BRYAN, GARNIER & CO

INDEPENDENT RESEARCH UPDATE

22nd March 2016

Luxottica

Turbulence almost over, make the most of it!

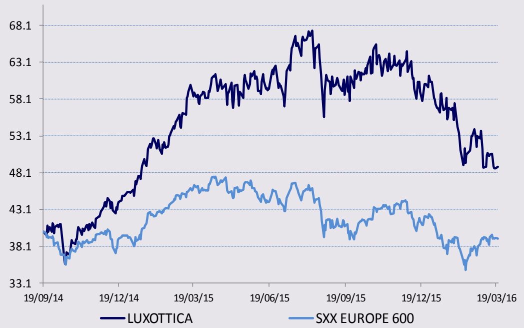
Luxury & Consumer Goods

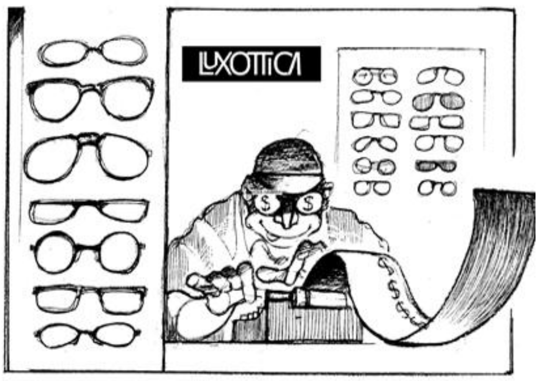
Fair Value EUR63 vs. EUR65 (price EUR48.70) **BUY**

Bloomberg	LUX IM
Reuters	LUX.MI
12-month High / Low (EUR)	67.5 / 48.7
Market capitalisation (EURm)	23,554
Enterprise Value (BG estimates EURm)	24,560
Avg. 6m daily volume ('000 shares)	851.3
Free Float	32.9%
3y EPS CAGR	14.5%
Gearing (12/14)	21%
Dividend yield (12/15e)	1.83%

YE December	12/14	12/15e	12/16e	12/17e
Revenue (€m)	7,652	8,837	9,366	10,017
EBIT (€m)	1,158	1,376	1,536	1,685
Basic EPS (€)	1.34	1.67	1.93	2.16
Diluted EPS (€)	1.44	1.68	1.94	2.17
EV/Sales	3.21x	2.78x	2.59x	2.38x
EV/EBITDA	15.9x	13.3x	11.9x	10.7x
EV/EBIT	21.2x	17.8x	15.8x	14.2x
P/E	33.7x	29.0x	25.1x	22.4x
ROCE	10.4	12.5	13.9	15.2

Price and data as at close of 18th March





After an excellent performance in 2015 (+33%), the share has plummeted 19% YTD, due to 2016-18 targets viewed as cautious by the market and a lack of visibility concerning governance. The share is now trading at a 5% discount in terms of 1-yr forward EV/EBIT relative to the average over 2014-16 (vs. +32% in December) and since we believe that management will provide convincing answers to these two issues, we advise making the most of current prices to strengthen positions. We have made no changes to our 2016-18 estimates but our new EUR63 Fair Value takes account of a slight increase in beta as well as the number of shares. Buy recommendation confirmed.

- **The US (~56% of sales) remains a catalyst:** excluding the negative impact of the 53rd week in the retail segment, **organic growth even picked up in North America in Q4** to 5.8% vs. 5.6% after 9M and 4.5% in Q3. For 2016, management is forecasting same-currency growth of 5-6%, driven especially by numerous store openings at LensCrafters and Target Optical. **Comparison is nevertheless set to be demanding in Q1 2016.**

- **Cautious 2016-18 targets?** We are forecasting same-currency growth of 6% in 2016 followed by 7% in 2017-18, namely **the best performance in our optical sample.** 2016-18 guidance for EBIT growth of 1.5x sales growth is admittedly lower than that seen over 2010-15 (2x sales growth). However, this is justified by the massive EUR1.5bn capex plan out to 2018. Although our assumptions are more cautious than the group's (1.3x sales growth over 2016-18e), **upside potential in EBIT margin** (BG: +40pb/year) **remains one of the highest in the sector** and EBIT should increase by EUR400m between 2016 and 2018, namely as much as during the 2010-14 period.

- **Governance: visibility to return gradually.** Mr Del Vecchio (61.4% of capital) needs to finalise the succession plan and the new governance structure. In the short term, we are very confident in the new management team's ability to efficiently implement and roll out the initiatives announced at the Investor Day (~1,280 store openings by 2018, digital strategy etc.).

Analyst:
Cédric Rossi
33(0) 1 70 36 57 25
crossi@bryangarnier.com

Sector Analyst Team:
Nikolaas Faes
Loïc Morvan
Antoine Parison
Virginie Roumage

Company description

With 2015 sales of EUR8.8bn, Luxottica is the global leader in luxury eyewear. The Italian group is organised into two businesses: (i) Retail (60% of sales) with the distribution of optical products via more than 7,000 sales points across the globe (LensCrafters, Sunglass Hut…) and (ii) Wholesale (40% of sales) which concerns the design, production and marketing of prescription frames and sunglasses thanks to a portfolio of house brands (Ray-Ban, Oakley…) and licences (Prada, Giorgio Armani, Ralph Lauren, Chanel…) that is unrivalled in the sector. Mr Leonardo Del Vecchio, the group's founder and current Chairman, remains the majority shareholder with 61.4% of the share capital. Worth noting is that Giorgio Armani holds a 5% stake. Free float stands at around 33%.

Income Statement (EURm)	**2012**	**2013**	**2014**	**2015e**	**2016e**	**2017e**
Revenue	7,086	7,313	7,652	8,837	9,366	10,017
Change (%)	*13.9%*	*3.2%*	*4.6%*	*15.5%*	*6.0%*	*7.0%*
Gross Profit	4,650	4,789	5,078	6,001	6,388	6,853
EBITDA	1,328	1,422	1,542	1,853	2,040	2,225
EBIT	970	1,056	1,158	1,376	1,536	1,685
Change (%)	*20.2%*	*8.8%*	*9.7%*	*18.9%*	*11.6%*	*9.7%*
Financial results	(126)	(99.3)	(97.5)	(98.5)	(80.0)	(67.5)
Pre-Tax profits	844	956	1,060	1,278	1,456	1,618
Tax	(306)	(408)	(414)	(471)	(524)	(574)
Minority interests	(4.2)	(4.2)	(3.4)	(2.8)	(2.9)	(3.1)
Net profit	534	545	643	804	929	1,040
Change (%)	*18.1%*	*1.9%*	*18.0%*	*25.1%*	*15.5%*	*12.0%*
Cash Flow Statement (EURm)						
Operating cash flows	1,023	1,015	1,128	1,382	1,516	1,650
Change in working capital	14.2	22.9	(11.8)	114	51.1	62.8
Capex, net	262	375	419	514	603	551
Financial investments, net	217	121	41.1	44.2	140	150
Dividends	232	277	312	691	427	480
Other	(72.0)	18.0	(81.0)	12.0	0.0	0.0
Net debt	1,662	1,461	1,013	1,006	711	305
Free Cash flow	747	617	720	754	862	1,036
Balance Sheet (EURm)						
Cash & liquid assets	790	618	1,454	1,461	1,755	2,162
Other current assets	1,637	1,618	1,714	1,944	2,046	2,172
Tangible fixed assets	1,192	1,183	1,318	1,355	1,454	1,466
Intangible assets	1,346	1,261	1,385	1,385	1,385	1,385
Other assets	3,477	3,403	3,724	3,724	3,724	3,724
Total assets	8,442	8,083	9,594	9,868	10,364	10,909
LT & ST debt	2,452	2,079	2,467	2,467	2,467	2,467
Other liabilities	1,996	1,854	2,199	2,314	2,366	2,429
Shareholders' funds	3,993	4,150	4,929	5,087	5,532	6,013
Total liabilities	8,442	8,083	9,594	9,868	10,364	10,909
Capital employed	6,432	6,188	6,792	6,943	7,093	7,168
Financial Ratios						
Gross Margin (% of sales)	65.62	65.48	66.35	67.91	68.20	68.41
EBITDA margin (% of sales)	18.75	19.45	20.15	20.97	21.78	22.21
EBIT margin (% of sales)	13.69	14.44	15.13	15.58	16.40	16.83
Tax rate	36.22	42.61	39.06	36.86	36.00	35.50
Net Margin	7.54	7.45	8.40	9.10	9.92	10.39
ROE (after tax)	13.42	13.15	13.06	15.83	16.81	17.32
ROCE (after tax)	9.62	9.79	10.39	12.52	13.86	15.17
Gearing	41.63	35.22	20.55	19.77	12.86	5.07
Pay out ratio	48.16	49.71	49.85	49.98	51.62	50.70
Number of shares, diluted	469,574	476,273	479,247	482,073	482,073	482,073
Per share data (EUR)						
EPS	1.14	1.14	1.34	1.67	1.93	2.16
Restated EPS	1.19	1.31	1.44	1.68	1.94	2.17
% change	*22.1%*	*9.7%*	*10.5%*	*16.1%*	*15.5%*	*12.0%*
BVPS	8.50	8.71	10.28	10.55	11.48	12.47
Operating cash flows	2.18	2.13	2.35	2.87	3.14	3.42
FCF	1.59	1.29	1.50	1.56	1.79	2.15
Net dividend	0.58	0.65	0.72	0.89	1.00	1.10

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

Table of contents

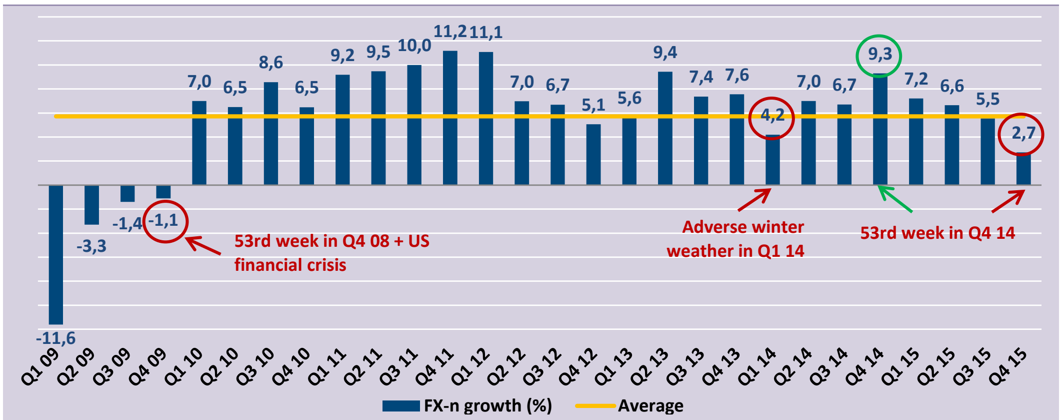
1. 2015 earnings in line with guidance

1.1. Sales: reading made difficult by calendar effects in the US

Whereas a number of investors were disappointed by the seemingly low level of organic growth in Q4 2015 (+2.7% FX-n excluding EyeMed effect), it is important to note that this relative weakness stemmed solely from calendar effects in the US in the last quarter.

