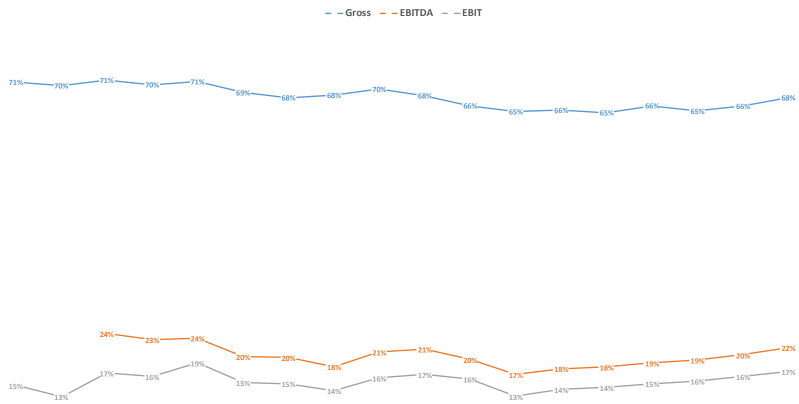
SINGULAR DILIGENCE

Luxottica (Borsa Italiana: LUX)

NOTE: ADRs also trade under "LUX" on the NYSE priced in U.S. Dollars

Luxottica (Borsa Italiana: LUX)

43.04 Euros



	EV/Sales	EV/Gross Profit	EV/EBITDA	EV/EBIT	EV/Owner Earnings
Safilo	0.58	0.99	7.21	11.75	11.75
Hunter Douglas	0.77	1.76	6.07	8.07	6.62
Nike	3.09	6.71	19.75	22.62	21.34
Estee Lauder	3.31	4.11	17.71	22.23	22.23
Essilor	4.28	7.17	17.68	24.31	23.69
Minimum	0.58	0.99	6.07	8.07	6.62
Maximum	4.28	7.17	19.75	24.31	23.69
Median	3.09	4.11	17.68	22.23	21.34
Mean	2.41	4.15	13.68	17.80	17.13
STDEV	1.64	2.80	6.50	7.36	7.52
CV	68%	68%	47%	41%	44%
Luxottica	2.44	3.60	11.26	15.71	14.12

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Min	Max	Median	Mean	Standard Deviation	Variation
Sales	1,538	1,874	2,417	3,101	3,179	2,825	3,180	4,371	4,676	4,966	5,202	5,094	5,798	6,222	7,086	7,313	7,652	8,837	1,538	8,837	4,821	4,741	2,119	45%
Gross Profit	1,089	1,315	1,719	2,181	2,254	1,946	2,161	2,990	3,250	3,390	3,457	3,332	3,808	4,054	4,707	4,789	5,078	6,001	1,089	6,001	3,291	3,196	1,377	43%
EBITDA			587	721	747	567	632	797	977	1,066	1,015	857	1,034	1,131	1,340	1,422	1,562	1,919	567	1,919	996	1,023	380	37%
EBIT	226	238	412	509	602	432	479	603	756	833	830	648	810	896	1,068	1,139	1,257	1,531	226	1,531	702	737	351	48%
Receivables					376	362	380	434	498	599	648	624	637	685	706	690	717	806	362	806	631	583	146	25%
Inventories					453	457	479	500	498	607	715	690	740	849	909	938	949	1,033	453	1,033	702	701	207	29%
PP&E					504	502	548	667	761	922	1,114	1,160	1,123	1,133	1,181	1,188	1,250	1,377	502	1,377	1,118	959	303	32%
Working Liabilities					487	417	506	651	718	817	864	885	1,010	1,164	1,257	1,238	1,292	1,489	417	1,489	875	914	338	37%
Net Tangible Assets					846	904	901	951	1,040	1,312	1,612	1,588	1,490	1,502	1,540	1,577	1,624	1,726	846	1,726	1,496	1,329	326	24%
MARGINS																								
Gross	71%	70%	71%	70%	71%	69%	68%	68%	70%	68%	66%	65%	66%	65%	66%	65%	66%	68%	65%	71%	68%	68%	2%	0.03
EBITDA			24%	23%	24%	20%	20%	18%	21%	21%	20%	17%	18%	18%	19%	19%	20%	22%	17%	24%	20%	20%	2%	0.11
EBIT	15%	13%	17%	16%	19%	15%	15%	14%	16%	17%	16%	13%	14%	14%	15%	16%	16%	17%	13%	19%	15%	15%	2%	0.10
TURNS																								
Sales/Receivables					8.46	7.81	8.37	10.07	9.40	8.28	8.03	8.16	9.10	9.08	10.03	10.61	10.67	10.96	7.81	10.96	9.09	9.22	1.08	12%
Sales/Inventories					7.01	6.18	6.64	8.74	9.38	8.19	7.28	7.39	7.83	7.33	7.79	7.80	8.07	8.55	6.18	9.38	7.80	7.73	0.85	11%
Sales/PPE					6.31	5.63	5.80	6.55	6.14	5.38	4.67	4.39	5.17	5.49	6.00	6.16	6.12	6.42	4.39	6.55	5.90	5.73	0.65	11%
Sales/NTA					3.76	3.13	3.53	4.60	4.50	3.79	3.23	3.21	3.89	4.14	4.60	4.64	4.71	5.12	3.13	5.12	4.02	4.06	0.65	16%
RETURNS																								
Gross Profit/NTA					266%	215%	240%	315%	313%	258%	214%	210%	256%	270%	306%	304%	313%	348%	210%	348%	268%	273%	44%	0.16
EBITDA/NTA					88%	63%	70%	84%	94%	81%	63%	54%	69%	75%	87%	90%	96%	111%	54%	111%	83%	80%	16%	0.19
EBIT/NTA					71%	48%	53%	63%	73%	64%	51%	41%	54%	60%	69%	72%	77%	89%	41%	89%	63%	63%	13%	0.21
GROWTH																								
Sales		22%	29%	28%	2%	-11%	13%	37%	7%	6%	5%	-2%	14%	7%	14%	3%	5%	15%	-11%	37%	7%	11%	12%	1.07
Gross Profit		21%	31%	27%	3%	-14%	11%	38%	9%	4%	2%	-4%	14%	6%	16%	2%	6%	18%	-14%	38%	9%	11%	13%	1.16
EBITDA				23%	4%	-24%	12%	26%	23%	9%	-5%	-16%	21%	9%	19%	6%	10%	23%	-24%	26%	10%	9%	15%	1.59
EBIT		5%	73%	24%	18%	-28%	11%	26%	25%	10%	0%	-22%	25%	11%	19%	7%	10%	22%	-28%	73%	11%	14%	22%	1.57
Receivables					-3%	-5%	15%	14%	16%	25%	-5%	-2%	6%	9%	-2%	-3%	11%	14%	-5%	25%	7%	6%	10%	1.50
Inventories					3%	-1%	10%	-1%	0%	43%	0%	-7%	23%	8%	7%	0%	2%	15%	-7%	43%	3%	7%	13%	1.75
PP&E					1%	-2%	20%	23%	7%	34%	11%	-2%	-5%	7%	2%	-1%	11%	9%	-5%	34%	7%	8%	11%	1.34
Working Liabilities					-21%	-6%	50%	14%	7%	20%	-6%	12%	16%	14%	2%	-5%	15%	16%	-21%	50%	13%	9%	17%	1.82
Net Tangible Assets					15%	-1%	0%	11%	8%	43%	9%	-11%	-1%	3%	2%	3%	3%	9%	-11%	43%	3%	7%	12%	1.84

SINGULAR DILIGENCE

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Luxottica (Borsa Italiana: LUX) is a Global Maker and Seller of Sunglasses and Eyeglasses

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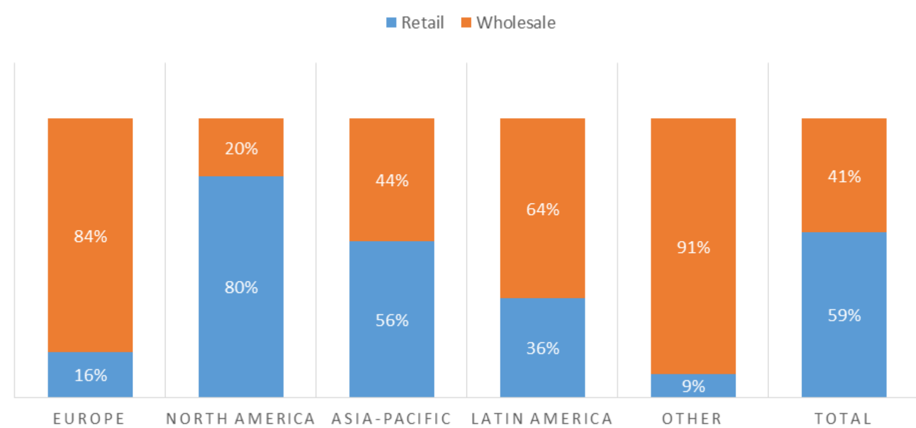
OVERVIEW

Luxottica is a vertically integrated eyewear company. Although founded in Italy, it now gets much of its sales and profits from the United States. And although founded as a part maker for prescription eyeglass frames (optical glasses) it now gets much of its sales and profits from sunglasses. The company can't really be referred to as either a producer or a retailer. Luxottica is truly vertically integrated. Last year, 59% of the company's sales came from its own stores. And much of the products sold in its own stores is produced by Luxottica itself. The two constants in Luxottica's history have been the focus on eyewear and the leadership of Leonardo Del Vecchio.



Luxottica gets 59% of its revenue from sales made in its own stores.

Del Vecchio moved to Agordo, Italy in 1961. The local authorities were giving out land to entrepreneurs in the hopes those entrepreneurs would create jobs and provide tax revenue. The Italian eyeglass frame making industry was nearby. So, Del Vecchio set up Luxottica as a part supplier to these companies. However, Del Vecchio saw there were better profits in selling entire frames than there were in just selling the parts. In the 1960s, Luxottica transitioned from being a parts supplier to being a frame maker. The company presented its first collection of prescription eyewear in 1971. Luxottica moved into distribution for the same reason it moved into producing its own frames. Del Vecchio felt distributors were making good profits instead of passing on the savings to customers. Luxottica could cut out the middle man by distributing its own frames. The company signed its first fashion license deal in 1988. It started putting out Georgio Armani branded frames.

In the early 1990s, U.S. retail chains were importing a lot of frames from Asia. Del Vecchio was worried that this trend toward cheap Asian imports would erode the profitability of his business over time. So, he acquired LensCrafters. In 1994, LensCrafters had 650 stores doing $700 million in U.S. sales. Luxottica's wholesale revenue in North America was just $200 million. This was probably about 10% of the U.S. frame market. It was a huge deal for Luxottica. The acquisition was synergistic in the sense that Luxottica replaced competitor's products sold at LensCrafters with the company's own products. In 1995 – the year Luxottica bought LensCrafters – about 5% of that chain's sales came from Luxottica frames. By 1996, it was 43%. In 2002, it was 76%. And today, over 90% of LensCrafters's sales come from Luxottica products.

Luxottica has made other acquisitions in the U.S. In 1998, it bought Ray Ban from Bausch & Lomb. Bausch & Lomb was big in eye care rather than fashion. The Ray Ban brand was not a good fit with Bausch & Lomb. For example, Bausch & Lomb moved manufacturing of Ray Ban to countries like Mexico and China. Luxottica's frames are made in Italy. Frames made in Mexico and China fell apart much faster than frames made in Italy. But Bausch & Lomb was selling Ray Ban through a lot of retailers – including drug stores. The price tag was as low as $30. At those prices and sold through those outlets, Bausch & Lomb couldn't afford to produce Ray Ban frames to the same standards as Luxottica frames. Ray Ban was a better fit for Luxottica than it had been for Ray Ban. Luxottica completely overhauled the brand. In fact, Luxottica stopped selling Ray Ban for 18 months. It moved the production of Ray Bans to Italy. This improved the durability of the frames. And then Luxottica started raising the price of Ray Ban sunglasses dramatically. In 1999, a pair of Ray Bans could be bought for as low as $30 in a drug store. By 2000, Luxottica had taken the brand out of drug stores and raised the price to $80 a pair. In 2002, it was $90 a pair. By 2009, it was $130. Today, Ray Bans sell for about $150. Ray Ban is a huge brand for Luxottica. Today, the brand generates about 27% of Luxottica's companywide sales.

Part of the reason Ray Ban has been so successful is Sunglass Hut. Luxottica bought Sunglass Hut in 2001. Sunglass Hut was already the dominant seller of premium sunglasses in the U.S. when Luxottica bought it. Estimates are that Sunglass Hut had more than 50% of the total market for premium sunglasses. Premium sunglasses are a small percent of the total unit market for sunglasses in the U.S. However, they are a large percent of the total dollar market for sunglasses in the U.S. Luxottica owns Sunglass Hut which is the biggest retailer of premium sunglasses in the U.S. It also owns the two biggest premium sunglass brands in the U.S.: Ray Ban and Oakley. Luxottica bought Oakley in 2007. Oakley is the second biggest sunglasses brand in the world behind Ray Ban. Both are American companies originally. But both are owned by Luxottica and get plenty of sales through Luxottica's Sunglass Hut stores.

Luxottica also bought Cole National in 2004. This gave the company Pearle Vision stores as well as Sears Optical, Target Optical, and other "store within a store" locations. Luxottica's retail presence is strongest in the U.S. where it owns the number one optical retailer (LensCrafters), the number two optical retailer (Pearle Vision), and the number one sunglasses retailer (Sunglass Hut). The company owns a retailer (OPSM) with stores in the Pacific: Australia (481 stores), Hong Kong (80 stores), New Zealand (34), Singapore (12), and Malaysia (12). It also owns a Latin American retailer with 390 stores spread across Chile, Columbia, Ecuador, and Peru.

Luxottica has the licenses to far more fashion brands than any eyeglass frame maker. Licenses include: Prada, Armani, Brooks Brothers, Bulgari, Burberry, Chanel, Coach, Dolce & Gabbana, Versace, Tiffany, Ralph Lauren, Michael Kors, Tory Burch, and DKNY.

Luxottica does not have a big share of the total unit volume market for eyeglasses. However, it does have a big share of the premium eyewear market. Luxottica probably has about 80% of the U.S. market for premium eyewear.

Here's the revenue mix. Sunglasses are about 56% of sales and optical eyeglasses are 44%. Company owned brands are about 68% of sales while licensed brands are 32%. Geographically, the company skews very American and also more toward the developed world. North America is 58% of sales, Europe is 18%, Asia is 13%, and Latin America is 6%. So, the U.S. and Europe are more than 75% of total sales.

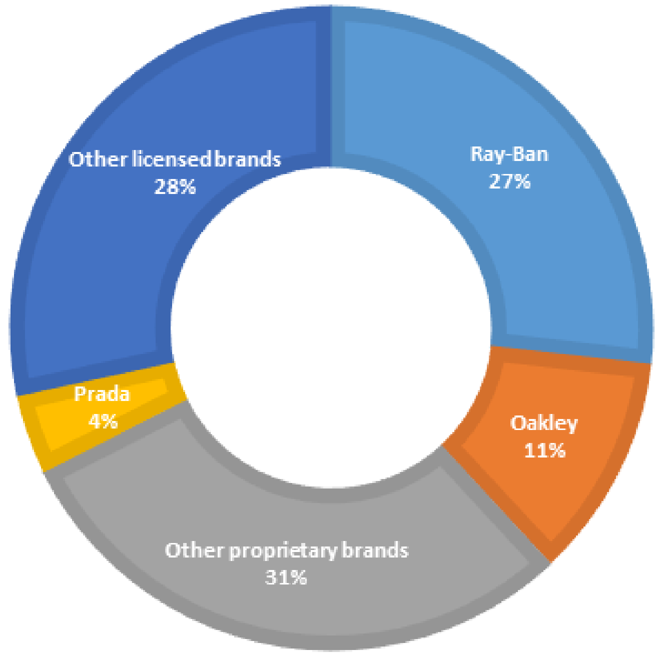
Quan and I consider Luxottica's four most important assets to be the sunglass brands Ray-Ban ($2.6 billion in sales), and Oakley ($1.1 billion in sales) plus the retail chains LensCrafters (over $2 billion in sales), and Sunglass Hut (also over $2 billion).

DURABILITY

Luxottica Depends Most on Ray-Ban, Oakley, Sunglass Hut, and LensCrafters

The biggest risk to the durability of Luxottica as a company is a decline in popularity of the Ray-Ban or Oakley brands. Ray-Ban accounts for 27% of Luxottica's sales. Oakley accounts for 11% of Luxottica's sales. The company's single biggest licensed brand is Prada. The non-renewal of the Prada license would cost Luxottica just 4% of its total sales. The combined sales of all of Luxottica's licensed brands adds up to a total of 32% of the company's sales. So, licensed brands are a big part of Luxottica's business. But, no single licensed brand is especially important. Even Prada at 4% of sales is really too small for us to spend time talking about. So, let's focus on Ray-Ban and Oakley.

Ray-Ban and Oakley are an especially big part of Luxottica's business in part because Luxottica owns Sunglass Hut. Companywide sales figures for Luxottica include both retail and wholesale revenue. So, for example, if Luxottica sales a pair of Prada branded frames to an independent eye doctor the company books that wholesale revenue as a sale. Imagine the eye doctor's office – which will sell the frames together with lenses to its patients – pays $80 for those glasses. Now, imagine the patient will actually pay $120 for the finished frames. In this case, Luxottica records only $80 as revenue. That's all Luxottica makes even though the frames will eventually sell for $120. Now, let's imagine a pair of Ray-Ban sunglasses that sell for the exact same $120. If those Ray-Bans are sold through a Sunglass Hut store – which Luxottica owns – then Luxottica will record the full $120 retail price of the sunglasses in its revenue. At first, it might seem like this skews the sales figures to make them less useful. In both cases, the part Luxottica supplied retails for the same amount. But, in the Ray-Ban example, Luxottica recorded more in sales. Did it really make more in profit? Almost certainly. The gross profit margin in optical eyeglass retail and in sunglasses retail is high. Each location does a fairly low amount of sales. But, all sellers mark-up the frames and lenses well above the price they pay for them. In cases where Luxottica only sells to a retailer – so it only makes a wholesale profit – Luxottica is making less money relative to the retail price of that product. It's also just making less money. On a unit basis, being vertically integrated leads to higher profits. This is because everything is in house. Using the $120 frames example, let's imagine it costs Luxottica $40 to make a pair of eyeglass frames it can then sell to a retailer for $80. The retailer then sells the eyeglass frame – often along with some other company's lenses – to a patient for $120. The patient either gets new frames for $120 or maybe new frames and new lenses – for example, a completely new prescription – for more like $240. But, Luxottica only makes $40. It only makes the wholesale profit. Now, consider those instances where Luxottica is vertically integrated along the chain of production and sale. Luxottica can make a Prada frame that costs it $40 and then sells that frame for $80 to an independent retailer. Or, Luxottica can choose instead to make a Prada frame that costs it $40 and then ship that frame to its LensCrafters stores. Competing stores will want to mark-up the Luxottica frames they buy for $80 to $120 at retail so they can make a solid profit. This means Luxottica can do the same. So, Luxottica can now match its competitor's retail price. It will also sell the frames for $120 at LensCrafters. But, now Luxottica is making an $80 profit on this pair of glasses. There is the $40 it makes as a wholesaler (as Luxottica). And then there is the $40 it makes as a retailer (as LensCrafters). This is how Luxottica manages to squeeze a lot of profit out of a fairly small unit share of the total eyeglass market. Obviously, Luxottica makes more money when it is so vertically integrated that it also owns the brand instead of licensing it. So, in our Prada example, Luxottica might have to pay 10% of the wholesale price (so $4 on a $40 sale) or 5% on the retail price (so $8 on an $80 sale) of a licensed brand. This is just an illustration. I don't know the exact terms of the Prada license. But, the royalty rate on a fashion brand would probably be in the 5% to 15% range. Let's call it 10% of the wholesale price for this illustration. So, let's compare three kinds of profitable transactions for Luxottica. Let's follow a pair of



Luxottica gets 69% of sales from its own brands of which Ray-Ban (27%) and Oakley (11%) are the biggest.

frames all the way through production and sale. Imagine an eyeglass frame made using the Prada brand. It might cost Luxottica $40 to make and retailers might be willing to pay $80 for it. But Prada would get a royalty. In this case, we'll assume it's 10% of the wholesale price. So, that's $8. In this case, the patient getting their new Prada frames at the doctor's office is willing to pay $120 for those frames. But, Luxottica only makes a $32 profit ($40 wholesale profit less $8 royalty). Prada makes the $8 royalty fee. And the eye doctor's office – or optical store of whatever kind – makes the $40 mark-up. So, the end customer may always be willing to pay $120 for frames. And Luxottica may always be able to physically make frames at a cost of $40 a pair. But, how that $80 profit pool ($120 retail price less $40 manufacturing cost) gets divvied up depends on who owns the brand name on the frame and who owns the store where the customer buys the frame. Luxottica can make a bigger profit selling these same Prada frames through its own LensCrafters stores. But, it could still only make a theoretical $72. That's because it can cut out the retailer. But, it can never cut out the brand owner when selling a licensed brand. However, Luxottica can cut absolutely everyone out when selling sunglasses. The two biggest sunglasses brands in the U.S. are Ray-Ban and Oakley. And the biggest retailer of sunglasses is Sunglass Hut. Luxottica owns Ray-Ban, Oakley, and Sunglass Hut. So, if it's possible that a customer would be willing to pay $120 for a pair of sunglasses with a manufacturing cost as low as $40 – Luxottica can keep that entire $80 gross profit for itself. Now, that is, of course a gross number. Sunglass Hut locations are expensive to rent. And Luxottica pays a lot for advertising. For example, you've seen Ray-Bans and Oakley sunglasses in movies. Luxottica paid for that product placement.

The brands Luxottica depends most on are Ray-Ban and Oakley. The retailers Luxottica depends must on are LensCrafters and Sunglass Hut. And the country Luxottica depends most on is the U.S. Overall, Luxottica gets 59% of its sales through the retail channel and 41% of sales through the wholesale channel. However, those are dollar figures – not unit figures. You can actually imagine given the higher prices at retail over wholesale – that Luxottica might be selling fairly similar amounts of physical product through its own retailers and through competitors. That's because – after mark-up – the 41% of sales that Luxottica gets from its wholesale channel would – at retail – actually be somewhat greater than what it generates through its own retail channel. Getting your head around that might be a little difficult. The simple point is this: Luxottica's worldwide production is – in actual units shipped – probably pretty evenly divided between shipments that go to Luxottica owned retailers and shipments that go to competing retailers. This is not true in the U.S. Luxottica gets 59% of worldwide revenue from its own stores. But, it gets 80% of U.S. revenue from its own stores.

What is Luxottica's single greatest concentration of product risk? It's Ray-Ban. Let me take you roughly through the degree of concentration here. Ray-Ban accounts for 27% of Luxottica's sales and possibly an even greater portion of Luxottica's profits. Ray-Ban's sales are 30% prescription eyeglasses and 70% sunglasses. That means Ray-Ban sunglasses alone account for 19% of Luxottica's sales. North America is about 60% of Luxottica's sales. So, the sale of Ray-Ban sunglasses in the U.S. is probably more than 11% of the company's profits. In other words, the sale of one type of product (sunglasses) under one brand (Ray-Bans) in one country (the U.S.) does contribute more than 10% of Luxottica's profits. So, there is some product, brand, and country concentration here. But, sunglasses and Ray-Bans and the U.S. have all proven to be pretty durable. Ray-Bans had a very bad period when Bausch & Lomb owned them before Luxottica improved the brand's image. But they were very popular before then. The sunglass market is long established in the U.S. And Ray-Ban, Oakley, and Sunglass Hut are the best known names in U.S. sunglasses. There is some risk that declines in U.S. mall traffic would harm Sunglass Hut directly and therefore Ray-Ban and Oakley as well. Luxottica owns all three. A lot of LensCrafters locations are also in malls. So, the fact that Luxottica gets 80% of its U.S. sales from some sort of retailer – Sunglass Hut, LensCrafters, and Pearle Vision especially – is the biggest risk to the company's durability. Luxottica could suffer somewhat from a decline in traffic to malls. Although this really should only affect Sunglass Hut. Purchases of prescription eyewear aren't tied to mall traffic trends. A decline in the popularity of Ray-Ban or Oakley would hurt Luxottica a lot. But, Luxottica controls those brands both in production and in retail. If the brands decline in popularity, it would have to be a self-inflicted wound. Luxottica has more complete control over those brands than almost any other brand owner in the world. Luxottica isn't just the producer of those brands. It's also often the retailer.

