MOI GLOBAL

Why Luxottica Remains an Attractive Long-Term Opportunity

This article is authored by MOI Global instructor Chris Swasbrook, managing director of Elevation Capital Management.

It is our pleasure to present one of our most recent investments to Best Ideas 2017. You might not be familiar with the name Luxottica (LUX.MI). However, it is likely that if you are wearing branded eyewear, your glasses are made by Luxottica, and potentially purchased through one of their retail stores.

Luxottica is the world's largest eyewear company. It is also Italy's largest fashion company. Its products are distributed across more than 150 countries, with 95 million prescription frames and sunglasses produced annually worldwide.

A GROWING GLOBAL EYEWEAR MARKET

The global eyewear market is currently estimated to be worth US$120B and is forecast to grow at a 2.4% CAGR to 2021E. Core segments within the industry are vision correction and sunglasses – both of which remain largely underpenetrated. It is currently estimated that over 2.5bln people require vision correction solutions but do not have access to it, while a further 5.8bln people are unequipped within the sunglass segment. Strong structural growth drivers and attractive socio-demographic factors are expected to support growth over the long term. Main drivers of growth within the eyewear market include:

- increased market penetration;
- a growing and aging global population;
- a widening middle class;
- increasing prevalence of poor eyesight;
- heightened consumer awareness toward the importance of UV and blue light protection;
- shifting perceptions toward eyewear as a fashion statement; and,
- a trend of premiumisation where the branded eyewear is outgrowing non-branded eyewear.

DOMINANT POSITION IN BRANDED EYEWEAR MARKET

Luxottica has the dominant proprietary and licensed brand portfolio in the industry. Its key proprietary brands are Ray-Ban and Oakley, which account 40% of its sales. Its licensed brands include: Giorgio Armani, Burberry, Bulgari, Chanel, Dolce & Gabbana, Michael Kors, Prada, Ralph Lauren, Tiffany & Co., Versace and Valentino.

RETAIL DISTRIBUTION NETWORK

Luxottica owns and operates several leading retail brands which hold dominant positions in their respective markets including global market leaders: Sunglass Hut and LensCrafters. The retail brands include: Sunglass Hut, LensCrafters, Pearle Vision, Sears Optical, Target Optical, OPSM, ILORI, EyeMed Vision Care, Optical Shop of Aspen, Laubman & Pank, GMO, Oliver Peoples, Alain Mikli, Oakley, David Clulow, Glasses.com and Econópticas.

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STRONG MOAT – VERTICAL INTEGRATED BUSINESS MODEL

Under the leadership of its founder, Leonardo Del Vecchio, the past few decades have seen the Company relentlessly pursue the integration of its entire value chain, from sketches to product design, manufacturing and distribution. The Company describes it as a "world of data, analytics, and infrastructure".

We believe this unparalleled vertically integrated business model is Luxottica's most important moat. Its presence across all stages of the value chain provides Luxottica with an extremely strong competitive advantage, and enables them to maximise efficiencies and extract value throughout their business, at the same time creating an enormous barrier to entry for competitors in the branded eyewear market.

GOVERNANCE ISSUES

Mr. Del Vecchio owns 66.5% of Luxottica. He has been praised in the past for stepping back and hiring outside management. However, since 2014 there has been a high level of disruption as Luxottica has lost three CEO/Co-CEOs and other senior managers. These seemingly regular changes in senior management, has resulted in investor concern toward succession plans and ultimately the future of the Company.

M&A OPPORTUNITIES

We take our cue from the Chairman when he stated earlier in the year that "another area that has our attention is the lens world, which is worth as much as the frame market and delivers very high margins". We believe the Company may revive the abandoned merger discussions between Luxottica and the world's largest lens manufacturer Essilor (ESSI.PA) in 2013. Other M&A opportunities are also possible such as expansion of their retail channel or continued consolidation within the frames business.

RECENT STOCK PRICE WEAKNESS PRESENTS A LONG-TERM OPPORTUNITY

Since August 2015, Luxottica stock has faced significant pressure following a broad correction in the Italian stock market, earnings revisions across several key markets and ongoing management concerns. This has resulted in the stock declining some 41% to a recent low of €39.92 October 2016, from an all-time high of €67.45 recorded in August 2015.

The Elevation Capital Value Fund established a position in Luxottica in October 2016, at an average cost of €40.65 per share – equal to 1.2% of the portfolio as at 30 November, 2016.

INVESTMENT THESIS

Luxottica is the undisputed leader in a structurally growing industry. There exist significant opportunities to increase market penetration while socio-economic drivers favour long-term growth. Qualitative factors such as the ongoing optimisation of the Group's vertical integration strategy and execution of current growth initiatives provide substantial headroom in this regard.

We acknowledge that softness within the eyewear market may create volatile trading conditions in near term. However ultimately the quality of the business has been established such that it can endure short-term uncertainty and still survive and thrive in the long run. In contrast to popular belief, it is our view that the active involvement and leadership of Mr. Del Vecchio since 2014 is a plus for the Company and the other 33.5% of shareholders – we maintain that concerns toward succession planning should be viewed as short-term "noise".

Luxottica currently trades at €50.30 per share, with an EV/EBITDA multiple of 13.35x (13/12/16). We currently value Luxottica under three scenarios': Conservative, Neutral and Optimistic with respective intrinsic value estimates of €53.23, €58.78 and €65.90 per share. From our cost basis of US€40.65 per share, our valuation/s represent respective upside potential of +30.95%, +44.60% and +62.12%.