It is also interesting to note that the 2.7% organic increase was the lowest since Q4 2009 (-1.1% FX-n), when Luxottica was obliged to face comparison with Q4 2008, which also consolidated a 53rd week for the year.

Fig. 1: Luxottica quarterly sales growth (FX-n, %):



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

Note that there were two types of calendar effect in Q4 2015:

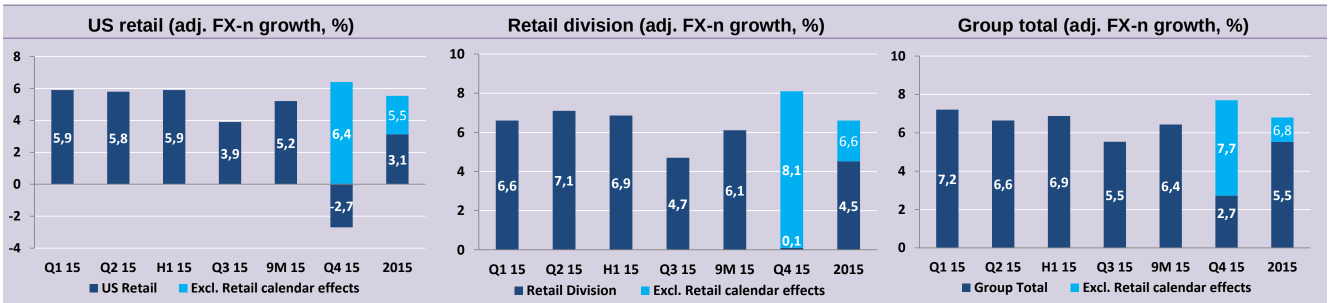
(i) **The 53rd week effect:** like a number of US retailers, operations in the US retail business are consolidated on the basis of 52 weeks of seven days (or 364 days), thereby obliging the group to book an additional week every five or six years in order to make up for the "extra days" (the last booking of this type was in Q4 2008).

(ii) **Realignment with Gregorian calendar:** the Italian group decided to align the calendar in the US retail business with that of the wholesale business and its other activities. From now on, all of the group's reporting is based on the Gregorian calendar.

Given these calendar effects, Q4 2015 included nine working days less than in Q4 2014, representing a differential of EUR90-95m in terms of sales according to Luxottica. The negative impact of these calendar effects therefore naturally took a hefty toll on the Italian group's performances, as the three charts on the following page show.

Excluding calendar effects, US retail sales would have risen by 6.4% in Q4 2015, instead of falling 2.7% while the Retail division's sales would have increased by 8.1% (instead of +0.1%) and **Luxottica's organic growth would have totalled 7.7% (vs. +2.7%), showing an acceleration in growth relative to the 6.4% posted over 9M 2015.**

Fig. 2: Calendar effects took a harsh toll in Q4 2015:

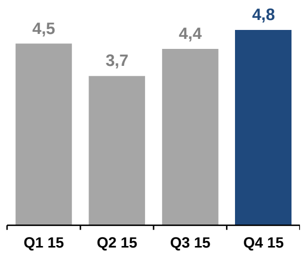


Source: Company Data; Bryan, Garnier & Co ests.

1.2. End demand did not slow in the US during Q4

Since a large number of luxury groups stated that US business had slowed during Q4 2015, the negative impact of these calendar effects prompted investors to believe the same for Luxottica. However, during the Investor Day on 2nd March, management stated several times that final demand remained robust and that the US market harboured the highest growth potential after emerging markets.

Quarterly lfl growth at Essilor in North America (%):



Source: Company Data

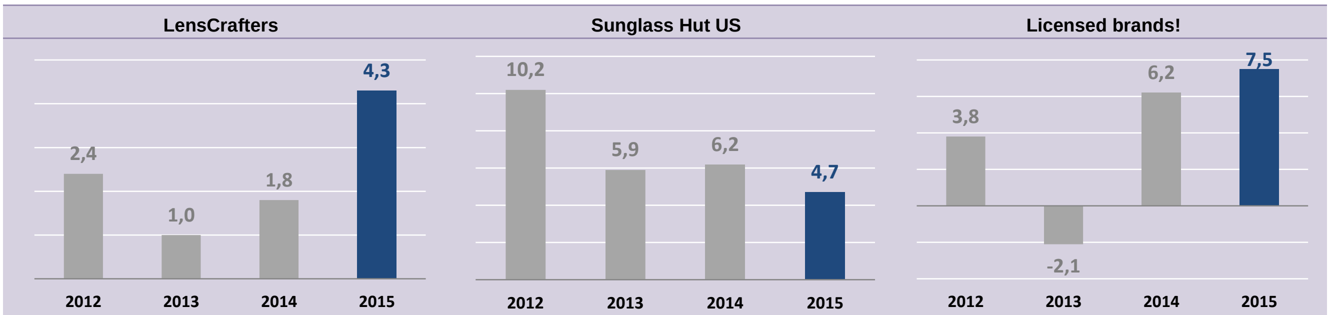
Note that Essilor also had the same optimistic message for 2016 as well as on potential in the US optical market, strengthened by robust Q4 2015 growth (see chart opposite). The growth posted by main Luxottica brands also validates the positive vision of its management:

(i) **LensCrafters (SSSG 2015: +4.3%):** the main Luxottica brand accounts for around 30% of US retail sales and posted its best performance since 2011 (+4.7%), thereby confirming the success of its repositioning and customer satisfaction since eye tests increased by 7% (main criteria to ensure a high conversion rate), or double the pace of market growth (+3.7%).

(ii) **Sunglass Hut (SSSG 2015: +4.7%):** the leading sunglasses distributor boasts the highest number of catalysts in common with luxury groups. As such, like luxury players, SGH was affected by the lower number of tourists in NYC, Hawaii, Florida and California, which represent around 15% of the banner's sales. In contrast, **other regions in the US, or 85% of sales, posted a same-store increase of 7.7%** in a sign that domestic demand is not weakening:

(iii) **Sears Optical and Target Optical (SSSG 2015: +7.5%):** the two chains' corners in department stores, with a midscale positioning, also posted attractive growth in 2015. Although Sears is struggling, sales at the optical corners continued to rise, whereas sales at Target Optical showed double-digit growth for the sixth year in a row!

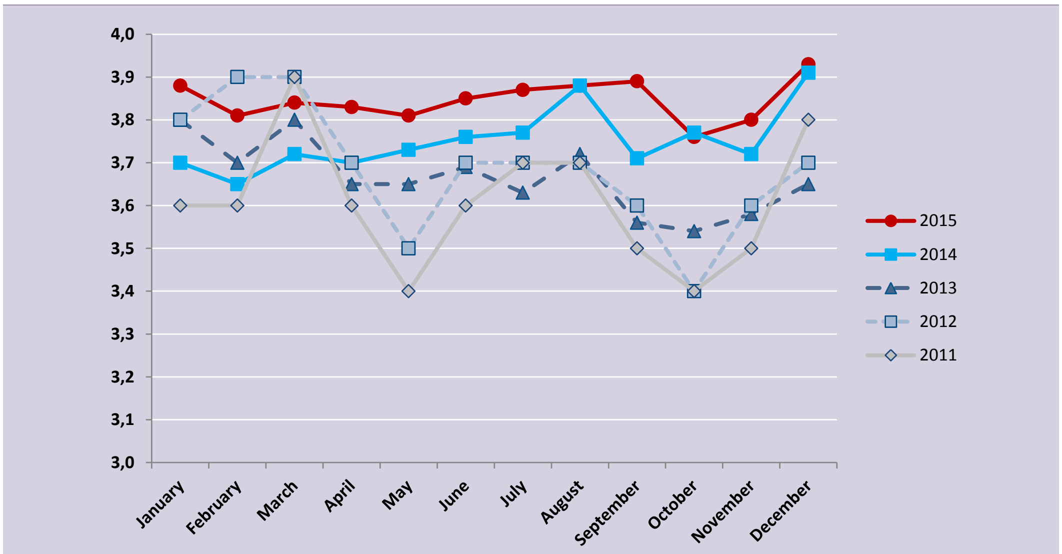
Fig. 3: Same-store growth at the major US banners (%):



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

Although the circuit is different to that of the optical chains (or even rival), the chart below shows that the confidence index in independent eye-care specialists in the US (optometrists, opticians etc.) remained high throughout the year, and even ended at a record level in December 2015 (3.93), again testifying to the promising outlook for the US optical market in 2016 and over the medium term.

Fig. 4: Trend barometer for independent eye-care professionals (1= very negative, 3= neutral, 5= very positive):



Source: Jobson Optical Research

1.3. Further widening in EBIT margin despite retail

As shown in the table below, **Luxottica delivered its two earnings rule-of-thumbs for the sixth year in a row** with EBIT up 11% and net profit up 12% same-currency in 2015.

Fig. 5: Luxottica main 2015 rule-of-thumbs (at constant-currency):

FX-n	2015 "Rule-of-thumbs"	2015 Achievements
Sales	"Mid to high single-digit growth"	+5.5%
Adj. Operating Income Growth	2x Sales	+11%
Adj. Net Income Growth	2x Sales	+12%

Source: Company Data

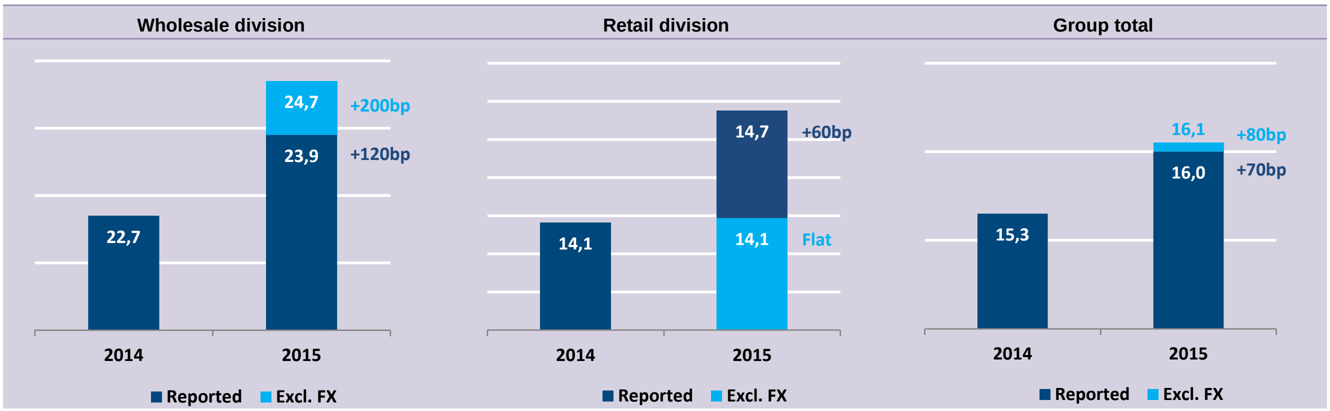
Performance by business:

- **Wholesale division:** profitability in this division widened by 120bp to 23.9% in reported terms, in a performance that was all the more impressive in that the increase faced a negative currency effect (+200bp same-currency) and the price adjustments in China. The main two catalysts were: **(i)** economies of scale and productivity gains in plants (costs only rose 2% in reported terms) and **(ii)** the start of synergies unlocked by the integration of Oakley that should play especially in 2016 and 2017.

