

L'Oréal

Price EUR150.15

Confidence in 2016

Fair Value EUR178 vs. EUR182 (+19%)

BUY

| | |
|----------------------------|---------------|
| Bloomberg | OR FP |
| Reuters | OREP.PA |
| 12-month High / Low (EUR) | 179.3 / 143.9 |
| Market Cap (EURm) | 84,084 |
| Ev (BG Estimates) (EURm) | 83,546 |
| Avg. 6m daily volume (000) | 779.5 |
| 3y EPS CAGR | 7.2% |

| | 1 M | 3 M | 6 M | 31/12/15 |
|----------------|-------|--------|--------|----------|
| Absolute perf. | 0.0% | -10.5% | -8.8% | -3.3% |
| Pers & H/H Gds | -3.1% | -10.7% | -7.9% | -7.7% |
| DJ Stoxx 600 | -9.0% | -16.1% | -18.4% | -14.6% |

| YEnd Dec. (EURm) | 2014 | 2015e | 2016e | 2017e |
|------------------|--------|--------|--------|--------|
| Sales | 22,532 | 25,257 | 26,030 | 27,332 |
| % change | | 12.1% | 3.1% | 5.0% |
| EBITDA | 4,730 | 5,248 | 5,490 | 5,782 |
| EBIT | 3,890 | 4,388 | 4,610 | 4,882 |
| % change | | 12.8% | 5.1% | 5.9% |
| Net income | 3,128 | 3,491 | 3,665 | 3,889 |
| % change | | 11.6% | 5.0% | 6.1% |

| | 2014 | 2015e | 2016e | 2017e |
|------------------|------|-------|-------|-------|
| Operating margin | 17.3 | 17.4 | 17.7 | 17.9 |
| Net margin | 13.9 | 13.8 | 14.1 | 14.2 |
| ROE | 15.4 | 13.7 | 14.2 | 0.0 |
| ROCE | 20.7 | 22.4 | 22.6 | 22.9 |
| Gearing | 3.3 | -2.3 | -6.7 | -10.5 |

| (EUR) | 2014 | 2015e | 2016e | 2017e |
|-----------------|-------|-------|-------|-------|
| EPS | 5.59 | 6.18 | 6.49 | 6.88 |
| % change | - | 10.6% | 5.0% | 6.1% |
| P/E | 26.9x | 24.3x | 23.1x | 21.8x |
| FCF yield (%) | 3.3% | 3.5% | 3.6% | 3.8% |
| Dividends (EUR) | 2.70 | 3.10 | 3.35 | 3.65 |
| Div yield (%) | 1.8% | 2.1% | 2.2% | 2.4% |
| EV/Sales | 3.8x | 3.3x | 3.2x | 3.0x |
| EV/EBITDA | 17.9x | 15.9x | 15.0x | 14.1x |
| EV/EBIT | 21.8x | 19.0x | 17.9x | 16.7x |

Friday's analysts' meeting gave L'Oréal's management the opportunity to review 2015 figures and also discuss 2016 prospects. Although we are maintaining our 2016 organic sales growth figure (+4.2%), we have reduced our reported sales due to a 1.5% negative FX effect. Consequently, we have reduced our FV from EUR182 to EUR178. Buy maintained.

ANALYSIS

- In 2015, L'Oréal grew almost in line with the near 3.9% growth seen in the global cosmetics market** with no outperformance if we include The Body Shop. Taking into account the cosmetics branch alone, L'Oréal outperformed the cosmetic market slightly (1.1x - see table below). This historically poor performance was due to one division, namely **consumer products** (48% of cosmetic sales) sales in which rose by only 2.5% while the market was up 4%, implying an acceleration by the market versus 2014 (+3.5%). This was the second consecutive year of underperformance for this division which was clearly The big disappointment of 2015. Fortunately, all the other divisions outperformed the market and particularly the **professional products** which grew 2.3x faster than the market (up only 1.5% vs +1% in 2014) where growth picked up slightly, particularly in the US. **The luxury products** division outperformed the very dynamic market (+5.5%) with a 6.1% increase (ie 1.1x faster). Lastly, the **active cosmetics** division was the best performer last year and grew 1.4x faster than the dermo cosmetics market.
- As expected, 2015 EBIT margin increased slightly (+10bp to 17.4%).** It is worth noting that gross margin increased 10bp to 71.2% despite a 80bp negative forex effect (both transaction and conversion effect) due to a weak euro against most other currencies. Nevertheless, this implied a 100bp improvement prompted by other factors (raw materials, production efficiency...).
- For 2016, L'Oréal's management expects a market increase close to last year's level (between 3.5 and 4%).** Management expects slightly better market momentum in North America and in Western Europe (excluding France where the pricing war between retailers is affecting market growth) while the situation in Brazil cannot be worse than in 2015. On the other hand, the environment in MC is not expected to improve in coming months.
- The Group's CEO, Jean-Paul Agon, was very clear on the target to really outperform the market this year** and also very confident that this could be achieved especially thanks to a progressive outperformance by consumer products given the aggressive launch pipeline, particularly with the Garnier brand (in the hair care and skin care segments). We do not doubt that other divisions should also be able to outperform the market again. As such, we maintain our target for 4.2% organic sales growth, but remain cautious for Q1 as the 2016 launch phasing will be much more effective from Q2, while the comparison basis is also tough for Q1 (+4% in Q1 2015), particularly in LATAM (+10%). Nevertheless, we have lowered our reported 2016 sales since we have introduced into our model a 1.5% negative FX impact given some negative moves for emerging currencies, particularly the NCY or the BRL.
- Concerning EBIT, L'Oréal expects a profitability gain even if management preferred to neither "quantify nor qualify" this improvement.** We argue that EBIT margin could increase by 30bp to 17.7%. This gain should be driven by gross margin (+40bp to 71.6%) as FX should have no further negative impact and others factors (see above) should remain well oriented. L'Oréal will act also in order to improve its market share, implying perhaps some higher A&P as % of sales.
- Lastly, we would highlight that after a year with a virtually stable pay-out ratio at 50.2% (50.6% in 2014) but a 14.7% dividend increase, we expect a P/O increase in 2016** in order to achieve what is, in our view, the ultimate group management target which is to increase the dividend by at least 10% per year on average over a long period as was the case between 2007 and 2015 (+10.6%).

VALUATION

- The stock is trading at 17.9x on 2016 EV/EBIT. FV EUR178 vs EUR182 previously. Buy maintained.

(continued next page)



NEXT CATALYSTS

- Q1 2016 sales to be reported in Mid April.

Cosmetic market and L'Oréal performance in 2015

| Lfl chge in % | Market | L'Oréal | dev (%) |
|-------------------------|------------|------------|------------|
| Western Europe | 1.0 | 2.3 | 2.3 |
| North America | 3.7 | 3.5 | 0.9 |
| New markets | 5.0 | 6.0 | 1.2 |
| | | | |
| Professionnal Products | 1.5 | 3.4 | 2.3 |
| Consumer Products | 4.0 | 2.5 | 0.6 |
| Luxury Products | 5.5 | 6.1 | 1.1 |
| Active Cosmetics | 5.5 | 7.8 | 1.4 |
| Cosmetics branch | 3.8 | 4.1 | 1.1 |

Source : Company Data; Bryan Garnier & Co. ests.

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