24th October 2016

Luxury & Consumer Goods

Essilor

Price EUR104.90

Bloomberg	EF FP
Reuters	ESSI.PA
12-month High / Low (EUR)	123.6 / 103.0
Market Cap (EUR)	22,878
Ev (BG Estimates) (EUR)	24,545
Avg. 6m daily volume (000)	447.4
3y EPS CAGR	10.1%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-9.5%	-14.0%	-8.5%	-8.8%
Consumer Gds	-0.6%	-1.3%	-0.5%	-2.9%
DJ Stoxx 600	0.5%	1.1%	-1.5%	-5.9%

YEnd Dec. (€m)	2015	2016e	2017e	2018e
Sales	6,716	7,107	7,595	8,122
% change		*5.8%*	*6.9%*	*6.9%*
EBITDA	1,263	1,337	1,435	1,559
EBIT	1,183	1,267	1,365	1,494
% change		*7.1%*	*7.8%*	*9.4%*
Net income	757.1	843.8	920.4	1,019
% change		*11.4%*	*9.1%*	*10.8%*

	2015	2016e	2017e	2018e
Operating margin	17.6	17.8	18.0	18.4
Net margin	11.3	11.9	12.1	12.6
ROE	13.3	13.1	12.8	13.4
ROCE	20.0	20.0	20.6	21.4
Gearing	34.7	24.5	15.9	13.7

(€)	2015	2016e	2017e	2018e
EPS	3.57	3.95	4.30	4.77
% change	-	*10.6%*	*9.1%*	*10.8%*
P/E	29.4x	26.6x	24.4x	22.0x
FCF yield (%)	3.8%	4.1%	4.4%	4.7%
Dividends (€)	1.15	1.30	3.15	4.15
Div yield (%)	1.1%	1.2%	3.0%	4.0%
EV/Sales	3.7x	3.5x	3.2x	3.0x
EV/EBITDA	19.8x	18.4x	16.8x	15.4x
EV/EBIT	21.1x	19.4x	17.6x	16.0x

All eyes on initiatives to renew growth in the US!

Fair Value EUR128 vs. EUR130 (+22%) BUY

While R&S recovered in Q3 (+6.9% LFL), the weak performance in North America (+1.5%) was the main negative point. This slowdown was marked by specific headwinds (TOI, expiration of some government supply programmes, Coastal.com) but also by softer underlying trends in the optical market which surprised the group, as it has not identified the specific reasons for this slowdown. Hence management remain cautious on this market for Q4 (~44% of the L&OI division). Our new FV of EUR128 vs. EUR130 reflects adjustments to our FY16 growth assumptions.

ANALYSIS

- **What is happening in North America?** After a strong start to the year (+4.7% LFL), Essilor experienced two disappointing quarters in a row for the first time since 2013. Like in Q2, **TOI** faced a significant decline in sales to third parties (impact: ~70bp) but contracts with government entities were not renewed (impact: ~1pp): **(i) Department of Veterans Affairs** as the Supreme Court had decided to apply the law: companies that do business with this government entity must be a SME and be at least 50% owned by veterans and **(ii) Medicaid:** two US states have decided to stop reimbursing some lens coatings. **Coastal** continued to be a drag on the US online business.

  Besides these company-specific headwinds, Essilor had to cope with an **unexpected slowdown in the Rx lens market**, justifying management's cautious tone at this stage, especially since the group has not identified the reasons behind this deceleration (macro environment? "wait-and-see" behaviour from consumers before the US elections?). On a positive note, there is no pressure on prices and the issue is only on volumes as eye exams decelerated (+1.2% 12m rolling at end June '16) and in-store traffic was down.

- **North America: what to expect for Q4 and onwards?** Essilor controls to some extent three key levers to regain some momentum: **(i)** another step up in marketing expenses to encourage consumers to replace their lenses and revitalise traffic, this strategy being successful in Europe against a fragile macro environment, and **(ii)** the further integration of the dynamic alliance group channel with the **Framedream project** (turnkey solution to deliver both lenses and frames to independent eye-care providers) that will be rolled out in 250 stores by the year-end. We believe this project will be a key competitive advantage (and a catalyst) for Essilor in the coming quarters, **(iii)** the revamped website for Coastal and its new commercial proposition should help regaining some traction over the next quarters (more in Q1 17 in our view). Last but not least, EI hopes that consumer confidence will improve after the US elections, putting an end to the "carry-over effect". Even if visibility remains limited, we expect a slight improvement over Q4 (+1.8%).

- **R&S: the rebound materialised and more to come in Q4.** The 6.8% increase confirmed that H1 issues were only temporary and was driven by **Foster Grant** (MSD growth vs. LSD growth in H1), **Bolon** (LSD increase vs HSD decline in Q2) and the **US readers** business, whilst **Costa** remained strong. Thanks to a solid backlog, management guided on an "outstanding Q4" on top of a challenging comparison base (Q4 15: +15%).

- **Our FY LFL growth forecast adjusted to 3.8% vs 4.2% previously,** implying a 3.7% increase in Q4. Essilor confirmed that LFL growth guidance ("around 4.5%") would not be reached but the group is committed to being as close as possible to the FX-n growth target (+8% / BG: +7.7%e) thanks to the contribution from acquisitions. CEO Hubert Sagnieres also confirmed that the FY contribution margin objective ("at least 18.8%") was not at risk (BG: 18.8% vs 18.9% initially). We leave our FY 2017 assumptions unchanged but the pace of growth in Q1 2017 should be similar to Q4 2016.

VALUATION

- We have nudged down our FV to EUR128 vs. EUR130 previously following two adjustments: **(i)** LFL growth forecast (+3.8% from +4.2%) and **(ii)** contribution margin (18.8%e from 18.9%e) given more limited operating leverage.

- **Luxottica** will release its Q3 sales this evening and might also confirm that market conditions were a bit more adverse in the US, raising some question marks about this market in the ST.

NEXT CATALYSTS

- FY results to be released by the end of February 2017. *Click here to download document*

Analyst:
Cédric Rossi
33(0) 1 70 36 57 25
crossi@bryangarnier.com

Consumer Analyst Team:
Nikolaas Faes
Loïc Morvan
Antoine Parison
Virginie Roumage

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London
Beaufort House
15 St. Botolph Street
London EC3A 7BB
Tel: +44 (0) 207 332 2500
Fax: +44 (0) 207 332 2559
Authorised and regulated by the
Financial Conduct Authority (FCA)

Paris
26 Avenue des Champs Elysées
75008 Paris
Tel: +33 (0) 1 56 68 75 00
Fax: +33 (0) 1 56 68 75 01
Regulated by the
Financial Conduct Authority (FCA) and the
Autorité de Contrôle prudential et de
resolution (ACPR)

New York
750 Lexington Avenue
New York, NY 10022
Tel: +1 (0) 212 337 7000
Fax: +1 (0) 212 337 7002
FINRA and SIPC member

Munich
Widenmayerstrasse 29
80538 Munich
Germany
+49 89 2422 62 11

New Delhi
The Imperial Hotel Janpath
New Delhi 110 001
Tel +91 11 4132 6062
+91 98 1111 5119
Fax +91 11 2621 9062

Geneva
rue de Grenus 7
CP 2113
Genève 1, CH 1211
Tel +4122 731 3263
Fax+4122731 3243
Regulated by the FINMA

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