MOAT

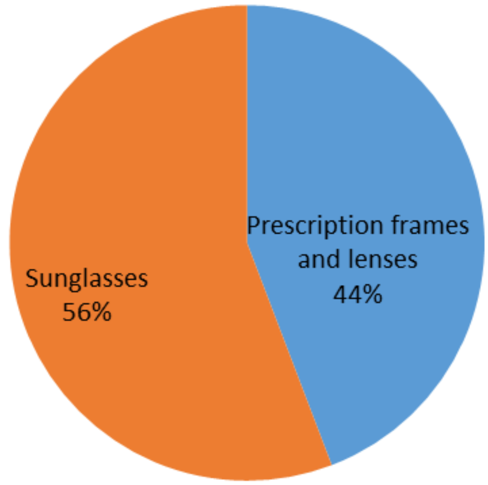
Luxottica's Moat is Widest in the United States and in Sunglasses

Luxottica's moat is wider in sunglasses than it is in prescription eyeglasses. Luxottica owns the biggest sunglasses retailer (Sunglass Hut) and the two biggest sunglasses brands (Ray-Ban and Oakley). Luxottica's position in the prescription eyeglasses industry is not as dominant. Prescription eyeglasses account for 44% of Luxottica's sales.

Luxottica doesn't make optical lenses. It only makes frames. And then it sells lenses through retailers like LensCrafters. Luxottica can supply its LensCrafters stores with frames. But it can't supply these stores with lenses. It has to get its lenses mostly from big lens makers like Essilor, Hoya, and Carl Zeiss. Essilor is the world's largest maker of optical lenses with a 41% global market share. Hoya is number two with a 20% market share. Zeiss is third with an 8% market share. So, these three companies control roughly 70% of the worldwide market for optical lenses. Luxottica provided some useful information about its dependence on Essilor in past annual reports. The most useful data is for the period from 2010 through 2013. Luxottica's percentage of retail lens merchandise that was bought from Essilor was 26% (in 2010), 25% (2011), 31% (2012), and 31% (2013). So, Luxottica was getting about 25% to 30% of its lenses from Essilor during those four years. There is no reason to believe the situation is much different today. Essilor has about 40% market share globally. Luxottica seemed to be buying no more than about 30% of its lens needs from Essilor. From these numbers, we can assume that Luxottica does not concentrate its lens buying with Essilor beyond what the lens retail industry as a whole does. But, Luxottica does not seem to do much to avoid depending on Essilor. So, Essilor has some market power. But it's limited.

Essilor is much larger than its competitors. The company estimates – in its own investor presentation – that it accounts for 75% of the entire optical lens industry's R&D. Quan and I believe this figure. There are reliable lists of the number of labs each company has in the U.S. Essilor's lab network is many, many times the size of its nearest competitors. And there have to be economies of scale when it comes to R&D. Very small networks can't possibly spend much of anything on R&D. In fact, Zeiss may benefit from work in related fields. Carl Zeiss makes lenses for a variety of other industries. Zeiss lenses are found in space telescopes, movie cameras, and cell phones. The company's work in related fields may spill over into applications in optical lenses. So, it's possible another company that was the size of just Zeiss's prescription eyewear lens business – but lacked Zeiss's other business segments – wouldn't be able to compete effectively. It's very possible that Luxottica buys its lenses much the way other retailers do. If that's true, we'd expect Luxottica to have the least bargaining power when buying lenses for its prescription eyewear retail business. We shouldn't assume Luxottica can get especially good prices for lenses despite its large size. Luxottica may have much greater market share relative to other retail chains. However, when it comes to lenses, Luxottica's size relative to Essilor is poor. Luxottica needs to get 30% or more of its lenses from Essilor. Essilor's doesn't necessarily need to sell 30% or more of its lenses to Luxottica.

I need to stop now to discuss a possible Essilor and Luxottica merger. This was rumored. And apparently Essilor approached Luxottica looking for a deal. In the end, Luxottica didn't want to do a deal. Several explanations have been given. One explanation is a lack of synergies. But, this isn't believable. There would probably be long-term revenue synergies from an Essilor and Luxottica deal. Luxottica has been able to increase the price it gets on prescription eyewear frames a bit over time. And it's been very successful passing on price increases on sunglasses. Luxottica controls the largest prescription eyewear chains in the U.S. (LensCrafters and Pearle Vision) and the largest sunglasses chain in the U.S. (Sunglass Hut). It also holds the best licenses in the industry. Luxottica is focused on premium eyewear. And its sales mix is 80% retail and 20% wholesale in the U.S. Essilor is very strong in lenses. The company has good relative size and technology. But Essilor has a hard time getting the end customer – the actual eyeglass wearer – to care enough about lenses to pay up. Luxottica would be in a position – with in store advertising, for example – to push certain higher priced lenses. Essilor's biggest problem is that it isn't close enough to the end customer. Luxottica's biggest problem is that it doesn't own a lens business. A pair of premium frames and lenses are often bought together in the same store. Luxottica and Essilor would be a good fit. A more likely explanation for why Luxottica decided not to do a deal is simply price and dilution. Leonardo Del Vecchio controls Luxottica. He has both a huge voting stake and a huge economic stake in the company. There are no plans for Del Vecchio's children to take over running the business. But there are plans for them to continue collecting dividends. When he dies, they will be very rich. Essilor is a big company. Del Vecchio might have to dilute his ownership in Luxottica quite a bit to take over Essilor. That's the explanation that makes more sense to me.



Luxottica gets 56% of its revenue from sunglasses. Luxottica owns Ray-Ban, Oakley, and Sunglass Hut.

Enough about Essilor. Luxottica and Essilor have no plans to merge. And Luxottica has a strong market position even without Essilor. But, that position is quite different depending on country and product category. Luxottica is mostly a retail company in the U.S. (80% retail and 20% wholesale). In Europe, the situation is reversed. Luxottica gets 84% of its European sales from its wholesale business. In Asia, Luxottica gets 56% of sales from retail. In Latin America, it's 36%. So, the only places where Luxottica gets a majority of sales from its owns stores is in the U.S. and in Asia. It's important to note that Luxottica's retail business is very vertically integrated. About 89% of the revenue generated by Luxottica stores is attributable to Luxottica produced products. So, if we take 59% of sales as being retail and multiply that by 0.89 we see that 53% of Luxottica's revenue is what I'd call fully vertically integrated. About 53% of sales are from a Luxottica product sold in a Luxottica store. For example, a pair of Oakley sunglasses sold in a Sunglass Hut would qualify.

Luxottica's licensing moat is very, very wide. We've talked about the licensing moat with Fossil and Movado. So, we won't focus on it too much here. The basic concept is that there are economies of scale in a business like designing and distributing watches or eyeglass frames. The company that starts out in the most stores, with the most designers, etc. often gets the biggest licenses first. This then opens more doors and spreads overhead across more unit sales. The fashion brand that wants to license its product often just wants to generate the most sales. So, each licensor is in a similar position. They will tend to prefer the same licensee. And that licensee is simply whoever has the best and biggest licenses already. Contracts exacerbate this situation. Contracts tend to run for 5 to 10 years. And there are switching costs – often a year of very poor sales – for both the licensor and licensee when they switch partners. Over the years, Luxottica has managed to steal a few licensed brands from competitors. In 2014, Donna Karen left Marchon for Luxottica. This was a 70 million Euro a year business. Dolce & Gabbana left Marchon for Luxottica in 2005. That was a 75 million Euro business. It was also 48% of Marchon's total sales at the time. Why did Dolce & Gabbana make the move? Well, Luxottica was able to grow the business from 75 million Euros in the year Dolce left Marchon to 120 million Euros in the first full year with Luxottica. In 2006, Ralph Lauren left Safilo for Luxottica. Ralph Lauren was 10% of Safilo's sales at the time. Armani also left Safilo for Luxottica. That happened in 2012. In both the Ralph Lauren and Armani cases, Luxottica hoped to increase sales by 30% to 50% within a year or so of the switch. This is probably why the switch was made. The licensor hoped for greater sales. Coach left Marchon for Luxottica in 2011. And then this year, Valentino left Marchon for Luxottica. As a result of these switches, Luxottica is in somewhat better financial shape than the competition. For example, Luxottica's biggest licensed brand is just 4% of its total sales. So, the loss of any one contract has little impact on Luxottica's profits. Some competitors have been hurt badly when they lost a license. The last time Luxottica lost a major license was in 2002. Armani was 10% of Luxottica's wholesale revenue in that year. Armani switched from Luxottica to Safilo (Luxottica's closest competitor) in 2002. But then Armani switched back to Luxottica in 2013. Luxottica has two advantages over competitors when fighting for licenses. One, Luxottica can pay an upfront royalty when first winning a contract because it is in better financial shape than some competitors. And then two, Luxottica simply has higher EBIT margins on the same level of sales. A single licensor only cares about the absolute royalties that the deal will generate. They don't actually care about the royalty rate itself. So, if Luxottica says it can generate $130 million in sales and pay a 10% royalty rate while Safilo says it can generate $100 million in sales and pay a 13% royalty rate – there's really no difference between the two offers. As we've seen, licensors often switch because they think they can get 30% to 50% higher sales with Luxottica than with the nearest competitor. That means the nearest competitor would need to offer 30% to 50% higher royalty rates to generate the same dollar amount of royalties. This just isn't economical. For example, Luxottica has a 16% companywide EBIT margin right now. That sounds good. But Luxottica's wholesale business is even better. Luxottica's wholesale EBT margin is 22%. Safilo's companywide EBIT margin is 6%. Could Safilo offer higher royalty rates than Luxottica? It would be easy to do if Safilo had a lot more licenses. It's easy for a company with a lot of licenses to aggressively bid for an incremental license because they already have the infrastructure in place to service the other licenses they own. It's a lot cheaper and more economical to add a seventh licensed brand to your portfolio than it is to add the first ever licensed brand to your portfolio.

Let's sum up Luxottica's moat by product area and geography. The moat is widest in sunglasses and in the U.S. The moat is also wide in the licensed business. However, the moat narrows when we are talking just prescription eyeglass frames in places like Europe where Luxottica has little retail presence. Luxottica is vertically integrated in sunglasses and in eyeglass frames. However, Luxottica is not perfectly vertically integrated. Luxottica's stores have their frames needs filled by Luxottica. But, they still need to buy their lenses from other companies. Essilor is a key supplier of lenses. It's important to clear up two misconceptions people have about Luxottica. One, Luxottica is an eyeglass frame company only. It doesn't make lenses. And two, Luxottica is actually more of a sunglasses company than an eyeglasses company. Luxottica's most dominant retail asset is Sunglass Hut. Sunglass Hut has far more than 50% of the premium sunglass market. Premium sunglasses are those costing more than $50. Sunglass Hut generally focuses on pairs that retail for $100 or more. And, of course, Ray-Ban and Oakley are the world's biggest sunglass brands. Luxottica's moat is widest in sunglasses. Sunglasses account for 56% of Luxottica's total sales. The company has scale advantages in licensing. And it controls the biggest chains in the U.S. for the retail of eyeglasses. It's hard to say if Luxottica has much if any moat when you are talking about things like non-licensed brand prescription sunglasses in other parts of the world. But, frankly, that's a small part of Luxottica's business. Over 50% of Luxottica's business is sunglasses. Over 50% of Luxottica's business is the sale of a Luxottica product in a Luxottica store. And over 50% of Luxottica's business is in the U.S. Luxottica's strength are sunglasses, vertical integration, and its retail position in the U.S. Those parts of the business definitely have a wide moat. Meanwhile, Luxottica's market power is weakest when it has to bargain for needed lens supplies from someone like Essilor. That is an unusual situation though. In almost all other cases, Luxottica's relative size is much bigger than both its competitors and its suppliers.

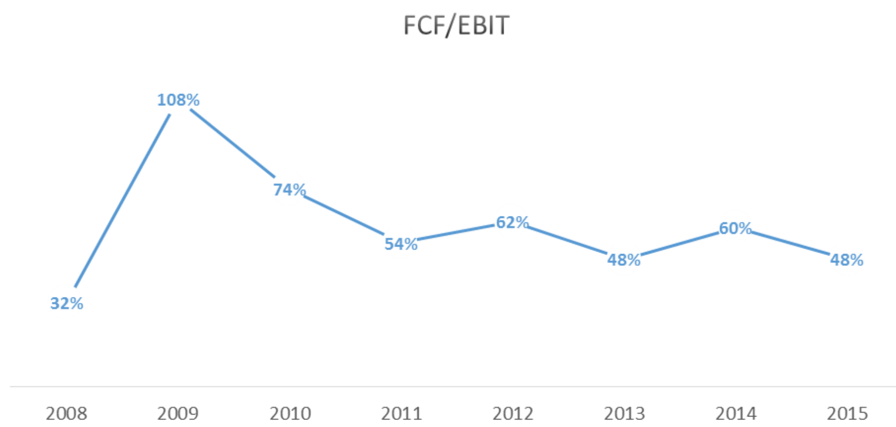
QUALITY

Luxottica Can Convert 90% of its Earnings into Free Cash Flow – Even While Growing 5% a Year

From 2008 through today, Luxottica converted 58 cents of every dollar of EBIT into free cash flow. This is the equivalent of a company with a 35% tax rate converting 90% of reported after-tax earnings into free cash flow. Luxottica was also paying interest during this time. And it was growing its sales at rates above nominal GDP growth. In the future, when Luxottica has no debt left and grows at a slower rate – it will convert more than 90% of reported earnings into free cash flow. It is very rare for a growing company to be able to pay out anywhere near 90 cents in dividends for each dollar it reports in earnings. Luxottica has a rare business model. That is why it deserves such a high P/E ratio. Because a high P/E ratio does not necessarily mean a high price-to-free cash flow ratio for Luxottica.

If Luxottica is able to grow comparable store sales, it should be able to grow its earnings per share faster than its overall corporate sales. From 2011 through 2015, Luxottica grew its earnings about twice as fast as its sales. Most of Luxottica's stores are small. Small stores have significant fixed costs as a percent of sales. So, additional sales at the same location are especially effective in increasing earnings faster than sales. The best illustration of this is Sunglass Hut. The average Sunglass Hut store is between 750 to 800 square feet. Between 70% and 80% of Sunglass Hut stores use a single person shift. There is only one employee at the store at any one time. This means that rent for the 750 to 800 square foot high traffic location – often in a mall – and the salary of the salesperson manning the store is fixed. The profitability of that store is going to depend on how much unit volume it does. So, the sale of an additional pair of sunglasses each day at that store would be very effective in increasing Luxottica's earnings faster than its sales.

Sunglass Hut is the most extreme example of a high fixed cost small format retail store. However, all of Luxottica's stores are pretty small. And the merchandise they are selling has pretty high gross margins. This is different from how more general retailers work. For example, a supermarket like Village – which runs Shop-Rites in New Jersey – might have a gross margin around 30% and fixed costs around 25% of sales. Luxottica's retail stores are a lot more like a restaurant. A restaurant would tend to double those numbers. Its gross margin could be closer to 60% on an additional meal sold. But, its fixed costs could be awfully close to 50% of all of its sales. So, a restaurant that is only a quarter full on average will go out of business quickly. A restaurant that is half full may break even. But a restaurant that is full three-quarters of the time could actually be very, very profitable. The difference isn't price. It's volume. A small format retail store selling high gross margin goods like eyeglass frames works the same way. In the specific case of Luxottica, there is also the added benefit of vertical integration. In a sense, each additional sale of a pair of frames at a LensCrafters or sale of a pair of sunglasses at Sunglass Hut counts double for Luxottica. It's an added retail sale. So, the store economics improve. But, it's also an added unit of production. So, the economics of the wholesale part of Luxottica that makes and distributes frames also improves. This wouldn't be true if Luxottica simply owned retail stores and factories. It is only true because Luxottica's retail stores are focused on selling Luxottica's own goods. In the U.S., Luxottica's retail operation generates just under 90% of its sales from Luxottica's own products. So, about 90% of the benefit to the stores also flows through the manufacturing business.



Over the last 8 years, Luxottica converted 58% of earnings before interest and taxes (EBIT) into free cash flow (FCF).

Like I said, all of Luxottica's stores are pretty small. The smallest is Sunglass Hut. It averages 750 to 800 square feet. Each store has one employee per shift. Sears Optical is 1,000 to 1,200 square feet. It has 2 to 3 employees per shift. Pearle Vision ranges from 1,000 to 3,000 square feet. It has 3 to 5 employees per shift. And, finally, LensCrafters stores average 4,000 to 4,500 square feet. They have 5 employees per shift. We can do some rough estimates of the actual unit volume of a typical store for both Sunglass Hut and LensCrafters. These are the two most important chains in Luxottica's retail empire. The average Sunglass Hut does $740,000 in sales a year. The average pair of sunglasses sold at a Sunglass Hut is priced at $150. So, that means a Sunglass Hut sells less than 5,000 frames a year. That's 417 a month or 96 a week or 14 a day. The average LensCrafters location does $2 million a year in sales. The average frame goes for $300. So, LensCrafters sells 6,667 frames per store per year. That works out to 555 pairs a month or 128 a week or 18 a day. These are really low unit volumes for a retail store. But the gross margin on these sales is high. And the EBIT margin is also high at the current sales levels.

Let's take a look at EBIT margin. Rent is 11% of sales. Depreciation is 4% of sales. So, occupancy is pretty much 15% of sales. That's the fixed cost of the location. Our best guess is that staff costs might be 25% to 30% of sales. Even if you assume staff costs are as low as 25% of sales, you see that labor plus location is 40% of sales. And this is essentially the fixed requirement to run a location that size. You need the square footage no matter what sales volume you are doing. And you need the requisite number of employees to cover that amount of square footage each shift. There may be some slight variability to labor. But, it's got to be very, very slight. Obviously, Sunglass Hut is fixed at one employee most of the time. And all stores need a base one employee plus an extra employee for every so much increase in square footage. You can't have one employee covering a 5,000 square foot store. So, Luxottica's profitability in the retail part of the business depends on comparable stores. Luxottica controls the brands it sells both at wholesale and at retail. So, it should have no problem with pricing. The real question is volume. So, can Luxottica eke out any same store unit sales growth? If it can, earnings in retail will grow faster than sales.

Wholesale is different. It depends on two factors. One is scale. The other is price. Luxottica has economies of scale in its manufacturing. Luxottica centralizes most manufacturing in Italy. So, there is no problem there. And it has economies of scale in its licensing business. But, you need economies of scale to enter a geographic market as well. You can't enter a country with just one brand. So all of your brands share some infrastructure in terms of the supply chain and marketing in a country. This is true of the watchmakers we've discussed in past issues like Swatch, Fossil, and Movado. The initial entry into a country where you hadn't been doing much business before is unlikely to be very profitable at all. However, additional sales in a mature, vertically integrated country like the U.S. would cause a much greater percent growth in profit than in sales. It's possible a 1% increase in U.S. comparable sales could cause a 2% increase in corporate profit. Growth achieved by simply entering a totally new country would not have this same benefit. Because you have to invest in the supply chain, the marketing, etc. and you start out with low levels of sales relative to that infrastructure. So, expense growth is high even if sales growth is high.

Luxottica is actually a lot like Swatch. Gross margin is very high. Right now, it's 68%. That's amazing for a company that has a lot of stores. In recent years, the rule of thumb has been that Luxottica can grow profit in the low double-digits if it grows sales in the mid -single-digits. In 2011, sales were up 7% and EBIT up 12%. In 2012, sales were up 7% and EBIT up 15%. In 2013, sales grew 8% while EBIT grew 16%. In 2014, it was sales up 7% and EBIT up 14%. And last year, sales growth was 6% while EBIT growth was 11%. So, the recent pattern has been predictable. But, sales growth has been awfully stable. So, this could be misleading. You shouldn't assume that at nearly no sales growth the operating leverage would look as good. A 1% sales gain wouldn't necessarily cause a 2% profit gain. The better assumption is that if Luxottica can always grow sales at say 6% or better in constant currency terms – it would have a real shot at 10% growth in earnings per share.

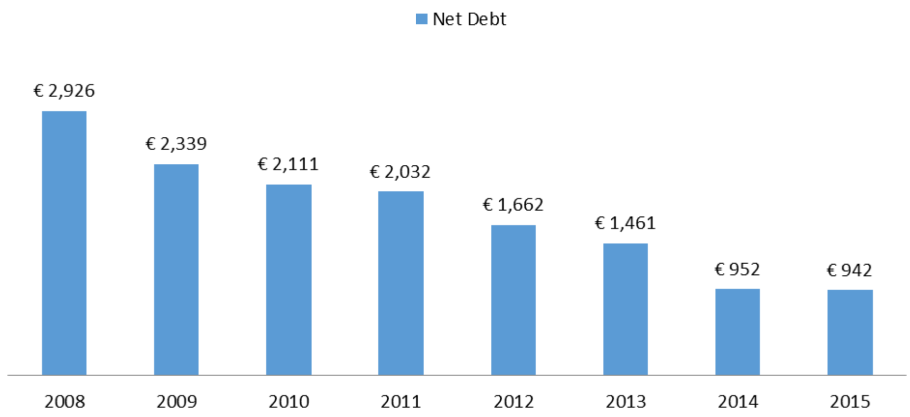
We know the economics of a model store for some of Luxottica's chains. So, we can calculate return on invested capital. At the store level, a Sunglass Hut has better than 75% pre-tax return on capital. A LensCrafters also has better than a 75% return on capital. Our estimate of overall pre-tax return on capital at Luxottica is 85%. That means the business has a return on tangible equity of greater than 50% even after taxes. This is a very high quality business. And, it's even better on a cash basis than an accrual basis. Most companies generate quite a bit less free cash flow than they report in earnings. From 2000 through 2015, Luxottica actually generated 3% more free cash flow than it reported in income. In other words, each dollar of EPS turned into $1.03 of free cash flow. It's very safe to treat Luxottica's reported EPS as if it was actual cash that could be used to pay dividends. Luxottica does retain some earnings. It doesn't have a 100% dividend payout. But this is due to acquisitions. Luxottica can use its earnings to pay down what little debt the company still has left and it could use cash to make acquisitions in the future. But, if the company is as successful managing its working capital over the next 15 years as it was over the last 15 years – it could actually grow organically at say 5% a year while paying out every last cent of its earnings in dividends. In fact, this is why Quan and I think Luxottica is actually not prohibitively expensive despite its high P/E ratio. Earnings aren't what matters. And dividends aren't what matters. What matters is the dividends a company could pay if it chose to. Historically, an average stock often grew sales (and dividends) at 5% to 6% a year while trading at about 35 times dividends. Since Luxottica can theoretically pay out all its earnings as dividends while growing 5% to 6% a year, it would be fairly valued even at roughly 35 times earnings. That's a shocking claim. But Luxottica's history backs it up. You can look at the company's long-term record. And you can see that it has grown while only using free cash flow to make acquisitions. Organic growth has not actually required the use of shareholder money. There is one huge caveat here. Luxottica has done a terrific job improving working capital management. That's an organizational trait. Market power certainly helps create the potential to collect payments faster and pay bills later. But market power alone doesn't lead to lower levels of working capital. The organization – from top management on down – has to be focused on pressing that advantage. It has to want to tie up less shareholder money in receivables, inventory, etc. Since Leonardo Del Vecchio has a huge economic interest in Luxottica and has directed the company in some way from its start – it's natural for the organization to have this drive now. Many years down the road, when the company is run by professional managers with little stake as shareholders – the situation may be different. Luxottica has the potential to turn all of its earnings into free cash flow. But, that's not a given. It's something the organization has to work for. So, as a Luxottica shareholder, you want to look for signs of continued managerial vigilance when it comes to working capital. The efficient conversion of reported earnings into actual free cash flow is an important part of the investment case at Luxottica.

