19th February 2016

Luxury & Consumer Goods

Essilor

Price EUR111.80

Solid LFL growths in 2015 and 2016 at the (slight) expense of profitability

Fair Value EUR134 (+20%) **BUY-Top Picks**

Bloomberg	EF FP
Reuters	ESSI.PA
12-month High / Low (EUR)	123.6 / 99.3
Market Cap (EUR)	24,200
Ev (BG Estimates) (EUR)	25,798
Avg. 6m daily volume (000)	578.4
3y EPS CAGR	14.2%

	1 M	3 M	6 M	31/12/15
Absolute perf.	2.1%	-8.0%	-2.0%	-2.8%
Consumer Gds	2.6%	-8.5%	-5.4%	-6.2%
DJ Stoxx 600	0.1%	-13.3%	-15.3%	-10.1%

YEnd Dec. (€m)	2014	2015e	2016e	2017e
Sales	5,670	6,730	7,199	7,700
% change		*18.7%*	*7.0%*	*7.0%*
EBITDA	1,043	1,275	1,382	1,501
EBIT	1,222	1,215	1,322	1,436
% change		*-0.6%*	*8.8%*	*8.6%*
Net income	929.3	775.3	865.6	963.3
% change		*-16.6%*	*11.7%*	*11.3%*

	2014	2015e	2016e	2017e
Operating margin	21.6	18.1	18.4	18.7
Net margin	16.4	11.5	12.0	12.5
ROE	18.9	14.5	14.3	14.6
ROCE	16.9	21.2	21.8	22.4
Gearing	34.6	28.0	18.5	12.5

(€)	2014	2015e	2016e	2017e
EPS	3.05	3.66	4.08	4.54
% change	-	*19.9%*	*11.7%*	*11.3%*
P/E	36.7x	30.6x	27.4x	24.6x
FCF yield (%)	3.3%	2.8%	3.8%	4.3%
Dividends (€)	1.05	1.15	2.15	3.15
Div yield (%)	0.9%	1.0%	1.9%	2.8%
EV/Sales	4.6x	3.8x	3.5x	3.3x
EV/EBITDA	24.9x	20.2x	18.4x	16.7x
EV/EBIT	21.3x	21.2x	19.2x	17.5x

FY15 sales increased 18.4% as reported and 4.6% LFL to EUR6,716m, in line with expectations (EUR6,724m and +4.6%e LFL) and the company's guidance ("at least +4.5% LFL"). In Q4 alone, sales grew at the same pace than in Q3 (+4.8% LFL vs. +4.4% in 9M). The FY contribution margin expanded 20bp to 18.8% consistent with the FY target ("at least 18.8%") but a bit shy of CS at 18.9%. This "cautiousness" is also reflected in the margin guidance for 2016 ("at least 18.8%" vs. CS: 19.3%), is it because of further marketing expenses or due to a higher dilutive impact from M&A? The sales guidance is reassuring ("around +5% LFL", "exceed 8% FX-n" vs. CS: +5.1%e / BG: +5%e). Analysts' meeting today at 10am (Paris time).

ANALYSIS

- **FY15 sales of EUR6,716m up 18.4% as reported and 4.6% LFL.** Acquisitions contributed 3.9pp, implying a higher scope effet in Q4 (+3.2%) than in Q3 (+1.7%) thanks to the numerous partnerships signed around the end of the year. As such, the FX-n growth amounted to 8.5% over 2015, in line with the company's guidance of "8-11% growth". It is worth noting the LFL growth acceleration in H2 with +5% vs. +4.2% in H1.

- **Still a strong end to the year in Europe and the US.** Besides healthier market trends in those two regions, Essilor also benefited from its successful combination of innovation (*Crizal Prevencia*, *Eyezen*, etc.) and media campaigns: growth in **Europe** was 4.5% (Q3: +4% / 9M: +3.8%), whilst the group achieved 4.8% growth in **North America** (Q3: +4.4% / 9M: +4.2%), also helped by the focus on key accounts (EyeMed, Wal-Mart, etc.).

- **Good trends in AMEA but slowdown in LatAm.** Sales in **AMEA** increased by 7.6%, representing a slight acceleration vs. Q3 and 9M trends (+5.9% and +5.6% respectively) fuelled by good trends in India (DD growth) and in China (HSD increase). The performance in **LatAm** has softened in Q4 (+4.7% vs. 7.4% in Q3 and +9.2% in 9M) given: **(i)** a demanding comparison base (Q4 14: +13.7%) and **(ii)** a volatile environment, particularly in Brazil which has already slowed down in Q3 (low single-digit growth vs. +9% in H1), partly offset by faster gains in Mexico and Colombia.