- **Retail division:** the 60bp widening in EBIT margin in the retail division (to 14.7%) stemmed solely from the positive currency effect since same-currency EBIT margin remained flat. This performance was slightly disappointing in view of the productivity gains made at LensCrafters and robust same-store growth at the group's main banners. The poor performances in eyewear retailing in Australia (OPSM) and in China/HK (LensCrafters) apparently weighed more on the margin than expected. Note that calendar effects only had a slightly negative impact of around 10bp.

After taking account of intra-group flows up 8% (to -EUR220m), Luxottica's EBIT margin widened by 70bp to 16% in reported terms and 80bp at constant forex.

Fig. 6: Change in EBIT margin by business:



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

2. 2016-18 outlook: investing in order to maintain high momentum

Automated production chain for the Ray-Ban Aviator model:

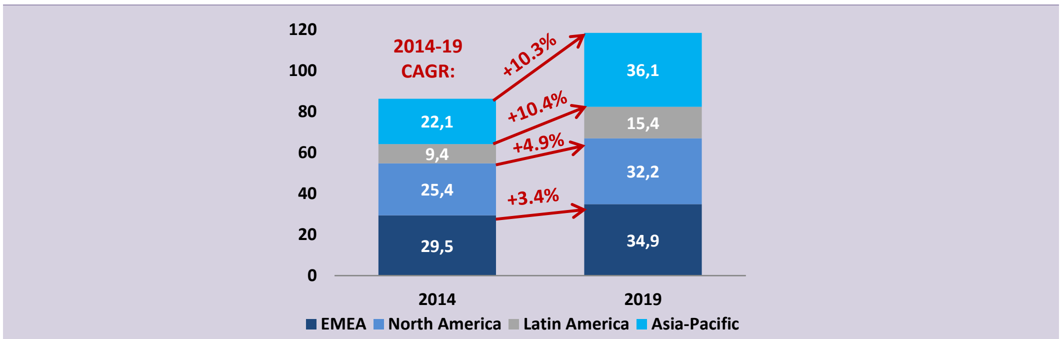
Source: Company Data

Note interestingly that the message delivered by Luxottica at its ID was similar in two ways to that given by Essilor a few weeks earlier:

(i) **The optical market is in a ramp-up phase** in all segments (prescription lenses, sunglasses, contact lenses etc.). Note that Euromonitor estimated the global optical market at EUR88bn in 2014 and was forecasting a CAGR of 6.5% for the 2014-19 period (BG: +4.5%).

(ii) **It is vital to step up investment spending (**capex and opex) in order to better capture these growth opportunities and to maintain favourable momentum over the MT. As discussed further on, these investments should concern: digital and e-commerce, the increase in production capacity and retail. A particular effort is set to be made in US optical retailing chains (LensCrafters, Target Optical) in which the group has invested little in the way of expansion in recent years.

Fig. 7: 2014-19 CAGR in the global optical market by region (EURbn and change in %):



Source: Euromonitor; Bryan, Garnier & Co ests.

As such, Luxottica has announced a capex programme of around EUR1.5bn over 2016-18, representing the same amount spent by the group between 2012 and 2015 (EUR1.57bn)! These investments are to be equally divided between the three main focuses set out in the table below:

Fig. 8: Three focuses of EUR1.5bn investment plan (2016-18):

Digital & E-commerce	Manufacturing & Supply Chain	Retail
STARS: roll out with a focus on North America, Asia and Latin America => 15% of wholesale sales by 2018 (2015: 8%) **"Digital Transformation":** - Customer centricity with a state-of-the-art **CRM** (>40m consumers recorded in North America) - Digitalise the POS/Favour omni-channel: roll-out the digital eye-exam platform *Clarifye,* the virtual try-on technology of glasses.com, etc. **Accelerate in e-commerce:** this channel should account for 7% of sales by 2018 (2015: 4%)	**Enhanced logistic distribution:** **- North America:** California-based DC of Oakley will be closed and the size of the DC in Atlanta will be tripled (to cover the US + Mexico) **- China:** new DC being built to serve all Asia and South East Asia **- Italy:** logistic hub is doubled **Increase process automation:** - Assembly line of **Ray-Ban Aviator** will be fully automated (~4% of LUX total volumes) - Capex: EUR60m (Payback: <1.5 years)	**2016:** over 500 store openings worldwide (o/w 300 DOS for Sunglass Hut) **Store opening programme by 2018:** **- LensCrafters (US):** +500 stores and 300 remodels/relocations **- Target Optical (US):**+180 stores **- SGH:** +700 stores worldwide

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

2.1. Digitalisation of distribution

When Leonardo Del Vecchio stated several times that Luxottica needed to step up its development in digital, he did not only mean increasing the weight of e-commerce (around 4% of sales in 2015), but also to digitalise distribution in order to strengthen customer relations (CRM, STARS, etc.), favour omni-channel solutions and reduce time-to-market.

2.1.1. Wholesale: stepping up global roll-out of STARS

Developed and launched in 2002, STARS (**S**uperior **T**urn **A**utomatic **R**eplenishment **S**ystem) is a real-time, in-store stock and assortment management software platform rolled out at Luxottica's key clients and based on two main pillars:

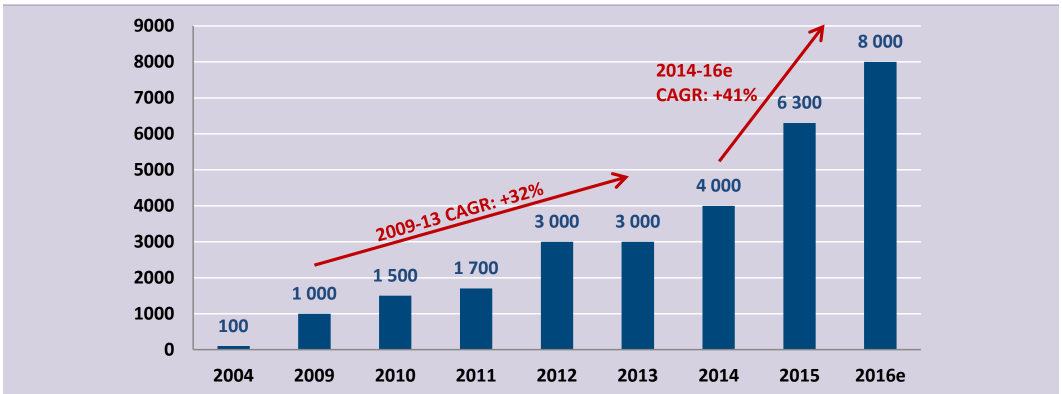
(i) **Product assortment:** based on brand segmentation, and the knowledge of Luxottica marketing teams, each store's assortment varies depending on its location and the profile of its customers. STARS is also a merchandising tool which advises how to present the products and optimise shop windows.

(ii) **Optimised stock levels:** Luxottica manages procurement of new models and the recall of older/unsold collections in order to maintain an optimal stock level, while minimising stock-outs thanks to the automatic replenishment system.

The global roll-out of STARS, enabling it to manage its clients' stocks and supply, provides obvious advantages for Luxottica: **(i)** strengthening ties with its key accounts, **(ii)** minimising stock run-down risks since real-time stock management helps the group better anticipate sell-out trends and adapt its production, **(iii)** increase the penetration rate of its brands thanks to sales and merchandising tools.

In recent years, the Italian group has massively stepped up the roll-out of STARS, especially in North America and emerging markets (Asia, Latin America). As shown by the chart below, Luxottica took 12 years to reach 4,000 accounts (2014), but this figure will double over two years to exceed the 8,000 mark at end-2016! **STARS accounted for around 8-9% of wholesale sales in 2015 and should increase this figure to 15% by 2018.**

Fig. 9: Change in number of third-party clients where the STARS programme is installed:



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

2.1.2. Retail: "Digitalising" sales points to favour omni-channel

Digitalising LensCrafters sales points

Application myLook ™ at LensCrafters helping customers better choose their glasses:

Source: LensCrafters

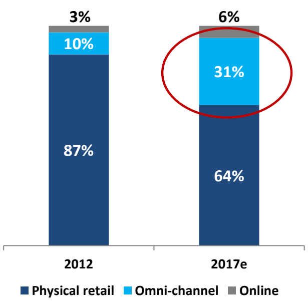
The introduction of digital services and tools in stores should above all enable Luxottica to improve the consumer experience and the expertise of its sales staff compared with independent rivals (see following section: 2.2.1). Since these initiatives should make all the stages of the sales process more fluid in the stores, they should help unlock fresh productivity gains beneficial to profitability and financial multiples. These initiatives above all concern LensCrafters, but if they are successful, they could also be rolled out to other group banners:

(i) **The *Clarifye* digital measurement system:** the quality of measurements taken during an examination is crucial for an optician since it favours the conversion rate as well as the average basket. The chain has already rolled out *Clarifye*, developed by Zeiss, in 200 stores. The new tool enables very precise digital measures (error rate of less than 50%) at a very high speed (turnaround time reduced by 18%). **It is to be deployed in around 70% of LensCrafters stores between now and end-2016.** Improving this service is set to be a **key differentiation factor** for premium chains such as LensCrafters, to stand out from independent opticians/optometrists and value players.

(ii) **15,000 iPads made available in LensCrafters stores:** the tablets above all provide sales staff easy access to customer files. **The LensSimulator ™ view simulator,** which helps customers better choose their frames and lenses using virtual reality, also favours the conversion rate and customer satisfaction.

The omni-channel strategy

Breakdown of market share in optical market depending on circuit (Germany, France, UK and Holland):



Source: Javelin Research

Note firstly that online sales only account for around 4% of global optical retailing and Essilor believes that this market share could increase to 6% by 2018. In contrast, the omni-channel strategy looks far more promising to us since it should account for around 31% of optical distribution (Germany, France, UK and the Netherlands) by 2017, compared with 10% in 2012, as shown by the chart opposite.