CAPITAL ALLOCATION

Luxottica Will Pay Down Debt, Make Acquisitions, and Then Just Distribute the Rest of its Earnings as Dividends

Since 2008, Luxottica has put about 250 million Euros a year toward debt reduction. That is about 0.52 Euros per share. In the future, Luxottica will stop paying down debt. That should free up about half a Euro per share in additional dividends. Luxottica can grow earnings faster than sales and it can grow dividends faster than earnings. So, the company is capable of high dividend per share growth on only moderate sales growth. In fact, Quan and I expect Luxottica to raise its dividends at a double digit percentage growth rate while only growing sales at a single digit percentage growth rate.

It's hard to predict exactly how Luxottica will end up allocating its capital while you own the stock. Del Vecchio has transformed his company in the past through acquisitions. And he could do so again in the future. He has said that he wants Luxottica to "(get) into as much direct contact as possible with the market." And this has been the trend Luxottica has followed. It started far from the end user. Luxottica began life in 1961 as a maker of parts for eyeglass frames. It supplied companies like Safilo. By 1971, Luxottica had moved closer to the end user of the glasses by making the frames themselves not just the parts. Luxottica then moved from just being a producer of frames to also distributing its own frames. Again this moved the company further downstream – closer to the final customer. In the 1990s, some retail chains were importing cheap frames from Asia instead of buying from Italian frame makers like Luxottica. So, Luxottica moved even further downstream through the acquisition of the LensCrafters chain. Not all of these moves were popular when Luxottica made them. Luxottica started by supplying parts to companies it then ended up in competition with. Luxottica had a wholesale business when it bought LensCrafters. The customers it sold these wholesale frames to were opticians, ophthalmologists, and optometrists. Luxottica's competitors encouraged these independent retailers to stop carrying Luxottica's frames in their stores, because otherwise they'd be paying money to the competition. Luxottica's acquisition of LensCrafters was very successful in getting greater visibility for Luxottica frames. Before Luxottica bought LensCrafters, that chain sold 95% non-Luxottica products. Today, it gets just 10% of its sales from suppliers other than Luxottica. The LensCrafters acquisition was a huge success for Luxottica. Luxottica got LensCrafters by buying all of U.S. Shoe for $1.4 billion. It then sold the footwear business to Nine West for $600 million. So, Luxottica's net price paid for LensCrafters was just $800 million. Today, LensCrafters generates over $300 million in pre-tax profit for Luxottica while also buying a lot of Luxottica products. This acquisition



Over the last 8 years, Luxottica reduced debt by 2 billion Euros.

increased Luxottica's market power and its profits in the U.S. It was a good strategic move.

Another good acquisition was the purchase of Ray-Ban. Luxottica bought Ray-Ban in 1998 from Bausch & Lomb. The original purchase price was $655 million. However, Bausch & Lomb eventually settled a dispute over this deal by paying Luxottica $42 million. So, the net purchase price was just $613 million. Today, Ray-Ban produces pre-tax profits of more than $500 million a year for Luxottica. It is also an important part of the product selection at Luxottica's Sunglass Hut. So, again this vertical integration of the wholesale and retail business provided Luxottica with both more profits and more market power. It is easier for Luxottica to enter new markets with Sunglass Hut because it owns Ray-Bans and it is easier to enter new markets with Ray-Ban because it owns Sunglass Hut.

Luxottica also acquired Sunglass Hut. You may have noticed a pattern here. Luxottica doesn't build businesses. It buys them. The company has really never created great new brands. It has simply bought existing brands that had once been great and revived those brands. Sunglass Hut was already the dominant retailer of premium sunglasses when Luxottica bought the company. As soon as Luxottica made the acquisition, it demanded price cuts from Sunglass Hut's top ten suppliers. Nine of the ten accepted these new terms. Oakley refused the terms. At the time, Oakley accounted for 25% of Sunglass Hut's sales. Oakley wanted to negotiate a compromise. Luxottica didn't. It simply cut orders from Oakley. Sunglass Hut was a huge buyer for Oakley. So, the company – which was then publicly traded – had to announce it would miss its earnings projections. The stock dropped 37% on this news. Only after Oakley's management had seen its stock drop did Luxottica work out a deal with the company. Luxottica got better pricing. Oakley got guaranteed minimum quantities. Six years later, Luxottica would go on to buy Oakley. Luxottica did the same thing at Sunglass Hut that it did at LensCrafters. In 2001 – before Luxottica bought Sunglass Hut – Luxottica's products made up just 14% of sales at Sunglass Hut. Luxottica wasn't even the biggest supplier to Sunglass Hut. Oakley was. Oakley accounted for 25% of sales to Sunglass Hut. But, by 2002, this number rose to 35% of sales as Luxottica cut its purchases from Oakley. Now that Luxottica owns Oakley, it has managed to squeeze out most other suppliers to Sunglass Hut and provides most of the product itself. Today, about 90% of all sales at Sunglass Hut come from Luxottica products. At LensCrafters, that same figure is also 90%. The biggest sunglass retailer in the U.S. is Sunglass Hut. And the biggest prescription eyewear retailer in the U.S. is LensCrafters. Both get 90% of their sales from Luxottica products. And that's only true because Luxottica bought those retail chains and then truly integrated them into the parent company. Luxottica practices real vertical integration. Think about Sunglass Hut. In 2001, Luxottica products accounted for under 15% of that chain's sales. And Oakley accounted for 25% of the chain's sales. Logically, the combination of Luxottica – which already owned Ray-Ban – and Oakley should add up to only 40% of Sunglass Hut sales. But, today, Sunglass Hut is 90% Luxottica products. That's the difference between acquiring a retail chain and actually integrating the retail chain into your operations. Luxottica's acquisitions don't just work because Luxottica is a good investor that pays a fair price for a chain or a brand that would be successful on its own. Luxottica's acquisitions have worked because Luxottica is good at integrating those acquisitions. What we are talking about here isn't a series of successful acquisitions – it's a serious of successful integrations.

In 2007, Luxottica bought Oakley. The company paid 11 times Oakley's expected EBITDA for 2008. That's not an especially cheap price. But, Luxottica did expect the price would be less than 7 times EBITDA after it realized the planned synergies on the deal. This deal worked out in large part because Oakley continued to grow under Luxottica's ownership. Oakley has had double-digit revenue growth in most years since that acquisition. Today, Oakley contributes over $240 million in EBIT. The original purchase price – in 2007 – was $2.25 billion. And Luxottica financed the deal with debt. It has since paid down most of that debt. Especially considering the cheap cost of borrowing from 2007 through 2015 – this worked out as a good deal financially. Again, it also improved Luxottica's market power. After the Oakley deal, Luxottica owned Sunglass Hut, Ray-Ban, and Oakley. That's a powerful combination. It is easy to enter new markets when you have the best sunglass retailer in the world and the two best sunglass brands in the world all under one corporate umbrella.

The acquisitions we've discussed so far – LensCrafters (technically, U.S. Shoe), Ray-Ban, Sunglass Hut, and Oakley – were all indisputable successes for Luxottica. There have been some deals which are much more of a mixed bag. In 2003, Luxottica bought Cole National. The purchase price was 660 million Euros but Luxottica then unloaded 20% of Pearle Vision Europe and all of "Things Remembered". This reduced the effective purchase price to under 360 million Euros. For that 360 million Euros, Luxottica got Pearle Vision, Sears Optical, Target Optical, and BJ Optical. Some of these failed. Others succeeded. Luxottica closed BJ Optical. And Sears Optical dwindled to essentially nothing along with the host stores of that chain. Pearle Vision's footprint shrank. Luxottica at one time owned 470 Pearle Vision stores and franchised another 405. This was in 2007. Today, Luxottica franchises 420 Pearle Vision stores. But, it only owns 112. This sounds like a failure. But, Luxottica greatly improved the profitably of these stores. The EBIT margin was less than 3% when Luxottica bought Pearle Vision. It expanded to more than 10% under Luxottica's ownership. The company also thinks there is room for growth using this Cole National acquisition. Today, there are 389 Target Optical stores. Luxottica plans to bring that number to 1,000. Luxottica also believes it can triple the number of Pearle Vision franchisees over the next 5 to 10 years. Assume both of these things are true. And that it will take 10 years. That would be about 600 more Target Optical stores and 800 more Pearle Vision franchises opened over 10 years. That kind of growth would require opening between two and three stores a week for a decade. This is completely speculative. But, Luxottica thinks there is still room for growth in that Cole National acquisition that gave them Pearle Vision.

Luxottica's presence in Asia is from its acquisition of OPSM. When Luxottica bought it, OPSM had 481 stores in Australia, 80 in Hong Kong, 32 in New Zealand, 12 in Singapore, and 12 in Malaysia. Before the acquisition, OPSM got 5% of its frames from Luxottica. Today, OPSM gets 89% of its frames from Luxottica. In 2003, the price paid was about 8 times expected 2004 EBITDA. Again, not an especially cheap price. But a fair one even before synergies. Some stores were closed since the financial crisis. It's unclear if Luxottica got an adequate financial return from this deal. The additional sales of its frames may have made that possible.

Luxottica's presence in Latin America is also based on an acquisition. It bought Multiopticas International in 2009. This gave Luxottica 390 stores in Chile, Peru, Ecuador, and Columbia. There have been 3 or 4 other acquisitions over the years. Almost all of them were of retailers in a specific country or group of countries. The deals were pretty small. One exception – because it's a brand not a retailer – is Alain Mikli. This is a luxury sunglass brand. It is sold through Sunglass Hut. So, this is an example of vertical integration.

Quan and I don't expect Luxottica to do any big deals. The last big purchase was the Oakley deal. We can't promise Luxottica won't do a big deal. But, Luxottica had the chance to buy Essilor. Essilor is the world's biggest optical lens manufacturer. It has around 40% market share worldwide. It probably has around a 30% share in Luxottica's own stores. We think Luxottica gets about 30% of its lenses from Essilor. In 2013, Essilor's CEO approached Luxottica with the possibility of a merger. Luxottica broke off talks after a few months. Essilor wanted better access to consumers. Luxottica saw little benefit in a deal.

So, what will Luxottica do if it stops all this merging? The dividend payout ratio is 50%. Since 2007, Luxottica has had cumulative earnings per share of 8.59 Euros and paid cumulative dividends of 4.66 Euros. That works out to 54%. So, let's call the dividend payout ratio 50% or more. However, Luxottica reduced debt from 2.85 billion Euros in 2007 to 940 million Euros today. Obviously, you can only do that once. At this rate, Luxottica will have no debt in a couple years. Luxottica has no need to retain earnings to grow EPS. As we discussed, Luxottica may be able to grow EPS as much as 10% a year while growing sales by 6% a year. At sales growth of 6% a year, Luxottica could theoretically pay out essentially all of its earnings in dividends. In fact, cumulative free cash flow – excluding the amount used on acquisitions – has exceeded reported EPS over the last 15 years. This 100% or better conversion rate of earnings into free cash flow was made possible by continual working capital improvement. That might not happen in the future. However, Luxottica should – even without any reduction in net working capital relative to sales – be able to support 6% sales growth while retaining just 10% of its reported earnings. In other words, Luxottica can grow sales by up to 6% a year while paying dividends of up to 90% of reported earnings. Take last year as an example. Luxottica earned 1.67 Euros per share. It paid a 0.72 Euro ordinary dividend and a 0.72 extraordinary dividend. That adds up to 1.44 Euros per share. Divide 1.44 in dividends into 1.67 in reported earnings. You get an 86% dividend payout ratio. Net debt declined from 952 million Euros to 942 million Euros. And sales grew and earnings grew. If you pay out 86% of earnings in dividends, grow at roughly double digits, and decrease net debt during the year – that means you can pay out almost all of earnings even while growing. So, capital allocation is an important part of the investment case at Luxottica. Basically, the number you see in EPS each year is the number the company needs to allocate on your behalf. Historically, they've done acquisitions – and done them well – whenever they've seen a good vertical integration opportunity. Whatever they haven't spent on acquisitions they've simply paid out in dividends. Quan and I expect that to continue. I'm not sure we've ever written about a company that's as good at doing acquisitions as Luxottica has been. The founder is still the Chairman here. We have no reason to doubt any future acquisitions will have a decent chance of creating value. There's no reason to prefer we – as shareholders – receive dividends instead of having Luxottica do a deal Del Vecchio thinks makes sense. And there's no reason to believe that any money Luxottica doesn't spend on acquisitions will end up being hoarded. It won't. They'll pay it out in dividends. So, capital allocation at Luxottica is a matter of either acquisitions that we can't predict ahead of time – or just dividends. The dividends we can predict. In the long-run, you'll tend to collect dividends that are roughly equal to EPS minus the amount spent on acquisitions. It's as simple as that. So, if there are no acquisitions while you own the stock – you'll end up getting all the company earns paid out to you in dividends. Right now, the regular payout ratio is around 50% of earnings. But, the company will either have to pay special dividends or it'll end up with net cash in just a couple years. We don't expect Luxottica to keep a meaningful net cash position. So, I think you'll end up getting paid a lot more in dividends while you own this stock than the current dividend yield suggests. This doesn't look like a high yield stock. But, in reality, if you see Luxottica trading at a P/E of 20 to 25 – that could mean you'll get an average dividend yield of around 4% through a combination of ordinary and special dividends. With Luxottica, it's totally fair to value the company as if earnings simply were dividends. That's how Quan and I look at this stock. We've thought of very few other stocks – like Wiley and Omnicom – that way. But, Luxottica will either do deals that preserve or create value or they'll just distribute the earnings as dividends. So, at Luxottica – earnings are functionally equivalent to dividends in terms of the value you'll receive.

VALUE

Luxottica has a High Price to Earnings Ratio – But a Reasonable Price to Free Cash Flow Ratio

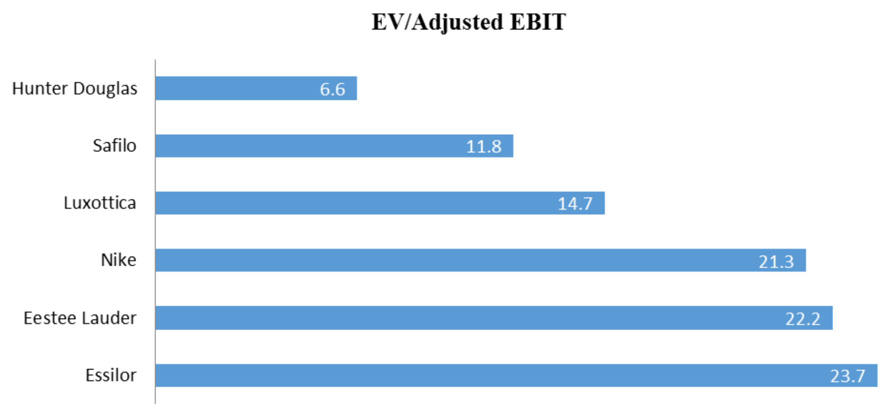
Luxottica is not a value stock. It also has no true peers. So, it can't be a relative bargain either. There really aren't any companies to relate it to. Safilo is a competitor. But Safilo is far inferior to Luxottica as a business. Essilor is in an adjacent business. Luxottica makes frames. Essilor makes lenses. Luxottica is by far the biggest maker of premium eyeglasses and sunglasses. Essilor is by far the biggest maker of eyeglass lenses. Essilor is a big supplier to Luxottica. And Essilor approached Luxottica looking to merge. So, Essilor is perhaps the closest thing Luxottica has to a publicly traded peer.

Essilor is the world's largest lens producer. It has a global market share of 41%. The number two player is just under half Essilor's size. Hoya has 20% market share. And the number three player is just under half the size of Hoya. Zeiss has an 8% market share. So, Essilor has an absolute market share of 41%. Relative market share is double that of the nearest competitor and five times that of the third place competitor. The top three companies have almost 70% of the market. It's a consolidated market. The three largest players account for most of sales and certainly almost all of research and development spending. Essilor is by far the biggest player. We don't have information on how much Luxottica spent on Essilor lenses in 2014 or 2015. But, we have information for the four years from 2010 through 2013. In those years, Luxottica got 25% to 30% of its lenses from Essilor. So, Essilor is a big supplier to Luxottica. Essilor's revenue mix is similar to Luxottica's. Essilor gets 48% of sales from North America, 28% from Europe, 18% from Asia plus Australia and New Zealand plus the Middle East plus Africa (though this is probably mostly Asia and Australia / New Zealand), and 6% from Latin America. North America and Europe are developed markets. So, more than 76% of sales come from developed economies. There would also be sales to developed Asian economies plus Australia and New Zealand. Overall, it's easy to imagine that more than 80% of Essilor's total sales come from what we'd consider developed economies and probably less than 20% come from emerging markets. So, there might be the same sort of long-term growth potential for demand here that there is at Luxottica. We can also compare Essilor's profitability and its growth to Luxottica.

Pre-tax return on net tangible assets is 50%. That means after-tax return on equity can be well over 30% without leverage. Essilor is undoubtedly a high quality business. What about growth? From 2002 through 2015, Essilor grew 9.7% a year – in constant currency terms – when we include acquisitions. If we exclude acquisitions, growth was just 4.8%. Luxottica grew 6.6% a year during the same period. So, both companies had pretty similar growth in the let's say 5% to 7% range. Essilor's organic growth was probably as fast or actually a bit faster than nominal GDP growth in the economies where Essilor's gets most of its sales. So, we can say that both Essilor and Luxottica have a history of growing organically a bit faster than the rate of GDP growth. They're slightly above average growth companies with far above average returns on capital. Sales grow a little quicker than the economies they are in. But, capital growth is much lower than normal. Essilor has spent most of its earnings on acquisitions. Since 2004, the company spent 86% of earnings on acquisitions. So, yes, Essilor grew at 10% a year. But, it did this without paying a dividend. That's not better than say growing 6% a year and paying a 4% dividend yield. What matters is the combination of the actual dividend paid and the growth from year to year. Essilor is not a better business than Luxottica. Quan and I both prefer Luxottica over Essilor. We feel more comfortable owning Luxottica, because we prefer Luxottica's capital allocation and its closeness to customers.

Essilor is an expensive stock. So is Luxottica. But Essilor is actually more expensive. Essilor trades at an EV/EBIT ratio of 24. Luxottica trades at 15 times our estimate of normal pre-tax earnings. So, Luxottica is about 38% cheaper than Essilor. If Luxottica and Essilor traded at the same price, Quan and I would prefer to own Luxottica. So, we think Luxottica is underpriced relative to Essilor right now.

Most of Luxottica's possible peers trade at very, very high multiples. Let's look at a company that might be considered similar to Luxottica but is more of a value stock. Value investors might prefer Hunter Douglas over Luxottica. I wouldn't blame them. We wrote about Hunter Douglas in a past issue of Singular Diligence. Quan and I both like that company a lot. It was very cheap on a normalized earnings basis coming out the housing bust. However, Hunter Douglas's future is not as bright as Luxottica's. First, let's compare the price of Hunter Douglas and Luxottica. Then, let's talk quality.



Luxottica trades at 15 times pre-tax earnings. That is equivalent to an after-tax P/E of 23.

Hunter Douglas trades at 8 times current EBIT or between 6 and 7 times our best estimate of normalized owner earnings. Normal earnings are higher than current earnings because while GDP and even employment has recovered to pre-crisis levels in the U.S. and some of Europe – housing has not. Hunter Douglas is a shades and blinds company. It benefits from the building of new homes and from people moving into existing homes. Those activities are a bit below normal levels even now. So, let's say Hunter Douglas trades for no more than 7 times normal earnings. Luxottica goes for 15 times normal earnings. That means Hunter Douglas is 53% cheaper than Luxottica. At today's price, should you prefer Hunter Douglas over Luxottica? I would. But, I'd actually suggest buying both stocks. Hunter Douglas is a value stock. Luxottica isn't. But, Luxottica has some advantages over Hunter.

Hunter Douglas is a more cyclical business. The average return on capital over a full cycle is acceptable – but not excellent. It's about 20% pre-tax. That works out to a 13% after-tax return on equity. That's obviously fine if you buy the stock cheap enough. The stock market returns well under 13% long-term. So, if Hunter is reinvesting your money at 13% a year – it's doing a lot better than you could buying an index fund. Hunter has also been profitable in every year. This includes the worst economic crisis in that industry's history. So, it's a safe stock. But, growth at Hunter is muted. The company already has 40% market share in the U.S. The revenue mix is 43% North America and 38% Europe. The European shades and blinds market is not bigger than the North American market. So, Hunter likely has around 40% market share on both continents. These are slow growth economies. And Hunter gets 72% of its sales from these places. Latin America provides just 9% of sales. Asia is 7%. Australia is 3%. Even if you consider all of Latin America and Asia to be emerging markets – that means Hunter's sales are 85% developed world and only 15% emerging markets. Growth might not be that valuable here. Let's say the U.S. and Europe grow at 5% a year forever. That's not a pessimistic view. In fact, it's hard to imagine European nominal GDP being as high as 5% given that continent's demographic trends. It will shrink in terms of people over the next couple decades. So, you need a lot of output growth per person to drive anything like 5% growth even with a few percentage points of inflation. But, let's say growth is 5%. Luxottica has returns on capital that are very, very high. Hunter Douglas doesn't. Hunter Douglas's after-tax return on equity is about 13%. To grow sales by 5 cents per share, Hunter Douglas may need to retain as much as 38 cents per share. It just can't grow at the same rate as Luxottica (5% or more a year) while also having a dividend payout ratio like Luxottica (50% to 100% a year). Ultimately, only two things matter when buying a stock. One, what is the dividend per share the stock is capable of paying right now? And then how much does the potential dividend grow each year? Your return in a stock is the combination of the actual dividend paid plus the growth in the dividend the stock could pay next year. Luxottica trades at 15 times pre-tax earnings. That's very high. But, it only trades at about 25 times its potential dividend during times of normal (5% to 6%) annual sales growth. Historically, the U.S. stock market has tended to grow sales per share at like 5% or 6% a year while trading at about 30 to 35 times dividends. Luxottica can grow as fast or faster than the U.S. generally. And it trades at a slightly lower level relative to the dividends it could pay. This is caused by Luxottica's very, very high return on capital and very, very high rate of converting earnings into dividends. So, Luxottica isn't an expensive stock. It's actually a roughly normally priced stock in terms of price to potential dividend. Hunter Douglas is cheap. Luxottica is a growth stock. Hunter Douglas is a value stock. Both are safe stocks. Both are dominant businesses. I think you could buy and hold both stocks forever. The upside potential in holding Luxottica forever is obviously higher because Luxottica has a much higher return on equity. But, the family that controls Hunter Douglas doesn't squander the earnings it retains. They invest excess cash in securities. They don't just hoard it. I think it makes sense to buy both Hunter Douglas and Luxottica. Pure value investors should just buy Hunter Douglas. Pure growth investors should just buy Luxottica. I am neither a pure value investor nor a pure growth investor. So, I'm happy owning both. Hunter and Luxottica are both good stocks to own forever. Hunter might be the better performer over the next 5 years. While Luxottica might be the better performer over the next 25 years.

GROWTH

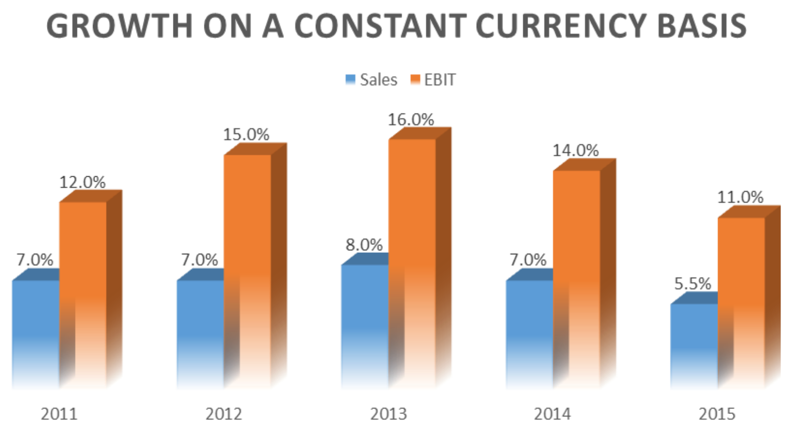
Luxottica May Only Need to Grow Sales by 5% a Year to Grow Earnings and Dividends by More Like 8% a Year

It is difficult to estimate Luxottica's future earnings per share growth. Quan and I don't like to assume earnings will grow much faster than sales. Nor do we like to assume a company will grow its own sales much faster than the market it competes in. Luxottica's history, however, suggests it can grow earnings faster than sales. Luxottica has also gained market share in some parts of its business. The company's share of its own brand – that is, not licensed – prescription eyeglass frames has not really grown over time. But the company has been able to grow its sunglasses business. And it has been able to get new licenses in its eyeglass frame business.

