

## Essilor

Price EUR118.45

## Short preview of Essilor's US operations ahead of US field trip

Fair Value EUR130 (+10%)

BUY

Bloomberg	EF FP
Reuters	ESSI.PA
12-month High / Low (EUR)	123.6 / 103.0
Market Cap (EUR)	25,833
Ev (BG Estimates) (EUR)	27,503
Avg. 6m daily volume (000)	450.9
3y EPS CAGR	10.1%

Next week Essilor is hosting a field trip in Dallas (TX) and Providence (RI) to present its strategy for North America, which accounts for 48% of total sales. Growth potential for Essilor nevertheless remains significant as the group continues to expand in fast-growing segments (online, sunglasses) and channels (e.g.: independent ECP alliance groups). We should also gain a good overview of the group's best-in-class supply chain (Rx labs, distribution centers) that leverages the group's growth catalysts.

## ANALYSIS

- **The US remains the world's largest optical market.** At end-March 2016, the US vision care market was worth around USD40bn (or ~EUR36bn), representing approx. 40% of the global market. Growth in the US eyewear market was quite robust at 4.7% (12m ending March 2016) and interestingly, **Rx lenses** was the best-performing segment (+6.5%). We assume this outperformance vs. sunglasses (+5.5%) continued in Q2 since the latter was impacted by unfavourable weather conditions across the country.

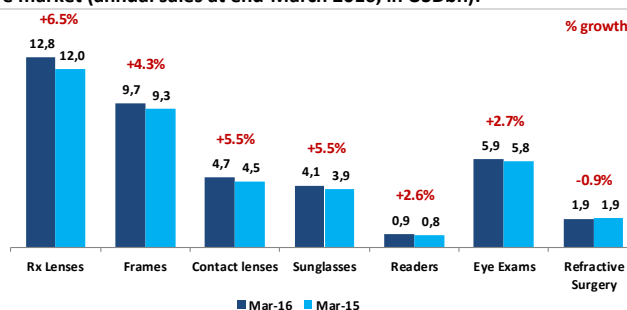
	1 M	3 M	6 M	31/12/15
Absolute perf.	5.6%	1.3%	10.2%	3.0%
Consumer Gds	0.7%	2.6%	4.2%	-0.6%
DJ Stoxx 600	2.2%	1.9%	2.2%	-4.9%

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	33.2x	29.8x	27.2x	24.7x
FCF yield (%)	3.4%	3.6%	3.9%	4.1%
Dividends (€)	1.15	1.30	1.35	1.45
Div yield (%)	1.0%	1.1%	2.7%	3.5%
EV/Sales	4.2x	3.9x	3.5x	3.3x
EV/EBITDA	22.1x	20.5x	18.7x	17.2x
EV/EBIT	23.6x	21.6x	19.6x	17.9x

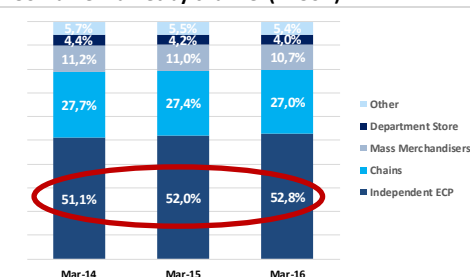
US total Vision Care market (annual sales at end-March 2016, in USDbn):



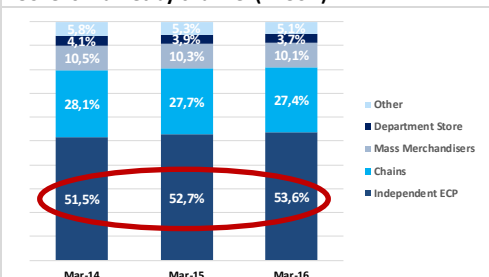
Source: The Vision Council

- **North America represents 44% of Lenses & Optical Instruments revenue.** Except for an unusually soft Q2 (+1.5% LFL) marked by temporary issue at Transitions, the US market was a key catalyst for Essilor (+5% in 2014 and +4.4% in 2015) thanks to robust underlying trends as well as a successful combination of media campaigns (*Crizal*, *Varilux*, *Xperio*) and innovation. With its multi-channel/multi-segment approach, Essilor makes sure that it is always present in the most dynamic channels, such as the independent ECP alliances or buying groups.
- **Essilor is consolidating the fast-growing ECP alliance channel.** Last year the group acquired the largest member alliance in the US, **Vision Source** (4,071 doctors) and **PERC/IVA** (respectively 3,141 and 912 doctors), followed by **Opti-Port** (33 members, 400+ offices) in April. Consequently, Essilor now covers **over 8,000 doctors, or >30% of the total channel** (~25,000 independent eye doctors), which represent a significant growth opportunity for Essilor to push its products and services further. As highlighted by the two charts below, the independent ECP channel has constantly gained market share in the frame and lens segments thanks to a high level of expertise and service. Vision Source enjoyed particularly strong momentum with retail sales up ~13.5% in 2015 to USD2.5bn, as the **second-largest optical retailer** in the US according to *Vision Monday*, just behind Luxottica.

