

Luxottica

Price EUR47.57

Q1 soft but pretty much in line, signs of accelerating sales growth and FY outlook confirmed**Fair Value EUR61 (+28%)****BUY Coverage initiated**

Bloomberg	LUX IM
Reuters	LUX.MI
12-month High / Low (EUR)	67.5 / 47.1
Market Cap (EURm)	23,012
Ev (BG Estimates) (EURm)	23,721
Avg. 6m daily volume (000)	883.7
3y EPS CAGR	12.7%

On Friday, Luxottica unveiled Q1 sales of EUR2,266m up 1.8% adj. FX-n (CS: ~2%) and 3.8% FX-n. As expected, this publication was marked by a challenging comparison base (mainly in the US) and calendar realignments (Retail Division), and was therefore difficult to read. Consequently, we focused our attention on management's optimistic message reiterating FY16 targets, which implies a clear acceleration from Q2. This is the first step towards restoring investor confidence in the group's execution and ability to sustain MT growth. Buy recommendation and EUR61 FV confirmed.

ANALYSIS

	1 M	3 M	6 M	31/12/15
Absolute perf.	-2.7%	-17.3%	-25.7%	-21.2%
Consumer Gds	-0.9%	-1.4%	-6.6%	-4.8%
DJ Stoxx 600	1.4%	-0.2%	-9.1%	-6.7%

YEnd Dec. (€m)	2015*	2016e	2017e	2018e
Sales	8,837	9,418	10,073	10,773
% change		6.6%	7.0%	7.0%
EBITDA	1,853	2,048	2,229	2,429
EBIT	1,376	1,541	1,687	1,850
% change		12.0%	9.5%	9.6%
Net income	804.1	932.2	1,042	1,153
% change		15.9%	11.8%	10.7%

* reported figures

	2015 *	2016e	2017e	2018e
Operating margin	15.6	16.4	16.8	17.2
Net margin	9.1	9.9	10.3	10.7
ROE	14.6	15.6	16.2	16.5
ROCE	12.0	13.3	14.6	16.2
Gearing	18.2	11.9	4.6	-4.5

* reported figures

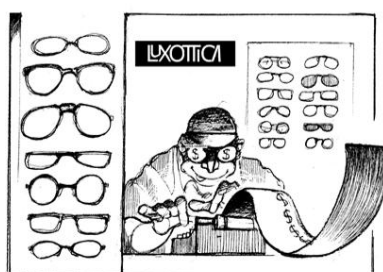
(€)	2015 *	2016e	2017e	2018e
EPS	1.68	1.94	2.17	2.40
% change	-	15.8%	11.8%	10.7%
P/E	28.4x	24.5x	21.9x	19.8x
FCF yield (%)	3.2%	3.8%	4.6%	5.7%
Dividends (€)	0.89	1.00	1.10	1.22
Div yield (%)	1.9%	2.1%	2.3%	2.6%
EV/Sales	2.7x	2.5x	2.3x	2.1x
EV/EBITDA	13.0x	11.6x	10.5x	9.3x
EV/EBIT	17.4x	15.4x	13.8x	12.3x

* reported figures

- **North America sales (+1.3% adj. FX-n) affected by technical effects...** 1/ The first headwind being the **tough comparison base** with the launch of Michael Kors which generated ~EUR20m (mostly in the US) that dented growth in US Wholesale in Q1 (+2.7%). 2/ This weak performance was also partly self-inflicted as the group implemented its **"Minimum Advertised Price"** (MAP) policy which prohibits wholesale customers from making deep discounts (online players are particularly targeted), hence provoking some sales disruptions.
- **... o/w US Retail (+0.9% adj. FX-n).** The main technical effect in Retail was 3/ **calendar realignments** (see chart overleaf), which had a negative impact of 1pp as the first days of the year generated lower sales than those at the beginning of April. **LensCrafters'** comps were up 2% (vs. 1.2% in Q4) driven by higher conversion rates. It is worth noting that the first stores @ Macy's will open in June. Comparable growth at **SGH** was down 1%, still affected by the lack of tourists (~15% of SGH US sales) while business generated in non-touristic areas was still in positive territory.
- **Good momentum in Europe (+4.2% adj. FX-n).** This performance was fuelled by Southern Europe and Eastern Europe which grew in double-digits, with France and the UK also impacted by the decrease in tourist flows. SGH comps were up double-digit and the retail banner already opened 8 POS at Galeries Lafayette in Q1.
- **Soft Asia-Pacific (-2.1% adj. FX-n) but impressive LatAm (+13.1% adj. FX-n).** Price adjustments in China continued to boost growth in **Mainland China** but **H-K/Macau** registered a double-digit decline, likewise in **South Korea** due to a temporary calendar effect as sales caught up in April. Comps in Australia-NZ increased 4.2%, with optical returning to growth (+3%). The best-performing region remained **LatAm**, driven by double-digit growth in **Brazil** in **Mexico**, which bodes well for the next quarters.
- **Current trading confirms the acceleration expected from Q2.** April was on track and management was satisfied with its order book for May and June, which are among the busiest months of the year. Moreover, adverse technical effects will gradually ease off in Q2 and throughout the rest of the year. Consequently the group showed its confidence in accelerating top-line growth as early as Q2, without forgetting the space contribution from new stores that should play positively in H2.
- **FY16 "rule-of-thumb" confirmed.** Management expects to achieve a 5-6% adj. FX-n sales increase, which implies, at least, an average 6% adj. FX-n growth over the remaining quarters. The group anticipates the EBIT to increase 1.5x faster than top line but we retain a more cautious forecast (1.2x).
- **LUX muscles up its optical business.** Indeed LUX is constructing three Rx labs (US, Italy and China) to better serve its optical stores in these regions. The group would not directly produce its own lenses and they will be edged and mounted internally, this lens and frames integration will enhance and improve the level of service, reduce lead times and increase efficiencies. The future US lab will particularly cover the 400+ LC stores @ Macy's which do not own in-store labs.