Emerging markets are a big opportunity for eye care companies. People in the developed world spend a lot on visits to eye doctors, prescription eyeglass lenses, and the frames those lenses go into. People in the developing world don't. For example, Quan and I both wear glasses. If Quan visits an eye doctor in Vietnam the visit is obviously cheaper (since labor is much cheaper in Vietnam). It could cost 80% less there. But then the lenses are also cheaper. Why? Because they are made and sold differently. In the United States, stores like LensCrafters and Pearle Vision don't stock a lot of what are essentially just semi-finished lenses to sell to the public. In Vietnam, this is what optical stores do. You basically get an off the shelf lens put into your frames right there and then. In the U.S., you place an order once you decide on a pair of glasses. The semi-finished lenses then undergo additional custom manufacturing to meet your specifications. This is a lot more expensive. People in the developed world may end up spending as much as 5 to 10 times more for their lenses than people in a developing economy like Vietnam. They are willing to do this. And since their visit to the eye doctor costs a lot and their custom finished lenses cost a lot – adding a pair of expensive frames on top does not seem like much of an extravagance. In the U.S., even a rather expensive pair of frames might only add up to one-third of the total cost of doctor's visit plus custom finished lenses plus frames. And eye care is pretty cheap compared to other forms of medical care in the same country. So, the willingness to pay a lot for each pair of eyeglass frames is high in the developed world and low in the developing world.

Let's review Luxottica's sales breakdown. North America is 58% of sales. Europe is 19%. That's the developed world. It adds up to 77% of sales. Emerging markets are 23% of sales (or less). We don't know exactly how big a part of sales developed countries in Asia add to total. But, we know Asia is 13% of sales, Latin America is 6% of sales, and everything else (so places like Africa) is only 4% of sales. The need for vision correction is really the same around the world. So, the size of the market is a matter of willingness to pay.

Essilor is the world's largest prescription lens maker. They provided information about the worldwide addressable market for prescription glasses in their 2015 annual report. There are 7.2 billion people in the world. Most of those people – 4.5 billion (63%) would benefit from vision correction. Yet only 1.9 billion – 26% of the world's population – use vision correction. So, 2.6 billion people – or 36% of the world's population – have unmet vision correction needs. It's easy to project demographic trends for decades. We know the world's population will grow a little under 1% a year from now through 2030. Older people need vision correction more than younger people. And we don't have technology to make the next generation of births any less in need of vision correction than the last – so, correction needs will grow faster than the population. How much does that matter though? Right now, there are 4.5 billion people with correction "needs". But, only 1.9 billion of those people – so 42% of them – actually use correction. In other words, most of the world's vision correction needs are unmet. This isn't surprising. Most of the people with correction needs – like most of the world's overall population – are on the continents of Asia, Africa, and South America rather than North America, Europe, and Australia. If we consider the developed continents to be North America, Europe, and Australia – that's only 18% of the world's population. This ignores developed Asian economies. They are big. But the emerging Asian economies are much, much bigger. There's no doubt that the vast majority of the world's correction needs – and maybe even as much as three quarters of the addressable market – is in emerging markets. Essilor estimates correction needs will grow 2.1% a year over the next 15 years. And correction wearers will grow 3% a year. That sounds like an aggressive growth estimate. But, keep in mind, that would actually mean that there would still be more people who need vision correction and don't get it in 2030 than the number of people who need correction and do get it. In other words, Essilor is estimating that only about 48% of the world's vision correction needs will be met in 2030. Luxottica has its own estimate of growth in emerging markets. In 2014, emerging markets were one-third of the unit volume market for eyeglass frames. Luxottica expects emerging markets to reach half the unit volume market for eyeglass frames sometime before 2020. Remember, this is unit volume. Each frame costs less in emerging markets. For example, Luxottica has production in China. That production is used only for sale in China. Luxottica does not export product out of that country. With the exception of China and India, I don't think Luxottica has done much regional production of frames at all. For example, Luxottica's biggest market by far is the United States. All Luxottica frames in the U.S. are made in Italy. Luxottica doesn't make things in the U.S. It only sells things here.



From 2011 through 2015, Luxottica's earnings grew between 11% and 16% a year on sales growth between 5.5% and 8% a year.

Even in the United States, a lot of frames are non-premium. Luxottica really only competes in the premium frame market. Likewise, Luxottica only competes in premium sunglasses. By unit volume, the premium market for both eyeglasses and sunglasses is much smaller than the non-premium market. For example, the worldwide unit volume market for sunglasses is 548 million pairs per year. About 510 million (93%) of these sunglasses retail for less than $100. Luxottica owns Oakley, Ray-Ban, and Sunglass Hut. You aren't going to find many pairs of Oakleys or Ray-Bans or even pairs of any other brands sold at Sunglass Hut for less than $100. So, Luxottica only competes in 7% of the worldwide market for sunglasses. It dominates the over $100 a pair market though. We estimate Luxottica has more than 50% market share in this segment.

Luxottica is a "premium" product company. It is not a "luxury" product company. We've talked about this distinction before. For example, see our issue on Swatch or our issue on Movado. Luxury products sell very well in emerging markets. Premium products sell very well in North America. American consumers spend a lot on premium eyewear. They don't spend a lot on luxury watches. Meanwhile, Chinese consumers spend a lot on luxury watches. But they spend very little on premium eyewear. Here's a shocking example. In 2013, there were 20 million cars sold in China. Audi and Mercedes sold 1 million units. By Chinese income standards, those brands are definitely luxury cars. Yet Luxottica sold only 1 million pairs of eyeglasses in China. Eyeglass frames are a lot less durable than cars. The replacement level for eyeglasses should easily be 2 to 3 times that for cars. If everyone who owned a luxury car also owned a pair of premium eyeglasses – you should be selling 2 or 3 million premium eyeglasses for every 1 million luxury cars. Chinese consumers account for 50% of the total luxury goods market. And yet China is just 3% of Luxottica's sales. Premium eyeglasses have not yet caught on in China. Sunglasses are seen as more of a luxury item and certainly more of a flashy fashion item. So, it should be easier for Luxottica to enter markets like China using its Sunglass Hut chain.

Luxottica should be able to grow its U.S. business at about the rate of nominal GDP growth. There's no reason for people to spend less on eyeglasses as a percent of household income over time. In fact, the opposite has tended to be true. So, if we assume the U.S. economy will grow by 5% a year in nominal dollars – so will Luxottica's U.S. optical business. The wholesale business may be able to grow faster than the retail business. Luxottica's wholesale business in the U.S. grew by 14% a year over the last 8 years while its retail business grew by just 3% a year. The wholesale and retail business combined should grow at between 5% and 6% a year in the U.S. Basically, we're confident Luxottica can always grow its U.S. sales at least as fast as nominal GDP. Spending on premium eyeglasses and premium sunglasses should grow faster than nominal GDP in emerging markets.

Luxottica's own goal is to double the size of the whole company in 10 years. This would require 7% annual sales growth. That is an organic growth goal. Obviously, Luxottica can double the size of the company if it buys something. Quan and I aren't sure if Luxottica will hit this goal. It might. But it depends on trends in emerging markets. If emerging market economies have weak growth over the next 10 years, I'm not sure Luxottica will grow 7% a year. But, even if economies like India, China, Brazil, etc. have a bad decade – Luxottica should have no problem growing 5% a year or faster. So, companywide sales growth should be in the 5% to 7% a year range through 2025.

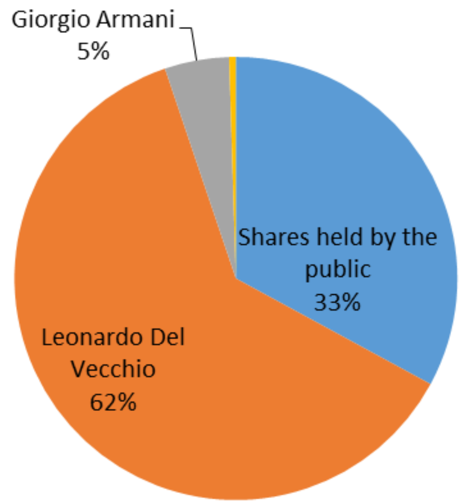
Earnings growth would be higher. Sales growth of 5% to 6% a year tends to convert into earnings growth of 7% to 9% a year. If we believe Luxottica can grow sales by 5% to 7% a year for the next 10 years, we should also believe the company can grow earnings by more like 7% to 9% a year. I think 8% is a realistic – but not especially conservative – earnings per share growth estimate. Luxottica's own organic sales growth target is 7% a year. We're completely certain that earnings per share will have to grow somewhat faster than organic sales. So, I'd say that while Quan and I might doubt Luxottica will double the size of the company in terms of overall sales by 2025 – we're confident Luxottica will double its EPS by 2025. Luxottica's most recent earnings per share result was 1.61 Euros. How fast would Luxottica have to grow its EPS to reach 3.22 Euros per share in 2025? Exactly 8% a year. That's doable. It's more than doable on 7% annual sales growth – which is Luxottica's target. It is perhaps even almost doable on 5% annual sales growth – which is the bottom end of the estimate Quan and I came up with. I'd be a little more cautious. I'd put it this way. Luxottica thinks it can grow its sales organically by 7% a year for the next 10 years. We know Luxottica can grow its earnings per share several percentage points faster than its sales. So, it's more than reasonable to assume Luxottica will grow its EPS by as much as the company hopes it can grow its organic sales. Even if Luxottica falls a few percentage points short of its 7% a year goal in terms of sales – it'd still hit 7% a year in terms of EPS growth. We discussed why this is in the quality section. Luxottica can increase the profitability of each of its stores. It can increase the companywide gross margin. So, my expectation is for 7% a year EPS growth from now through 2025. That sounds aggressive. But, Luxottica's past record is actually better than that. Obviously, if you buy the stock today and hold it for the next 10 years while it grows EPS by 7% a year and pays a dividend yield of between 2% and 4% a year – you would expect a 10 year return of between 9% and 11% a year. In other words, you'd expect to make 10% a year over the next 10 years. That sounds like a good estimate to me. And I can't think of many other investments that I expect to return 10% a year for as long as 10 years. There are many cheaper stocks than Luxottica. But there aren't many stocks that will provide better returns over the next 10 years.

MISJUDGMENT

Luxottica's Founder and Controlling Shareholder is in his 80s

The biggest risk of misjudging Luxottica is management risk. Current management is great. But Luxottica went through three CEOs in 18 months. In September 2014, Luxottica fired Andrea Guerra. Mr. Guerra – Andrea is a man's name in Italy (it means Andrew) – had been CEO of Luxottica from 2004 to 2014. He became CEO when he was 38. He was fired when he was 48. During Guerra's ten years as CEO, Leonardo Del Vecchio – who was still Chairman of the company – became less involved in the operations of the company. He rarely attended board meetings. And Guerra was given the power to make long-term strategic decisions – not just operational decisions. Luxottica performed well from 2004 through 2014. Sales doubled during those ten years. You can look at the datasheet at the start of this issue to see just how well Luxottica did during Guerra's time as CEO. There are rumors out there about what might have caused the rift between Del Vecchio and Guerra. We included them in the notes for the "misjudgment" section. So, you can go look for them there if you're really interested. But, I don't think the rumors are worth repeating here. Del Vecchio said he wanted to double sales over the next 10 years and Guerra didn't share that ambition. He told Guerra he wanted a co-CEO structure. Remember, Guerra had been sole CEO for 10 years. Obviously, Guerra refused. In fact, he resigned. Luxottica then went ahead with Del Vecchio's dual CEO plan. It promoted a company insider to the position "CEO of Operations". And it hired an outsider for the position "CEO of Market". The operational CEO was supposed to focus on: profit margins, cost management, and capital allocation. The marketing CEO was supposed to focus on growth across all markets and distribution channels. Like I said, the CEO of Operations job was given to an insider. That insider was Enrico Cavatota. He had long been Luxottica's Chief Financial Officer. Cavatota only lasted a few weeks in the job. He quit. The disagreement between Del Vecchio and Cavatota was apparently over the independence of the company's management. Here, I should pause for a rumor. It is true that Leonardo Del Vecchio – who is 80 years old and controls 62% of Luxottica – remarried in 2010. The woman he remarried – Nicolleta Zampilla – is Del Vecchio's fourth wife. She was also his second wife. So, he remarried a woman he had previously divorced. It's possible that changes in Del Vecchio's family life have caused changes in Luxottica's corporate life. For instance, top executives may have been annoyed that Zampilla had increasing influence with Del Vecchio and had started intervening more at Luxottica. After Cavatota resigned, Luxottica made Massimo Vian CEO of Operations. Vian had long been the Chief Operating Officer at Luxottica. So, the position was again filled by an insider. The first time the operational role had gone to the CFO. The second time it went to the COO. The CEO of Markets job went to an outsider. That outsider was Adil Mehboob-Khan. Mehboob-Khan had worked at Procter & Gamble for 27 years. In January of this year (2016), Luxottica announced Mehboob-Khan was leaving. Luxottica also announced Leonardo Del Vecchio will assume the CEO of Markets position on an interim basis. The plan is for Del Vecchio to strengthen Luxottica's marketing in areas like emerging markets, digital development, and e-commerce. Then he will leave marketing to a successor.

Del Vecchio's presence may make it hard to attract talent. Luxottica's long-term CEO quit. And Luxottica's long-term CFO was made co-CEO and then immediately quit too. So, Luxottica lost a couple long-term homegrown executives in the last few years. There is also no Del Vecchio family member who wants to succeed Leonardo. Leonardo's son Claudio had been co-CEO of Luxottica – along with his father – in the 1990s. But he left. He's been very successful on his own. And by now I'm sure he's independently quite wealthy in addition to being one of Leonardo Del Vecchio's heirs. That's because Claudio went on to run Brooks Brothers. Claudio is a member of the Del Vecchio family. He had run – or rather, co-run – Luxottica for a while. And he's a very successful businessman. He seems especially good at U.S. retail which is an important part of Luxottica. It seems the only reason he left Luxottica is because he wanted to make it on his own instead of remaining forever in his father's shadow. This makes sense. Leonardo wasn't going anywhere. He wasn't really going to retire as early as the CEOs of most public companies do. When Claudio left Luxottica in 2000, his father was already 64 years old. He could probably tell his father wasn't going anywhere. And now Leonardo is 80 years old and in addition to still being the Chairman of Luxottica he is also the (allegedly) interim CEO of Market. So, he is Chairman of the company. And he's in charge of the company's marketing. He's basically the Chairman and CEO again – at age 80.



Leonardo Del Vecchio owns more than 60% of Luxottica that will eventually be inherited by his wife and children.

The succession at Luxottica is very uncertain. Leonardo Del Vecchio controls the majority of Luxottica on both a voting basis and an economic basis. He is worth something like $20 billion. He has six children. These six children are the offspring of three different mothers. So, that's a pretty complex situation. Now, they can all be rich without being involved in running Luxottica. Take $20 billion of net worth – or more than 60% of Luxottica shares – and divide it up among six children plus a surviving widow if there is one. Every heir can be a billionaire. There is, of course, a real risk of legal battles. And the longer Del Vecchio lives, the bigger a problem this can be. You've probably heard news reports of the situation at Viacom with Sumner Redstone. Redstone is 93. Del Vecchio is only 80. And Luxottica is an Italian company not an American company. So, the situation isn't the same. But, it has some of the same risks.

So what is the plan for succession at Luxottica? We can break it down into two parts. There is ownership succession. And then there is managerial succession. At most family companies, these two types of succession are unified or at least related. At Luxottica, the plan is to make them completely separate. Here it is. Upon his death, Leonardo Del Vecchio's stake in Luxottica – which represents a majority of the company – would be split 25% to his wife (Nicoletta Zampilla) and 12.5% to each of his six children. Neither his wife nor any of his children would be involved in Luxottica's operations. In fact, Claudio isn't even on Luxottica's board anymore despite being the head of Brooks Brothers and the son of Luxottica's founder. If anyone should be a member of Luxottica's board, it should be Claudio. But, he's not on the board. Now, Luxottica is controlled by a family holding company called Delfin. The plan is that upon Leonardo Del Vecchio's death, his heirs would receive dividends from Delfin (so, from Luxottica really) but wouldn't have a say in running Luxottica. This would be ensured by appointing independent directors to Delfin. So, the family holding company which controls Luxottica would no longer be truly family run as far as the board. That could reduce Del Vecchio's seven heirs to being the equivalent of billionaires who basically just receive checks from a trust fund. I'm skeptical this will work as planned. Family members often have a lot of influence over someone in their later years. The wife and children in this situation aren't just heirs. They are also Del Vecchio's wife and children. They could convince him to change the succession plan. In fact, Del Vecchio already changed the plan once. The plan used to be for his stake to be split between his six children. Now, the plan is for his wife to get 25% of everything and for each of his children to go from inheriting 16.67% to just 12.5% of his estate.

Since Del Vecchio is the founder and still owns a majority of Luxottica, it's reasonable to doubt Luxottica will ever really transition away from being a family company to being a professionally managed company. And before Claudio left in 2000, it was definitely reasonable to assume he'd be Leonardo's successor. But, this is what Leonardo Del Vecchio himself said about succession: "I have never considered or even given the impression to anyone to involve my children or even my grandchildren in the management of Luxottica. Kids remain always kids and it's possible to fire an important executive, but it's not possible to fire one of your children." In 2016, Leonardo said: "I've already started to look into the company's younger management. My successor is among them."

FUTURE

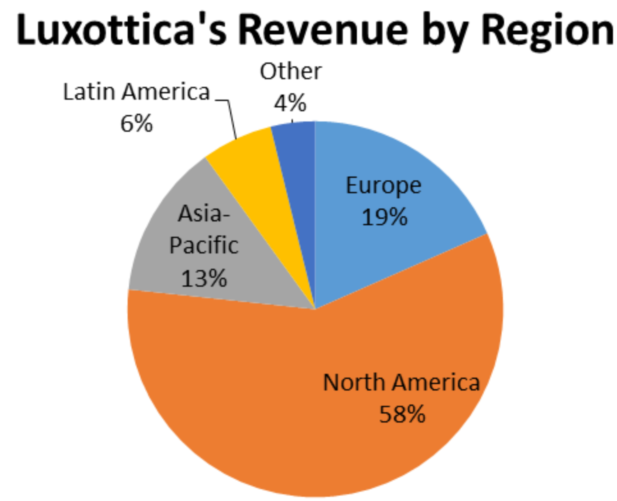
Del Vecchio Thinks Luxottica Will Double its Sales in Ten Years; Quan and I Think Luxottica May Not Double its Sales – But Will Certainly Double its Earnings Per Share – By 2026

We've talked a little bit about how fast Luxottica might be able to grow over the next 10 years. But, in these final "Future" sections of the issue, I like to apply a standard approach. That approach is to look at what the business we are buying into might look like in five years. And to think about what someone – usually a 100% control buyer, but that's unlikely in Luxottica's case – might pay for that business. Then we work back from 5 years into the future (so 2021) to today (2016). And we come up with a total return potential. What percent return can you make in this stock if you commit to buying it today and holding it for 5 years. Why 5 years? Because that's the shortest period I can think of that still counts as being a long-term investment. I know most people reading this usually trade in and out of stocks a lot quicker than 5 years. If you check your portfolio today, I bet you didn't own most of the stocks in there back in 2011. If that's true, you tend to own stocks for less than 5 years. Which means you tend to not be a long-term investor. That's the reality. And I know that. But this is a buy and hold newsletter. It presents long-term investment ideas. Anything shorter than a 5 year holding period definitely isn't long-term. So, my compromise with reality is to assume you will buy Luxottica today and you really will hold it for 5 full years no matter what happens with either the stock price or the business performance.

That's the assumption. Now, let's look at what kind of return you can get if you really do make a long-term commitment here. Over the next 5 years, Luxottica should be able to grow sales by 5% to 7% a year. Luxottica's own goal is to grow sales organically by 7% a year for the next 10 years. Quan and I are confident Luxottica can grow faster than nominal GDP growth. Luxottica gets maybe 70% to 75% of its sales from truly developed countries. These might grow GDP at a nominal pace of 4% to 5% a year over the next 5 years. The other 25% to 30% of sales comes from emerging markets. These economies could grow quite a bit faster than 4% to 5% a year in nominal terms. And – in emerging markets – spending on sunglasses and eyeglasses should grow faster than nominal GDP. We feel sure Luxottica can grow at least 5% a year. Luxottica's management hopes to grow 7% a year. Let's split the difference and assume Luxottica's sales grow 6% a year from 2016 through 2021. Luxottica's current EBIT margin is 17.3%. If EBIT growth is two full percentage points above sales growth, Luxottica's EBIT margin in 2020 would have to reach 19%. A 5-year period of 8% annual EBIT growth would mean Luxottica's EBIT would reach 2.25 billion Euros in 2020. So, that's our future EBIT number. Now, let's look at enterprise value (EV).

Luxottica has net debt. The company has 928 million Euros of cash and 1.87 billion Euros of debt. So, net debt is 948 million. Luxottica's net interest expense is high relative to its net debt. This is because Luxottica's debt comes with a roughly 5.7% yield while Luxottica's cash has just a 1.2% yield. This is because Luxottica's cash really is cash. The company isn't investing in long-term bonds or anything like that. It's possible there will be a change in interest rates over the next 5 years that will benefit Luxottica. But, we're going to assume that is not true. Luxottica has net interest expense of 95 million Euros (that's 106 million Euros in expense on the debt less 11 million Euros of income on the cash). And we'll use that as a constant annual expense over each of the next 5 years. So, in 2020, Luxottica's projected pre-tax income would be 2.15 billion Euros. That's 2.25 billion Euros in EBIT less 95 million Euros in net interest expense. We'll use Luxottica's historical tax rate of 37% to get a net income figure of 1.36 billion Euros. If we assume Luxottica's share count stays constant – that means EPS in 2020 should be 2.82 Euros. Over the last 10 years, Luxottica's free cash flow was 102% of reported earnings. Luxottica only used 63% of reported income to pay dividends and reduce debt. The rest mostly went to acquiring Oakley. We'll assume Luxottica is not going to make another acquisition on the scale of the Oakley deal. In fact, we'll assume Luxottica does no acquisitions at all. Obviously, this assumption will most likely turn out to be false. Luxottica will buy something. But we don't know what. And we don't know for how much. Historically, Luxottica's deals have created more value than they've destroyed. So, we'll just treat any acquisitions as value neutral – and omit the possibility of acquisitions from our calculation entirely. Without acquisitions, Luxottica would've generated more free cash flow that could be converted into dividend payments than it actually reported in earnings. That's based on the last 10 years of actual results. When looking ahead over the next 5 years, Quan and I don't want to be quite that aggressive. So, instead of assuming Luxottica will pay out 102% of its earnings in dividends – we'll assume Luxottica will pay out 90% of its earnings in dividends. We will also assume that Luxottica will trade at 30 times its dividend at the end of our 5-year holding period. Our EPS assumption for 2020 was 2.82 Euros. Our dividend payout rate assumption is 90%. So, we're assuming a 2.54 Euro per share dividend in 2020. If we believe Luxottica should trade at 30 times its dividend – or a 3.33% dividend yield – we're projecting a 76 Euro a share price for the stock in 2020. That's 27 times earnings. So, yes, we're assuming the stock will have a P/E of 27 when we sell it. That's very, very aggressive. But, there's no reason Luxottica should ever be priced like a value stock.

