

Essilor

Price EUR109.35

Essilor's priority: fuelling top line growth

Fair Value EUR132 vs. EUR134 (+21%)

BUY-Top Picks

| | |
|----------------------------|--------------|
| Bloomberg | EF FP |
| Reuters | ESSI.PA |
| 12-month High / Low (EUR) | 123.6 / 99.3 |
| Market Cap (EUR) | 23,669 |
| Ev (BG Estimates) (EUR) | 25,674 |
| Avg. 6m daily volume (000) | 583.5 |
| 3y EPS CAGR | 12.9% |

| | 1 M | 3 M | 6 M | 31/12/15 |
|----------------|-------|--------|--------|----------|
| Absolute perf. | -1.6% | -9.4% | -1.9% | -5.0% |
| Consumer Gds | 0.6% | -9.2% | -4.4% | -6.6% |
| DJ Stoxx 600 | -2.0% | -14.3% | -14.4% | -10.8% |

| YEnd Dec. (€m) | 2014 | 2015e | 2016e | 2017e |
|-----------------|-------|--------|-------|-------|
| Sales | 5,670 | 6,716 | 7,186 | 7,683 |
| % change | | 18.4% | 7.0% | 6.9% |
| Contr. From Op. | 1,043 | 1,263 | 1,358 | 1,460 |
| EBIT | 1,222 | 1,183 | 1,288 | 1,390 |
| % change | | -3.2% | 8.9% | 7.9% |
| Net income | 929.3 | 756.6 | 843.8 | 930.9 |
| % change | | -18.6% | 11.5% | 10.3% |

| | 2014 | 2015e | 2016e | 2017e |
|-------------|------|-------|-------|-------|
| EBIT margin | 21.6 | 17.6 | 17.9 | 18.1 |
| Net margin | 16.4 | 11.3 | 11.7 | 12.1 |
| ROE | 18.9 | 15.1 | 14.9 | 15.1 |
| ROCE | 16.9 | 20.8 | 21.2 | 21.7 |
| Gearing | 34.6 | 37.4 | 27.6 | 21.5 |

| (€) | 2014 | 2015e | 2016e | 2017e |
|---------------|-------|-------|-------|-------|
| EPS | 3.05 | 3.57 | 3.98 | 4.39 |
| % change | | 16.9% | 11.5% | 10.3% |
| P/E | 35.9x | 30.7x | 27.5x | 24.9x |
| FCF yield (%) | 3.3% | 2.5% | 3.6% | 4.1% |
| Dividends (€) | 1.05 | 1.15 | 2.15 | 3.15 |
| Div yield (%) | 1.0% | 1.1% | 2.0% | 2.9% |
| EV/Sales | 4.5x | 3.8x | 3.5x | 3.3x |
| EV/EBITDA | 24.4x | 20.3x | 18.6x | 17.2x |
| EV/EBIT | 20.9x | 21.7x | 19.7x | 18.0x |

This is not the first time that investors have tended to lose sight of Essilor's growth strategy to always favour top-line growth (lfl + acquisitions) ahead of margin expansion. The decision to further increase consumer marketing spend by EUR14m in 2016 is a good illustration of this strategic choice (=>20bp negative impact on the CM). In view of this 2016 CM guidance, we have reduced our 2016 and 2017 estimates by 1.5% and 2.5% respectively, although the growth story remains intact: Essilor will again rely on its levers (innovation, brand portfolio, etc.) to capture growth opportunities within the global optical market. FV adjusted to EUR132 vs. EUR134 but Buy recommendation confirmed.

ANALYSIS

- **Essilor virtually controls the pace of margin improvement.** The group is not affected by the significant margin pressure that hampers profitability for many groups in the consumer sector (adverse FX, weak organic growth rates, pricing issues, etc.). Following its traditional growth strategy, in 2015 the group deliberately decided to reinvest most of its margin/synergy gains in marketing spend (EUR215m vs. EUR150m in 2014) and in SG&A as Essilor muscles up its presence in fast-growing markets. However, Essilor met its 2015 CM guidance ("for at least 18.8%").
- **Limited downward revision to our 2016 and 2017 CM assumptions (-1.5% and -2.5% respectively).** We have increased our FX-n growth forecast to 8% vs. 7% previously to be consistent with the company's guidance ("to exceed 8%") although this is offset by a negative FX impact (-1% vs. zero initially), hence our top-line growth forecast remains broadly unchanged. As for profitability, Essilor is set to invest further in boosting top line growth since consumer marketing spend is set to increase by EUR14m, implying a 20bp negative impact and accounting for two-thirds of the "margin gap" between our previous and new CM assumptions. Moreover, a 3pp scope effect should imply a higher dilutive impact from bolt-on acquisitions. It is worth noting that our 2016e CM assumption (18.9%) is slightly ahead of guidance.

NEW and OLD contribution margins for 2016 & 2017:

| EURm | 2016e | | | 2017e | | |
|-----------------|-------|-------|----------|-------|-------|----------|
| | NEW | OLD | % change | NEW | OLD | % change |
| Contr. From Op. | 1,358 | 1,379 | -1.5 | 1,460 | 1,498 | -2.5 |
| Margin (%) | 18.9 | 19.2 | -30bp | 19.0 | 19.5 | -50bp |

Source: BG ests

- **Successful growth strategy and execution to continue in 2016.** The sequential acceleration in lfl growth throughout 2015 not only illustrated the ramp-up in growth but more importantly, Essilor's successful execution in capturing these growth opportunities, even in markets where the macro environment was volatile (e.g.: Italy and Spain grew DD, Brazil was up around 5% lfl). Furthermore the two "new categories" will also play a key role in achieving around 5% lfl growth in 2016: **1/ sunwear** (around 13% of total sales): the sunglass brand portfolio (Bolon, Costa, etc.) and sunlenses production should both grow by more than 10%; **2/ online:** revenue should also increase in double-digits as Coastal has been turned around. **Consequently we are comfortable with our 5% lfl growth forecast for 2016, vs. the company's guidance for "around +5%"**.
- **No signs of a slowdown in North America.** While many luxury and consumer groups reported softer trends in Q4, Essilor continued to enjoy solid growth (+4.8% lfl, +4.4% in 2015). The group is quite confident about 2016 in light of: (i) healthy market trends, (ii) a successful combination of media campaigns and innovation and (iii) a higher contribution from two fast-growing channels: independent ECP's (acquisitions of Vision Source and [PERC/IVA](#)) and online platforms).

VALUATION

- We expect that the temporary disappointment caused by "cautious" CM guidance should gradually make room for a focus on solid top-line momentum and MT growth prospects. Our new FV of EUR132 vs. EUR134 reflects our CM adjustments but we are making no change to our Buy recommendation.

NEXT CATALYSTS

- Essilor will report its Q1 16 Sales on 21st April 2016.



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| | |
|---------|---|
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