Consequently, we believe the development of online sales and digital are more of a growth opportunity for Luxottica over the medium term, combining the assets of its global network of more than 3,700 optical stores (proximity, quality of eye exam, expertise of sales force etc.), with the advantages of internet (available 24 hours a day, large choice of frames and references etc.):

(i) **Strengthening customer knowledge:** a total of USD50m is to be invested to roll out a global CRM platform covering all of the group's banners. In North America, the large data base (40m clients!) enables Luxottica to send **personalised and targeted offers, which already represent 10% of Retail Optical North America (RONA) sales.**

(ii) **Click-and-collect:** the website is becoming an extension of the physical store, enabling customers to make an appointment for an eye exam or try on a pair of glasses in the nearest store, hence the advantage of having more than 3,700 optical stores throughout the world. The click-and-collect concept (i.e.: ordering online and collecting the product from the store) is practical since it means customers can try on their glasses while benefiting from the advice of a sales person.

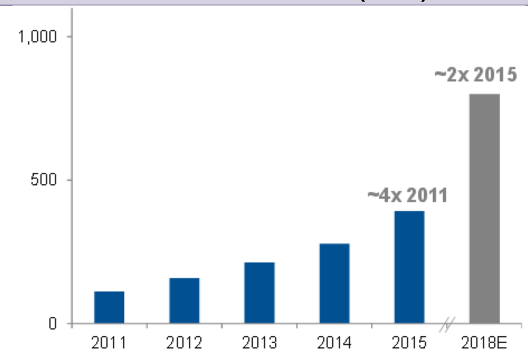
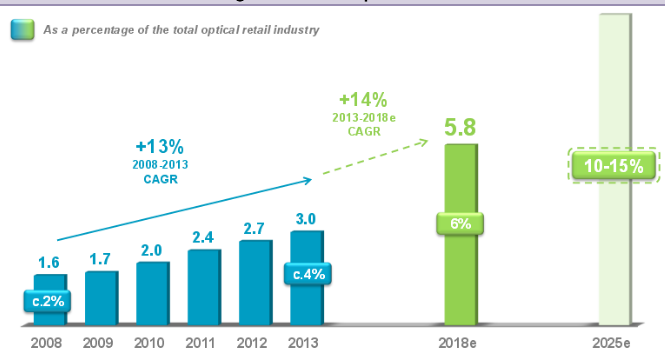
(iii) Increasing interaction with consumers: thanks to their online profiles, banners can not only better assess their customers, but also interact with them remotely (i.e. inform them when their glasses are ready, provide advice, etc.), thereby favouring their return to the store.

2.1.3. 2018 target: to double the size of e-commerce

Concerning its exposure to e-commerce, the two charts below show that the Italian group is not lagging since **online sales, which rose 50% in 2015, account for around 4% of total sales (including 2% directly via its platforms), which is almost as much as the global market share of online sales in optical retailing**.

In contrast, in line with Leonardo Del Vecchio's aim, the group is to step up its online presence, **since it aims to virtually double its sales out to 2018, to reach a market share of 7% of the total, representing a higher level than the global market.**

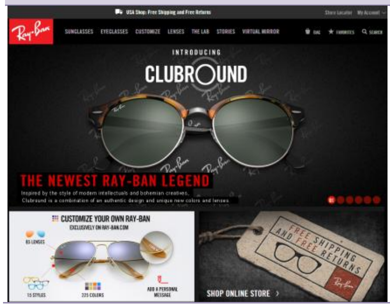
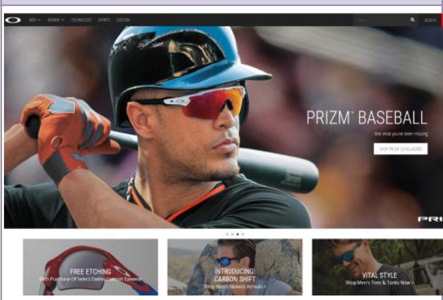
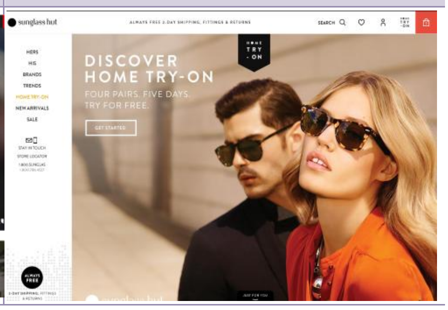
Fig. 10: Change in Luxottica e-commerce vs. global market out to 2018:

Luxottica e-commerce sales (EURm):	Weight of online optical retail:
	

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

Unsurprisingly, sunglasses still account for a large share of online sales since the RayBan, Oakley and Sunglass Hut banners are the ones driving growth in the circuit. Catalysts for **Ray-Ban** and **Oakley**, are: **(i)** the customisation service (Ray-Ban Remix and Oakley Custom), **(ii)** the introduction of a wider offer of prescription frames and **(iii)** the opening of merchant sites in new countries. Concerning **Sunglass Hut**: **(i)** the omni-channel strategy, **(ii)** exclusive collections on the internet and **(iii)** also the roll-out of the merchant site in other markets.

Fig. 11: Luxottica's three main e-commerce platforms:

RayBan.com	Oakley.com	Sunglasshut.com
- 2015 e-commerce sales: +80%	N/A	- 2015 e-commerce sales: +60%
		

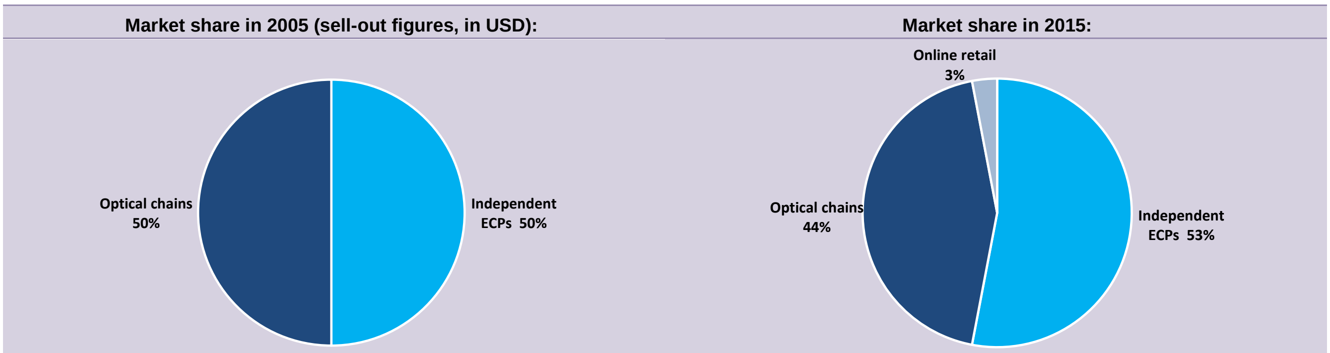
Source: Company Data; Bryan, Garnier & Co ests.

2.2. Retail: an ambitious opening programme

2.2.1. Reacting to competition from independents

As the two charts below show, independent optometrists and opticians have increased their market share by three points to 53% over 10 years, to the detriment of optical retailing chains, thanks to their better expertise in eye-test measurements and advice in choosing lenses.

Fig. 12: Corrective lenses: independents have won market share since 2005:

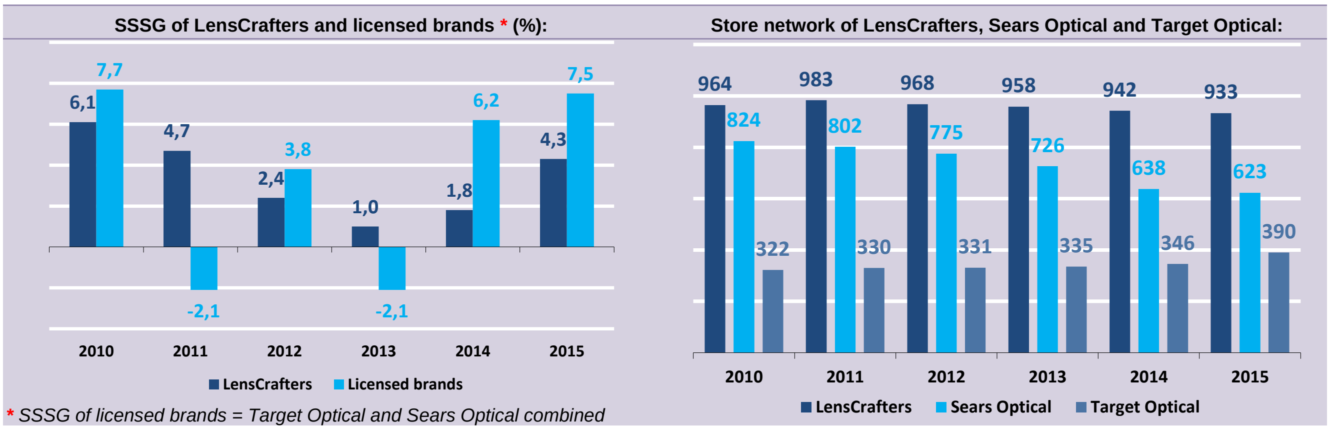


Source: Essilor, VisionWatch

Luxottica still dominates the US optical retailing market with market share of around 9%. **LensCrafters** has succeeded its repositioning, as shown by the acceleration in same-store growth since 2013, although the right-hand chart shows that the banner has also reduced its store network in North America since 2011.

The **Sears Optical** and **Target Optical** eyewear corners that are positioned in the midscale segment and which are managed as concessions by Luxottica in the Sears and Target department stores, have had mixed performances: **Sears Optical** has suffered from the breakdown of its host chain which is undergoing a massive reorganisation (143 department stores closed between 2010 and 2015, 50 more planned for 2016), with almost 200 optical corners having closed between 2010 and 2015 although Luxottica has nevertheless restored the situation with a return to same-store growth over the past two years. Meanwhile **Target Optical**, posted its sixth year in a row of double-digit same-store growth in 2015 and is the only group eyewear brand to have increased its store network (+68% since 2010).

Fig. 13: Change in Luxottica e-commerce vs. global market out to 2018:



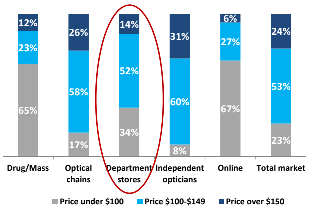
Source: Company Data; Bryan, Garnier & Co ests.

2.2.2. US: optical retailing back on the attack!

As mentioned previously, the introduction of more digital functions in the optical chains should help improve the purchase experience and favour efficiency gains. These initiatives should be supplemented by an ambitious store-opening programme at **LensCrafters** and **Target Optical** in order to strengthen their density in the North American market.

LensCrafters: 500 new sales points at Macy's over 2016-18…

Glasses sales by circuit and by price segment (%):



Source: VisionWatch

Encouraged by the success of the Sunglass Hut corners since 2009 (around 670 corners), which has helped triple sunglass sales at Macy's, the two partners have decided to introduce around 500 LensCrafters shop-in-shops between now and 2018 in order to round out the glasses offering. A few details on the partnership:

- **(i) A premium/luxury offering:** in addition to Ray-Ban and Oakley, the offer is to focus on luxury licences such as Prada and Armani. This choice is perfectly coherent with the fact that 56% of prescription glasses sales in the department stores are priced at more than USD100 (see chart opposite), thereby guaranteeing a high level of sales per square metre (= positive for margins).