Think of it this way. Let's say you buy Luxottica today and it is paying a dividend yield of at least 2%. Let's further assume that sales growth over the next 5 years is in the 4% to 6% a year range. That should – through operating leverage – provide earnings growth of 6% to 8% a year. Your return from holding the stock – not from flipping it – would be the rate of dividend growth plus the dividend yield. So, your natural rate of return in the stock should be in the 8% to 10% range from 2016 through 2020. Quan and I don't think the U.S. stock market as a whole will return as much as 8% a year. Stocks are more expensive now than they have been in the past. Yes, that's because interest rates are lower. But, that doesn't change the fact that if they are more expensive now than they have been in the past – they have to return less going forward. So, Luxottica is an expensive stock on a P/E basis. It's not an especially cheap stock even on a price-to-dividend basis. But, it is priced to return more (8% to 10% a year) over the next 5 years than other stocks are. If that's also true at the end of the next 5 years, then Luxottica's P/E multiple should not contract. As long as



North America and Europe account for 77% of Luxottica's total revenue. So, emerging market revenue is less than 23% of sales.

Luxottica is priced to return more over the next 5 years than the stock market generally – there should be no contraction in the P/E. The P/E should only fall to the level of the overall market when Luxottica's future prospects become as poor as the overall market. Luxottica can grow earnings by 6% to 8% a year. That's as good or better than the overall market. It can also have a dividend payout of 90%. Let's say the market generally has a dividend yield of 3%. If Luxottica has a 90% dividend payout, it would need to trade at 30 times earnings to have a dividend yield of 3%. I think Luxottica actually might be "fairly valued" versus the stock market even when it trades a little over 30 times earnings. That's because I feel more confident it can grow earnings faster than other stocks while paying out more in dividends. Anyway, we are assuming here that Luxottica will end the period 2016 -2021, with a still quite high P/E of 27. So, this isn't a value investment. We're assuming you'll be able to sell the stock at 27 times earnings. The case for a true value investment should never assume you can sell a stock for more than 15 times earnings.

Finally, there's the issue of whether Luxottica really will pay out all of its free cash flow in the form of regular and special dividends – or whether it'll just pile up cash. I think it won't pile up cash. But, let's assume it will for now. Over the next 5 years, Quan and I expect Luxottica to generate more than 4 billion Euros in free cash flow. The company has less than 1 billion Euros in net debt. So, it would have over 3 billion Euros in free cash flow after it eliminated all its net debt. Cash accumulation over the next 5 years would total 8.32 Euros per share. Let's be pessimistic and say Luxottica will only have a 50% dividend payout. That's 0.94 Euros per share right now. Maintaining a 50% dividend payout for the full 5 years would leave the company with net cash of over 3 Euros per share. In fact, quite a lot over 3 Euros per share. That's why I think Luxottica will end up having a dividend payout ratio much, much higher than 50% of reported earnings while you own the stock.

So, what should you do? Should you buy Luxottica? It's not a value investment. So, if you're purely a value investor – the answer has to be no. If you're a buy and hold investor – I think the answer should be yes. I think Luxottica can offer an adequate return (8% to 10% a year) if you make the long-term commitment to buy the stock today and hold it through all of 2021. If you can't trust yourself to hold Luxottica for a full 5 years – you definitely shouldn't buy the stock. If you can trust yourself to buy and hold the stock for 5 years, but don't want to hold it forever – maybe you should buy it. I'm not sure. But, if you are looking for a stock to buy and hold forever – Luxottica is definitely your stock. This is a perfect buy and hold forever stock. Of the stocks we've written about for Singular Diligence so far, I think Luxottica and Frost are the two stocks to buy today and hold forever. Frost is cheaper. So, if you don't own Frost – go and buy that stock first. Then buy Luxottica. But, if you already own Frost – you should add Luxottica to your portfolio today. Again, I'm saying this only to buy and hold forever investors. If you're a Buffett investor – if you run your portfolio the way Buffett runs Berkshire's portfolio – then go and buy Luxottica right now. If you're more of a value investor with an investment horizon of 5 years or even less – I don't know if Luxottica is the stock for you. Luxottica is expensive. The stock will probably always be expensive. It's a lot more expensive than The Restaurant Group (the last stock we wrote about for Singular Diligence). But, I'm a lot more confident holding Luxottica forever than I would be holding The Restaurant Group. So, if you're looking for a buy and hold forever investment – choose Luxottica over The Restaurant Group. If you're looking for a buy and sell in 5 years investment – choose The Restaurant Group over Luxottica. And if you don't yet own Frost – buy that stock first. Luxottica is the second best buy and hold forever stock behind Frost.

Luxottica (Borsa Italiana: LUX)

Appraisal Value: 52.20 Euros

Price-to-Appraisal Value: 83%

Owner Earnings	(in millions)
Pre-tax Owner Earnings	
Reported EBIT	€1,376
+ Adjustment for the reorganization of Oakley	€66
+ Amortization of trade names and trade marks	€73
+ Amortization of customer relations, contracts, and lists	€16
= Pre-tax Owner Earnings	€1,531

Business Value

Luxottica's business value is €26,027 million.

- Pre-tax owner earnings are €1,531 million
- Fair multiple = 17x pre-tax owner earnings
- €1,531 million * 17 = €26,027 million

Fair Multiple

Luxottica's business is worth 17x pre-tax owner earnings

- Luxottica is worth 27x after-tax owner earnings
    - Luxottica can grow earnings in the high single digits
    - Luxottica needs to retain only 10% of its earnings
- 17x pre-tax owner earnings is equivalent to 27x after-tax owner earnings
    - Effective tax rate is 37%

Share Value

Luxottica's stock is worth €52.20 a share

- Business value is €26,027 million
- Cash: €928 million
- Debt: €1,870 million
- Equity value is €25,085 million
- €26,027 million + €928 million – €1,870 million = €25,085 million
- Equity Value = €52.20
    - 480.51 million outstanding shares
    - €25,085 million / 480.51 million = €52.20

Price/Appraisal

Luxottica is trading at 83% of its value.

- Business Value = €26,027 million
- Enterprise Value = €21,620 million
- €21,620 million / €26,027 million = 83%

	EV/Sales	EV/Gross Profit	EV/EBITDA	EV/EBIT	EV/Owner Earnings
Safilo	0.58	0.99	7.21	11.75	11.75
Hunter Douglas	0.77	1.76	6.07	8.07	6.62
Nike	3.09	6.71	19.75	22.62	21.34
Estee Lauder	3.31	4.11	17.71	22.23	22.23
Essilor	4.28	7.17	17.68	24.31	23.69
Minimum	0.58	0.99	6.07	8.07	6.62
Maximum	4.28	7.17	19.75	24.31	23.69
Median	3.09	4.11	17.68	22.23	21.34
Mean	2.41	4.15	13.68	17.80	17.13
STDEV	1.64	2.80	6.50	7.36	7.52
CV	68%	68%	47%	41%	44%
Luxottica (Market)	2.44	3.60	11.26	15.71	14.12
Luxottica (Appraisal)	2.94	4.34	13.57	18.93	17.00

ABOUT THE TEAM

Geoff Gannon, Writer

Geoff is a writer, blogger, podcaster, and interviewer. He has written hundreds of articles for Seeking Alpha and GuruFocus. He hosted the Gannon On Investing Podcast, The Investor Questions Podcast, and The Investor Questions Podcast Interview Series. He wrote the Gannon On Investing newsletter in 2006 and two GuruFocus newsletters from 2010-2012. In 2013, he co-founded The Avid Hog (the predecessor to Singular Diligence) with Quan Hoang. Geoff has been blogging at Gannon On Investing since 2005.

Quan Hoang, Analyst

Quan is a stock analyst. Quan won first prize in Vietnam's National Olympiad in Informatics in 2006. He graduated from Manhattanville College in 2012 with a B.A. in finance and a minor in math. In 2013, Quan co-founded The Avid Hog (the predecessor to Singular Diligence) with Geoff Gannon.

Tobias Carlisle, Publisher

Tobias Carlisle is the founder and managing director of Eyquem Investment Management LLC, and serves as portfolio manager of the Eyquem Fund LP and the separately managed accounts.

He is best known as the author of the well regarded website Greenbackd, the book Deep Value: Why Activists Investors and Other Contrarians Battle for Control of Losing Corporations (2014, Wiley Finance), and Quantitative Value: a Practitioner's Guide to Automating Intelligent Investment and Eliminating Behavioral Errors (2012, Wiley Finance). He has extensive experience in investment management, business valuation, public company corporate governance, and corporate law.

Prior to founding Eyquem in 2010, Tobias was an analyst at an activist hedge fund, general counsel of a company listed on the Australian Stock Exchange, and a corporate advisory lawyer. As a lawyer specializing in mergers and acquisitions he has advised on transactions across a variety of industries in the United States, the United Kingdom, China, Australia, Singapore, Bermuda, Papua New Guinea, New Zealand, and Guam. He is a graduate of the University of Queensland in Australia with degrees in Law (2001) and Business Management (1999).

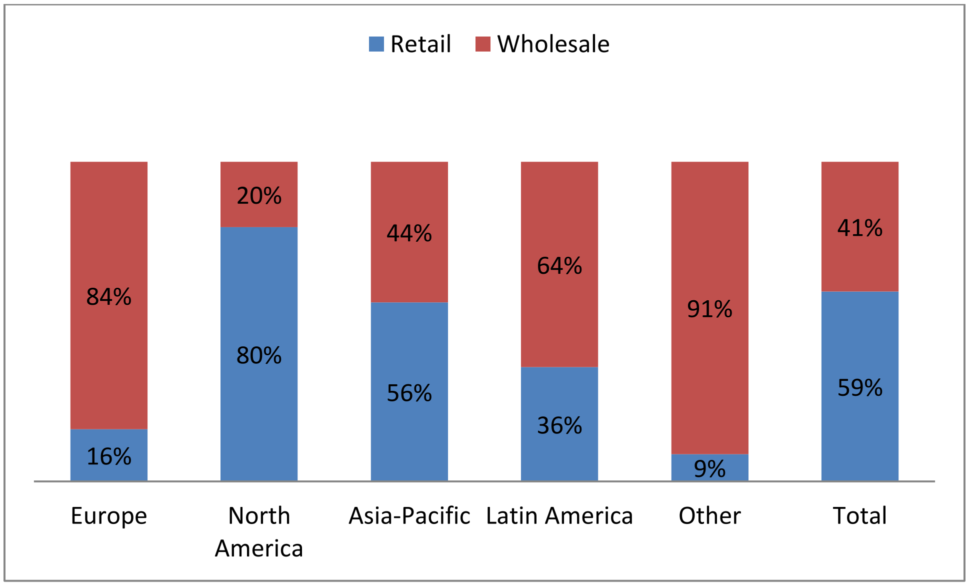
SINGULAR DILIGENCE

NOTES

Luxottica (Borsa Italiana: LUX)

Overview

Leonardo Del Vecchio Builds His Eyewear Empire by Following Vertical Integration



59% of Luxottica revenue comes from its own stores

- Luxottica is the creation of Leonardo Del Vecchio
  - He spent much of his childhood in a Milan orphanage
  - From the orphanage, he was apprenticed to a factory
    - He learnt to make tools and molds
- He set up his own mold shop
  - Producing parts for eyeglass framers
- Del Vecchio moved to Agordo
  - To start Luxottica
  - In 1961
  - In the foothills of the Dolomite Mountains
    - In Northeastern Italy
  - In Agordo
    - Northeastern Italy
  - The local authorities were giving out land to entrepreneurs for free
    - Hope to create jobs and provide tax revenue
  - South of Agordo were the Dolomites and the Veneto plains
    - Centers of the Italian optical industry
- He realized that there were far more profits in producing the entire frames[1]

- => made the whole frames
    - Presented the first collection of prescription eyewear
        - In 1971
- He decided to become a distributor of his own frames for the same reason
    - LUX was lowering cost and raising quality
    - But distributors were just fattening their profit margins
        - Instead of passing on the savings to the retailers
- Luxottica started making designer frames
    - For Georgio Armani
        - Under licensing agreement
        - In 1988
    - Then followed up with other designers
- In early 1990s, chains were importing more and more frames from the far east[2]
- Del Vecchio found a solution to reverse the trend
    - Luxottica acquired LensCrafters
        - In 1995
        - LensCrafters revolutionized the optical retail industry with its superstore format
            - Combine eye care, eyewear and onsite labs
            - It focuses on convenience and value
                - Deliver good eyeglasses within one hour
                - At competitive prices
        - In 1994
            - LensCrafter had 653 stores
                - Revenue: $706 million
            - Luxottica's wholesale revenue in North America: $199.2 million
                - 10% of the total eyeglass frame market
                    - $1.87 billion
    - Luxottica upgraded LensCrafters to a premium chain
        - Put more Luxottica's designer frames into LensCrafter stores
    - % of LensCrafters revenue come from Luxottica products
        - 1995: 5%
        - 1996: 43%
        - 2002: 76.3%
        - 2015: over 90%
- Luxottica acquired Ray-Ban
    - In 1998

- From Bausch & Lomb
- Ray-Ban was the largest sunglasses brand
- Bausch & Lomb mismanaged Ray-Ban
- When Luxottica acquired Ray-Ban in 1999[3]
  - Ray-Ban shades were sold for as low as $29
  - Available everywhere from gas stations to drugstores
  - Manufacturing was scattered across the globe
    - Mexico
    - China
    - Ireland
  - Ray-Ban frames fell apart 4 times faster than those of Luxottica's other frames
- Luxottica fixed the brand
  - Brought production to Italy
    - Improved quality
  - Pulled Ray-Ban out from 13,000 retail outlet[4]
  - Stopped selling for 1.5 years
  - Gradually raised price
    - The starting price for a pair of Aviator
      - 1999: $29
      - 2000: $79
      - 2002: $89
      - 2009: $129
      - 2014: $149
- Today, Ray-Ban accounts for **26.8%** of Luxottica's revenue
  - €2.4 billion
  - => retail revenue is well over €3 billion

- Luxottica acquired Sunglass Hut
  - In 2001
  - Sunglass Hut at the time was the dominant retailer of premium sunglasses
    - Hold 50% market share in the U.S.
- Luxottica's conquest of premium sunglasses culminated with the acquisition of Oakley
  - In 2007
  - Oakley is the second biggest sunglasses brand in the world
- Luxottica acquired Cole National
  - In 2004

        - Reinforced its position in optical retail
            - In North America
        - The acquisition gave Luxottica
            - Pearle Vision
                - The second largest chain
                    - Behind LensCrafters
            - Sears Optical
            - Target Optical
            - BJ Optical
- Retail presence in emerging market was established through some acquisitions
    - OPSM
        - 481 stores in Australia
            - 35% market share
        - 34 stores in New Zealand
        - 80 stores in Hong Kong
        - 12 stores in Singapore
        - 12 stores in Malaysia
    - Multiopticas International
        - 390 stores in
            - Chile
            - Peru
            - Ecuador
            - Columbia
- Luxottica entered licensing agreements for other famous brands
    - Prada
        - Prada, Prada Linea Rossa and Miu Miu
    - Armani
    - Brook Brothers
    - Bvgalri
    - Burberry
    - Chanel
    - Dolce & Gabbana
    - Versace
    - Tiffany
    - Valentino
    - Ralph Lauren
    - Coach

    - Michael Kors
    - Tory Burch
    - DKNY
- Today, Luxottica is the dominant manufacturer of premium eyewear
    - Some estimated that Luxottica has **80%** market share in the premium segment
        - $13 million market
- Luxottica's 2015 revenue: €8,837 million (almost $10 billion)
    - Retail: €5,244 million
        - 59% of total revenue
        - 7,235 stores
    - Wholesale: €3,593 million
        - 41% of total revenue
        - Sells to 200,000 retail doors
- Revenue by brand
    - Licensed brands account for **32.4%** of revenue
        - €2,863 million
    - Proprietary brands account for **67.6%** of revenue
        - €5,974 million
- Revenue by products
    - Sunglasses: **55.8%** of revenue
        - €4,931 million
    - Optical eyeglasses: **44.2%** of revenue
        - €3,906 million
- Revenue by region
    - North America: 58.3%
    - Europe: 18.4%
    - Asia-Pacific: 13.3%
    - Latin America: 6.1%
    - Other: 3.8%
- Luxottica's main assets
    - Ray-Ban: €2.4 billion revenue ($2.6 billion)
    - Oakley: €1 billion revenue ($1.1 billion)
    - LensCrafters: $2 billion revenue (estimate)
    - Sunglass Hut: €2 billion revenue (estimate)
- Price range of Luxottica's sunglasses
    - Arnett, Vogue: $80-120

- Michael Kors, Ralph: $100-180
- Coach, Polo Ralph Lauren: $150-200
- Ray-Ban, Oakley, Revo, Coach: $150-220
- Burberry, Dolce & Gabbana, Versace: $200-300
- Giorgio Armani, Prada, Persol, Tiffany: $250-350
- Bvlgari, Fendi, Miu Miu: $350-500
- Dior: $500-600

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[1] "Married in his early twenties, **Del Vecchio set up his own mold shop, producing parts for eyeglass framers. In 1961 he moved to tiny Agordo, in the foothills of the Dolomite Mountains in northeastern Italy, and started Luxottica**. He chose Agordo largely because the local authorities were giving out land free to entrepreneurs in the hopes that they would create desperately needed jobs and provide tax revenue. The Dolomites and the Veneto plains just to the south were also centers of the Italian optical industry, offering Del Vecchio's tiny, fourteen-worker factory easy access to customers.

It didn't take him long to figure out that there were far more profits in producing the entire frames than in selling parts to manufacturers. For the same reason, in the 1970s he decided to become a distributor of his own frames. "**We were lowering our costs and raising our quality**," Del Vecchio told an Italian publication a few years ago. "**But our distributors were just fattening their profit margins instead of passing on the savings to the retailers**." Luxottica now owns or controls nineteen distributors and subsidiaries throughout Europe, the Americas, and Asia, delivering more than 14 million frames a year to retail stores and opticians around the world and earning Luxottica a net income of $99.2 million in 1995." – *Italy's Gem of a Giant*, Jonathan Kandell, World Business, September 1996

[2] "**The Del Vecchios say they were motivated by concern that big chains such as LensCrafters, which has more than 600 stores, were dominating the American optical market and selling too many cheaper, Asian-made frames instead of pricier brands such as the Luxottica labels.** The chains controlled 35 percent of the market, yet only 10 percent of Luxottica's sales were through them.

"**The LensCrafters operation represents 'insurance' for Luxottica's growth far beyond the next five years**," Leonardo Del Vecchio informed shareholders in his latest annual report.

But until now, Luxottica and LensCrafters seem to have aimed at different segments of the United States market. **LensCrafters' success is due mainly to its strategy of going after budget-conscious consumers** and those clients who purchase their prescription glasses through Medicare or health insurance plans that will not cover the cost of more upscale frames. **Luxottica, on the other hand, has been raising its profit margins by going after increasingly affluent consumers. Thus, as a proportion of total Luxottica sales, designer frames have climbed from 38 percent in 1991 to more than 58 percent in 1995**. And sunglass frames now account for almost 40 percent of total sales-up from only 12 percent in 1991.

Luxottica has been introducing its pricier brands into LensCrafters stores. Eventually all these outlets will have Luxottica sunglass and prescription-frame display spaces. "**They are obviously trying to get people to upgrade their purchases at LensCrafters**," says MarieChristine Keith, an analyst with HSBC James Capel's London office who keeps tabs on Luxottica**. Although it's not at all clear yet, she adds, customers appear willing to pay more for eyeglasses, even if their insurance doesn't fully cover them.**" – Italy's Gem of a Giant, Jonathan Kandell, World Business, September 1996

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Luxottica switched production to Italy, primarily to Agordo, where the company also has its product-development headquarters, and immediately ramped up manufacturing for numerous existing Ray-Ban models, including Predator (made famous in the movie "Men in Black"), Shooters and Caravan. But the company knew that the biggest potential lay in its two iconic models: Aviator and Wayfarers." – Ray-Ban Hopes to Party Like It's 1983 by Relaunching Its Wayfarer Shades, Christina Passariello, Wall Street Journal, 27 October 2006

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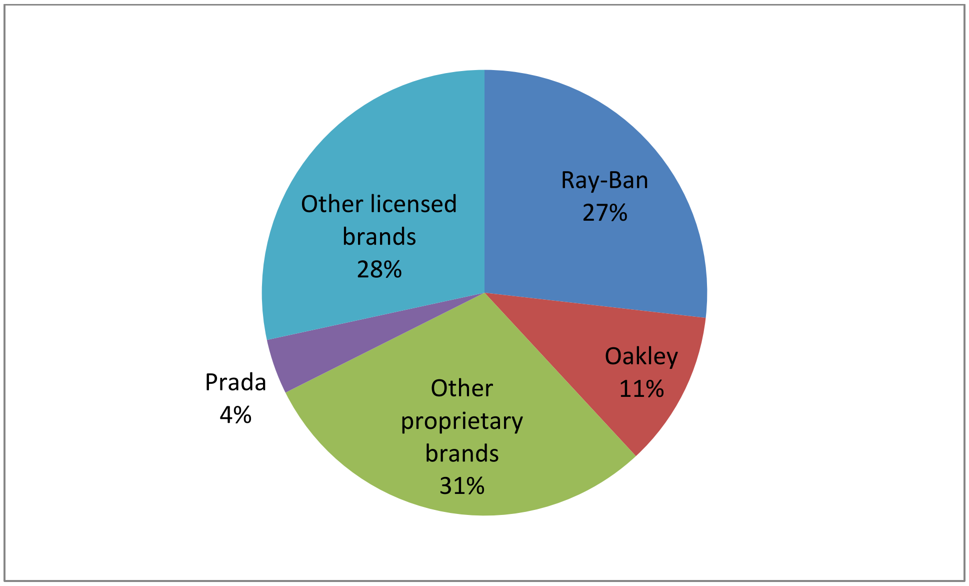
Convenience stores and gas stations are not the best avenues for cultivating an upscale image. So Luxottica made the painful decision to exit 13,000 points of sale in the early 2000s, sacrificing revenue in the short term in the belief that would pay off later. The company was making eyewear for luxury names like Bulgari, Chanel and Armani, so it already had ins with high-end stores. **By 2004, Luxottica was able to leverage the improved reputation of Ray-Ban to command higher prices again, selling the shades at Neiman Marcus and Saks Fifth Avenue. In 2000, a year after the acquisition, the starting price for a pair of Aviators was $79. Two years after that, that had risen to $89**. **And by 2009**, as Ray-Ban started using newer materials like lightweight carbon fiber and more sophisticated lens technology, **the entry price had reached $129**."We needed to clean the market of many pieces of low-quality, old Ray-Bans and clean up the distribution," says Volpetti." – *How Ray-Ban Brought Its Brand Back from the Brink*, Phil Wahba, Fortune, 27 January 2016

Durability

Luxottica Has a Diversified Portfolio of Strong Brands



3 biggest brands account for 42% of Luxottica's revenue

- **Biggest Negative:**
- The demand for Luxottica's products is durable
  - Contact lenses
    - About 40 million Americans wear contact lenses
    - Contact lens consumers are the most profitable consumers in optical[1]
      - They come in every year
      - They buy not only contact lenses
        - But also sun and eyewear
  - Refractive Surgery has minimal impact on the eyewear market
    - # of U.S. residents who opted for refractive surgery
      - (source: the Vision Council's Vision Watch report)
      - 2015: **935,000**
      - 2014: **893,000**
      - Total since 2011: **3.1 million**
    - # of U.S. adults using some form of vision correction: 188.7 million
      - **159.2 million** of them use Rx eyeglasses
      - **15-16 million** children use Rx eyeglasses
    - Reasons for not doing refractive surgery
      - Regression after the surgery is common