VALUATION

- As announced during the Investor Day in early March, this first quarter was soft due to some technical effects, self-inflicted wounds (e.g. MAP policy which led to the closure of several wholesale customers) and a difficult comparison base.
- At the conference call, management spent much time explaining that the negative impact from these hurdles would gradually diminish, whilst LUX is ready to accelerate growth just when the peak sun season starts. This explains its confidence in the FY16 outlook, as all targets were confirmed.

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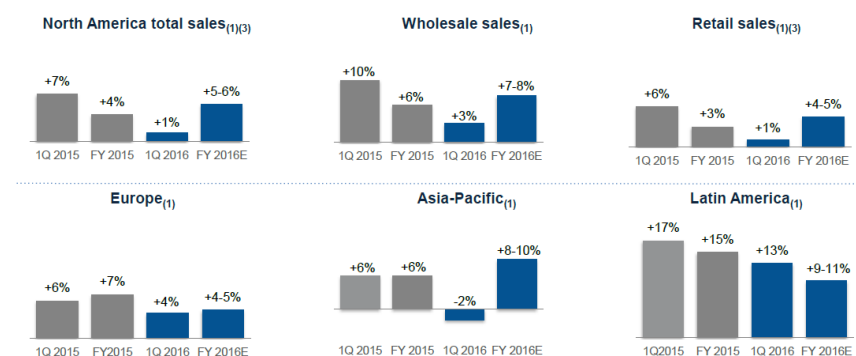
- At 2016e EV/EBIT of 15.3x, the stock is trading on a 7% discount to the 2004-16 historical average and now offers an attractive valuation within our Optical & Eyewear sample (excl. Safilo) since Essilor and GrandVision trade at 20.3x and 17.7x 2016e EV/EBIT respectively. We have made minor adjustments at the top line level (FX impact) but leave our FV unchanged at EUR61. Buy recommendation confirmed.

Table 1: adj. FX-n by region:

EURm	Q1 15	Q1 16	Adj. FX-n growth
Wholesale	275	286	2.7
Retail	1,040	1,066	0.9
North America	1,315	1,352	1.3
Europe	425	435	4.2
Asia-Pacific	298	281	-2.1
Latin America	130	120	13.1
ROW	84	77	-5.4
Total Luxottica	2,252	2,266	1.8

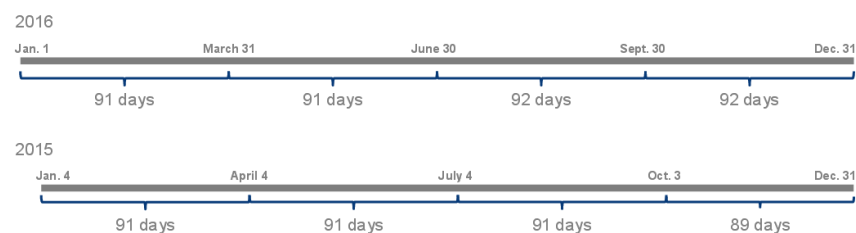
Source: Company Data

Graph 1: Revenue roadmap by region:



Source: Company Data

Graph 2: Calendar realignments and working days in North America:



January 1-3, 2016 lower quality days for seasonality compared to April 1-4, 2015

Source: Company Data

NEXT CATALYSTS

- Luxottica will report H1 16 results on 27th July 2016.

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