- **(ii) Numerous services in a small space:** eye exams are carried out by one of the banner's optometrists (five days a week in corners with high footfall, three days a week for others), who is equally well equipped as they would be in a traditional store (*LensSimulator* ™, *Clarifye*, 3D mirror, etc.) despite a surface area around four times smaller (around 75-110m² vs. ~370m²).

Management is planning to open 80 stores as of April 2016. Based on cautious estimates (sales/m² equivalent to a LensCrafters store, namely EUR4k and average surface area of 75m²), this partnership could generate sales of around EUR25m in 2016, representing a positive impact of 50bp on organic growth in the Retail segment (+30bp on a group scale), which is already factored into our estimates.

We are convinced that this shop-in-shop model for department stores should enhance margins and financial ratios further out since, for an equivalent level of sales /m² as for a traditional store, the weight of opex and capex invested is lower.

… and 300 renovations/relocations between now and 2018

This programme above all concerns the new store concept, which is currently being tested near Detroit and for which customer reviews have been very positive. Note that it was high time that LensCrafters modernised its concept since the current one has been in place since 2006. The programme is to concern almost 300 stores over 2016-18 (out of a total of 933 at end-2015), and management is forecasting that this roll-out will last until 2020).

As discussed in the previous section, the new concept includes the digitalisation of the sales point and aims to improve the consumer experience in terms of the eye exam (more private area), the presentation of products and the speed of execution (less time spent in the store), which is also an advantage for LensCrafters in terms of productivity.

This effort focused on the consumer experience is key for resisting the rising momentum of independent optometrists and to stand out from other rival chains. If successful, the banner should reach its medium-term growth target more easily (+3-4% same-store).

Target Optical: 80 new stores planned in 2016

In 2015 Target Optical, whose positioning is more midscale compared with LensCrafters, posted same-store sales growth of more than 10% for the sixth year in a row. This momentum has stemmed primarily from the record level of customer satisfaction. After the 44 stores opened in 2015, Luxottica managed to obtain the opening of 80 new sales points for this year, bringing the total to around 370 stores, or a presence in just 25% of Target department stores, and this bodes well for growth opportunities.

Fig. 14: Expansion programmes at LensCrafters and Target Optical:

LensCrafters	Target Optical
<u>LensCrafters to open up to 500 shop-in-shops @ Macy's</u>: - **80** locations should be opened in **2016** - ~**250** new corners per year in **2017** and **2018** **- Ave size:** 800-1,200 sq. ft. / 75-100 sqm vs. 4,000 sq. ft. / 370 sqm for a typical LensCrafters store <u>New retail format (*see picture below*):</u> - Already **110** stores refreshed in **2015** - **300** stores to be remodelled or relocated over **2016-18**	<u>2015:</u> - **Sixth consecutive year of double-digit comps** - **44** stores opened to 390 (~20% host saturation) <u>2016:</u> - **80** new stores to be added (~25% host saturation) - Acceleration of e-**commerce** presence for Target Optical **=> Double-digit comps expected** <u>2016-18:</u> **+180 stores in total**

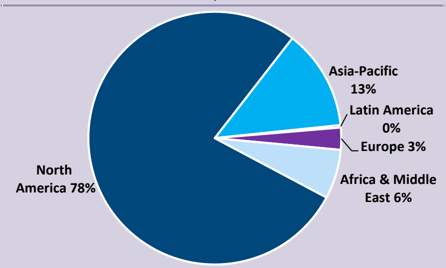
Source: Company Data; Bryan, Garnier & Co ests.

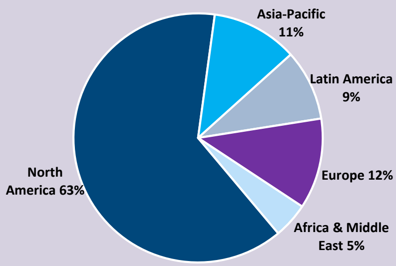
2.2.3. Global development driven primarily by Sunglass Hut

In 2015, the global leader in specialty sun retailing posted double-digit organic growth (+10%) for the sixth year in a row, driven by same-store growth of 6.4% (o/w +4.7% in the US) as well as by the opening of 300 stores throughout the world. The charts below show that Sunglass Hut has undergone significant international expansion, especially in Europe (12% of total stores vs. 3% in 2010) and in Latin America (9% vs. ~0% in 2010), reducing the weight of the US in overall sales from 90% in 2010 to 65%.

Fig. 15: SGH has witnessed significant international expansion since 2010:

	2010	2015
Presence in…	8 countries	22 countries
Sales breakdown (US/International, in %)	90/10	65/35
Store network (excl. franchised stores)	2,229	3,040
Global store footprint (as a % of total store network)		





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

2018 target: 4,000 stores throughout the world

Although it is already Luxottica's most international brand, Sunglass Hut is "only" present in 22 countries and still has plenty of markets to enter, the majority of which naturally concern emerging regions (South-East Asia, Latin America and China):

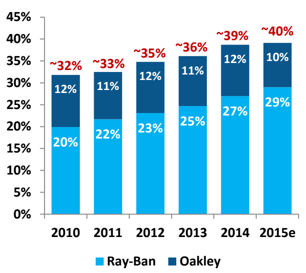
(i) **2016: 300 new POS:** management stated that the opening effect would account for half of the 8-10% growth expected in 2016. In addition to openings in emerging markets (China, Thailand, Malaysia etc.) note the **57 new corners in Galeries Lafayette department stores** in France, with the partnership inspired by that existing between SGH and Macy's in the US. This is set to be the group's first presence in Retail in France, which is already one of the group's main Wholesale markets (around 3-4% of total sales). Note that SGH aims to enter **South Korea** and **Japan**, and this could encourage it to sign **new partnerships with local department store chains** since these are a favoured destination for purchases of luxury goods.

(ii) **2017-18: ~300 additional stores:** these openings are still set to concern emerging markets, but also high-growth circuits (online, travel retail, department stores).

2.3. Our 2016-18 estimates

2.3.1. Heading for an acceleration in organic growth in 2017-18?

Ray-Ban and Oakley represent almost 40% of Luxottica's overall sales!



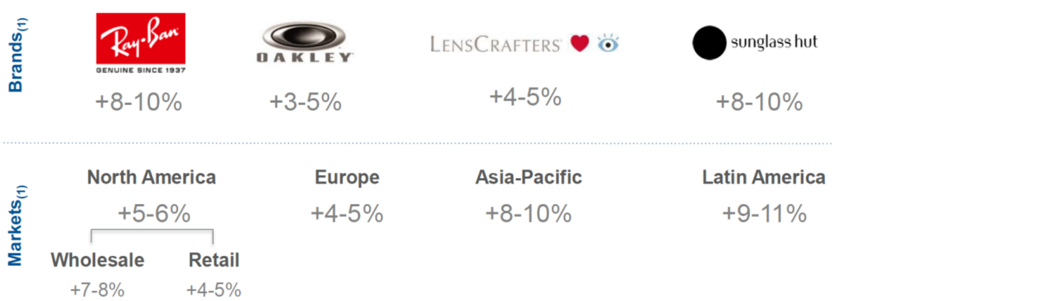
Source: Company Data, Bryan, Garnier & Co ests.

After adjusted organic growth of 5.5% in 2015, **Luxottica unveiled a target for same-currency sales growth of 5-6% for 2016**:

(i) **Ray-Ban** and **Oakley**: as the chart opposite shows, these two brands now account for 40% of total Luxottica sales compared with 32% in 2010! We believe that **Ray-Ban** will again be capable of exceeding guidance (+8-10%) whereas **Oakley** should be capable of picking up and reaching its 3-5% growth target, after suffering from its further integration into Luxottica in 2015. Indeed, the two brands can make the most of solid catalysts: extension of the distribution network and the STARS programme, penetration of new markets via wholesale and retail (e.g. Sunglass Hut store openings) and the rising momentum of e-commerce.

(ii) **Acceleration in North America (+5-6% vs. +4% in 2015)**, driven by both the Wholesale segment (STARS, integration of Oakley complete) and the Retail segment (new concept and store openings at LensCrafters, expansion of Target Optical). **Europe** and **Latin America** should continue to post robust growth but the group is above all expecting more beneficial momentum in **Asia-Pacific** (price cuts in China, OPSM relaunch).

Fig. 16: Guidance 2016 par marque et par région :



Source: Company Data

2017-18: we are forecasting an acceleration to 7% same-currency

In 2017, the **Wholesale** division should benefit from the launch of the new Valentino licence announced in February, which could generate EUR50m in sales at cruising speed. In our view, Oakley is set to pursue its rebound and international expansion, now making the most of the Italian group's salesforce. Note that the US brand is set to launch its first Radar Pace glasses model, developed with the help of Intel, towards the end of 2016. Although volumes could remain limited initially, this model could lead to future developments in terms of smart glasses.

Momentum should also accelerate in the **Retail** division with the ramp-up in a number of initiatives launched in 2016: at LensCrafters (introduction of the new store concept, shop-in-shop openings at Macy's), expansion of Target Optical and Sunglass Hut, recovery at OSPM (Australia) and LensCrafters in HK/Macao. The high surface area effect (almost 1,280 new stores expected over 2016-18) should naturally contribute to boosting organic growth.

Fig. 17: Our organic growth forecasts compared with group guidance:

FX-n	2016	2017-18
Top line guidance	+5-6%	Mid to high single-digit
BG forecast	**+6%**	**+7% in 2017 and 2018**

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

2.3.2. Profitability should continue to increase despite this ambitious investment programme

As we mentioned in our sector report in December 2015, Luxottica has abandoned its target for EBIT growth double the pace of sales growth after successfully delivering this target for six years in a row between 2010 and 2015. After suffering particularly harshly from the plunge in volumes during the 2007-08 crisis and the dilutive impact caused by the Oakley acquisition, the **Wholesale division** posted the highest increase (+570bp over 2009-15) thanks to economies of scale, productivity gains and the increasing weight of emerging markets.

Profitability in the **Retail division** widened by 280bp over the same period, despite expansion in emerging markets which generally has a dilutive effect (especially for optical distribution), but efficiency gains at LensCrafters and Sunglass Hut and same-store growth (operating leverage) helped drive this upward momentum.

Fig. 18: Change in adjusted EBIT margin by division between 2009 and 2015:

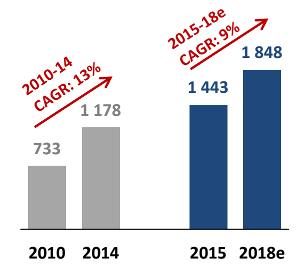
** After inter-segments transactions* *Source: Company Data*

The 2016-18 guidance to 1.5x sales growth should be seen in perspective

While the market initially seemed disappointed by this new guidance for 2016-18, we believe that the feeling should gradually fade for the following reasons:

(i) The aim to increase profitability: Luxottica's business model is based on vertical integration (synergies between Wholesale and Retail, control of entire value chain) and this automatically contributes to increasing profitability via organic growth (volume effect) and productivity gains. This strategy differs to that of Essilor, where increasing profitability has never been a priority.