- **Dynamic Readers & Sun (+10.2%).** This momentum is driven by the ramp up in the CVS contract (7,800+ stores) and by robust growths achieved by the sunglass band portfolio. Last but not least, sales in **Equipment** remained in the negative territory (-13.6%) due to intra-group restatements and a volatile environment in emerging markets (Rx labs have decreased their capex investments).

Essilor LFL quarterly sales:

% change	Q1 15	Q2 15	Q3 15	Q4 15	2015
North America	4.5	3.7	4.4	4.8	4.4
Europe	2.5	5.0	4.0	4.5	4.0
Asia-Pacific-Middle-East- Africa	5.6	5.2	5.9	7.6	6.1
Latin America	10.0	10.5	7.4	4.7	8.0
Lenses & Optical Instruments	**4.4**	**4.9**	**4.8**	**5.2**	**4.8**
Equipment	-2.1	-7.1	-6.4	-13.6	-8.1
Readers & Sun	1.8	3.2	9.9	15.3	7.3
Total group	**4.0**	**4.4**	**4.8**	**5.3**	**4.6**

Source: Company Data

- **The FY15 contribution margin (18.8%, +20bp) met the guidance ("at least 18.8%") but...** it came is slightly below the market expectations (BG and CS: 18.9%e). In our view the deviation might come from a more significant dilutive impact from bolt-on acquisitions in H2 as the group closed numerous deals in Q4. The **GM** expanded 100bp to 59.7% which enjoyed several tailwinds (product and price mix, synergies from the integration of TOI). The 22% increase in **S&D** costs reflects the strong acceleration in consumer marketing spend (EUR215m expected vs. EUR150m in 2014).

- **Group net income rose 17.9% to EUR757m (CS: 767.5m).** The net income was affected by: **(i)** restructuring provisions of EUR22m (Rx labs in Europe), **(ii)** a less favourable financial result (-EUR63m vs. –EUR44m in 2014) as the net debt increased to EUR2.1bn vs. EUR1.8bn in 2014), and **(iii)** a higher tax rate (27.5% vs. 26% last year). As a reminder COO Laurent Vacherot expected the tax rate to decrease gradually by ~1 p.p. per year to come back to the "normative level" of ~26% by 2017.

(To be continued next page)

Essilor 2015 adjusted results:

EURm	2014	2015	% change
Sales	5,670	6,716	*18.4*
Gross Profit	3,328	4,012	*20.6*
Gross Margin (%)	58.7	59.7	*+100bp*
Contribution from operations	1,057	1,263	*19.4*
As a % of sales	18.6	18.8	*+20bp*
Operating Profit	989	1,183	*19.6*
Net profit attributable to shareholders	642	757	*17.9*
EPS	3.05	3.57	*17.0*

Source: Company Data

- **FY16 outlook: reassuring sales guidance…** Essilor expects a sales growth of "around 5% LFL", which is aligned with expectations (BG: +5%e / CS: +5.1%e). The top line increase is anticipated to "exceed 8% FX-n", implying a higher contribution from acquisitions since we were expecting +7% FX-n. T
- **but is the contribution margin target too cautious?** Semantics is key: Essilor guides on a CM of "at least 18.8%", which leaves room for a margin expansion this year. Yet, this guidance remains shy of our expectations (+30pb to 19.2% / CS: 19.3%). In our view this cautiousness might be explained by two major factors: **(i)** a more significant dilutive impact from bolt-on acquisitions since Essilor seems to expect a ~3pp impact from external growth in 2016 and **(ii)** another ramp-up in marketing expenses.

VALUATION

- The share price might come under pressure pending further clarifications from the management about this cautious margin guidance. **However this possible negative market reaction must be put into perspective: (i) *ceteris paribus* a CM of 18.9% instead of 19.2% (our assumption) should only lead to 1.6% downward revision to our FY16 CM forecast and (ii) the profitability improvement has never been a key priority for the group (e.g.: CM remained almost stable over 2010-13) which prefers to fuel a solid top line growth.**
- Consequently we would recommend to take advantage of any weakness in the share price given the group's sound fundamentals and a rather upbeat LFL growth outlook which is one of Essilor's key performance indicators.

NEXT CATALYSTS

- Analysts' meeting todat at 10am (Paris time) // Q1 15 Sales on 21st April 2016.

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