Luxottica

Price EUR57.55

Q4 sales publication overshadowed by co-CEO for Markets' departure

Fair Value EUR65 vs. EUR66 (+13%) **BUY**

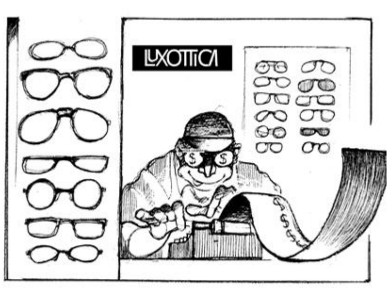
Bloomberg	LUX IM
Reuters	LUX.MI
12-month High / Low (EUR)	67.5 / 50.7
Market Cap (EURm)	27,834
Ev (BG Estimates) (EURm)	28,857
Avg. 6m daily volume (000)	744.2
3y EPS CAGR	15.8%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-6.0%	-10.1%	-13.5%	-4.7%
Consumer Gds	-4.5%	-5.3%	-4.7%	-3.4%
DJ Stoxx 600	-7.4%	-8.9%	-13.1%	-6.4%

YEnd Dec. (€m)	2014	2015e	2016e	2017e
Sales	7,652	8,837	9,550	10,209
% change		*15.5%*	*8.1%*	*6.9%*
EBITDA	1,542	1,891	2,113	2,303
Reported EBIT	1,158	1,421	1,580	1,734
% change		*22.7%*	*11.2%*	*9.7%*
Net income	642.6	843.7	967.9	1,078
% change		*31.3%*	*14.7%*	*11.4%*

	2014	2015e	2016e	2017e
EBIT margin (rep.)	15.1	16.1	16.5	17.0
Net margin	8.4	9.5	10.1	10.6
ROE	13.1	16.7	17.6	18.0
ROCE	10.4	13.1	14.7	16.1
Gearing	20.6	20.2	10.4	1.6

(€)	2014	2015e	2016e	2017e
EPS	1.44	1.76	2.02	2.25
% change	*-*	*21.7%*	*14.7%*	*11.4%*
P/E	39.8x	32.7x	28.5x	25.6x
FCF yield (%)	2.6%	2.9%	3.7%	4.1%
Dividends (€)	0.72	0.92	1.05	1.20
Div yield (%)	1.3%	1.6%	1.8%	2.1%
EV/Sales	3.8x	3.3x	3.0x	2.7x
EV/EBITDA	18.7x	15.3x	13.4x	12.1x
EV/EBIT	24.9x	20.3x	18.0x	16.1x



Last Friday, Luxottica announced Q4 15 adj. sales of EUR2,059m (+8.9% as reported and +2.7% adj FX-n) which came shy of CS and our expectations by ~3% only because of a higher impact from the realignment of the retail calendar and the 53rd week last year (adj FX-n growth of 7.7% excl. those calendar effects) whose impact is on U.S retail only (-2.7% adj. FX-n / +7.7% excl. calendar effect). The breaking news was clearly the departure of co-CEO for Markets Mr Khan as Mr Del Vecchio and him acknowledged that LUX was not fully capturing the significant growth prospects because of this co-CEO structure. Therefore Mr Khan will be replaced by Mr Del Vecchio whilst Mr Vian remains CEO for Product & Operations. In our view this announcement will revive some issues about the governance, especially from those who were dubious about this co-CEO structure, we adopt the same stance than during the previous "governance crisis" (Sep-Nov 2014): the business model and strategy remain sound. All eyes are now be turned towards the ID on 2nd March! Our new FV of EUR65 reflects slight adjustments on our FY15-16 EBIT forecasts (-1%) but Buy recommendation reiterated.