CAGR in EBIT between 2010-14 and 2015-18e (in EURm and %):



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

(ii) Potential operating leverage remains high: despite very robust growth in EBIT margin (+440bp to 16%) between 2009 and 2014, profitability should increase by around 40bp a year over 2016-18 on our estimates, which remain slightly more cautious than Luxottica's target (BG: 1.3x sales growth).

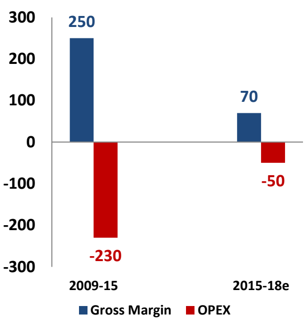
(iii) Robust growth in overall EBIT: despite a 2015-18e CAGR of around 9%, lower than the 13% seen over 2010-14, EBIT should increase by more than EUR400m over the next three years, the same amount as over the 2010-14 period (see chart opposite).

(iv) Cautious guidance in view of EUR1.5bn capex programme? While these significant investments could explain why management preferred to maintain some room to manoeuvre, note that virtually all of this capex is destined to shake-up sales growth which should enhance margins and financial multiples further out.

Main catalysts of operating leverage

Despite the downgrade to guidance, the same buoyant factors are set to drive Luxottica's profitability:

Breakdown of widening in adjusted EBIT margin (bp):



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

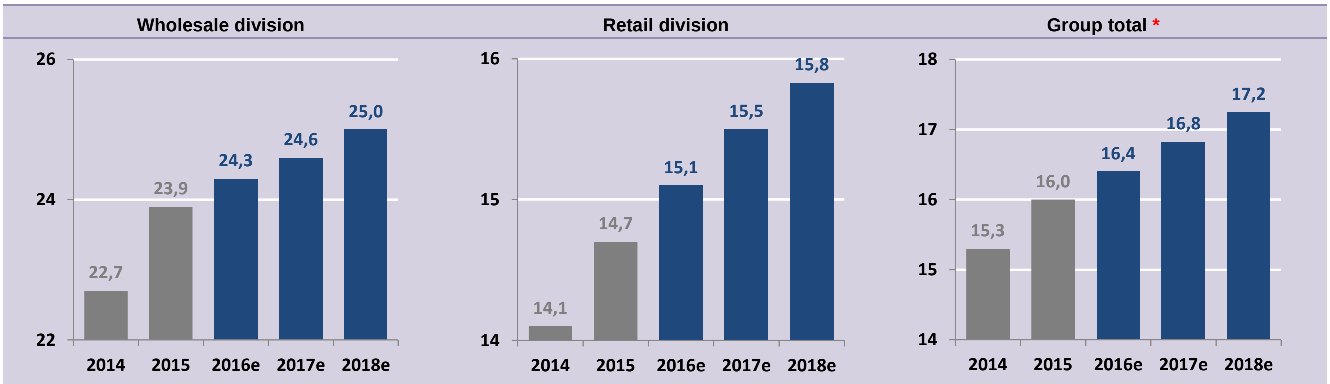
(i) Volume effect: organic growth of 6-7% over 2017-18 implies beneficial economies of scale and operating leverage for both divisions. The fact that the group had to increase plant capacities proves that utilisation rates were close to maximum levels.

(ii) Efficiency gains: every year, the group manages to identify fresh cost savings in production, the supply chain and logistics (reducing lead times etc.). These projects also concern the retail division with the improvement in productivity in the sales team, initiatives to increase the conversion rate etc.

In addition, **we believe a large share of the projects financed by the EUR1.5bn investment plan should generate additional productivity gains, thereby enhancing the margin further out: 1/** automation of production chains for the Ray-Ban *Aviator* model (~4% of total volumes) should unlock further productivity gains, **2/** the digitalisation of sales points should improve the customer experience and make the sales process more fluid (=> higher sales/store) and **3/** the concept of corners located in department stores (e.g. SGH at Macy's and Galeries Lafayette, LensCrafters at Macy's) offers very high sales/m² potential but requires little capex and opex.

Since the majority of the catalysts set out previously should have a positive impact at the group level, we are forecasting an increase in profitability for both divisions, as shown by the charts below:

Fig. 19: Our EBIT margin forecasts by division (2016-18e):



** After inter-segments transactions* *Source: Company Data*

We are therefore forecasting a 40bp annual widening in EBIT margin over the next three years. **The table below shows that our forecasts are fairly cautious since EBIT growth would represent 1.1-1.4x sales growth, compared with the group's guidance for EBIT growth of 1.5x sales growth.**

Fig. 20: Our forecasts vs. the group's guidance (1.5x sales growth):

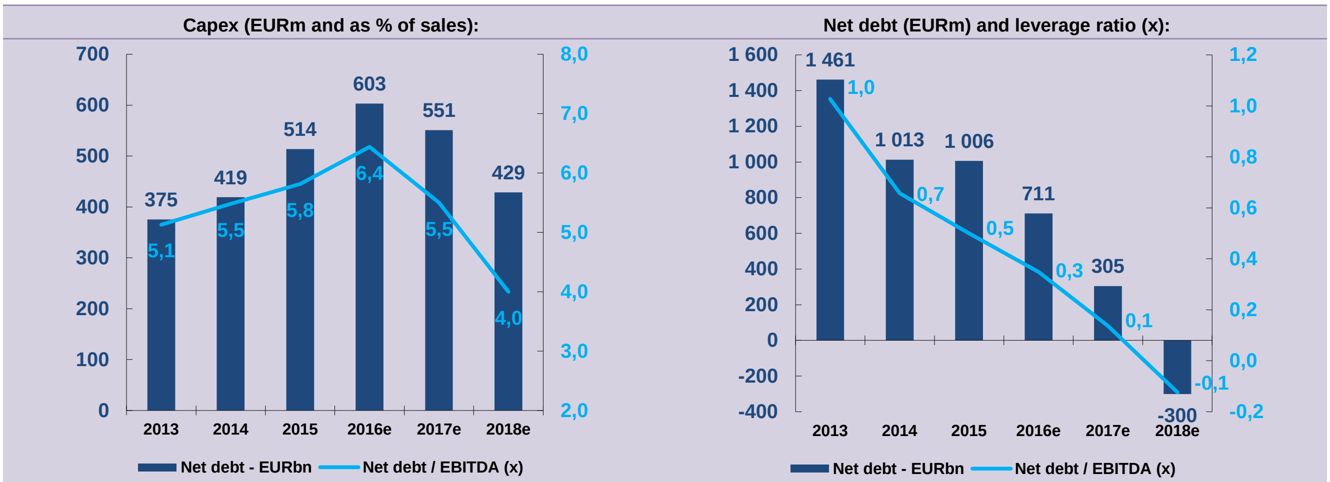
FX-n	2016e	2017e	2018e
Sales growth (%)	6.0	7.0	7.0
EBIT growth (%)	6.5	9.7	9.6
Ratio (x)	**1.1x**	**1.4x**	**1.4x**

Source: Bryan, Garnier & Co ests.

Further debt reduction despite the EUR1.5bn investment plan

Although we are forecasting capex of EUR1.58bn, slightly higher than the amount communicated by the group for 2016-18 (EUR1.5bn) with a natural peak at the start of the programme (around 6.4% of 2016e sales), Luxottica is set to continue its debt reduction and could even be in a net cash position at end-2018.

Fig. 21: A cleaned up balance sheet despite the EUR1.5bn capex plan:



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

3. Valuation: make the most of attractive entry points!

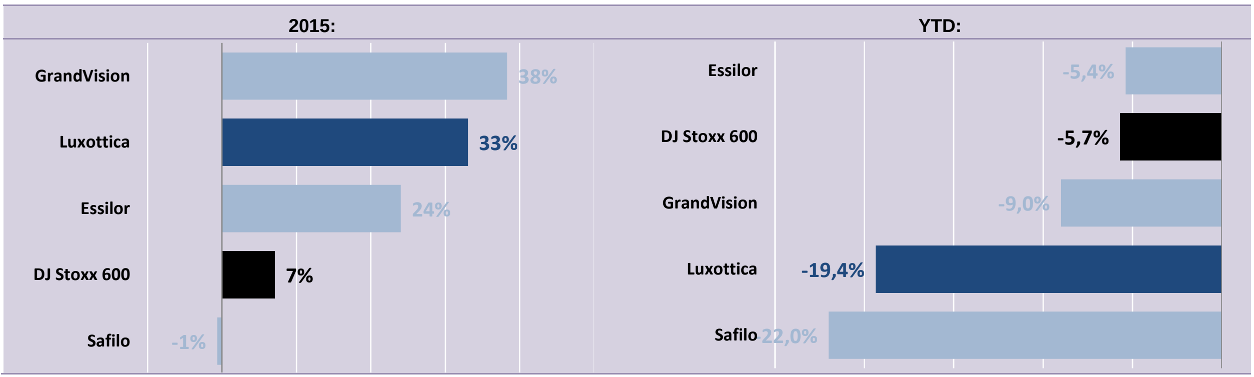
3.1. In a turbulent zone since the start of the year

The **Luxottica** share posted one of the best performances of 2015, gaining 33% on the back of excellent fundamentals and the surge in the USD. However, the start of this year has been far more turbulent with the share price plummeting almost 19% YTD. In our view, two main factors explain this correction:

1/ The surprise resignation of co-CEO Adil Khan announced on 29th January: the departure revived fears of another governance crisis at the head of the Italian group. Even though the market does not seem genuinely worried about the possible impact on Luxottica's operating performance, this third CEO departure in 18 months has taken a toll on the group's SRI profile, thereby clearly accelerating the share's sell-off since early February, and **triggered profit-taking moves on the share which had increase by 70% since its low point of October 2014.**

2/ A relative disappointment on 2016-18 EBIT guidance: in addition to the negative impact of the 53rd week, which clouded the market's reading of 2015 earnings, a number of investors seem to have been disappointed by the lower EBIT growth target, whereas the group stated on several occasions during 2015 that its historical EBIT guidance for EBIT growth double the pace of sales growth, would be difficult to deliver for a seventh year in a row, given the EUR1.5bn investment programme. **Although EBIT is only set to grow by 1.5x the pace of sales growth, this nevertheless points to the highest EBIT margin widening in the sector over 2016-18,** excluding Safilo.

