26th July 2016

Luxury & Consumer Goods

Luxottica

Price EUR44.64

Lowered FY16 guidance as initiatives and challenging macro weigh on the Group's ST performance

Fair Value EUR54 vs. EUR58 (+21%) **NEUTRAL vs. BUY**

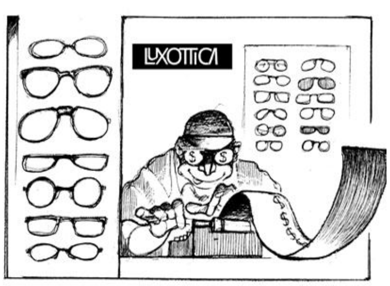
Bloomberg	LUX IM
Reuters	LUX.MI
12-month High / Low (EUR)	67.5 / 42.7
Market Cap (EURm)	21,601
Ev (BG Estimates) (EURm)	22,365
Avg. 6m daily volume (000)	1 028
3y EPS CAGR	10.0%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-3.3%	-7.4%	-21.5%	-26.1%
Consumer Gds	1.6%	1.9%	4.6%	-1.6%
DJ Stoxx 600	-0.3%	-2.3%	0.6%	-7.0%

YEnd Dec. (€m)	2015	2016e	2017e	2018e
Sales	8,837	9,135	9,633	10,207
% change		*3.4%*	*5.5%*	*6.0%*
EBITDA	1,853	1,896	2,135	2,305
Rep. EBIT	1,376	1,388	1,600	1,738
% change		*0.9%*	*15.2%*	*8.6%*
Net income	804.1	826.7	977.6	1,072
% change		*2.8%*	*18.3%*	*9.7%*

	2015	2016e	2017e	2018e
Rep. EBIT margin	15.6	15.2	16.6	17.0
Net margin	9.1	9.1	10.1	10.5
ROE	14.6	14.1	15.5	15.9
ROCE	12.0	12.0	13.9	15.3
Gearing	18.2	13.0	6.0	-2.7

(€)	2015	2016e	2017e	2018e
EPS	1.68	1.72	2.04	2.23
% change	-	*2.7%*	*18.3%*	*9.7%*
P/E	26.6x	25.9x	21.9x	20.0x
FCF yield (%)	3.4%	3.7%	4.7%	5.8%
Dividends (€)	0.89	1.00	1.10	1.22
Div yield (%)	2.0%	2.2%	2.5%	2.7%
EV/Sales	2.6x	2.4x	2.3x	2.1x
EV/EBITDA	12.2x	11.8x	10.3x	9.3x
EV/EBIT	16.4x	16.1x	13.7x	12.3x



Yesterday Luxottica unveiled H1 results that were slightly below expectations: sales of EUR4.72bn (CS: EUR4.74bn) and an adj. EBIT of EUR857m (CS: EUR854m), implying a limited 30bp-margin decline to 18.2%. Against this soft Q2 and because of more challenging macro conditions, LUX warned on the FY16 outlook (FX-n growth of 2-3% vs. +5-6% previously / adj. EBIT growth: 1x sales growth vs. 1.5x initially), all the more since the Group is still impacted by internal initiatives (i.e. MAP policy, Oakley reorganisation, etc.). Consequently, we align ourselves to this more cautious stance (BG FY16 estimates: -5.5%) even if we remain convinced that these painful actions will reap fruits in the MT. We downgrade our recommendation to Neutral vs. Buy and reduce our FV to EUR54 vs. EUR58.