        - We get refractive error mostly due to habit
      - Rx eyeglasses are a fashionable item
        - Why need a surgery?
    - After refractive surgery, people still buy[2]
      - Sunglasses, and
      - Reading glasses
- Luxottica has a diversified portfolio of strong brands
  - Licensed brands
    - **32.4%** of total revenue
    - Among licensed brands are
      - Prada
        - Prada, Prada Linea Rossa and Miu Miu
      - Armani
      - Brook Brothers
      - Bvgalri
      - Burberry
      - Chanel
      - Dolce & Gabbana
      - Versace
      - Tiffany
      - Ralph Lauren
      - Coach
      - Michael Kors
      - Tory Burch
      - DKNY
      - Valentino
    - Prada is the biggest licensor
      - Prada, Prada Linea Rossa and Miu Miu account for 4% of sales
        - About €350 million
    - Luxottica's advantage in distribution help attract brands
      - Retail revenue account for
        - **59%** of total revenue
        - **80%** of revenue in North America
      - Luxottica has
        - 7,235 owned stores
        - 200,000 wholesale customers around the world

- Luxottica gets new brands overtime
  - Bvgalri: 1997
  - Chanel: 1999
  - Prada: 2003
  - Versace: 2003
  - Donna Karan: 2005
  - Dolce & Gabbana: 2006
  - Burberry: 2006
  - Ralph Lauren: 2007
  - Paul Smith: 2007
  - Tiffany: 2008
  - Tory Burch: 2009
  - Coach: 2012
  - Armani: 2013
  - Michael Kors: 2015
  - Valentino: 2016
- The only significant license Luxottica lost was Armani
  - In 2002
    - Armani accounted for 10% of wholesale revenue
      - About €110 million
  - Armani didn't renew the license because Leonardo Del Vecchio and Giorgio Armani had some disagreements
    - Armani switched to Luxottica's closest competitor
      - Safilo
    - But Armani returned to Luxottica
      - In 2013
- Prada tried to do itself
  - Prada cease licensing its brand to Luxottica
    - In 1999
  - Formed its own eyewear company
    - Eyewear International Distribution
      - In partnership with De Rigo
  - But Prada returned to Luxottica
    - In 2002
    - Prada's eyewear revenue was €33.6 million
      - 2015 revenue: €350 million
- Recently Gucci decide to take eyewear in-house

        - Kering decided to end relationship with Safilo 2 years early
            - End in Dec 2016 instead of Dec 2018
        - Kering eyewear is big
            - €350 million business
            - Making it the 5th biggest among premium players[3]
        - Kering is expected to face challenges in distribution[4]
        - It has to develop relationships with local eyewear retailers
            - 3 largest competitors could block it out of parts of the market
    - It's reasonable to expect Luxottica will get more strong brands overtime
- Owned brands
    - **67.6%** of revenue
    - Among Luxottica's owned brands are
        - Ray-Ban
        - Oakley
        - Revo
            - A performance sunglasses brand
        - Arnette
            - An active lifestyle eyewear
            - Attract young and "forever young" consumers
                - With an easy going style
        - Vogue Eyewear
            - Launched in 1973
            - Under the same name as the famous fashion magazine
            - An international contemporary fashion brand
                - Reflects dominant fashion trends of the moment
        - Persol
            - The iconic "Made in Italy" eyewear brand
            - A favorite luxury brand in the world of cinema
                - With the appeal of
                    - Timeless design
                    - Art-like quality
        - Oliver People
            - Another luxury brand like Persol
            - Frames are crafted from the finest quality materials
                - Manufactured in limited quantities
        - Alain Mikli

        - Another luxury brand
    - Luxottica
        - Launched in 1967
        - Is the group's original line
    - Sferoflex
        - Takes its name from the patented flexible hinge
            - Enabling the temples to conform to the shape and size of the face
            - => increasing the resilience of the frame itself
                - And ensuring perfect fit
- Two biggest brands
    - Ray-Ban
    - Oakley
- Ray-Ban:
    - Accounts for **26.8%** of revenue
        - €2.4 billion
        - => retail revenue is well over €3 billion
    - Of Ray-Ban's revenue:
        - Rx eyeglasses: 30%
        - Sunglasses: 70%
    - Ray-Ban is the sunglasses of choice for Hollywood
    - Ray-Ban's strength comes from
        - Product placements
            - Hundreds of product placements in TV and movies each year
                - => Subtly familiarize consumers with the brand
        - Retail presence
            - Nice in-store display creates temptation
                - Sunglasses are high impulse purchase
            - Well-trained in-store consultants educate consumers about brands
    - Ray-Ban's durability benefit from Luxottica's retail operations
        - Sunglass Hut has no competitor in premium sunglasses
    - The biggest risk is brand dilution
        - Bausch & Lomb mismanaged Ray-Ban
        - When Luxottica acquired Ray-Ban in 1999[5]
            - Ray-Ban shades were sold for as low as $29

- Available everywhere from gas stations to drugstores
- Manufacturing was scattered across the globe
  - Mexico
  - China
  - Ireland
- Ray-Ban frames fell apart 4 times faster than those of Luxottica's other frames

- Luxottica fixed the brand
  - Brought production to Italy
    - Improved quality
  - Pulled Ray-Ban out from 13,000 retail outlet[6]
  - Stopped selling for 1.5 years
  - Gradually raised price
    - The starting price for a pair of Aviator
      - 1999: $29
      - 2000: $79
      - 2002: $89
      - 2009: $129
      - 2014: $149
  - Re-launched Ray-Ban Wayfarer
  - Introduced Rx line[7]
    - Become the biggest Rx brand
    - Now account for 30% of the brand revenue
  - Reach out to female consumers

- Luxottica has always focused on the premium segment
  - => Ray-Ban is safe in Luxottica's hand

- Oakley
  - Account for **11.3%** of total revenue
    - About €1 billion revenue for Luxottica
      - Brand revenue at retail is higher
  - Oakley is the sunglasses of choices for athletes
    - People recognize Oakley when they're involved in sports
    - Attract athletes and the enthusiast
      - Very loyal group of consumers
  - Oakley is recognized as the best performing sun lens in the world
    - Has a strong portfolio of 600 patents
  - Oakley's positioning is durable

- Retail presence is important for Luxottica
    - Retail revenue account for
        - **59%** of total revenue
        - **80%** of revenue in North America
    - Luxottica has
        - 7,235 owned stores
        - 200,000 wholesale customers around the world
    - Dedicated stores help sell premium sunglasses
        - Nice in-store display creates temptation
            - Sunglasses are high impulse purchase
        - Well-trained in-store consultants are good at getting people buy things
            - And educate consumers about brands
        - Non-dedicated big stores can't sell premium sunglasses as quickly
            - Without salespeople, consumers may buy only cheap sunglasses
    - Retail is even more important for premium optical frames
        - People seems to pay less attention to brand of optical frames
            - Than to brand of sunglasses
        - Upscale retail outlets are the best advertising for premium optical frame
            - Attract some consumers who are willing to pay
        - That's why Luxottica acquired LensCrafters
        - In early 1990s, chains were importing more and more frames from the far east[8]
        - Luxottica saw acquiring LensCrafters as the only solution[9] [10]
            - Luxottica introduced its pricier brands into LensCrafters stores
                - Try to get people upgrade their purchases at LensCrafters
                - Customers appear willing to pay more for eyeglasses
                    - Even if their insurance doesn't fully cover them
            - Created a boutique atmosphere at LensCrafters to sell eyeglasses at boutique prices
                - LC updated its image with a contemporary design[11]
                    - Combines style and functionality
                    - Make the store inviting and easy to shop
                    - Reinforces LC's brand image
                    - Give the store more curb appeal
                        - Stand out better
                    - Allow complete visibility of the interior space
                        - Fashioned in brushed aluminum

            - The façade has a sleek, slightly high-tech look
        - Strategically placed graphics convey strong product and services messages
    - Departure from the standard, almost utilitarian appearance of LC's previous prototype[12]
        - New format had
            - Maple wood flooring and cabinetry
            - Blue carpeting
            - Comfortable seating
            - Warmer, softer look
    - Create a wall display system
        - Allow shoppers access to a good amount of product
        - Frames sit on small nose plugs
            - Are displayed on the world directly in front of the customers
        - Others are displayed in stylish floor units
        - => showcase and accentuate the product
            - Previously, all of the frames at LC were displayed in cases
- Sales clerks are trained to give customers advice[13]
    - Undergoing once-a-month fashion huddles in stores
        - Review trends in cosmetics and accessories
    - One training session focuses on using words with care[14]
        - How to tell a woman with an ample face that she needs square glasses
            - "softer edges look better with bolder shapes
        - One customer was brand agnostic
            - He tried on a few pairs
        - => it became clear that he didn't want "feminine" glasses
        - The saleswoman explained: "Ray-Ban are more masculine"
        - He tried on several pairs and didn't like
        - The saleswoman realized that he didn't like glasses with thin temples
            - => suggested a thick black Ray-Ban frame at $124

            - "They are sporty yet conservative and classy"
        - He agreed
    - Luxottica succeeded
        - % of LensCrafters revenue come from Luxottica products
            - 1995: 5%
            - 1996: 43%
            - 2002: 76.3%
            - 2015: over 90%
        - LensCrafters grew strongly
            - 1994: $706 million
            - 1996: $905 million
            - 1997: over $1 billion
            - 1998: $1.11 billion
            - 1999: $1.3 billion
- Luxottica acquired LensCrafters despite backlash from retailers
    - LUX was concerned about the 3 O's[15]
        - Opticians
        - Ophthalmologists
        - Optometrists
    - Competitors told the 3 O's: "look at those horrible Luxottica people-they've become your competitors"
    - An independent retailer might still have to sell clients an Armani frame
        - But he could afford to drop other non-designer LUX lines
            - Nobody asks for by name
            - There are many other frame makers out there
- Luxottica hoped to raise visibility of Luxottica products
    - Through retail presence
        - Backed by advertising campaigns
            - Aimed at getting American to become more fashion conscious about eyewear
    - Then independent retailers may return to Luxottica[16]
- Luxottica was correct
    - Wholesale business in the U.S. was slow for a long time[17]
        - From 1995 to 2005
        - Some retailers weren't very happy

            - LUX didn't service them anymore
        - But Luxottica began to re-work on wholesale in 2005, 2006
        - Since 2007, U.S. wholesale has grown faster than U.S. retail
            - In $, average annual sales growth rate was
                - Wholesale: **14%**
                    - 2007: $407 million
                    - 2015: $1,169 million
                - Retail: **2.9%**
                    - 2007: $3,761 million
                    - 2015: $4,719 million
    - Luxottica has been trying to replicate this strategy in other countries
        - By acquiring and expanding retail presence
            - Educate consumers
            - Create demand for premium optical frames
            - Then the wholesale business will follow
- The Internet won't kill Luxottica
    - It's hard to sell optical eyeglasses online
        - People still need prescriptions from doctors
            - And measure pupillary distance
        - There's some risk[18]
            - It's harder to get glasses fit properly when buying online
            - Wearing the wrong eyewear can also cause
                - Eyestrain,
                - Headaches or
                - Even double vision
            - Wrong glasses can cause lasing harm to children's vision
                - If a lens isn't centered on the pupil in one eye
                    - Brain may shut off the eye that isn't seeing clearly
                    - After a few months or years => the brain forgets how to see out of that eye
                - This is not a place to cut corners
        - Customer acquisition cost can be high
            - People don't buy optical eyeglasses often
                - Average once every 2 years
            - => advertisement won't create impulse purchase
        - After 6-12 months, online startups will sell[19]
            - Sun

        - Contact lenses
        - Or close
- Warby Parker gets a lot of attention
    - It sells basic prescription frame and lenses for $95
    - Revenue is said to exceed $100 million
    - It's valued at $1.2 billion
        - Has raised a total of $215 million from investors
    - It advertises all over the internet
    - But it isn't profitable yet
        - It can has big advantage in fulfilling cost per sale
            - Most optical stores sells less than 20 frames a day
        - But it probably has very high customer acquisition costs
- Even if Warby Parkers succeeds, it's just a value alternative
    - LensCrafters is in premium niche
        - LensCrafters has less than 10% market share
        - Luxottica has less than 15% market share in the U.S.
    - There's always value offer[20]
        - 2 eyeglasses for $99
        - 50% off
        - Etc.
- Weakening mall traffic won't hurt LensCrafters[21]
    - It's a destination
    - People book a visit with a doctor days before
        - They go to LensCrafters for an eye check
        - And LensCrafters tries to convert the visit into a sale
- Declining mall traffic may hurt Sunglass Hut
    - But penetration of premium sunglasses is still low[22]
        - 80% of American buy eyewear under $50
            - 60% of Americans buy eyewear under $35
    - Lower mall traffic can be offset by higher conversion
        - Into store visit
        - Into sales
- Luxottica's sunglasses business is well positioned online
    - It has so many big brands

[1] "A new focus for LensCrafters is going to be aggressive contact lens marketing and merchandising. **Contact lens customers** are really someone that we have not paid much attention to over the last 20 years, but we're finding that they **are the most profitable consumers you can have in Optical. They come in every year, they buy not only contact lenses but they buy sun and eyewear to go with it. So they spend more per year than any customer out there** and we've been somewhat silent in that category. Well, we're not going to be silent this year. About 20% of our marketing message will be oriented to bringing the contact lens customer in." – Kerry Bradley, COO of Luxottica Retail, Luxottica 2006 Q4 Earnings Call, 06 March 2007

[2] "**Laser surgery is growing, it probably is not growing at the rate that everyone was expected 4, 5, 10 years ago**. It grows, in any case it is growing. What we expect is for sure that as we continue to grow, **it's not something that's going to change the landscape of the industry. Always remember that on the other side when you are going through a laser surgery for your eyes, this accelerates the need for reading glasses and sunglasses**. So we feel that laser surgery will grow, but we don't feel that it will be more than 1 percent of the market in the eyewear." – Andrea Guerra, Luxottica's former CEO, Luxottica 2004 Q4 Earnings Call, 16 February 2005

[3] "In September, Kering told press, "**The current size of the Kering brands' business is roughly €350 million [making] Kering one of the top five players in this industry… Kering will fully control the eyewear value chain, from design to product development and supply chain, and from branding and marketing to sales**."

But why did Kering choose to go it alone? In the statement announcing the launch of its eyewear division, Kering highlighted that, "The premium segment of the eyewear business is currently growing in the high double-digits."

The importance of eyewear as an entry-level product for its brands speaks to the other key advantage stemming from Kering's move: control. The Exane BNP Paribas report states, "**The ubiquitous distribution typical of most license contracts adds to brand trivialisation risk**." By taking its eyewear in-house, controlling development, distribution and sales, Kering could "maintain desirability through perceived exclusivity."

What's more, Kering is now free to work with multiple manufacturing partners — including the Safilo Group — on a case-by-case basis. This freedom will allow the company to build out each of its eleven brands' eyewear businesses in a way that is carefully tailored to the consumer profile and DNA of each brand." – *A Closer Look at the $13 Billion Premium Eyewear Market*, Robin Mellery-Pratt, The Business of Fashion, 15 May 2015

[4] “Indeed, although Kering has a global network of stores (respectively, Gucci and Saint Laurent had 408 and 91 monobrand points of sale in 2014, according to statistics compiled by Exane BNP Paribas), it pales in significance compared to the own-retail network of Luxottica. In the unlikely event that Luxottica, the largest eyewear retailer in the world, stopped buying Kering eyewear, Kering would lose key distribution points, especially outside of its own stores in North America. Furthermore, **Kering would have to develop wholesale relationships with local eyewear retailers to achieve full reach: most small regional towns have an optician — few, however, have a Gucci store**.

“**If you're coming in new and you're trying to leverage a brand, I think you have a very long way to go. It's very difficult to build a solution, work-wise, when your three largest competitors could block you out of parts of the market**,” said Claudio Gottardi, chief executive of Marchon.” – *A Closer Look at the $13 Billion Premium Eyewear Market*, Robin Mellery-Pratt, The Business of Fashion, 15 May 2015

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[77] "In 2000, all of Ray-Ban sales were for non-prescription sunglasses. Luxottica, tapping its core strength in the prescription-sunglasses area, brought Ray-Ban into its "optical" business three years later. **Fast forward to 2015, and some 30% of Ray-Ban revenues come from prescription glasses, which are generally pricier and more profitable**." – *How Ray-Ban Brought Its Brand Back from the Brink*, Phil Wahba, Fortune, 27 January 2016

[8] **"The Del Vecchios say they were motivated by concern that big chains such as LensCrafters, which has more than 600 stores, were dominating the American optical market and selling too many cheaper, Asian-made frames instead of pricier brands such as the Luxottica labels.** The chains controlled 35 percent of the market, yet only 10 percent of Luxottica's sales were through them.

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appear willing to pay more for eyeglasses, even if their insurance doesn't fully cover them." – Italy's Gem of a Giant, Jonathan Kandell, World Business, September 1996

[9] "**Analysts said today that Luxottica was forced to pursue the acquisition in part because of the recent growth of the low end of the eyeglass frame market, a growth that Lenscrafters fueled by selling cheap frames imported from Far Eastern countries like China and Taiwan**. With its products aimed primarily at the middle to upper end of the market, Luxottica was forced to step in to reverse the trend." – *Luxottica to Acquire U.S. Shoe for $1.4 Billion*, John Tagliabue, 18 April 1995

[10] "To buy U.S. Shoe, which also owned optical retail chain LensCrafters and women's apparel retailer Casual Corner, Del Vecchio paid $1.4 billion, most of it in cash. **Until then he'd had no direct retail experience. But the acquisition, he believed, was the only way to prevent Luxottica from being squeezed by discount chains like Wal-Mart--even if it meant competing with his best customers, small opticians then providing 90% of his sales. "I would have risked a lot more sitting back,"** he says. He sold the shoe business to Nine West for $600 million and took Casual Corner private, turning it over to his eldest son, Claudio." – *Tough Guy*, Luisa Kroll, Forbes, 04 February 2002

[11] "LensCrafters, the nation's largest retail optical chain, has updated its image with a contemporary design that combines style and functionality. **In addition to making the store inviting and easy to shop, the new look is intended to reinforce LensCrafters' brand image.**

"**Our main objective was to bring a stronger design image to the store. We also wanted to make the message conveyed by LensCrafters stores more consistent with its brand advertising**," says Michael Schuster, president, Michael Schuster Associates Inc., Cincinnati, which executed the design in cooperation with the Cincinnati-based LensCrafters, which operates 620 stores nationwide.

The updated design also reflects the increased competition in mall-based retail optical stores.

"**We needed to give the store more curb appeal**," Schuster says, "**so that it would stand out better and look more inviting to shop.**"

To that end, **the storefront has been opened up, allowing complete visibility of the interior space**. **Fashioned in brushed aluminum, the facade has a sleek, slightly high-tech look that enhances LensCrafters brand image and updated positioning**. Strategically placed graphics convey strong product and services messages.

"**The openness at the lease line works to invite the consumer into the store**," says Jim Hennessey, vp, store design, LensCrafters" – *LensCrafters Polishes Image with Style*, Marianne Wilson, Chain Store Age, October 1996

[12] "**The new interior offers a departure from the standard, almost utilitarian appearance of LensCrafters' previous prototype. Maple wood flooring and cabinetry, blue carpeting and comfortable seating give the store a warmer, softer look. Some fixtures are accented with maple laminates; others with metal**.

"**The idea was to create a customer-friendly environment to buy technical products that reduces anxiety and promotes service**," Schuster explains. "One of the ways we accomplished this was by combining such high-tech design elements as stainless steel with more residential ones."

The retailer's signature colors-blue and red-accent the space and are featured on the floor fixtures. The strong graphics program communicates products, available services and helps educate consumers.

…

One of the most crucial components of the new design was **the creation of a wall display system that allows shoppers access to a good amount of product. Frames sit on small nose plugs and are displayed on the wall directly in front of the customer. Others are displayed in stylish floor units**.

"**The new fixturing is designed to showcase and accentuate the product**," Schuster says. "Previously, all of the frames at LensCrafters were displayed in cases."" – *LensCrafters Polishes Image with Style*, Marianne Wilson, Chain Store Age, October 1996

[13] "**Sales clerks will now serve as style consultants, undergoing once-a-month fashion huddles in stores to review trends in cosmetics and accessories**. The focus of one recent lesson: pairing baby doll dresses with oversize rectangular sunglasses.

The goal, executives said, is to drastically upgrade the shopping experience at the 23-year-old chain, whose sterile stores are increasingly at odds with the Versace, Prada and Bulgari frames on its shelves.

The makeover, which will include a fashionable dress code for employees, is also aimed at putting as much distance as possible between LensCrafters and its fast-growing discount competitors, like Wal-Mart Stores, which alone controls an estimated 10 percent of the United States eyewear market." – *At LensCrafters, Selling Candor and Designer Frames*, Michael Barbaro, New York Times, 15 April 2016

[14] "**But most of the interaction consists of a sales consultant, trained to know what glasses fit what faces, telling a customer what they think** -- delicately, of course, but candidly. **(One training session focuses on using words with care. How, for example, do you tell a women with an ample face that she needs square glasses? Consider this: "Softer edges look better with bolder shapes."**)
…
At the Fifth Avenue store on a recent afternoon, Patrick Comasky, a contractor, told a saleswoman he wanted to buy a pair of sunglasses. He was brand agnostic, he said, but as he tried on a few pairs, **it became clear what he did not want: "feminine" glasses.**

"Ray-Ban are more masculine," the saleswoman explained. He tried on several pairs, dismissing each with a "No, it's not right for me."

Observing that he did not like glasses with thin temples, the saleswoman suggested a thick black Ray-Ban frame, at $124. "They are sporty yet conservative and classy," she told him. And he agreed, buying them on the spot.

"People don't know what they want," the saleswoman, Christina Livingston, said. "They want you to tell them."" – *At LensCrafters, Selling Candor and Designer Frames*, Michael Barbaro, New York Times, 15 April 2016

[15] "**A bigger worry for Luxottica is the reaction of independent retailers-including opticians, ophthalmologists, and optometrists (known in the trade as "the three o's")**-to the Italian giant's entry into their business. "Luxottica's rivals have had a field day telling the three o's: `**Look at those horrible Luxottica people-they've become your competitors**,'" says Constance Maneaty, a Bear Stearns analyst. "**An independent retailer might still have to sell clients an Armani frame, but he can afford to drop other nondesigner Luxottica lines, which nobody asks for by name**."

Maneaty's comments are echoed by some retailers, small and large. "**We're dealing more with lines other than Luxottica's, and I know of other optometrists and opticians who have also cut back their Luxottica orders**," says David Bierbrier, the proprietor of Optometric Arts, an optical store in New York's World Financial Center.

"**Nothing personal, but it doesn't make sense for us to support a competitor, so we don't buy from Luxottica anymore**," says Tom Greenberg, chairman of Vision Plaza, a New Orleans-based optical chain with stores in Louisiana and Mississippi. "**It**

wasn't a difficult decision, because there are many, many other frame makers out there."

Luxottica is hoping to woo back the defectors by mounting an advertising campaign throughout the United States that will supposedly benefit the entire optical industry. The campaign is **aimed at getting Americans to become more fashion-conscious about eyewear and spend more money on both sunglasses and prescription spectacles.**" – Italy's Gem of a Giant, Jonathan Kandell, World Business, September 1996

[16] "Claudio Del Vecchio, who runs Luxottica's operations in North America, acknowledged that **Luxottica faced opposition from independent retailers but said the company would seek to use Lenscrafters' marketing strength to raise the visibility of Luxottica products, thus helping the independents as well**.

"**Until we can prove this, not all may follow us**," he said." – *Luxottica to Acquire U.S. Shoe for $1.4 Billion*, John Tagliabue, New York Times, 18 April 1995

[17] "As we said and I will repeat this, this is not our numbers; this is numbers that are given from different sources. And this is about premiumization of sunglasses. This is about premiumizations of lenses and this about baby boomers coming in the Optical reality.

So when we go and look to a part, an asset of our business where we have done a wonderful job in the last years is the wholesale part. So I will take care of that. **Many of you heard how we have been slow for a long time between '95 and 2005, we basically went to sleep. We didn't really tackle wholesale. Why was that? Because we had acquired LensCrafters in '95. We had a little bit of people not very happy between our customers and we gave it up.**

We didn't service them anymore. We didn't -- be proactive anymore. We were not happy. We were not nice. We were not efficient. We were not, nothing. We began to re-work on wholesale in 2005, 2006; took some years to take it back to where we wished and now it's three, four years of rapid, fantastic, wonderful growth. Is this finished? Absolutely, not." – Andrea Guerra, Luxottica's former CEO, Luxottica 2013 Investor Day, 08 October 2013

[18] "**It can be harder to get glasses to fit properly when buying online, especially for people who need significant optical correction**, experts say. As a result, people with extreme nearsightedness, farsightedness or astigmatism, or those who wear bifocals, may end up with glasses bought online that don't fix their vision problem. **Wearing the wrong eyewear can also cause eyestrain, headaches or even double vision**.