Fig. 22: Absolute performances in the optical sector (as of 18/03/2016):



Source: Datastream, Bryan, Garnier & Co

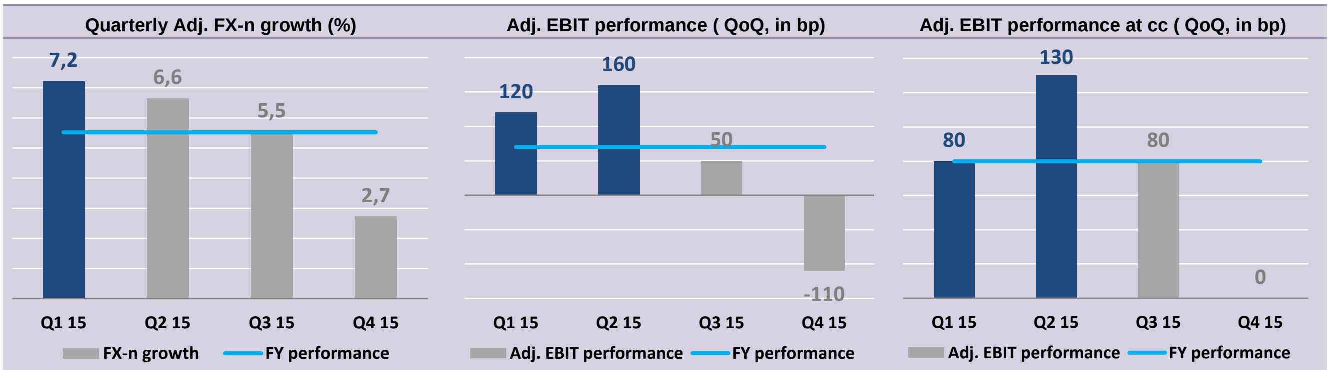
3.2. Watch out for comparison base in Q1 2016

Although management pointed out that the beginning of the year had gone well, it nevertheless reminded that Q1 2016 compared with a difficult Q1 2015 in terms of organic growth since last year, **Luxottica benefited from the launch of the Michael Kors licence, which generated sales of around EUR20m in the quarter,** prompting a positive impact of 2.5 points on wholesale growth (+8%) and around 0.5 points on the group's performance (+7.2%). In addition, management estimated that the calendar realignment should also have a slight impact on growth in Q1 2016.

In terms of **profitability**, the middle and right-hand charts below show that adjusted EBIT margin increased sharply in Q1 (+120bp and +80bp same-currency) and especially Q2 2015 (+160bp and +130bp same-currency). The group naturally benefited from the additional volumes provided by Michael Kors and productivity gains in the Retail division.

As such, we are forecasting a Q1 2016 performance below our forecasts for 2016, namely for organic growth of 4-4.5%, as well as a slight decline in margin.

Fig. 23: Quarterly operating performance (negative impact of 53rd week included in Q4 2015):



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

3.3. Governance: what's the situation today?

Throughout this report, we have attempted to show that the new guidance does not undermine the group's fundamentals or our forecasts for 2016-18, since we had already anticipated it.

In contrast, we admittedly have little visibility on two significant governance questions which are currently Mr Del Vecchio's two priorities:

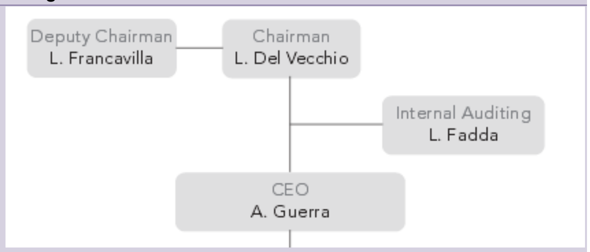
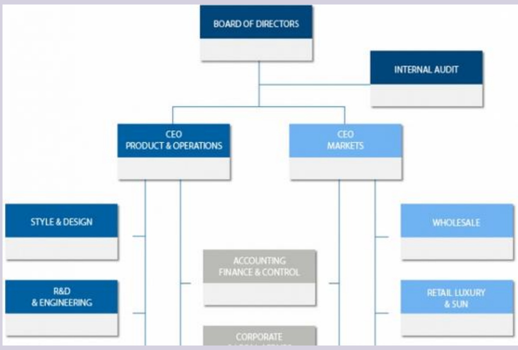
(i) **The group's future organisational structure:** during his introductory message at the Investor Day, Mr Del Vecchio confirmed his aim to resume his position as non-executive chairman "in a few years' time", in order to hand over the reins to a management team backed by a "strong and independent" Board of Directors. In our view, the current management team should remain identical for the next three years, but a few changes could be made during the handover.

(ii) **The succession plan:** in view of Mr Del Vecchio's age (81 next 22nd May) and his strategic importance within his group, a large number of investors consider that the lack of succession plan so far is a sword of Damocles hanging over Luxottica. For this reason, Mr Del Vecchio has confirmed during several interviews that preparing this succession plan would be one of his priorities.

3.3.1. Three changes in organisational structure in 18 months

The table below sets out the changes and nominations made up until 31st January 2016:

Fig. 24: Luxottica set up a co-CEO model in September 2014:

Comments	Organisational structure:
Organisational structure until 31st August 2014	
Non-executive Chairman of the Board of Directors: Mr Del Vecchio **CEO:** Andrea Guerra (since 2004) **General Manager and CFO:** Enrico Cavatorta (since 1999) **Luxottica's management was based on three organisational clusters reporting directly to CEO Andrea Guerra:** - **Functions:** Finance, IT, Communications, etc. - **Businesses:** Wholesale, Oakley, Retail Optical North America, etc. - **Operating Processes:** Marketing, Operations, etc.	 *(extract from the organizational chart)*
Organisational structure from 1st September 2014 to 31st January 2016: "Co-CEO Model"	
<u>**September 1:**</u> Mr Del Vecchio took over as **Executive Chairman**, **He headed an executive committee overseeing a new management structure which split Mr Guerra's job in three:** - **Enrico Cavatorta** was appointed **CEO of Corporate Functions** and **Interim CEO of Markets** - **Operations**: **Massimo Vian** who reported directly to the Chairman <u>**October 13:**</u> - **Enrico Cavatorta resigned** following disagreements on the governance structure => Executive responsibilities were taken over by the **Chairman** **- Massimo Vian was appointed co-CEO of Operations and Product** <u>**October 22:**</u> - **Adil Khan** to be appointed **co-CEO for Markets** in January 2015 - **Massimo Vian** appointed interim **CEO** pending the arrival of Mr Khan <u>**January 19, 2015 (*see organisational chart rhs*):**</u> - **Adil Khan** became **CEO for Markets** and **Massimo Vian** was appointed **CEO for Product and Operations**, **Functions (*at the centre*) were reporting to both CEOs** <u>**January 31, 2015:**</u> - **Adil Khan** resigned as the co-CEO structure model hampered LUX's reactivity and "entrepreneurial spirit" by weighing down its decision-making process => **Mr Del Vecchio replaced Mr Khan** concerning the executive responsibilities	 *(extract from the organizational chart)*

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

Although all 2015 guidance was reached, Mr Del Vecchio and Mr Khan noted that this dual-headed governance had made decision-making procedures more complex and heavy, thereby prompting Mr Khan to resign and Mr Del Vecchio to launch a huge group-wide simplification programme in order to shake up Luxottica's development.

Apart from Leonardo Del Vecchio who has taken over Adil Khan's executive functions, we have identified four key people in the management team that are presented in the table on the following page and who animated the Investor Day on 2nd March. Massimo Vian confirmed that for the moment, **at least six people referred directly to Mr Del Vecchio: three of the four top managers set out below, the country manager for China, Oakley's chairman Andrea Dorigo, and the chairman of EyeMed (Lukas Ruecker).** Massimo Vian stated that only four or five people would report to Leonardo del Vecchio in the future.

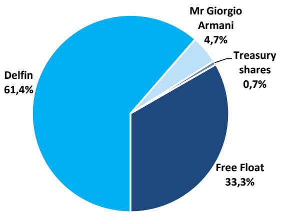
Since the team shown below was involved in defining 2016-18 targets and is responsible for their smooth execution, we believe it should remain in its current state until the Board of Directors and top management reach a conclusion in the project for a new governance structure. **In our view, investor confidence should gradually be restored thanks to the stability of this team, the first positive results of new initiatives and guidance delivery.**

Fig. 25: The four main members of the management team:

			
Massimo Vian	**Paolo Alberti**	**Nicola Brandolese**	**Stefano Grassi**
CEO for Product & Operations *=> He refers to Mr Del Vecchio*	**Executive Vice President Wholesale** *=> He refers to Mr Del Vecchio*	**President Retail Optical Americas** *=> He refers to Mr Del Vecchio*	**Chief Financial Officer** *=> He refers to Massimo Vian*
Joined LUX in 2005	**Joined LUX in 2009**	**Joined LUX in 2012**	**Joined LUX in 2007**
- Jan 2015: appointed CEO for Product and Operations **- 2010-14:** Group Chief Operations Officer **- 2007-10:** Operations Director for Asia **- 2005-07:** Head of Industrial Engineering Division	**- 2009-present:** Executive Vice President Wholesale *Prior to joining LUX, he held various assignments at Bulgari, L'Oréal, Johnson & Johnson and P&G*	**- Jan 2014:** appointed President of Retail Optical of Americas **- 2012-14:** Group Business Development Director and Chief Digital Officer *Prior to joining LUX he held various assignments at News Corp. and the Boston Consulting Group*	**- Oct 2014:** appointed Chief Financial Officer **- 2012-14:** Group Controlling & Forecasting Director **- 2008-12:** Group Controller of the Retail business **- 2007-08:** Finance Manager of Luxottica Retail North America

3.3.2. Succession plan: the earlier the better!

Luxottica shareholding structure (on 30th April 2015):



Source: Company Data

Leonardo Del Vecchio clearly plays a central and strategic role within the Italian group that he founded in 1961:

(i) **He remains the key shareholder** controlling the Delfin family holding company which owns 61.4% of the capital as the chart opposite shows.

(ii) **He takes an active part in establishing and executing strategy,** and is at the root of the vertical integration strategy (downstream diversification in retail to control distribution). It was Mr Del Vecchio who recently decided to step up the group's development in digital.

(iii) **He plays a confederating role:** despite three CEO departures in 18 months, virtually all top managers have remained in their positions, thereby added weight to our feeling that these governance crises should have little impact on the group's operating management. We are convinced that these managers and the group's staff hold Mr Del Vecchio in high esteem and are fully mobilised in succeeding the 2018 plan.

The flip side to this strategic position: Mr Del Vecchio's age (81 on 22nd May) worries investors since the lack of a succession plan leaves a threat and uncertainty on two subjects: **1/** transmission of power and **2/** the choice of his heirs in terms of the future of Delfin's stake in Luxottica.

The current situation at Delfin

As mentioned in our previous sector report, the Delfin family holding company underwent a capital reorganisation at the end of 2014 (EUR162m according to Italian daily *Sole 24 Ore)*, enabling Leonardo Del Vecchio to increase his stake to 25% (vs. 1.7% previously), whereas his six children saw their stakes diluted to 12.5% (vs. 16.4% previously). The shares remain dismembered: Mr Del Vecchio has usufruct and hence control of Delfin, whereas his children have bare ownership of the shares.