ANALYSIS

- **U.S Wholesale (Q2: -5.8% adj. FX-n) impacted by two major headwinds: 1/** the sun business of **Ray-Ban** (-5% decline) was affected by the implementation of the "**Minimum Advertised Price**" (MAP) policy, which prohibits wholesale customers from making deep discounts, especially the online players (-50% in Q2). **2/ Oakley Sport Channel** continued to struggle, mainly due to a poor retail environment (i.e. Sports Authority went bankrupt), justifying the group's reorganisation that is underway and should be completed over the next quarters.
- **U.S. Retail was more resilient (+1.1% adj. FX-n). LensCrafters** posted comps of 0.5% (Q2 15: +6.4%) and **licensed brands** (Sears Optical and Target Optical) achieved SSSG of 6.1%. Despite the bad weather and soft tourist flows, **Sunglass Hut** achieved 0+ comps in Q2 after -1% in Q1 and these trends have accelerated further in July.
- **Asia-Pacific still soft (0.5% adj. FX-n).** Results in **Mainland China** slowed down in Q2 (but still positive) since the Group's is shifting to a direct **go-to-market approach**, i.e. shifting to independent distributors to own distribution, leading to sales disruptions. A good example is the opening of nine **Ray-Ban stores** in MC to enhance the brand's visibility. Like the MAP policy in the U.S., this initiative is key to increase the brand's equity in the MT/LT but it proved to be more harmful than expected in the ST because of a more difficult macro environment. Whilst sales in **H-K** were declining double-digit again, trends in **India**, **Japan** and **S-K** were well-oriented.
- **Good surprises in Europe (+5%) and LatAm (+12.9%).** Once again, in our **view there is a correlation between the robust growths posted by these two regions and the fact that LUX has not implemented any painful initiative there** (e.g.: MAP policy or distribution reorganisation) and both are supported by the precious STARS program. This is particularly true in **Europe** which was also affected by an unusually cold and wet weather in May and June. LUX achieved a double-digit increase in **Mexico** and **Brazil** irrespective of the economic turmoil in the latter.
- **Solid adj. EBIT margin (-30bp to 18.2%).** Indeed, we consider that the Group's profitability was quite resilient considering: **1/** a poor sun season and a weak FX-n growth in H1 (+1.6% vs. 3% required for a positive operating leverage) and **2/** the numerous self-inflicted initiatives launched this year. These headwinds were partly compensated by efficiency gains (esp. in wholesale: +100bp) and a tight opex cost control (opex were down 100bp). Below, inventory write-downs and the Group's initiatives have led to exceptional costs of EUR69m in H1.
- **PW on 2016 targets: we revised down our estimates by 5.5%.** Since these Group's initiatives were eventually more harmful than expected and would take a bit longer to deliver in a challenging macro environment, LUX has adopted a more cautious stance and lowered its targets: **1/ FX-n sales growth** of 2-3% vs. +5-6% initially (CS was around 4% prior to yesterday's publication) and **2/ Adj. EBIT and income** to grow in line with sales vs. 1.5x faster previously. Consequently, we are now expecting a top line growth of 2.5% FX-n (implying +3% in H2) and an adj. EBIT increase of 1.3% (or 0.6x sales), representing a stable EBIT margin at 16%.

VALUATION

- **Why are we changing our perception in the ST? These initiatives were implemented when the business and the macro have deteriorated, leading to more painful and complicated implementations, all the more since it was exacerbated by a poor sun peak season in the U.S (~56% of sales).** Hence, we do not feel that the management knows precisely when would be the tipping point for major projects such as the MAP policy or the Oakley integration. As an illustration, the management confirmed it is expecting an acceleration in H2 thanks to well-flagged drivers (i.e. LensCrafters @ Macy's store opening programme, calendar realignment and the easier comparison base) but the positive contribution should be finally lower than anticipated, as reflected by the lowered guidance.

- **Why do we remain confident in the MT/LT?** Let's be clear: we have and we will support these actions (*see graph 1 below*), which are key to: **1/** strengthen the group's business model, **2/** protect Ray-Ban and Oakley's brand equity (~27% and ~11% of sales respectively) and **3/** prepare the next MT/LT growth drivers. We remain convinced that the current top management will successfully implement the main targets of the Strategic Plan (retail expansion, digitalization strategy, ramp-up of its optical business), leading to more dynamic top line and EBIT growth rates in 2017-18 vs. 2016.

- **Pending first tangible signs of a turnaround thanks to the initiatives launched earlier this year, we now adopt a Neutral recommendation (vs. Buy) and a FV of EUR54 (vs. EUR58) that reflect our new estimates.**

Table 1: adj. FX-n by region:

EURm	Q1 16	Q2 16	H1 16
Wholesale	*2.7*	-5.8	*-1.6*
Retail	*0.9*	1.1	*1.0*
North America	***1.3***	**-0.3**	***0.5***
Europe	*4.2*	5.0	*4.6*
Asia-Pacific	*-2.1*	0.5	*-0.8*
Latin America	*13.1*	12.9	*13.0*
ROW	*-5.4*	-7.0	*-6.2*
Total Luxottica	***1.8***	**1.4**	***1.6***

Source: Company Data

Table 2: H1 16 Results:

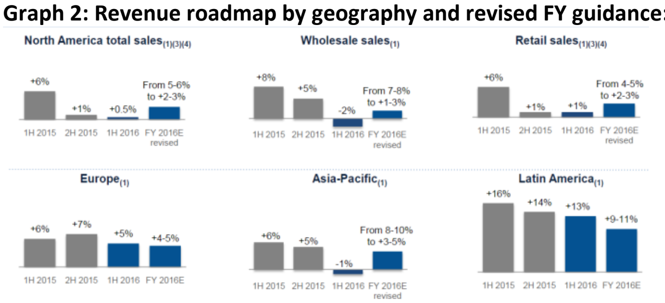
EURm	H1 15	H1 16	% change
Adjusted net sales	**4,752**	**4,719**	***-0.7***
Reported net sales	4,667	4,719	*1.1*
Adjusted operating income	**879**	**857**	***-2.5***
% margin	18.5	18.2	*-30bp*
Reported operating income	859	788	*-8.2*
% margin	18.4	16.7	*-170bp*

Source: Company Data

Graph 1: Summary of the Group's initiatives:

Source: Company Data

Graph 2: Revenue roadmap by geography and revised FY guidance:



Source: Company Data

NEXT CATALYSTS

- Q3 16 Sales on 24th October 2016. *Click here to download document*

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