For children, whose visual systems are still developing, the wrong glasses could cause lasting harm, says David Hunter, ophthalmologist-in-chief at Boston Children's Hospital. "This is not a place to cut corners," he says.

In addition to lens power, **getting the right glasses requires choosing a frame that is not too big or small for one's face, and a few key measurements traditionally made by opticians. One is pupillary distance, or the space between a person's pupils. Another is segment height, or where to place the transition on bifocal or progressive lenses**.

...

Nashville, Tenn., ophthalmologist Rebecca Taylor says for teens and adults, a poor-fitting pair of glasses can be uncomfortable. **The frames may not feel right, you may not be able to see as well and you could get headaches**. But they are "not going to cause ocular harm," she says.

However, **wearing the wrong glasses for a long time could injure children's vision. If a lens isn't centered on the pupil in one eye, the brain may shut off the eye that isn't seeing clearly, Dr. Hunter explains. If this persists a few months or years, "in a young child, the brain forgets how to see out of that eye**."" – *The Pros and Cons of Buying Glasses Online*, Dana Wechsler Linden, 20 October 2015, Wall Street Journal

[19] "So this is what we're doing. We are extremely moving on. I think this is obvious. I mean, on eCommerce, things are finally moving. **Sun is a much easier subject than Optical. Optical has still many different tries and tests across the ocean, across the world and United States as well. Many people are saying, "Okay. Let's go in and do Optical retail online." After 6, 9, 12 months, either they sell Sun or they sell contact lenses or they close, with some exceptions**." – Andrea Guerra, Luxottica's former CEO, Luxottica 2013 Investor Day, 08 October 2013

[20] "Jeff Marsh, Analyst: And just one additional question. LensCrafters, any change in the promotional attitude of your competitors and if so, how did you address that in providing the good results this quarter? Thank you.

Kerry Bradley, COO of Luxottica Retail: There has not been a significant change. It is really more of the same by most of the competitors and we are just competing in a different way. It is still competition. We're just competing with a branded strategy and a little less promotional focus ourselves. But I would say that **most of our competitors are still doing the 2 for 99, 50 percent cent off, complete pair, etc.**" – Luxottica 2004 Q2 Earnings Call, 28 July 2004

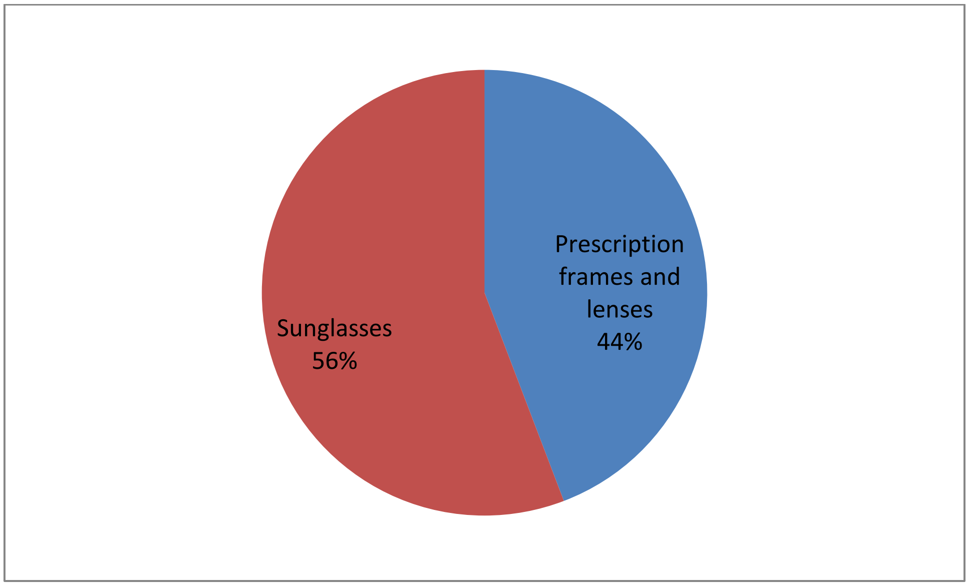
[21] "You always please remember that inside malls where traffic might decline, **LensCrafters is a traffic destination. You don't enter a LensCrafters by chance.**

You book a visit with a doctor days before, and you plan your trip to the mall because you go to LensCrafters to get your eye check. And then you are in the store, and it's our ability to convert that eye exam into our sales." – Massimo Vian, Luxottica's CEO, Luxottica 2016 Q1 Earnings Call, 29 April 2016

[22] "Definitely it is incredible to say that **North America continues to be one of our strongest emerging markets**. As Adil said today, we are breaking that paradigm of Americans buying eyewear. **80% of Americans buy eyewear under US$50. In fact, some statistics say that even 60% of Americans buy eyewear under US$35**. I will show you how we are trying to break that paradigm in the charts to come." – Adil Mehboob-Khan, Luxottica's former CEO, Luxottica 2014 Q4 Earnings Call, 03 March 2015

Moat

Luxottica's Moat Is Stronger in Sunglasses than in Prescription Eyeglasses



Sunglasses account for 56% of Luxottica's revenue

- **Biggest Negative**:
  - Luxottica doesn't make optical lenses
  - Essilor is a big supplier
  - Essilor has **41%** global market share
    - Next competitors are
      - Hoya: about 20% market share
      - Carl Zeiss: about 8% market share
  - Essilor account for 75% of the industry's total R&D
    - (According to Essilor's 2014 full-year result presentation)
    - % of Luxottica's retail lens merchandise comes from Essilor
      - 2004: 9.9%
      - 2005: 10%
      - 2006: 15%
      - 2007: 15%
      - 2008: 12%
      - 2009: 9%
      - 2010: 26%
      - 2011: 25%
      - 2012: 31%

      - 2013: 31%
      - No information for 2014 and 2015
        - The % might have declined
- **Michael Porter Questions**
  - (-) means low
  - (=) means medium
  - (+) means high
  - **For the industry**
    - Is the threat of new entrants high or low?
      - (+) Barrier to entry is low
    - Is the bargaining power of buyers high or low?
      - (=) chains like Wal-Mart has purchasing power
    - Is the threat of substitutes high or low?
      - (-) Contact lenses or refractive surgery aren't big threat
    - Is the bargaining power of suppliers high or low?
      - (+) Essilor dominates the lenses market
    - Is the rivalry within the industry high or low?
      - (+) a lot of promotion in the industry
  - **For the company**
    - Is the threat of new entrant different for this company specifically?
      - (-) Barrier to entry is low
        - But the damage to Luxottica is low
    - Is the bargaining power of buyers different for this company specifically?
      - (-) Luxottica sells to consumers or to small optical stores
    - Is the threat of substitutes different for this company specifically?
      - (-) Contact lenses or refractive surgery aren't big threat
    - Is the bargaining power of suppliers different for this company specifically?
      - (=) Essilor dominates the lenses market
        - But % of Luxottica lenses merchandise bought from Essilor is lower than Essilor's market share
    - Is the rivalry within the industry different for this company specifically?
      - (-) Luxottica separates itself from price competition
- Luxottica's moat comes from
  - Brand power
    - Strong owned brands

            - Persol
            - Oliver People
            - Alain Mikli
            - Ray-Ban
            - Oakley
            - Revo
            - Vogue
            - Arnette
            - Luxottica
            - Etc.
        - Complemented by a strong licensing business
            - Strong licensed brands
                - Prada
                    - Prada, Prada Linea Rossa and Miu Miu
                - Armani
                - Brook Brothers
                - Bvgalri
                - Burberry
                - Chanel
                - Dolce & Gabbana
                - Versace
                - Tiffany
                - Ralph Lauren
                - Coach
                - Michael Kors
                - Tory Burch
                - DKNY
                - Valentino
    - Distribution
        - Distribution include retail and wholesale/franchising
            - Revenue mix by channel is
                - North America
                    - Retail: 80% (€4,097 million)
                    - Wholesale: 20% (€1,054 million)
                - Europe
                    - Retail: 16% (€265 million)
                    - Wholesale: 84% (€1,361 million)

        - Asia-Pacific
            - Retail: 56% (€660 million)
            - Wholesale: €518 million
        - Latin America
            - Retail: 36% (€194 million)
            - Wholesale: 64% (€394 million)
        - Other
            - Retail: 9% (€29 million)
            - Wholesale: (€310 million)
        - Total
            - Retail: 59% (€5,244 million)
                - 89% of retail revenue comes from Luxottica products
            - Wholesale: 41% (€3,593 million)
- Retail operation include
    - In sunglasses: has a global chain Sunglass Hut
        - 3,006 Sunglass Hut stores worldwide
    - For optical eyeglasses: national chains in different market
        - In the U.S.
            - LensCrafter
                - 926 stores
            - Pearle Vision
                - 112 owned stores
                - 420 franchised stores
            - Target Optical
                - In 389 Target stores
            - Sear Optical
                - In 619 Sear stores
            - These chains have different positioning
                - LensCrafter: Upscale optical retailer
                - Pearl Vision: Neighborhood doctor
                - Target Optical: simple and fun[1]
                    - Frames are fun
                        - No stodgy, old frame
                    - Geared to women, youth and children
                    - Has one lens price
                        - Don't talk about lens

                - One of the best lenses possible
            - Sear Optical: in the value segment
                - Doesn't contribute much EBITDA
        - These operations are supported by EyeMed
            - The 2nd largest vision insurance company in the U.S.
    - In Asia-Pacific
        - Australia/New Zealand
            - OPSM: 308 stores
                - Similar to LensCrafters
            - Laubman & Pank: 25 store
                - Similar to Pearle Vision
        - Hong Kong/China
            - LensCrafters: 287 stores
    - In Latin America
        - GMO: 482 stores
    - In Europe
        - David Clulow: 115 stores
    - Chains outside the U.S. tend to be premium
        - Similar to LensCrafters

- To analyze Luxottica's moat, we'll apply our framework and look at
    - Licensing business
    - Sunglass Hut
    - LensCrafters
        - Understanding LensCrafters's strength can give us some hint about optical retail operations in other market
    - Wholesale/licensing
    - EyeMed

Licensing business

- Customer acquisition
    - Luxottica's distribution clout help maximize the potential of licensed brands
        - Big brands switched to Luxottica mostly for this reason
            - Donna Koran ended relationship with Marchon
                - In 2014
                - Entered relationship with Luxottica
                    - Expected €70 million sales

                • Within the first 12 months
        - Dolce & Gabbana ended relationship with Marcolin
            - In 2005
            - The business was doing €75 million
                - 48% of Marcolin's €148 million
            - D&G was aiming at further international development
                - => need to exploit its potential in eyewear
            - Luxottica expected €120 million from D&G[2]
                - Within the first 12 months
        - Ralph Lauren ended relationship with Safilo[3]
            - In 2006
            - Ralph Lauren accounted for 10% of Safilo's revenue
                - One of the biggest source of Safilo's revenue
            - Luxottica wanted to grow Ralph Lauren's sales by at least 50%
        - Armani ended relationship with Safilo
            - In 2012
            - Armani eyewear sales was €165 million
            - Luxottica expected €200 million revenue from Armani collections
        - Coach ended relationship with Marchon
            - In 2011
            - Luxottica expected more than $100 million in annual sales
        - Valentino ended relationship with Marchon
            - In 2016
            - Valentino see the relationship with Luxottica important for its growth process[4]
    - Luxottica tends to pay upfront royalty
        - Competitors with weak balance sheet can't match
- Customer retention
    - Long-term contract
        - 5-10 years
    - The only significant license Luxottica lost was Armani
        - In 2002
            - Armani accounted for 10% of wholesale revenue
                - About €110 million

        - Armani didn't renew the license because Leonardo Del Vecchio and Giorgio Armani had some disagreements
            - Armani switched to Luxottica's closest competitor
                - Safilo
            - But Armani returned to Luxottica
                - In 2013
- Margin protection
    - Licensors tend to look at potential sales
        - Instead of royalty rates
    - Luxottica has huge scale advantage over competitors
        - Example:
            - Safilo's EBIT margin: 6%
            - Luxottica's EBIT margin: 16%
                - Wholesale EBIT margin: 22%
- Moat evaluation
    - Barrier to entry: high
        - It makes more sense to enter relationships with existing players
        - Licensors may only switch from one incumbent to another
    - Impact of new entrant: low
        - Licensing contracts are long
        - Licensors tend to prefer strong existing licensees
    - Rivalry among existing firms
        - Main competitors include
            - Safilo has license for
                - Banana Republic
                - Boss
                - Céline
                - Dior
                - Fendi
                - Fossil
                - Marc Jacobs
                - Kate Spade
                - Swatch
                - Tommy Hilfiger
            - Marchon has license for
                - Calvin Klein
                - Salvatore Ferragamo

        - Chloé
    - De Rigo has license for
        - Lanvin
        - Loewe
        - Carolina Herrera
    - Marcolin has license for
        - Tom Ford
        - Balenciaga
        - Tod's
        - Ermenegildo Zegna
  - Existing firms compete on the ability to maximize sales
    - Don't compete on price
- Conclusion
  - Luxottica has a wide moat in the licensing business
    - Its portfolio of brands will get stronger overtime
      - Bvgalri: 1997
      - Chanel: 1999
      - Prada: 2003
      - Versace: 2003
      - Donna Karan: 2005
      - Dolce & Gabbana: 2006
      - Burberry: 2006
      - Ralph Lauren: 2007
      - Paul Smith: 2007
      - Tiffany: 2008
      - Tory Burch: 2009
      - Coach: 2012
      - Armani: 2013
      - Michael Kors: 2015
      - Valentino: 2016

Sunglass Hut

- Customer acquisition
  - Attractive products
    - Sunglass Hut's positioning: "find your cool"[5]
      - A variety of products

            - Extremely segmented across different regions and demographics
        - Less than 50% of the assortment is consistent
            - 25% change constantly
                - The brand assortments are different
            - 25% is different
                - The assortment in key brands is different
        - Exclusive products
            - 30-45 different front-doors in a year
                - Exclusive window
            - Sunglass Hut has exclusive programs[6]
                - Example: Have an exclusive Ray-Ban style
                    - Marketing at the front door
                - Exclusive programs with other brands
                    - Oakley
                    - Prada
                    - Versace
                    - Etc.
    - Prime location
        - Sunglass Hut is in shopping mall or airports
            - Being in prime locations is important for impulse purchase
            - Front door is the first contact with the customers[7]
                - Invest significantly in changing the window displays[8]
                    - Make them pop
                    - Catch consumers' eyes
                    - Drive traffic into the stores
    - Well-trained store associates
        - Get people to pay more for sunglasses
        - Tell stories about brands
        - Store associates are good at getting people buy
            - Sunglass Hut experience has 5 steps[9]
                - Invite
                    - Welcome customer
                    - Don't sell them right away
                    - Create a connection
                        - Is their football team playing today?
                        - Where they get their handbag they're carrying
                        - Etc.

- Engage
  - Why are you in today?
    - Going on holiday?
    - Going to a class reunion?
- Interact
  - Styling tray
    - Put 5 or 6 frames in the tray
    - Encourage the customer to try them on
  - Tell them if the frame looks good or not
  - Tell them that this is a good frame
  - Tell them stories about the frames[10]
    - What's behind a Bvlgari frame?
    - What it means to have a Channel on your face?
    - Tell them how cool Ray-Ban is
    - Tell them about the performance in lens technology in an Oakley
- Appreciate

- Mindshare
  - Building Sunglass Hut's reputation as a fashion brand[11]
    - Began the first TV campaign in the U.S.
      - In 2014
  - Marketing mix[12]
    - 33% in store
      - In visual merchandizing
      - In windows
      - In the tool to tell some stories
      - **130 million people** cross Sunglass Hut doors each year
        - Over 3,000 stores
    - 35% in digital
      - Plan to move to 50% in the next 3 years
    - CRM
      - Know customers better
      - Build a relationship with them
    - PR
      - To be perceived in a more consistent way as a fashion authority

                - Sunglass Hut has 97% awareness on Fashion Female Core Target
- Customer retention
    - We have no clear evidence about customer loyalty
    - Wild guess: high
        - People tend not to down trade
        - There's no premium alternative to Sunglass Hut
    - CRM is an important pillar in Sunglass Hut's marketing plan
        - Communication to consumer[13]
            - Advertising
            - Target message
                - Send fashion messages to the fashion customers
                - Send sport messages to the Oakley customers
        - 4 or 5 weeks is a proper timing to give new ideas to consumers
            - Give them reason to enter Sunglass Hut
- Margin protection
    - Customer willingness to pay is high
        - Sell to premium consumers
    - Sunglass Hut has no competitor
        - Sunglass Hut acquired its only direct competitor
            - Sunsation
            - In 1995
    - Sunglass Hut has great power
        - Sunglass Hut has well over **50%** market share in the U.S.
            - U.S. sunglasses market is about $3.9 billion
                - Premium sunglasses market is about $2.6 billion
                    - (sunglasses cost more than $50)
                - Sunglass Hut focuses on sunglasses above $100
                    - Its revenue in the U.S. is about $1.4 billion
        - Oakley story
            - Luxottica acquired Sunglass Hut
                - In 2001
            - Luxottica demanded price cuts from suppliers
                - Within weeks of the acquisition
            - All ten accepted the terms except Oakley
                - Oakley represented 25% of SH's sales
            - Oakley tried to negotiate but Luxottica refused

            - Luxottica drastically cut orders from Oakley
                - Oakley had to slash its financial projections for 2001
                - Oakley's share declined by 37% within a day
            - Several months after, the two companies reached an agreement
                - LUX could obtain preferred pricing terms from Oakley
                    - It purchases certain minimum quantities
                    - Or Oakley's products accounted for at least 15% of Sunglass Hut's total retail sales in the U.S.
            - Luxottica finally acquired Oakley
                - In 2007
    - Sunglass Hut is becoming the place where[14]
        - Key launches want to happen
        - Key brands want to launch innovation
            - Or launch new segments
- Moat evaluation
    - Barrier to entry: low
        - But there are big challenges
            - Entrants must be in prime location
                - Has high fixed cost
                - Sunglass Hut stores are about 750-800 square feet
                    - Mostly run by one employee
            - This is a high fashion business
                - Requires some experience
            - Average store holds 850 frames[15]
                - Choose from tens of thousands of options
                - Have to balance classic product with new lenses
                    - Classic product like a Ray-Ban aviator
                - Have fresh flowers
                    - Introduced 1,600 New Product Introductions (NPIs)
                        - 1,600 new styles, new SKUs
                        - In 2013 alone
                    - Customers expect Sunglass Hut to have the latest, exclusive products
                        - Can't find anywhere else
                    - Change the front doors every 2 weeks
                        - Sunglass Hut is a high impulse business
                        - Need to catch consumers' eyes

- Invest significant $ in changing the windows
  - Drive traffic into stores
- Sunglass Hut has no proper competitor[16]
  - People might be scared to enter the business
    - Seasonal
      - 10 years ago, stores may sell nothing in November
    - Sunglass Hut was able to create a category that's not seasonal anymore
  - People are scared about getting enough store volume
    - Sunglass Hut has experience in selling premium shades
    - Sunglass Hut has built an unbelievable compelling story
      - And it's visible
- Impact of new entrant: low
  - Entrants may not have access to premium brands
    - Sunglass Hut has a lot of exclusive products
  - New entrant don't have strong brand awareness
    - They might want to avoid opening close to Sunglass Hut
      - Or choose to target budget consumers
- Rivalry among existing firms
  - No real competitor

- Conclusion
  - Sunglass Hut has a wide moat

LensCrafters

- Customer acquisition
  - Attract premium consumers
    - LensCrafters has strong brand awareness
      - LensCrafters has been advertising for decades
        - On television
        - In catalogues
        - In newspapers
    - LensCrafters offer great store experience
      - Consumers get eyeglasses within 1 hour
        - Optical retailers tend to make less than $500,000 revenue
          - Don't have enough scale to build in-store labs
          - They send order to central labs

                - Customers get eyeglasses in 1 or 2 weeks
        - LensCrafter stores average $2 million
            - (or more)
            - Has in-store lab
    - Premium atmosphere
        - Utilize many of the principles found in apparel retailing
            - Soft lighting
            - Stylist fixtures
            - The way the product is presented
            - (4,160 square-foot store)
        - The stores feature[17]
            - Elegant eyewear display boxes
            - Beautiful wood flooring
            - Sleek decorative accents
            - Artistic lighting fixtures
        - Displays eyewear collections by designer brand
            - => helps customers shop for the style that's right for them
            - Reduces focus on price
                - Other retailers arrange frames by prices
        - The doctor's office is more integrated into the overall space
        - The waiting room has a warm, residential feel
            - Is shared by both the dispensing and fitting areas
            - Customers can shop as they wait to see the doctor
        - Store clerks serve as style consultants
            - Help customers find the right eyewear look
                - That compliments personal tastes and styles
- LensCrafters offers nice assortments of great designer brands
    - Notice: This attraction is weaker than at Sunglass Hut
        - People seems to pay less attention to brand of optical frames
            - Than to brand of sunglasses

- Customer retention
    - Customers buy every 2 years
        - Most people return to the last optical stores they bought from
    - Several millions of people come back to LensCrafters each year[18]
- Margin protection

- Customer bargaining power is weak
  - Customers are individual consumers
  - Willingness to pay is high
- LensCrafters target premium customers
  - Focuses on separating LensCrafters from price-oriented competition[19]
    - Best in the nation for quality and service in fashion
    - The same way for Sunglass Hut

- Moat evaluation
  - Barrier to entry: low
  - Impact of new entrant: low
    - Consumers are loyal to their optical stores
    - New competitors tend to focus on budget consumers
  - Rivalry among existing firms
    - Independents: don't have scale to advertise
      - Own 40-50% of the market
    - Chains: tend to focus on value/price
      - Highmark:
        - Has more than 700 Visionworks stores
        - Revenue: $1.5 billion
        - EBIT: $120 million
      - Wal-Mart: About $1.5 billion revenue
      - Costco: About 800 million reenue
    - Online competitors: sell cheap eyeglasses
      - Warby Parker
      - Zenni Optical
- Conclusion
  - LensCrafter carved out a premium niche
    - Wide moat in this segment
  - But this segment is a small part of the market
    - Brand seems less important in optical frame than in sunglasses
    - LensCrafter has less than 10% market share in the U.S.
      - Optical market in 2015:
        - (Source: Vision Council's Vision Watch Report)
        - Lenses: $12.5 billion
        - Frames: $9.5 billion
        - Contact lenses: $4.5 billion
        - => frames and lenses are $22 billion

            - LensCrafters revenue is around $2 billion
                - => less than 10% $ market share
                    - Even lower volume market share
    - Luxottica has about 15% market share
        - Luxottica's optical retail in North America is about $3 billion

Wholesale/Franchising

- Customer acquisition
    - Luxottica attracts retailers by brand power
        - Brand is more important in sunglasses than in optical frames
            - => Wholesale business sell more sunglasses
                - Example:
                - In 2008, optical frames and lenses accounted for
                    - 53% of total revenue
                    - 35-40% of wholesale revenue
    - Luxottica provides support to retailers
        - STARS program
            - Built around an inventory management software platform
            - Improves sales performance through
                - Product assortments
                    - Based on brand segmentation
                        - Tailored to each store's customer profile
                - Continuous product refresh
                    - Reflect new product releases and market trend
                    - Automatically remove under-performing items
                - Optimized stock levels based on
                    - Sales trends
                    - Seasonality
                    - Store profiles
                - Automatic stock replenishment
                    - Ensures sold items are replaced in a timely manner
                        - Through exchange of sell-out data
            - STARS is all about[20]
                - Counseling on assortment
                - Help maximize revenue
                    - By emphasizing the bestselling items

