Sector View

Optical & Eyewear Sector

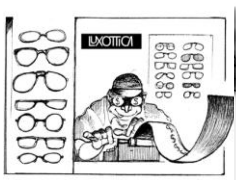
H2 should be better for all our sample even if the macro scenario limits visibility somewhat

	1 M	3 M	6 M	31/12/15
Consumer Gds	1.8%	4.2%	7.9%	-0.3%
DJ Stoxx 600	1.6%	2.6%	7.2%	-6.1%

*Stoxx Sector Indices

Companies covered

ESSILOR		**BUY**	**EUR130**
Last Price	EUR114,35	*Market Cap.*	EUR24,939m
GRANDVISION		**BUY**	**EUR28**
Last Price	EUR26	*Market Cap.*	*EUR6,616m*
LUXOTTICA		**NEUTRAL**	**EUR54**
Last Price	EUR43,46	*Market Cap.*	*EUR21,030m*
SAFILO		**NEUTRAL**	**EUR11**
Last Price	EUR7,985	*Market Cap.*	*EUR500m*



Although the Optical & Eyewear sector is very clearly enjoying structural catalysts and harbours significant growth potential over the MT-LT, sometimes our groups can be affected by temporary setbacks. In H1, the very poor performance in sunglasses (bad weather, slowdown in China) weighed on performances at both LUX and EI but we believe this was more temporary for the latter as the Italian group is also suffering from its "self-inflicted initiatives". Its main competitor SFL posted a very good Q2 but visibility remains limited ahead of the Gucci transition at the end of 2016. Last but not least, sales & earnings momentum at GVNV clearly improved in Q2 and the group was the only player not to be affected by internal or external headwinds. As such, we should remain picky within our sample over the remainder of the year.

ANALYSIS

- **Where the sun did not shine in Q2: North America...** The sunglass category was hit particularly harshly by adverse weather conditions, affecting **EI's** own brand portfolio (FGX and Costa that was still positive) and sales of sun lenses. **LUX** was also naturally impacted by the poor sun peak season, especially since the Group implemented painful initiatives that have hampered growth (*see next page*). In this difficult context it is interesting to note that **SFL's** wholesale business performed quite well with 7.6% adj. FX-n, notably driven by a robust growth with department stores. The **sport sunglass brands** (Oakley, Costa and Smith) had a difficult time with sporting goods retailers, as highlighted by the bankruptcy of Sports Authority (450 stores). Besides this weather effect, the **sun specialty retail chains** faced a lack of traction in tourist areas but **Sunglass Hut** (LUX) managed to rebound slightly in Q2 with SSSG of 0.5% vs. -1.3% in Q1, whilst **Solstice** (SFL) declined 18.2% as 11 stores were closed (to a total of 118 DOS).

- **… and Greater China (particularly H-K/Macau).** After a difficult start to the year, with sales down 33% due to implementation of the ARTEMIS inventory management, **Bolon** (**EI**) achieved a lower-than-expected rebound in Q2 given a softer Chinese sunglass market. **LUX** revenue decelerated in China vs. Q1 but remained in positive territory thanks to the price adjustments implemented in Q3 2015. This slowdown was mainly caused by a shift in the distribution model (i.e. from independent distributors to own distribution), causing some sales disruption. On the positive side, the optical business was well-oriented for both **EI** and **LUX** in Mainland China, but was still down in double-digits for the Italian group in H-K/Macau, which was also a drag on **SFL's** performance in the region (-27.3% FX-n).

- **Europe and LatAm were robust for all our sample.** Indeed, **EI** achieved 4.5% LFL growth in **Europe**, representing the fifth consecutive quarter of growth above 4% (vs. MT target: 0-1%). This sound performance was a clear illustration of the successful combination of incremental marketing expense and innovation (*Eyezen* had a strong launch). **GrandVision**, which has the highest exposure to Europe within our sample (~89% of sales) posted SSSG of 3.6% vs. 0.9% in Q1, largely driven by an acceleration in Western Europe ("G4": +3.2% vs. 0.3%) and in Northern/Central Europe ("Other Europe": +2.1% vs. -0.5%). **LUX** achieved 5% FX-n with double-digit growth in Spain, Italy and Turkey, while **SFL** recorded an impressive 13.2% FX-n driven by increases above 10% in key markets such as Italy, Germany, France and the UK.

- **Latin America: EI** (+11.4% LFL) even accelerated in Brazil, sales were up mid single-digit (vs. low single-digit in Q1) thanks to its multi-channel strategy (successful roll-out of mid-tier Kodak brand) and media push. Revenue in Argentina, Colombia and Mexico soared above 20%. **GVNV** also experienced robust trends in the region, with comparable growth in double digits, driven by Mexico. **LUX** posted 12.9% FX-n growth in the region with increases above 20% in Brazil and Mexico, while comps at **GMO** (optical retailer owned by LUX) increased high single-digit. **SFL** also returned to positive territory in Latin America.

