

Luxottica

Price EUR51.25

Investor Day Feedback: today's investments are tomorrow's robust sales and profit growth**Fair Value EUR65 (+27%)****BUY**

Bloomberg	LUX IM
Reuters	LUX.MI
12-month High / Low (EUR)	67.5 / 49.1
Market Cap (EUR)	24,788
Ev (BG Estimates) (EUR)	25,842
Avg. 6m daily volume (000)	801.4
3y EPS CAGR	14.5%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-4.9%	-20.6%	-14.0%	-15.1%
Consumer Gds	-0.2%	-8.4%	5.8%	-4.1%
DJ Stoxx 600	1.9%	-11.2%	-3.6%	-6.8%

YEnd Dec. (€m)	2014	2015e	2016e	2017e
Sales	7,652	8,837	9,366	10,013
% change		15.5%	6.0%	6.9%
EBITDA	1,542	1,853	2,040	2,224
EBIT (reported)	1,158	1,376	1,536	1,685
% change		18.9%	11.6%	9.7%
Net income	642.6	804.1	928.9	1,040
% change		25.1%	15.5%	11.9%

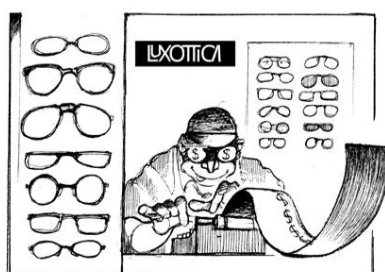
	2014	2015e	2016e	2017e
Operating margin	15.1	15.6	16.4	16.8
Net margin	8.4	9.1	9.9	10.4
ROE	13.1	16.1	17.1	17.7
ROCE	10.4	12.6	14.2	15.6
Gearing	20.6	21.0	11.7	3.5

(€)	2014	2015e	2016e	2017e
EPS	1.44	1.68	1.94	2.17
% change	-	16.1%	15.5%	11.9%
P/E	35.5x	30.6x	26.5x	23.6x
FCF yield (%)	2.9%	3.2%	4.0%	4.4%
Dividends (€)	0.72	0.92	1.05	1.20
Div yield (%)	1.4%	1.8%	2.0%	2.3%
EV/Sales	3.4x	2.9x	2.7x	2.5x
EV/EBITDA	16.7x	13.9x	12.5x	11.2x
EV/EBIT	22.3x	18.8x	16.6x	14.8x

The market is sometimes demanding. Yesterday's negative reaction was possibly due to cautious current trading in Q1 2016 and profit guidance, which seemed to have disappointed some investors. Admittedly, the new 2016-18 earnings target (to grow at 1.5x sales) is lower than the historical "rule-of-thumb" (2x sales) but was no surprise to us since management stated several times in 2015 that the historical "rule-of-thumb" could hardly be reiterated for a seventh year in a row. Achieving this targeted operating leverage in a context of significant investments is also reassuring in our view, especially since the group also expects to increase ROIC. Buy recommendation and FV of EUR65 confirmed.

