10th October 2016

Luxury & Consumer Goods

Luxottica

Price EUR40.85

Q3 2016 sales preview: a more harmful impact from the MAP policy

Fair Value EUR52 vs. EUR54 (+27%) **NEUTRAL**

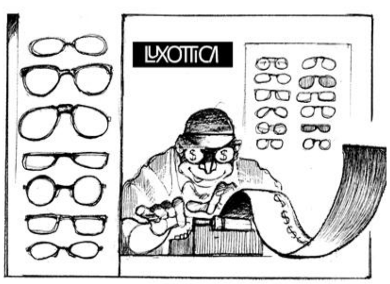
Bloomberg	LUX IM
Reuters	LUX.MI
12-month High / Low (EUR)	65.6 / 40.9
Market Cap (EURm)	19,775
Ev (BG Estimates) (EURm)	20,539
Avg. 6m daily volume (000)	865.7
3y EPS CAGR	8.0%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-6.4%	-4.2%	-15.5%	-32.4%
Consumer Gds	-4.0%	1.3%	2.8%	-3.4%
DJ Stoxx 600	-3.1%	5.4%	3.5%	-7.2%

YEnd Dec. (€m)	2015	2016e	2017e	2018e
Sales (rep.)	8,837	9,084	9,491	9,966
% change		*2.8%*	*4.5%*	*5.0%*
EBITDA	1,853	1,886	2,063	2,202
EBIT (rep.)	1,376	1,381	1,535	1,648
% change		*0.3%*	*11.2%*	*7.3%*
Net income	804.1	821.8	936.1	1,014
% change		*2.2%*	*13.9%*	*8.4%*

	2015	2016e	2017e	2018e
Operating margin	15.6	15.2	16.2	16.5
Net margin	9.1	9.0	9.9	10.2
ROE	14.6	14.0	14.9	15.2
ROCE	12.0	11.9	13.3	14.5
Gearing	18.2	13.0	6.1	-2.1

(€)	2015	2016e	2017e	2018e
EPS	1.68	1.71	1.95	2.11
% change	-	*2.0%*	*13.9%*	*8.4%*
P/E	24.4x	23.9x	21.0x	19.3x
FCF yield (%)	3.8%	4.1%	5.0%	6.0%
Dividends (€)	0.89	0.95	1.07	1.16
Div yield (%)	2.2%	2.3%	2.6%	2.8%
EV/Sales	2.4x	2.3x	2.1x	2.0x
EV/EBITDA	11.2x	10.9x	9.8x	8.9x
EV/EBIT	15.1x	14.9x	13.1x	11.9x



The Retail division could post more favourable trends (Sunglass Hut US, first store openings, etc.) but these first improvements will be overshadowed by the group's well-known own initiatives in Wholesale (MAP policy at Ray-Ban US and direct go-to-market approach in mainland China). Following our revised forecast for Q3 (+1.1%e adj. FX-n), our FY assumption (+1.8%e) is now slightly more cautious than FY guidance (+2-3%), but still implies 3% growth in Q4. Our revised FY forecast leads to a new FV of EUR52 vs. EUR54.

ANALYSIS

- **MAP policy at Ray-Ban North America: a higher headwind in Q3.** In Q2 Ray-Ban's US sun business fell by ~5%e mainly due to the implementation of the "**Minimum Advertised Price**" policy, which had a direct impact on online sales (-50% in Q2). As highlighted in our previous comments, the group could not communicate on a precise tipping point in the ST. Hence our estimates retained the same negative impact until the anniversary effect in Q2 201,7 but it now appears **that this headwind could be higher-than-expected in Q3 given its implementation in July**. This situation confirms that this MAP policy, although necessary to protect brand equity, remains the main drag on the group's organic growth.

- **Mainland China affected by the change in distribution model.** Indeed, the group is adopting a direct **go-to-market approach** for its Wholesale business, i.e. shifting from independent distributors to own distribution, causing sales disruptions in the ST, while the Chinese sunglass market remains robust despite a more challenging macro environment. Note that **LUX's Head of Wholesale and Retail for Greater China Paolo Ciarlariello recently left the group** and this departure might be explained by these reorganisations.

- **First signs of improvement in Retail.** The division started enjoying some levers in Q3: **(i)** more favourable weather conditions that should be particularly positive for Sunglass Hut US, **(ii)** the first store openings of LensCrafters @ Macy's and Target Optical across the US (+80 and +40 stores to be opened throughout H2) and **(iii)** the US calendar realignment that would contribute positively in H2 (+1 day in Q3 and +3 days in Q4).

- **We nudge down our FY16 assumptions by 60bp.** This is the direct consequence of more cautious expectations for Q3, particularly in the **Wholesale Division** given a more adverse impact from the MAP policy and a complicated sport sunglass channel (Oakley). The three above-mentioned drivers for **Retail** are reflected in the gradual acceleration, notably a higher contribution from the store openings and the retail calendar realignment. Consequently, **our FY FX-n growth for 2016 (+1.8%e vs. 2.4%e previously) is now below the Group's FY guidance of 2-3%**, which is justified given low visibility, particularly with regards to the MAP policy.

Adj. FX-n by division:

%	Q1 16	Q2 16	Q3 16e	Q4 16e	2016e
Wholesale	2.1	0.2	*-2.0*	*0.5*	*0.3*
Retail	1.6	2.3	*3.0*	*4.5*	*2.8*
Total Luxottica	**1.8**	**1.4**	***1.1***	***3.0***	***1.8***

Source: Company Data, BG ests

VALUATION

- Initially we were hoping for a slight acceleration in Q3, mainly driven by the first store openings and more favourable weather conditions whilst the MAP policy headwind was expected to be in line with Q2. The latter would eventually be a higher drag than the group's expectations (and our forecasts), leading to this another weak organic growth. Hence our new FV of EUR52 vs. EUR54 is a consequence of our new FY assumptions.

- We still believe that the group's initiatives, though painful in the ST, should enable LUX to restore traction in the MT, especially since the global optical market continues to grow. At 13x 2017e EV/EBIT, the stock is trading at a 20% discount vs. 2004-16 historical average.

NEXT CATALYSTS

- Luxottica will release Q3 2016 sales on 24th October.

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