Organic growth by region (GrandVision: comparable growth):

LFL growth (%)	North America		Europe		Asia-Pacific		Latin America		ROW / Other	
	Q2	H1	Q2	H1	Q2	H1	Q2	H1	Q2	H1
Essilor *(Lenses only)*	1.5	3.1	4.5	4.6	8.5	8.7	11.4	10.3	-1.5 *	-5.8 *
GrandVision **	n/a	n/a	3.2/2.1	1.8/0.8	Americas & Asia: 9.7 and 9.2				n/a	n/a
Luxottica	-0.3	0.5	5.0	4.7	0.5	-0.7	12.9	13.0	-7.0	-7.6
Safilo	-1.2	-3.4	13.2	6.1	-27.3	-27.8	ROW incl. LatAm: 9.5 and 2.0			

** = Readers & Sun / ** Europe= G4 and Other Europe respectively*

Source: Company Data, BG

- **H1: margin contraction for everyone, GrandVision excepted. EI's** contribution margin narrowed 20bp to 18.9% as efficiency gains and a positive product-mix were offset by the poor performance of Transitions in the US, higher marketing expenses and M&A, but remains in line with the FY target ("at least 18.8%" vs. 18.8% achieved in 2015). **GVNV** benefited from a better SSSG (op. leverage) and a positive product-mix, driven by a higher share of exclusive brand frames (+10pp to ~70%) and fewer sunglass sales (less profitable). Hence adj. EBITDA margin improved 20bp to 16.3% (+60bp to 16.7% excl. M&A). **LUX's** adj. EBIT margin narrowed 30bp to 18.2%, which was quite satisfactory in our view given the poor sun season and weak FX-n growth in H1 (+1.6% vs. 3% required for a positive op. leverage) and the numerous self-inflicted initiatives. These headwinds were partly offset by efficiency gains and tight cost control (opex: -100bp). **SFL's** adj. EBITDA margin was only down 40bp to 8.9% thanks to a 90bp-improvement in Q2. This rebound was entirely derived from cost-cutting measures and positive operating leverage (opex costs: -160bp), offsetting the negative product-mix implied by the Gucci transition.

VALUATION

- As most of the groups in our sample were affected by a more difficult macro environment as well as "company-specific" setbacks, it is important that we try to assess the tipping point towards more favourable sales/earnings momentum:

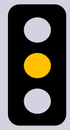
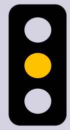
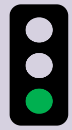
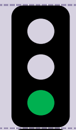
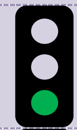
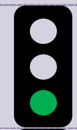
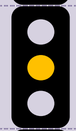
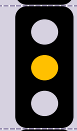
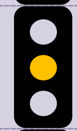
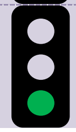
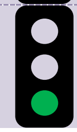
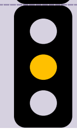
  1/ GrandVision was the only group to post better-than-expected H1 results thanks a strong second quarter, fuelled by the group's growth pillars (exclusive brand portfolio, competitive offering, store openings) whilst the profitability continued to improve despite the dilutive impact from M&A. This favourable momentum bodes well for H2, especially since comparison bases will become easier (SSSG of 2.9% in H2 15 vs. +5.2% in H1). **Hence GVNV would be our safest choice at this stage.**

  2/ Essilor: we believe that the **factors behind weak LFL growth in Q2 were temporary** and expect actions within Transitions and the R&S division (Bolon and Costa: geographical expansion, travel retail) to drive the rebound in H2. The further integration of the alliance groups (fast-growing channel), should also fuel LFL growth in North America from Q3. The lower FY sales target still implies 5% growth over H2, **confirming that a rebound could take place as early as Q3.**

  3/ Luxottica: we feel that **LUX suffered particularly from its initiatives** (MAP, Oakley integration, etc.) as the group performed quite well in Europe/LatAm where no actions were initiated. These initiatives were eventually more painful and complicated to implement given more challenging business and macro conditions. Even if the new FY sales guidance implies a slight acceleration in H2 (~+3%e adj. FX-n vs. +1.6% in H1), **visibility is limited in the ST.**

  4/ Safilo: The **first positive results** of the longstanding actions implemented over the last two years are emerging, as highlighted by the Q2 performance. However, the **Gucci transition** remains a key issue for H2 (~16-17% of sales), as well as the **underperformance of its own brands**. If SFL handles the transition as efficiently as Georgio Armani in H2 2012, it could reassure investors and provide a key catalyst for the stock. In the meantime, **visibility is also limited in the ST.**

Our general overview for our Optical & Eyewear sample:

Company	(i) Q2 Organic Growth	(ii) H1-Results Performance	(iii) FY16 Outlook	Comments
Essilor				(i): 3.2% LFL growth miss (CS: +5%) vs. +5% in Q1 due to a poor performance in photochromic (Transitions) and sun lenses (ii): CM: -20bp to 18.9% (CS: 19%) but it is consistent with FY guidance ("at least 18.8%" vs. 18.8% achieved in 2015). (iii): FY16 LFL growth target was slightly revised down to "~4.5%" vs. "~5%" because of the Q2 miss, it does not imply any slowdown in H2 (+5%), FY CM target was maintained.
GrandVision				(i): Comparable growth of 3.6% (CS: +2.3%) vs. 0.9% in Q1, all three regions have accelerated (ii): Adj. EBITDA margin up 20bp to 16.3% (+60bp excl. M&A), driven by a favourable product-mix, efficiency gains and a positive op. leverage (iii): No FY guidance but MT targets were confirmed (sales up >+5% FX-n and adj. EBITDA growth in the high single-digits)
Luxottica				(i): Adj. FX-n sales growth slightly decelerated to 1.4% vs. 1.8%, dented by Group's own initiatives and the weak sun peak season (ii): Adj. EBIT margin down 30bp to 18.2% as efficiency gains and a tight cost control have partly offset the margin headwinds (iii): Lowered FY16 targets: FX-n growth of 2-3% (% (=> +3%e in H2) vs. +5-6 previously and adj. EBIT growth: 1x sales growth vs. 1.5x initially)
Safilo				(i): Sharp acceleration of the "going-forward PF" with +9% vs. +1% in Q1 that was affected by production bottlenecks (ii): Adj. EBITDA margin down 40bp to 8.9%, the Gucci transition was almost offset by cost-cutting measures and a positive op. leverage (iii): No FY targets but management is "reasonably optimistic" about H2 even if the Gucci transition limits the visibility

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