ANALYSIS

- Yes, LUX will invest more than EUR1.5bn over the next three years...** Following recent interviews with Mr Del Vecchio, the group confirmed a significant investment plan of EUR1.5bn over 2016-18, or ~6% of sales, broken down as follows: (i) 1/3 dedicated to **IT and digitalisation** (see below), (ii) 1/3 dedicated to **manufacturing** (increased capacity and automation lines) and (iii) 1/3 dedicated to **retail** (store openings and remodellings, digitalising POS, etc.). These significant investments might explain the relative cautiousness regarding operating income guidance, which again, did not surprise us as LUX often repeated last year that the historical "rule-of-thumb" could hardly be reiterated for a seventh consecutive year.
- ... But these capex investments will drive earnings and ROIC over the MT.** Indeed initiatives in both divisions will contribute to this improvement. In **Retail**: the roll out of shop-in-shops in host stores like LensCrafters @ Macy's (500 s-i-s by 2018) or Sunglass Hut @ Galeries Lafayette (57 s-i-s in 2016) is a good illustration: these POS require less capex and opex but generate very high sales per sqm, meaning a very profitable business model (+high ROIC) which could be scalable in other countries in our view. In **Wholesale**: STARS (inventory management and automatic replenishments) covered 6,300 doors globally and LUX will roll it out in the US and LATAM in 2016. STARS enables LUX to control and run the inventory of wholesale partners, which is a new form of retail without capex or real estate, hence accretive for margins and FCF. **The group aims for STARS to account for 15% of Wholesale sales by 2018 vs. 9% currently.**
- Digitalising Luxottica is one of the key priorities for top management.** E-commerce accounts for ~4% of total sales, a 50/50 split between its own e-commerce platforms (i.e. RayBan.com, Oakley.com and SunglassHut.com) and third parties. LUX is targeting a **share of 7% of total sales by 2018**. Besides expanding these e-commerce platforms, the digital transformation will impact the entire group: IT/supply chain (CRM, data collection, MyLuxottica) but also Retail (Clarifye digital eye exam, lens simulator, etc.) to digitalise the customer experience in POS. Over the LT, management is convinced that digitalisation will release efficiencies and increase speed throughout the group, enhancing margins and FCF generation.
- Cautious current trading but 2016 guidance in line with our expectations.** Although the months of January and February "were good", management reminded that Q1 is facing a challenging comparison base at the top-line level (launch of Michael Kors contributed ~2.5p.p to Wholesale growth of ~EUR20m) and on profitability which increased 110bp (adjusted) and 150bp (reported). However the 2016 outlook implies a gradual acceleration throughout the year, explaining why we have made no changes to our assumptions.
- A few words about governance and M&A.** In an introductory message, Mr Del Vecchio confirmed that he wanted to leave the executive functions "in a few years" and return to his previous position of non-executive Chairman and shareholder. He could hand over the reins to internal managers - four of them led the ID: Massimo Vian (CEO Product and Operations), Stefano Grassi (CFO), Paolo Alberti (Executive VP Wholesale) and Nicola Brandolese (President of Retail) - backed by a "strong and independent BoD as it is now".
- As for M&A, management has clearly ruled out any strategic acquisition** (i.e. Essilor or Carl Zeiss), which confirms our belief that a large transaction was not a priority for LUX in light of a group-wide simplification plan (not really compatible with a big acquisition...) and a huge capex investment plan to fuel MT/LT organic growth. The group's expansion into the lens category will be carried on "internally and organically".

*(To be continued next page)*

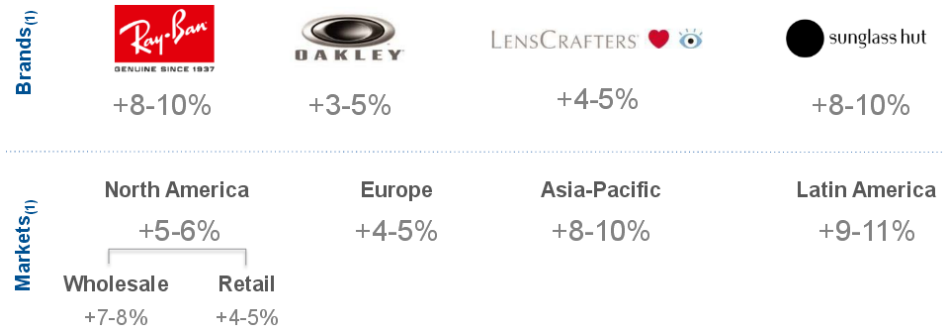
VALUATION

- In our view, the share price decline yesterday could be explained by the prudent current trading statement for Q1 and profit guidance, which seemed to have disappointed some investors. Concerning governance, it will be interesting to see the precise responsibilities and tasks given to Francesco Milleri, a long-time advisor for Mr Del Vecchio who was appointed as a Group Director to assist the Executive Chairman.
- Interestingly, Essilor also faced the same negative market reaction a few days ago after some investors were disappointed by fairly conservative margin guidance, which was justified by incremental marketing expenses and an ambitious capex investment plan to fuel future topline growth.
- However, since Essilor's growth strategy is to always favour top-line growth ahead of margin expansion, it is worth highlighting that operating leverage would be higher for Luxottica. Buy recommendation and FV of EUR65 confirmed.

NEXT CATALYSTS

- Luxottica is due to report Q1 results on 29th April 2016.

2016 Roadmap by brands and markets (FX-n growth):



Source: Company Data

Table 2: Outlook for 2016-18:

EURm	2016	2017-18
Sales growth (FX-n)	+5-6%	Mid to high single-digit
Operating income and net income	At least 1.5x sales	At least 1.5x sales

Source: Company Data

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