ultra HD and OLED TVs more affordable. Consumer distaste for having to wear 3D glasses and limited content will remain a real barrier to mass adoption of 3D TV.

Looking into 2014, strength in new car sales is expected to drive demand for factory-installed electronics, including in-vehicle entertainment systems, security and remote start systems. Sales of smartphones, tablets and related accessories, the ramp up of new video game consoles, increased adoption of ultra HD and OLED TVs and continued strong demand for automotive electronics are expected to result in more positive industry growth. Most of the other categories of consumer electronics will continue to decline.

Sony and Microsoft launched their respective next generation video game consoles in November. Consumers delayed hardware purchases earlier in the year in anticipation of these new systems. As a result, the video game hardware segment will incur another year of negative growth. The new consoles’ higher price point and a lack of backward compatibility for existing games should help drive significant growth in 2014 despite the growing influence of mobile-based social gaming.

As always, the key uncertainty for manufacturers and vendors are the margin opportunities given fierce competition. TVs and PCs continue to drag down manufacturer’s profit margins; forcing manufacturers to aggressively restructure their operations while at the same time invest in new growth opportunities in order to improve profitability.

Retailers have been reorganizing to capitalize on the connected devices trend (smartphones, tablets, e-readers and related service plans and accessories) and the growing shift toward online purchasing. Retailers that are able to provide an effective multi-channel offering and optimize their pricing, promotions, product mix and inventory management will be most successful in fending off competition.
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