ANALYSIS

- **Why Mr Khan resigned after just one year at the side of Massimo Vian?** According to LUX, this resignation is neither due to strategic disagreements with Chairman and Founder Mr Del Vecchio or Massimo Vian, nor by unsatisfactory results since LUX has achieved all its rule-of-thumbs and major initiatives such as the integration of Oakley's wholesale activities or the new pricing strategy in China were successfully implemented. It seems that Mr Del Vecchio and Mr Khan have both stated that this co-CEO structure model was hampering LUX's reactivity and "entrepreneurial spirit" by weighing down its decision-making process. Admittedly these arguments were emphasized by those who doubted about the effectiveness of this co-CEO model and they might consider that Mr Del Vecchio "backpedalled" on his decision to implement this new organisation. **This is why we think this announcement will again revive some concerns about the governance at the helm of Luxottica until, at least, the Investor Day (2nd March).**
- **Mr Del Vecchio was interviewed by Italian newspaper *Corriere della Sera* (29th Jan): 1/** he confirmed that Mr Khan's departure was only due to a structure reorganisation as the group must be quicker ("more digital and simplify the decision-making process"), **2/** LUX is **about to launch a vast plan to reorganise and simplify all the commercial, marketing and markets functions by 2017**, **3/ Mr Del Vecchio intends to give up executive role after the implementation of this plan**, he also specified that his successor should be chosen internally and would certainly not be one of his six children, confirming his previous commitment made in October 2014.
- **Why do we remain confident about the outlook despite this new episode? 1/** Like in 2014, we continue to think that this new reorganisation is only at LUX's top management and should not affect the group's senior management who is responsible for the "day-to-day" operations and is key for the good execution and the achievement of the MT/LT targets, **2/** although this co-CEO model was not as efficient as initially planned, LUX achieved all its FY15 rule-of-thumbs for the sixth consecutive year, highlighting the sound and proven business model and strategy, **3/** Mr Del Vecchio is replacing Mr Khan concerning the executive responsibilities for Markets to ensure a continuity both internally and externally.
- **Q4 Wholesale sales of EUR758m (+7.7% / +7.1% adj. FX-n).** Growth was driven by a robust performance of **Europe** (~+6%) where the group enjoyed favourable weather conditions and easy comps (-8% in Q4 14). As expected, the moderate growth in the **U.S** (+2.8% vs. +7% in Q3) is justified by: **(i)** a very tough comparison base (+19% FX-n in Q4 14) and **(ii)** the integration process for Oakley's wholesale activities which might have caused minor disruptions. LUX regained some traction **Asia-Pacific** (+7.4% vs. +1.8%), partly helped by a good rebound in China following the new pricing policy since October (-10-15% on average). Last but not least, the activity in **Latin America** remained robust (+15% FX-n) irrespective of the sluggish macro environment in Brazil.
- **Q4 adj. Retail sales of EUR1,301m (+9.6% / +0.1% adj. FX-n) affected by the U.S calendar effect.** Indeed the retail calendar was nine days shorter than in Q4 14 which also enjoyed a 53rd week. Based on our estimates, **this headwind amounted to a negative sales impact of ~EUR95m, or approx. 10.4 p.p. on the U.S retail adj. FX-n growth (=> +7.7% excl. the calendar effect instead of -2.7%).** Consequently **LensCrafters** achieved a SSSG of 1.2% (vs 3.8% in Q3) whilst **SGH** posted comps of 5.3% (vs. 6.8% in Q3). Sales at **OPSM** (Australia-NZ) declined by 1.3% same-store given the harsher competition, a price repositioning should be implemented this year.

(To be continued next page)

Adjusted FX-neutral growth by division (%):

Adj. FX-neutral growth *	Q3 15	9M 15	Q4 15	2015e
Wholesale division (~42% of sales)	6.8	6.9	7.1	6.9
Retail division (~58% of sales)	4.7	6.1	0.1 / 8.1 **	4.5 / 6.6 **
Group total	**5.5**	**6.4**	**2.7 / 7.7 ****	**5.5 / 6.8 ****

** Before the change in accounting method at EyeMed (FY15: -EUR174m)* *Source: Company Data*
*** FX-n growth excluding the retail calendar effect*

- **FY15 adj. EBIT margin is set to widen 100bp to 16.3%.** Ahead of the FY15 results (1st March) we nudge down our FY15 & FY16 EBIT assumptions by 1% to reflect the lower-than-expected sales in 2015. However we leave our forecasts of margin improvement unchanged: we expect EBIT margin in the **Wholesale division** to increase 110bp (to 23.8%) while profitability in the **Retail division** should widen 90bp to 15.0%. The main margin enhancers are: **(i)** volume growth and mass scale effect, **(ii)** focus on store productivity (Retail) and **(iii)** efficiency gains at the group level. **LUX confirmed it would achieve its margin "rule-of-thumb" for the sixth consecutive year** (i.e. to grow EBIT 2x as fast as sales).

VALUATION

- **We anticipate a significant negative market reaction this morning**, which might equal the 9% drop achieved on 13th October when Mr Cavatorta resigned. As explained on the previous page, like in 2014, we maintain our positive stance since we believe than LUX will again convince investors that the business model and the growth prospects are still valid:

  (i) All eyes on the Investor Day on 2nd March… Naturally investors' are looking forward to hearing the management's explanations about this reorganisation of the organisational structure, which will be at the centre of the Investor Day. Management must reassure investors by confirming his commitment to stability and continuity at the helm of the group.

  (ii) … and on fundamentals! 1/ We hope that the presentation of the "**multi-year plan**" during the ID will be convince enough to demonstrate that LUX's capacity to capture growth opportunities within the eyewear market remains intact. Key topics should be on the growth catalysts (online channel, travel retail, etc.) and on the above-mentioned reorganisation and simplification plan, while other subjects might be of interest (i.e. emphasis on ROCE/ROI ratios?, a higher shareholder return policy?). **2/ LUX has plenty of growth opportunities for 2016**, especially in the Retail Division considering the implementation of the new store concept at LC, the partnership with Macy's and the "re-set plan" at OPSM. 2016 will probably be a milestone year in the development of **smart eyewear** (Intel and Google partnerships). **3/ Helpful Q1 16 results** (29th April) will confirm that this new reorganisation has not affected the group's operating performance, as highlighted by the pleasing first weeks of 2016.

- **In our view, these two milestones (i.e. ID and Q1 16 results) will be crucial to ease market's concerns and prerequisites for a rebound in the share price like after the 2014 "governance crisis" when the stock rallied ~35% from 15th October 2014 until 15th January 2015.**

- We slightly adjust our FV to EUR65 vs. EUR66 to factor in minor adjustments on our FY15-16 EBIT assumptions following the negative calendar effect on the top line development.

NEXT CATALYSTS

- FY15 results to be released on 1st March // Investor Day on 2nd March.

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