11th May 2016

Luxury & Consumer Goods

Safilo

Price EUR7.37

Production bottlenecks hurt Q1 and might also affect Q2

Fair Value EUR11 vs. EUR12,5 (+49%) **NEUTRAL vs. BUY**

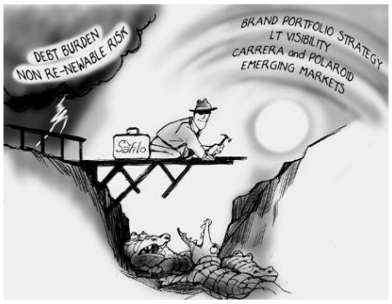
Bloomberg	SFL IM
Reuters	SFLG.MI
12-month High / Low (EUR)	13.6 / 7.4
Market Cap (EURm)	461
Ev (BG Estimates) (EURm)	502
Avg. 6m daily volume (000)	128.8
3y EPS CAGR	72.5%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-3.5%	-4.8%	-35.0%	-31.2%
Consumer Gds	1.9%	6.0%	-5.2%	-3.8%
DJ Stoxx 600	1.3%	6.7%	-10.6%	-8.1%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	1,279	1,287	1,217	1,290
% change		*0.6%*	*-5.5%*	*6.0%*
EBITDA	82.4	102	81.6	103
EBIT	0.8	63.1	45.1	64.5
% change			*-28.4%*	*43.0%*
Net income	-52.3	33.6	23.6	37.6
% change		*NS*	*-29.6%*	*59.1%*

	2015	2016e	2017e	2018e
Operating margin	0.1	4.9	3.7	5.0
Net margin	-4.1	2.6	1.9	2.9
ROE	-5.2	3.2	2.2	3.4
ROCE	0.2	3.6	2.6	3.6
Gearing	9.0	3.8	1.3	-2.0

(EUR)	2015	2016e	2017e	2018e
EPS	0.11	0.59	0.35	0.57
% change	-		*-41.4%*	*64.6%*
P/E	66.5x	12.5x	21.3x	12.9x
FCF yield (%)	NM	5.6%	8.5%	4.8%
Dividends (EUR)	0.00	0.10	0.15	0.20
Div yield (%)	NM	1.4%	2.0%	2.7%
EV/Sales	0.4x	0.4x	0.4x	0.3x
EV/EBITDA	6.7x	4.9x	5.8x	4.3x
EV/EBIT	662.5x	8.0x	10.5x	6.8x



Q1 2016 sales of EUR302m fell short of expectations (CS: EUR310m) largely due to production bottlenecks (mid single-digit negative impact) in Italian plants given higher-than-anticipated demand and the supply chain reshuffle. This new headwind renders the timing of a recovery more uncertain in the ST and leads us to cut our FY16 assumptions by 7%. We also adopt a more cautious stance by downgrading our recommendation to Neutral, pending better visibility and the first positive results from catalysts (proprietary brands, new licenses, etc.). Our new FV is EUR11 vs. EUR12.5 previously.

ANALYSIS

- **Q1 sales came in at EUR302m (-6.6% FX-n) vs. CS of EUR310m.** This organic sales growth decline was caused by lost sales from the discontinued small Kering licenses (AMQ, Bottega Veneta and Saint Laurent were still in the PF in H1) and the progressive exit of Gucci (~18-19% of total sales). The "going-forward brand PF" was only up 1% (vs. +2% in Q4), shy of our 3% forecast as the group encountered production bottlenecks resulting from stronger-than-expected final demand for "Made-in-Italy" brands which occurred when Safilo implemented its Integrated Supply Chain Planning. **Consequently, management estimated the sales miss impact to be around 5pp.**

- By region, focusing on "going-forward brand PF", **Europe** remained robust with 3.6% adj. FX-n, driven by double-digit growth in France and Italy. In **North America**, the good performance of the wholesale channel (+3.1% adj. FX-n) was overshadowed by the 17% sales drop at Solstice, given a tough retail environment and the closure of 11 stores (121 DOS vs. 132 at the end of Q1 15). **In Asia** (-14.6% adj. FX-n), half of the decline was due to challenging market conditions in Greater China whilst the other half was due to self-inflicted wounds, as Safilo shut down several wholesale accounts in China throughout 2015.

- **Q1 adj. EBITDA margin down 160bp to 8.4%.** Despite a 50bp increase in GM to 61.1% (+90bp excl. FX), driven by a favorable price-mix and lower obsolescence costs, adj. EBITDA margin was affected by negative operating leverage and the sluggish US retail business (-50bp).

Q1 sales by region:

EURm	Q1 15	Q1 16	FX-n growth (%)	"Going-forward brand PF" FX-n growth (%) *
Europe	132.9	130.1	-1.7	3.6
North America	132.9	127.2	-5.6	0.8
Asia-Pacific	37.5	26.7	-28.3	-14.6
ROW	21.1	17.6	-6.0	2.8
Total	**324.3**	**301.6**	**-6.6**	**1.0**

* = *excluding the Kering licences that were/will be discontinued* *Source: Company Data*

- **More difficult to identify the timing of a recovery in the ST…** According to management, these production bottlenecks should be solved in the course of Q2 and if the group has not registered any order cancellations, management does not rule out that risk. This situation also means that growth of the "going-forward brand PF" will be partly hampered by this issue during the peak sun season, whilst the gradual termination of the Gucci license will continue to weigh on the group's performance.

- **… We have cut our FY16 assumptions by 7%.** We have lowered our FY sales forecast (-4%) to factor in: **(i)** the negative impact from the sales disruptions in Q1 and probably in Q2 as well, and **(ii)** a more significant sales decline at Solstice. Moreover, the performance of Carrera (~9% of sales) in Q1 was irrelevant as the new Maverick collection was launched in April but growth in the "going-forward brand PF" should continue to be driven by the licensed brand PF. In view of weaker organic sales growth and a more negative impact from the US retail business, we have also reduced our earnings assumptions over 2016.

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VALUATION

- Arguably we maintain our positive stance on the stock to play the first positive results of the numerous initiatives implemented last year, but these are ultimately longer in coming. In our view, these new production bottlenecks in the Italian plants could prompt additional doubts from investors on the ability to improve execution.
- We continue to believe that these projects will strengthen the group's fundamentals but the road is still long before seeing clear signs of a recovery in the ST. Upside momentum could stem from a successful relaunch of Carrera, a faster solving of this production issue (and no major orders cancellation) and a higher contribution from the new licenses (Givenchy, Swatch, Havaianas in H2 16) to offset the Gucci transition.
- Against this more challenging backdrop, we adopt a Neutral recommendation and our new FV of EUR11 vs. EUR12.5 reflects adjustments to our 2016 forecasts.

NEXT CATALYSTS

- Safilo is due to report H1 2016 results on August 3rd.

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