US frame market by channel (in USD):



US lens market by channel (in USD):

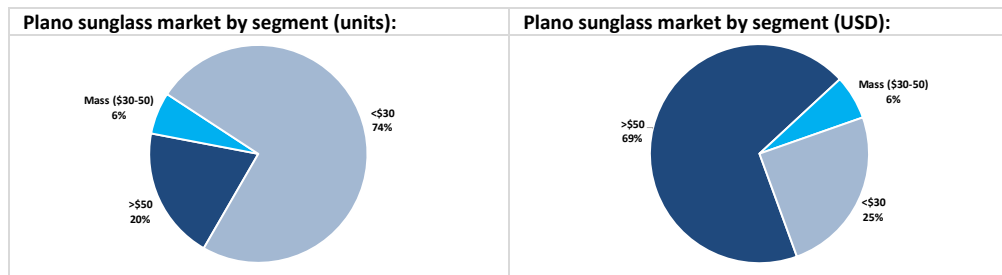


Source: The Vision Council

- **Sunglass & Readers division: US sunglass market still underpenetrated.** The right-hand chart on the next page shows that nearly 74% of sunglasses sold in the US retail for less than USD30, vs. an

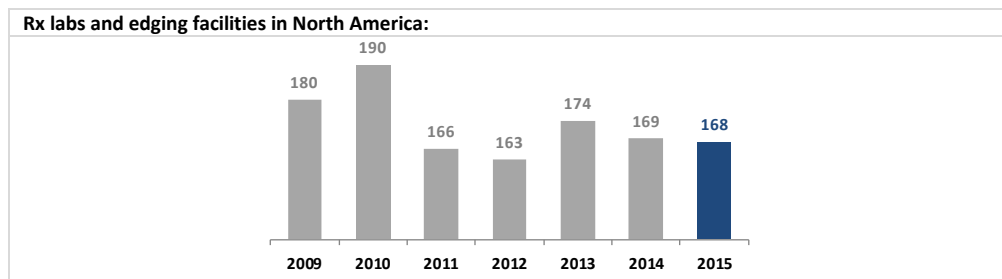


average retail price of EUR80 in Europe. Essilor favours premiumisation in the US sunglass market by: **(i)** increasing the sun lens standard (higher quality, more innovation), **(ii)** educating customers through media campaigns and **(iii)** developing its proprietary brands (*Foster Grant, Costa*, etc.), especially in more selective channels (independent opticians, etc.). The value segment is addressed by **FGX** sun brands (readers) that continues to penetrate new channels and gain new accounts. Despite unfavourable weather conditions and poor trends within the performance segment, **Costa** (retail price: >USD150) remained in positive territory thanks to a media push, distribution gains (doctor alliances, travel retail) and geographical expansion across the US.



Source: The Vision Council

- Online business: a small but fast-growing channel.** We believe that Essilor's exposure to the US online business is slightly higher than the industry (online retail = ~5% of US total optical retail) and according to *The Vision Council*, the online channel had a 3.9% market share in the Rx frame segment, especially for entry-level products. As in other segments, Essilor has a multi-channel/multi-segment approach with three main BtoC online platforms: **(i) EyeBuyDirect** that sells value Rx eyeglasses and frames, **(ii) FramesDirect** mostly offers premium eyeglasses and sunglasses and **(iii) Coastal** that sells contact lenses and eyeglasses. Revenue from the first two websites grew in double digits in H1 while Coastal was lagging behind as the group is testing a new commercial proposal/customer experience. This online business will continue to be a key growth catalyst for Essilor, especially in the US.
- Supply chain: maintaining this best-in-class execution to capture growth potential.** During the field trip, we will visit the **Innovation & Technology Center** for North America (three in the world: Creteil, Dallas and Singapore) that focuses on product quality and consumer/market trends, as well as one of **Essilor's largest Rx labs** in the US (Omega Dallas), giving us a good overview of the group's key competitive advantages (R&D, customer-centric organisation, supply chain). Essilor has extensive coverage with 168 Rx labs, although the network has been streamlined in recent years (2010: 190 Rx labs). In our view, this is a consequence of the increasing importance of the seven export labs, two of them based in Mexico, to address the North American customers.



Source: Company Data

#### VALUATION

- Besides having a clearer view on Essilor's operations in North America, this event might be a good opportunity to have more colour on current trading after a soft Q2. Buy recommendation and FV of EUR130 confirmed.
- It is worth noting that presentations concerning the US market might also be of interest for Luxottica shareholders as a read-across, since the Italian group generates 56% of its revenue there.

#### NEXT CATALYSTS

- US field trip on 27-30th September // Q3 results on 21st October.

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