Fig. 26: Shareholding positions within Delfin:

	Mr Del Vecchio	Mr Del Vecchio's six children
Stake in Delfin	**25%**	**75%: each child has a 12.5% stake**
Ownership	**Usufruct** => He still owns 100% voting rights	**Bare ownership**

Source: Bryan, Garnier & Co ests.

What role for Leonardo Del Vecchio's heirs?

In recent years, **the Luxottica founder has stated on several occasions that he was opposed to one of his six children taking over as head of the Italian group** given the group's "overly large size today", especially since to our knowledge, **only the oldest child Claudio Del Vecchio, has held management positions between 1978 and 1997 (see below).** Note that the Luxottica founder's six children stem from three different unions:

- **Three children from the first union:** Claudio Del Vecchio (born in 1957), Marisa Del Vecchio (1958) and Paola Del Vecchio (1961): Claudio Del Vecchio has responsible for Italy and Germany between 1979 and 1982, and then directed the group's operations in North America between 1982 and 1997. He was a member of the Board of Directors between 1986 and 2014. Currently owner and CEO of the Brooks Brothers chain, **he stated in October 2014 that neither he, nor any of the other five children intended to succeed their father.**

- **One child from the second union:** Leonardo Maria Del Vecchio (1995).

- **Two children from the third union:** Luca (2000) et Clemente (2004).

Further out, we believe that Mr Del Vecchio's heirs could keep their stakes in Luxottica without having an executive or operational role within the group. As such, finalising the succession plan is imperative in order to clarify the relations between Delfin and Luxottica and ensure the continuity of the group's management, which would naturally reassure investors.

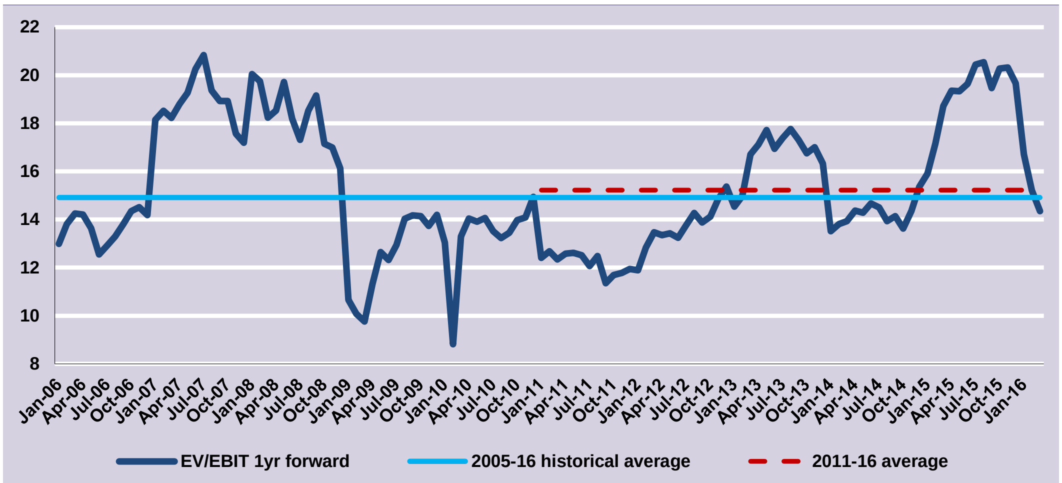
3.4. 1-year forward EV/EBIT: return to average

The chart on the following page shows that the Luxottica share is currently trading on a slight 5% discount in terms of forward EV/EBIT, vs. a premium that reached a peak of 38% last August and still stood at 32% at end-December. The plunge in the share price prompted by the governance crisis and growth forecasts considered cautious by some, is visible in the chart.

As such, we believe the share's re-rating should take place: **1/** as the group delivers attractive earnings proving to the market that the current management team is capable of reaching the 2016-18 targets and once Mr Del Vecchio provides answers to the questions investors are asking over the succession plan and the new governance structure.

In addition to the Italian group's solid fundamentals, we believe that three points favour a rebound in the share price: **1/** 77% of sales stem from North America and Europe, thereby limiting the risk of a downgrade to estimates caused by emerging markets currencies, **2/** momentum remains robust in Asia (China: around 3% of sales) and in Latin America (around 6% of sales) and **3/** the group's excellent track record in terms of reaching guidance since 2010, which is reassuring in the current backdrop.

Fig. 27: Change in 1-year forward EV/EBIT (2006-16):



Source: Datastream, Bryan, Garnier & Co

3.5. DCF valuation

We are forecasting high single-digit sales growth over 2016-18, in line with the group's targets. This growth should primarily be driven by the success of Ray Ban (around 30% of sales, double-digit growth over 10 years) and the relaunch of Oakley (around 10% of sales), whereas the licence portfolio is due to welcome Valentino as of 2017. The numerous initiatives launched in retail should also help anticipate an acceleration in growth in this division. As of 2019, we gradually reduce sales growth towards our growth rate to infinity of 2.5%.

Concerning changes in operating profitability at Luxottica, we believe our scenario is cautious since after estimating growth in EBIT margin over 2016-19 (+120bp to 17.6%), we then assume a stable level between 2020 and 2025. Note that over the medium/long terms, emerging markets should contribute to margin widening, especially in optical distribution which remains well below the level of profitability shown in mature markets (lower average spend and lower sales per store).

Note that we have notched up our WACC assumption from 6.5% to 6.6%, given the higher cost of capital (6.8% vs. 6.6%) following the slight increase in beta (to (0.75). The cost of debt remains unchanged at 3.5%.

Fig. 28: DCF valuation:

EURm	2016e	2017e	2018e	2019e	2020e	2021e	2022e	2023e	2024e	2025e
Net sales	**9 366**	**10 017**	**10 718**	**11 415**	**12 100**	**12 705**	**13 340**	**13 940**	**14 567**	**15 150**
% change	*6.0%*	*7.0%*	*7.0%*	*6.5%*	*6.0%*	*5.0%*	*5.0%*	*4.5%*	*4.5%*	*4.0%*
EBIT	1 536	1 685	1 848	2 009	2 134	2 241	2 353	2 459	2 570	2 672
EBIT margin (%)	16.4%	16.8%	17.2%	17.6%	17.6%	17.6%	17.6%	17.6%	17.6%	17.6%
Income taxes	-524	-574	-619	-673	-715	-751	-788	-824	-861	-895
Tax rate (%)	36.0%	35.5%	33.5%	33.5%	33.5%	33.5%	33.5%	33.5%	33.5%	33.5%
Operating profit after taxes	**1 012**	**1 111**	**1 229**	**1 336**	**1 419**	**1 490**	**1 565**	**1 635**	**1 709**	**1 777**
+Depreciations	504	539	536	571	605	635	667	697	728	758
-Change in WCR	51	63	75	80	85	89	93	98	102	106
-Investments in fixed assets	603	551	536	565	599	629	660	697	728	758
Operating cash flow	**862**	**1 036**	**1 154**	**1 262**	**1 341**	**1 408**	**1 478**	**1 538**	**1 607**	**1 671**

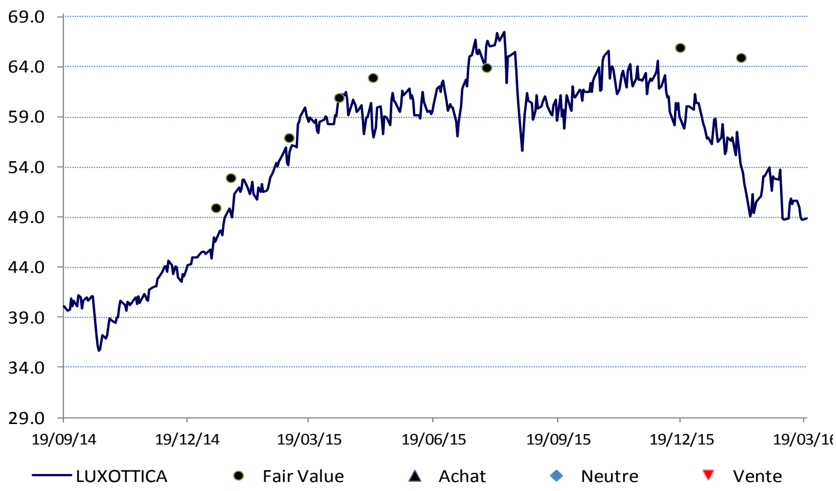
PV of terminal value	21,769
+PV of future cash flows (2016-25)	9,218
= Enterprise Value	**30,987**
Net debt (2016e)	-711
Other liabilities	321
Minority interest	7
Financial assets	188
Theoretical value of equity	**30,135**
Number of shares (m)	482.1
Theoretical FV per share (€)	**63**

Source: Bryan, Garnier & Co ests

Assuming slightly higher WACC (-EUR1.5) and a slight increase in the number of shares to 482m (-EUR0.5m), our new Fair Value works out to EUR63. We are making no change to our Buy recommendation.

Price Chart and Rating History

Luxottica



Ratings		
Date	**Ratings**	**Price**
13/10/11	BUY	EUR20.35
29/09/08	SELL	EUR16.56
27/06/07	BUY	EUR28.58

Target Price	
Date	**Target price**
01/02/16	EUR65
18/12/15	EUR66
28/07/15	EUR64
05/05/15	EUR63
10/04/15	EUR61
04/03/15	EUR57
03/03/15	Under review
20/01/15	EUR53
09/01/15	EUR50
18/06/14	EUR46
10/01/14	EUR45
23/05/13	EUR44
30/04/13	EUR41
04/03/13	EUR38

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Stock rating

BUY	Positive opinion for a stock where we expect a favourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential upside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.
NEUTRAL	Opinion recommending not to trade in a stock short-term, neither as a BUYER or a SELLER, due to a specific set of factors. This view is intended to be temporary. It may reflect different situations, but in particular those where a fair value shows no significant potential or where an upcoming binary event constitutes a high-risk that is difficult to quantify. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.
SELL	Negative opinion for a stock where we expect an unfavourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential downside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

Distribution of stock ratings

BUY ratings 72% NEUTRAL ratings 0% SELL ratings 28%

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BRYAN, GARNIER & CO

London	Paris	New York	Geneva	New Delhi
Beaufort House	26 Avenue des Champs Elysées	750 Lexington Avenue	rue de Grenus 7	The Imperial Hotel
15 St. Botolph Street	75008 Paris	New York, NY 10022	CP 2113	Janpath
London EC3A 7BB	Tel: +33 (0) 1 56 68 75 00	Tel: +1 (0) 212 337 7000	Genève 1, CH 1211	New Delhi 110 001
Tel: +44 (0) 207 332 2500	Fax: +33 (0) 1 56 68 75 01	Fax: +1 (0) 212 337 7002	Tel +4122 731 3263	Tel +91 11 4132 6062
Fax: +44 (0) 207 332 2559	Regulated by the	FINRA and SIPC member	Fax+4122731 3243	+91 98 1111 5119
Authorised and regulated by	Financial Conduct Authority (FCA)		Regulated by the	Fax +91 11 2621 9062
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