16th February 2016

Luxury & Consumer Goods

Luxottica

Price EUR51.00

New rumours of large transactions and governance changes…

Fair Value EUR65 (+27%) **BUY**

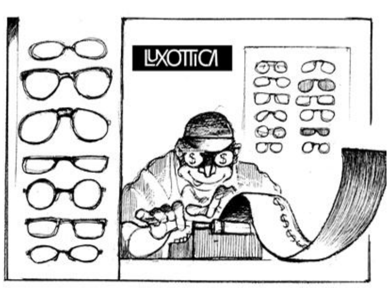
Bloomberg	LUX IM
Reuters	LUX.MI
12-month High / Low (EUR)	67.5 / 49.1
Market Cap (EUR)	24,667
Ev (BG Estimates) (EUR)	25,689
Avg. 6m daily volume (000)	812.6
3y EPS CAGR	15.8%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-9.8%	-17.9%	-21.5%	-15.6%
Consumer Gds	1.6%	-7.3%	-6.6%	-7.4%
DJ Stoxx 600	-2.4%	-12.9%	-16.7%	-12.0%

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
Rep. EBIT margin	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	35.3x	29.0x	25.3x	22.7x
FCF yield (%)	2.9%	3.3%	4.2%	4.6%
Dividends (€)	0.72	0.92	1.05	1.20
Div yield (%)	1.4%	1.8%	2.1%	2.4%
EV/Sales	3.4x	2.9x	2.6x	2.4x
EV/EBITDA	16.7x	13.6x	11.9x	10.8x
EV/EBIT	22.2x	18.1x	16.0x	14.3x



Yesterday morning Italian newspaper "Il Sole 24 Ore" mentioned that the current management shake-up could lead to the resurgence of market speculation over LUX being tempted by a merger with Essilor or by the acquisition of Carl Zeiss Vision Care. As for us, we continue to believe that large transactions within the optical industry are not likely in the ST, especially since Mr Del Vecchio has announced other priorities for LUX including (i) a group-wide simplification plan (not really compatible with a big deal…) and (ii) a succession plan which has crystallised most investor concerns recently. All eyes will be on the Investor Day on 2nd March!

ANALYSIS

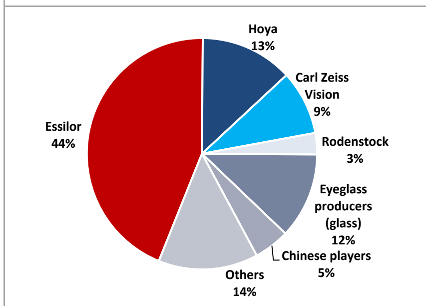
- **Essilor (bis repetita): Better to stay friends…** Admittedly the two global leaders know each other very well and have set-up many partnerships across the globe: **(i)** EI is LUX's largest lens supplier in North America (BG ests: ~30% of total lens purchases), **(ii)** EI runs the Rx lab activity of OPSM in Australia-NZ through a 70-30 JV and **(iii)** EyeMed Vision Care (LUX) chose EI as its main supplier for Rx lab services procurement and supply of products.

- **… than enter into a bad marriage…** Since the first failed attempt in 2013, this merger scenario has resurfaced several times. However, as highlighted in our Sector Report, we still believe that significant hurdles for a merger remain: **(i) governance at LUX:** this has always been the stumbling block, the new "LUX+EI" capital structure would only leave Mr Del Vecchio with a slight blocking minority whereas he is surely not ready to relinquish control of LUX, **(ii) a leadership conflict:** both groups have the most talented profiles in this industry and could face the same problems in appointing top managers within the newco than Publicis-Omnicom (failed merger) or Lafarge-Holcim; **(iii) two difficult-to-combine organisations** as supply chains supporting ophthalmic lenses and sunglasses are totally different and **(iv) antitrust risks** since "LUX+EI" would become an "all-powerful supplier" (>44% market share in lenses, >30% in frames) for their customers.

- **What about Carl Zeiss Vision Care?** First of all, LUX would certainly not acquire the entire Carl Zeiss Group (2014/15 revenue: EUR4.5bn) since the latter is 100%-owned by a foundation and operates in various activities (semiconductors, medical technology, etc.), only the Vision Care/Consumer Optics segment (sales: EUR1bn) could interest the Italian group. The acquisition of Carl Zeiss VC would enable LUX to hold the world's third largest ophthalmic lens manufacturer whilst the Italian group only produces a small part of its sunglass lenses (close to zero concerning Rx lenses) and the size of Carl Zeiss VC would imply two main advantages vs. the Essilor deal: a very small/no dilution of family holding Delfin ownership in LUX and limited risks concerning leadership and antitrust.

- **Three main hurdles in our view. 1/** LUX would have to pay a significant price to convince Carl Zeiss to sell one of its core activities (~22% of 2014/15 total revenue and ~30-40%e of group's Op profit), representing a possible EV/sales transaction multiple of up to 1.5-2x (or EUR1.5-2bn) for the entire segment, or less if Consumer Optics is excluded from the deal; **2/** Vision Care/Consumer Optics does not seem to be in great shape as sales remained flat FX-n over FY 2014/15 (ending September), compared with a global ophthalmic market growing at 3-4% and +8.4%e FX-n for Essilor's lens activity (+4.7%e LFL) over 2015, **3/** this move would be a "declaration of war" against Essilor, calling into question some partnerships between the two groups, which have carefully avoided direct competition so far.

Ophthalmic lens market: global market share (%):



Source: Essilor, BG ests

- **Questions marks remain on governance.** While Mr Del Vecchio declared in two interviews that his successor would certainly be appointed internally, an adviser close to him (Francesco Milleri) is rumoured to be joining the Board as Executive Vice-President according to the "*Il Sole 24 Ore*". **If the rumour proves to be right, we do not think that investors would be completely reassured pending further clarification at the Investor Day.** Indeed the growing influence of Mr Milleri after Mr Guerra's departure and some "interferences" between Delfin and LUX top management were the leading causes of Mr Cavatorta's resignation in October 2014. *(To be continued next page).*

Moreover, Mr Milleri's appointment as Executive VP alongside Mr Vian (CEO for Product & Operations) would imply that Mr Del Vecchio **intends to keep the co-CEO structure model**, which is rather surprising considering his desire to simplify and accelerate the decision-making process within the group.

VALUATION

- These rumours, taken up by the "*Il Sole 24 Ore*" newspaper, show that there are still uncertainties about the future strategy and governance at Luxottica two weeks after the departure of Mr Khan. We will probably have to wait until the Investor Day on 2nd March to get the first answers and explanations regarding these two hot topics.
- With regards to M&A, the timing is not right in our view since LUX is about to launch a vast simplification plan in all commercial, marketing and markets functions. We clearly believe that LUX is able to accelerate its pace of growth without acquiring Carl Zeiss Vision Care, which involves a few doubts and risks.
- Last but not least, on the governance issue, we believe that Mr Milleri could be appointed to the Board without any executive functions and just to represent Delfin and/or the Delvecchio family, which could reassure the market by avoiding the risk of conflicting interests between the family and the operating performance of LUX.

NEXT CATALYSTS

- FY15 Results on 1st March // Investor Day in Turin on 2nd March.

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