1st August 2016

Luxury & Consumer Goods

Essilor

Price EUR114.55

After the temporary slowdown in Q2 we believe in the rebound in H2

Fair Value EUR130 (+13%) **BUY**

Bloomberg	EF FP
Reuters	ESSI.PA
12-month High / Low (EUR)	123.6 / 100.4
Market Cap (EURm)	24,983
Ev (BG Estimates) (EURm)	26,652
Avg. 6m daily volume (000)	503.6
3y EPS CAGR	10.1%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-3.7%	1.3%	0.2%	-0.4%
Consumer Gds	4.5%	4.2%	2.8%	-0.7%
DJ Stoxx 600	4.7%	0.1%	-0.1%	-6.5%

YEnd Dec. (€m)	2015	2016e	2017e	2018e
Sales	6,716	7,132	7,625	8,157
% change		*6.2%*	*6.9%*	*7.0%*
EBITDA	1,263	1,341	1,449	1,566
EBIT	1,183	1,271	1,379	1,501
% change		*7.5%*	*8.5%*	*8.9%*
Net income	757.1	846.6	923.3	1,017
% change		*11.8%*	*9.1%*	*10.1%*

	2015	2016e	2017e	2018e
Operating margin	17.6	17.8	18.1	18.4
Net margin	11.3	11.9	12.1	12.5
ROE	13.3	13.2	12.9	13.4
ROCE	20.0	20.1	20.9	21.5
Gearing	34.7	24.5	15.9	13.7

(€)	2015	2016e	2017e	2018e
EPS	3.57	3.96	4.32	4.76
% change	-	*11.0%*	*9.1%*	*10.1%*
P/E	32.1x	28.9x	26.5x	24.1x
FCF yield (%)	3.5%	3.8%	4.0%	4.3%
Dividends (€)	1.15	1.30	3.15	4.15
Div yield (%)	1.0%	1.1%	2.7%	3.6%
EV/Sales	4.0x	3.7x	3.4x	3.2x
EV/EBITDA	21.5x	19.9x	18.1x	16.7x
EV/EBIT	22.9x	21.0x	19.0x	17.4x

Although we felt that management's tone was a bit more cautious in light of the poor performance in R&S and a difficult macro environment, it is committed to accelerating LFL growth in H2 (+5%e) thanks to numerous initiatives in all businesses and across all geographies while Q2 headwinds should have a lesser impact throughout the remainder of the year. We have notched down our FY16 estimates by only 1.5% (lower FY16 LFL target, FX) but FV is unchanged at EUR130 and our Buy recommendation confirmed as the ST/MT growth story is solid.

ANALYSIS

- **Why this slowdown in North America (+1.5% vs. +4.7% in Q1)?** Following Luxottica's soft H1 numbers in North America (+0.5% FX-n), Essilor's disappointing performance (CS: +5%e) might have caused concern last Friday. According to COO Laurent Vacherot, three main headwinds impacted Q2: **(i) Transitions ("TOI"):** a more significant sales decline to third parties than expected, due to a key customer that did not renew its order (impact: ~1pp on NA LFL growth), **(ii) Coastal:** whilst the other online platforms grew in double-digits, Coastal still struggled to rebound and **(iii) a soft month of June:** the overall market had a slow start before accelerating towards the end of the month.
- **Is this deceleration structural or just temporary?** In our view it is only a temporary softness**: (i) Transitions:** Essilor launched several initiatives (marketing campaigns, innovation) to boost internal sales and offset the structural decline in actitivity with 3rd parties (lesser impact expected over the next quarters though), **(ii) the further integration of the alliance groups**, which is a fast-growing channel, will also fuel LFL growth over H2 and beyond, **(iii)** the **US optical market** was better-oriented in July.
- **What happened to the Sunwear division?** Although we were expecting the unfavourable weather conditions to affect the R&S division, we were surprised by the magnitude of the sales drop (-5.8% LFL vs. CS: +5.5%): **(i)** the expected rebound at **Bolon** in **China** was eventually lower-than-expected (HSD decline vs. -33% in Q1) because of a soft Chinese sunglass market, **(ii) the bad weather in Europe/US** affected **FGX** and **Costa** (still positive).
- **R&S: Essilor is guiding for a rebound in H2. Bolon** should return to growth in H2 as the brand is penetrating new channels (travel retail) and new markets (Southeast Asia), especially since the inventory software is now fully operational in China. As the weather improves in Europe/US, **Costa** and **FGX** should accelerate, the former is also expanding in travel retail and outside the US Essilor and expects a modest LFL growth for 2016 (BG: +0.5%e), implying a rebound in H2 (BG: +5%e).
- **Impact of lower FY16 sales guidance on our EPS estimate: -1.5% only.** Our LFL growth assumption is now aligned with the revised target (BG: +4.5%e vs. +5% previously), leading to "combined growth" of 8.2% (guidance:>8%). We have retained a more negative FX impact (~2%). As for CM, we are leaving our forecast unchanged at 18.9% (target: "at least 18.8%") after having achieved 18.9% in H1. On the positive side, Laurent Vacherot confirmed that the tax rate should be around 26.5% (vs. 27.5% in 2015), which is lower than our initial forecast (27%).

VALUATION

- In our view the significant market correction last Friday was more due to profit-taking moves triggered by the Q2 miss and the stock outperformance (+10% ytd vs. CAC40 prior the publication) than concrete concerns about the group's MT growth story. As a reminder, the lower FY16 sales guidance still requires 5% LFL growth over H2, which is feasible in our view given the sound fundamentals of the Lenses & Optical core business – 87% of sales (+5% in H1 despite a weak North America in Q2), representing one of the highest top line momentums in the optical & eyewear industry. Buy recommendation and FV of EUR130 confirmed.

NEXT CATALYSTS

- US Field Trip: 28-30th September // Q3 2016 Sales on 21st October 2016.

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