            - STARS helps improve revenue by 15-20%[21]
                - With 15-20% less inventories
            - STARS covered 10% of wholesale revenue in 2014[22]
                - Luxottica expected the number to increase to 20%
                    - In 3 years
                    - Not including STARS using in franchising
        - Franchising
            - Pearle Vision has 420 franchised stores
            - Pearle Vision's promise: genuine eyecare from your neighborhood doctor
            - Franchisees are doctors[23]
                - They want to take care of eyes
                - But they're in the retail business
                - They want someone to help with[24]
                    - Select the right frame manufacturers
                    - Negotiate for them
                        - With manufacturers
                        - With insurers
                    - Provide a lab service
                    - Marketing
                    - Provide a supply chain solution
        - Most retailers are small operations
            - 3-5 people
            - Tend to be owned by doctors
            - They don't have necessary skills in retail to
                - Maintain an assortments of 700-800 frames
                    - Different styles
                    - Different brand
                    - Different relationships with retailers
                - Get consumers into their stores
            - They don't have scale to optimize their operations
            - STARS and franchising are strong propositions
                - Luxottica has better scale than competitors to invest in these systems
- Customer retention
    - Optical retailers purchase inventories based on
        - What frames are selling

        - Sales representatives
            - Sales reps are usually biggest source of information for retailers
                - Sales reps know
                    - What the best-selling frames are
                    - When new releases are available
            - Sales reps visit retailers once every 1-2-3 months
            - An optical store may have relationships with several sales reps
                - Allotting a specific number of frame board slots to each rep
        - Wholesaler's relationship with retailers is stable
- Margin protection
    - Luxottica's designer frames tend to get premium price
        - Retailers get cheap frames from other manufacturers
    - Retailers are mostly mom and pops
    - Scale is important in this business
        - Safilo has much lower margin
            - (the closest competitor)
            - Safilo's EBIT margin: 6%
            - Luxottica's EBIT margin: 16%
                - Wholesale EBIT margin: 22%
- Moat evaluation
    - Barrier to entry: high
        - Relationship with retailers was already established
        - Manufacturers entered the business by acquiring wholesalers
            - Luxottica and Safilo acquired wholesalers in the 1980s
        - Scale is important
            - It's impossible to establish your own direct presence with one single brand[25]
    - Impact of new entrant: weak
        - Luxottica has a strong portfolio of great brands
        - New competitors, if any, will be in the low end segment
    - Rivalry among existing firms: tough
        - Like any wholesale business
- Conclusion
    - Moat is strong in Sunglasses wholesale
        - Consumer willingness to pay is higher
    - Moat is decent in optical wholesale
        - Consumer willingness to pay is lower than in sunglasses

                - => retailers have more options

EyeMed

- Customer acquisition
    - EyeMed is the 2nd largest vision insurance company in the U.S.
        - Has about 40 million members
            - 30% market share
        - The largest vision insurer has 37% market share
    - EyeMed sells to
        - Direct to the client
            - HR director
                - Responsible for creating portfolio benefits for their imployees
            - EyeMed has 9,600 direct clients
        - Work through health plans
            - Work with top 3 of 5 health carriers
                - Aetna
                - WellPoint
                - Humana
            - These carriers sell a bundled medical offering to the employer groups
    - EyeMed's provider network include 22,000 doors
        - 5,000 are retailers
            - Half are owned by Luxottica
                - LensCrafters
                - Pearle Vision
                - Target Optical
                - Sear Optical
        - The rest are independents
    - EyeMed differentiates by
        - Access to retail and independents
            - Including 5 of the top 6 national retail chains
                - LensCrafters
                - Sears Optical
                - Target
                - JC Penny

        - Pearle Vision
    - Value proposition
    - Customer service
      - 24/7 access through web, smartphones, etc.
      - It takes EyeMed 14.2 seconds to answer calls
  - EyeMed also advertises that you can get designer brands
- Customer retention
  - Customers rarely change health plans
- Margin protection
  - Customers are big
  - But the industry is concentrated
  - 3 or 4 Managed Vision Care companies have 80% market share in the U.S.
- Moat evaluation
  - Barrier to entry
    - High
    - It's very difficult to build a new network
    - Compliance cost is high
  - Impact of new entrant
    - Minimal
  - Rivalry among existing firms
    - 3 or 4 firms control 80% market share in the U.S.
      - Firms compete on
        - Network
        - Customer service
- Conclusion
  - EyeMed has a wide moat

Conclusion

- Luxottica has wide moat in sunglasses
  - Strong brands
    - And keep getting stronger
  - Strong distribution
    - Control the access to premium consumers
- Luxottica's moat is weaker in optical eyeglasses
  - Luxottica has a wide moat in the premium segment
  - But brand power is weaker in optical frame than in sunglasses
    - Making the segment relatively small

[1] "In terms of licensed brands, we're very excited about what's going on at Target. We've taken two years working closely with the Target leadership in Minneapolis to really conform the Target Optical business model to what Target, the host store, is. And **it's simple, fun and in style. We call it the anti-optical, and we've worked with them and we now have what we believe is the right model**. We're excited about it, they're excited about it. We're seeing very high comp sales behind this Target model. **You'll come in, all the frames are fun. They're not stodgy, old frames. They're fun. They're geared to women and youth and children more so than men**.

We have one lens price. You come in, we don't talk a lot about lenses like we would at a LensCrafters or at a Pearle. We just say, here's the one lens we believe in. It happens to be one of the best lenses possible. But it's a simple price. We don't do discounts, we don't do coupons, we don't do sales. Here's what it is every day and that model is really working well for Target. So we see Target growing substantially in this year and in the years to come. We will be adding 30 more Super Target locations as Target opens those stores." – Kerry Bradley, COO of Luxottica Retail, Luxottica 2008 Investor Day, 07 February 2008

[2] "**"**Throughout our life we have always taken those choices that seemed to be the most natural ones, and this choice was undoubtedly among the most difficult ones" -- affirm Domenico Dolce and Stefano Gabbana. "**The 10 year long collaboration with Marcolin was certainly positive and fruitful. Now, aiming at a further international development of the Group, we felt the need to exploit our potential even more within a dimension that can guarantee the company's growth**".
…
The first new Dolce & Gabbana and D&G Dolce & Gabbana eyewear collections will be presented in January 2006. **Luxottica Group expects to generate sales from the new collections of approximately euro 120 million during the first twelve months since its commercial launch, with additional growth beyond that through the fifth year**. Luxottica Group indicated that terms are in line with license agreements with other major brands already in the Group's portfolio. Additionally, terms include a euro 60 million January 2006 advance payment on royalties that will mature over the five-year term of the initial agreement." - *Luxottica Group and Dolce & Gabbana Sign Five-Year EyeWear Licensing Agreement*, PR Newswire, 07 October 2004

[3] "**Sales of Ralph Lauren sunglasses are about €100m a year, accounting for about 10 per cent of Safilo revenues**. **Luxottica wants to grow the sales by at least 50 per cent over ten years**, and said it was hoping for $1.75bn in revenues over the 10-year life of the contract.

Unusually, Luxottica disclosed that it had paid Ralph Lauren $200m in upfront royalties, a move that would have been difficult for Safilo to counter since its

balance sheet is not as strong.” – *Luxottica grabs Ralph Lauren from sunglass rival, Adrian Michaels*, Financial Times, 27 February 2006

[4] “Valentino was previously under contract with Marchon, another eyewear company that produced and distributed all of the brand's eyewear.

"**The agreement with Luxottica has a strategic value in the growth process of the brand**," Valentino SpA chief executive officer, Stefano Sassi, stated in a release.

"I believe that Luxottica is the ideal partner to develop a project of great quality and consistent with our brand values in high-end eyewear where we aim to replicate the success of our key product categories, including apparel and accessories," Sassi said.” – *Valentino Signs Eyewear Licensing Agreement With Luxottica*, Alexandra Suarez, Fashion Times, 23 February 2016

[5] “Product, product, product. It's what consumers come to a specialty retailer to buy and we're trying to have them finding. **Our positioning, I think we presented that in the past, is “find your cool**. So it's a variety of products, extremely segmented across different regions and demographics. **Our product has be fresh, has to be right, has to be exclusive**. The key driver we talk about is product freshness, it is the frequency of what units you add.

We now move from probably three years ago quarterly to weekly adding a new style in every single store. And, the new product introduction index, so how many products you introduce given your display, is consistently above 100% all geographies, all regions. So very nice number. Right, very different from years ago. So an enormous effort of our supply chain to support this ambition to make this happen.

Right product, when I say right product, it's being deep in terms of **the assortment of the key items that really make the difference, probably less than 10% of the total display. And continuously rotating new products**. On the other side, being right in how we segment the assortment by segment to segment. So, we talk later about segments.

Another number to leave you with is that if you go in a different store in different segments **in a given moment of time, probably less than 50% of the assortment is consistent. There is a 25% that change constantly because the brand assortments are different. And there is another 25% which is different because the assortment in the key brands is different**. And learning and at the same time how to manage the assortment has been extremely instrumental to the numbers we've been doing.

Last point, exclusive product. We have in the key countries, let's say North America I think is the easiest, between 30 and 45 different front-doors in a year. North America has been 44, the plan is 44 for 2012. And every single of these windows will have exclusive product going with, with a fantastic by-product that **we have been using the Sunglass Hut experience to continuously convince our Wholesale clients, our Wholesale partners to do exactly the same things, of course with different styles and different exclusives in the same time**, which Paolo was referring to with storytelling." – Fabio D'Angelantonio, Former President of Sunglass Hut, Luxottica 2011 Q4 Earnings Call, 29 February 2012

[6] "**We have more exclusive programs. And by that I mean, for example, right now we have an exclusive Ray-Ban style. Only Sunglass Hut gets that, that we're marketing at the front door. And we're going to follow that with exclusives from Oakley, from Prada, from Versace** and continue Ray-Ban exclusives throughout the year so that there's an only at Sunglass Hut message which we think is powerful." – Kerry Bradley, COO of Luxottica Retail, Luxottica 2008 full year conference call, 13 March 2009

[7] "For a retailer like Sunglass Hut, the store is a key element, is a key driver. By year end, we will have almost 70% of our stores will be looking very good. We will visit together a store tomorrow so you will see how they look like and what is the experience that we are giving to the customer.

So by year end, around 70% of the stores will be looking very good, it means that it will be either new or with an updated design. And this is very important to us, because this -- well, first of all, because the newest stores outperform the other stores. And second, because **this consistency allows us to communicate better and stronger our message through our front door and that's the first contact with the customer that is walking in the mall, in the street, in the shopping center, so we will drive customers in that way**." – Valerio Giacobbi, EVP North America Retail, Luxottica 2008 Investor Day, 07 February 2008

[8] "We are the authority in premium and fashion sun. **We also change our front doors pretty frequently. Frankly, very frequently, as often as every two weeks. We are a high impulse business. We need to catch consumers' eyes when they are walking by our stores through the malls. So we invest significant dollars in changing those windows, making them pop, making them come to life. What that does is drives more traffic into our store**, which ultimately drives our business." – John Haugh, General Manager of Sunglass Hut – North America, Luxottica 2013 Investor Day, 08 October 2013

[9] "Our magic is really our culture. 86% in our recent associate satisfaction survey indicated they were highly engaged to be with our business. Our people love our

business. We don't have help wanted signs in our windows. We get who we want to work in our stores. We're really, really fortunate.

But I think what's also important in addition to the passion, the energy, and the magic is a methodology. **We introduced something about a year and a half ago called Sunglass Hut Experience**. It's very simple, but we think it's very powerful.

First step, invite. We welcome the customer into our house, into our store. We ask them what they're doing on a Saturday. We don't try to sell them right away. Is their football team playing today? Where did they get their handbag they're carrying? We create a little bit of a connection right away before we sell them anything.

Then we engage. What engage means is why are you in today? Going on a holiday. Going to a class reunion. Sat on my last pair of sunglasses. But **we want to understand what might have brought them into our store today**. **They might just be browsing. But by understanding that, we can have a better connection with them and have a better chance of selling them a pair of sunglasses**.

Then we interact. Interact means that's kind of where we make our money, that's where we try to sell something. **We have what we call styling tray. We put five or six different frames in that styling tray and we encourage the customer to try them on. We tell them when they look good, when tell them when they don't look good. We tell them that this is a good frame, this is the history behind the frame. And then we try to sell them a second frame when they buy the first frame**.

Finally, we appreciate. Our frames are $150, $250. We have an Oakley Pit Boss right now in our stores for $600. When you put that baby on, you look like a rock star. You are ready to conquer the world, so **we thank the customer for being with us, we thank them for buying the Oakley Pit Boss and we tell them to get back quickly and tell their friends to come back.**" – John Haugh, General Manager of Sunglass Hut – North America, Luxottica 2013 Investor Day, 08 October 2013

[10] "**When a customer enters the store, then we need to tell stories**, then we need to merchandize. What we need to do is tell the customer **what is behind a Bvlgari frame. We need to tell the customer what it means to have a Chanel on your face. We need to tell the customer how cool Ray-Ban is. We need to tell the customer about the performance in the lens technology in an Oakley**. We have to do that through our merchandizing." – John Haugh, General Manager of Sunglass Hut – North America, Luxottica 2013 Investor Day, 08 October 2013

[11] "A few factors worth to mention for what concerned the first point, which is our effort to **build Sunglass Hut's reputation as a fashion brand, are that we had the biggest**

global summer campaign ever, including even television for the first time in the US. This drove high-single-digit sales growth in our largest markets. Brand reaches new level of awareness relevancy with consumer in the major markets of the United States and Australia. And we believe the [lack of fashion penetration and] our mix of sales is still a great opportunity for our business and keeps growing in all geographies." – Fabio D'Angelantonio, Former President of Sunglass Hut, Luxottica 2011 Q4 Earnings Call, 29 February 2012

[12] "In terms of marketing strategy, we have doubled, as John said, our marketing investment in the last four years. **With 2,000 stores and almost 90 million people walking in our doors every year, we leverage our stores has the most powerful media channel. One-third of our marketing investment is in our store, is in our visual merchandizing, is in our window, is on all the tool we put together to tell some stories to our customer about product and about brand**.

Obviously, we have changed **our marketing mix in the recent years to become more and more digital and to target our younger customer. Today, we invest 35% of our marketing investment in digital and we plan to move this number from 35% to 50% in the next three years**.

Other two important pillars of our marketing plan are CRM and PR. So, **our CRM program is a fantastic opportunity for us to know better and better our customer and to build a relationship with them. In terms of PR, we have a solid and strategic strategy because PR should allow us to be perceived in a more consistent way as a fashion authority; not only in sunglasses market, but in all the fashion accessories market**.

The last point I want to show you is about a research we did in US in August. We usually do this kind of research, the brand tracking, twice per year in US to understanding how healthy is our brand and what's going on into the market. **So as you can see, our brand awareness is really high. It's almost 97% on our Fashion Female Core Target, which means that 9 of 10 people thinks to Sunglass Hut when it comes to buy sunglasses**." – Luca Lo Curzio, Global Leader – Marketing of Sunglass Hut, Luxottica 2013 Investor Day, 08 October 2013

[13] "The second driver and brand builder and driver of the customers will be the communication to consumer, the advertising, and **we are going to do a lot of communication and even more than this year, target communication to our consumer with the e-mails, with the catalogs, with customized mailings, and thank you to our -- thanks to our database, we will be able to send fashion messages to the fashion customer and sport messages to the Oakley customers**, **come see the new Oakley collection or the new style**. So it will be a targeted

message." – Valerio Giacobbi, EVP North America Retail, Luxottica 2008 Investor Day, 07 February 2008

[14] Luxottica's founder Leonardo Del Vecchio stated when Luxottica acquired Sunglass Hut: "The acquisition of Sunglass Hut is the next step in our strategy to penetrate the retail market in North America, which we started in 1995 with the acquisition of LensCrafters. In fact, we are bringing under the same umbrella over 2,500 stores by combining the leading sunglass retail chain with the largest optical retail chain in North America. **At the same time, this operation is the natural outcome of our strategy to strengthen our presence in the sun segment, which we started two years ago with the Ray-Ban acquisition. In fact, Sunglass Hut is the only chain that has the market position needed to set new trends, adding value to existing brands and supporting the launch of new ones.**"

[15] "When we look at what works in retail, it's product. People buy product. People buy our sunglasses. It starts with where we are with product. **Our challenge, our opportunity, our team literally chooses from tens of thousands of frames**. Tens of thousands of options are out there**. Our average store holds about 850 frames. So what we have to do is curate tens of thousands of options and put the right curation**, the right selection, the right offering in the stores for our customers to come in and purchase.
What we have to do is **we have to balance classic product like a Ray-Ban Aviator, which while classic continues to be invented with folding, with new lenses**. In fact, this holiday, we will have a solid gold Aviator in our stores that retails for about $3,500, which we're very proud of. That's premiumization. We feel good about that.

We also have something we call fresh flowers. Everybody who knows retail knows that new products are really the life blood of retail. **We will introduce 1,600 what we call NPIs, New Product Introductions, into our business this year**; 1,600 new styles, new SKUs will roll into our stores. **What that allows us to do, our customers expect from us to have the latest, to have exclusives, to have things they can't find anywhere else**. By continuing to bring this newness and these fresh flowers into our business, we deliver and we exceed expectations of anybody in the sunglass business.

We are the authority in premium and fashion sun. We also change our front doors pretty frequently. Frankly, very frequently, as often as every two weeks. We are a high impulse business. We need to catch consumers' eyes when they are walking by our stores through the malls. So we invest significant dollars in changing those windows, making them pop, making them come to life. What that does is drives more traffic into our store, which ultimately drives our business." – John Haugh, General Manager of Sunglass Hut – North America, Luxottica 2013 Investor Day, 08 October 2013

[16] "Julian Easthope, Analyst – Barclays Capital: Yes. Hi, it's Julian Easthope from Barclays. Yes, I've got a couple of questions please. First, in terms of Sunglass Hut, it's been such an immense success. I just wonder why you haven't really got a proper competitor? And why is it sort of -- was there a big barrier to entry? Why have you have been so successful in keeping that's as almost by itself out there?

Andrea Guerra, Luxottica's CEO: So Sunglass Hut is a secret formula, Julian, so we cannot just talk about it today. So the reality is that **for a long time people have thought about sunglasses as a very seasonal object, so people are just scared to enter seasonal businesses, what do I do in October, what do I do in November**.

And if you -- I mean, probably, there are people that have been looking at Sunglass Hut for a long time. Sunglass Hut was selling watches and one of the first thing we said, "Let's demonstrate to ourselves that we can be successful in October, November, February and March which are the tough months."

I mean, **you could have stores almost 10 years ago that in November were selling zero in a day**. And I think that that is the secret. **We have been able to create a category which is not seasonal anymore**. Department stores are understanding that, my usual talk about scarves and umbrellas. This is a year-long category and I think that we have been able to carry along.
The second point is density. People are scared about businesses where there's not enough density during the day and during the seasons. And, again, we have been able with everything, Fabio, when people talk about experience, even myself when teams are coming to meet talking, we want to show you our new experience, we want to talk to you about our new experience in our store. And sometimes my reaction is, okay, now they weren't telling me the story.

I think that **Sunglass Hut has built an unbelievable compelling story and it's visible**. I mean, you enter a store and you're entering a theater, you're entering something else. **So season and density I think are the big two issues for our competition** and I think that we solve them with very secret formulas that's very visible." – Luxottica 2013 Investor Day, 08 October 2013

[17] "**The store design features elegant eyewear display boxes, beautiful wood flooring, fashion graphics, sleek decorative accents and artistic lighting fixtures. Every feature of the design directs the spotlight on the shopping gallery of designer eyewear collections**, while the "fit and finish" stations are more privately situated and separated from the shopping and frame selection.

"**Displaying the eyewear collections by designer brand is also a change we've begun to incorporate that helps our customers shop for the style that is right for**

them, in a premium environment that makes the shopping experience an enjoyable one," McLaughlin said.

"Also inside the store, an important part of the brand's transformation is that **LensCrafters associates are focused on helping customers find the right eyewear look that compliments personal tastes and styles**, in addition to ensuring the proper functional choices."

"People are viewing eyewear as an accessory," says fashion expert and author Lloyd Boston, LensCrafters chief style officer. "How a person accessorizes with eyewear speaks volumes about that person and it is an expression of their individual style. LensCrafters associates understand that by advising customers on style, they can help enhance and bring out the customer's unique personality."" – *LensCrafters Makes a New Appearance*, PR Newswire, 20 April 2006

[18] *“”*

[19] “**We believe that in both brands the future in 2004 and beyond is clearly to continue separating LensCrafter and Sunglass Hut from the price oriented competition. We think that the world is shaking out such that there are retailers who [inaudible] for price and that is basis for purchasing from them and we think that LensCrafter is given the opportunity here to really position itself up as the best nation for quality and service in fashion and Sunglass Hut the same way**. So I think we will be more aggressive in getting that story across sometimes that translates to more dollars, sometimes it doesn't but we want to be more aggressive and really selling our story of why we are different, why we are better and we are seeing some good results from that right now, and expect that too to be our story going into 2004." – Kerry Bradley, COO of Luxottica Retail, Luxottica 2003 Q3 Earnings Call, 29 October 2003

[20] “We have very high coverage and excellent Wholesale, and let me state that as a person that knows Wholesale – you will hear a little more about our Wholesale business later – but **our reps are becoming more and more consultants to the optician. They are able to partner with the optician and the storeowners to grow the business. We have a program called STARS, which is all about counseling on assortment, guiding the assortment so that stores can maximize their revenue by emphasizing really the bestselling items, and we are able to partner and tell them what to do**. We can get up to a 20–25% lift in the individual store performance via that method, and of course our reps are super-digitized and have all of the state-of-the-art technology to get that visit to be impressive and to be meaningful to our clients.” – Adil Mehboob-Khan, Luxottica’s former CEO, Luxottica 2014 Q4 Earnings Call, 03 March 2015

[21] "We have STARS, a new roll-out, also in the United States. Imagine: **STARS was only in Europe before last year**. Within those 750 new doors, we have about 400 that are going to be Michael Kors boutiques, the first time that STARS moves into the world of boutiques. **Remember that STARS is able to generate between 15% and 20% more sales off-take, and that is with about 15% to 20% less inventory**. Obviously those clients that allow us to choose their assortments gain great strength from this system." – Adil Mehboob-Khan, Luxottica's former CEO, Luxottica 2014 Q4 Earnings Call, 03 March 2015

[22] "**In terms of STARS, Adil mentioned 10% of revenues; I think he meant approximately 10% of Wholesale revenues, and that is where we are today. Where are we looking at? In three years from now, I am hoping to do about 20% of Wholesale revenues in STARS**. Where is the upside there? The upside is that we are seeing an acceleration of STARS as more clients actually that are in STARS are happy because they are growing faster than the market with a lot less capital expenditures. Now, the other thing that is important: **I think the other great upside is that our first license now in April would start with STARS. We are currently in talks with another two licensees – I will not mention the names – that are interested in also doing STARS. That is another upside that I did not consider when I say in three years 20% of Wholesale revenues**." - Paolo Alberti, Luxottica's EVP Wholesale, Luxottica 2014 Q4 Earnings Call, 03 March 2015

[23] "**Genuine eye care from your neighborhood doctor, a promise that was started 50 years ago**. Most important words, eye care first, glasses second. Take care of the eyes guess what, you're going to buy the glasses. That's what we stand for. That's what this revolution or of getting back to its roots is all about.

Now that was one differentiation. Today's market place is about brands being differentiated. Differentiate or die is what people say. So we have done that. But we also within Luxottica want to differentiate it in another fashion, a differentiation on what we call a business model differentiation. And what was that? It's called franchising.

…

Second, if you build a franchising business founded on listening to the operator and making them successful based on their profitability we called it unit economics, you have an asset light scalable model. So that -- the next journey where we put together putting governance models, listening to our franchisees and doctors and making it a doctor-centered brand.

So what were the doctors looking for? We went to optometry schools and listened to them, listen to the 3rd year students and the 4th year students. What were they telling us? They were telling us "**Pearle vision. Wow. You guys are taking back to genuine care. Help us run a business. We are doctors. We want to take care of eyes**." What did that mean? Well**, we're on the retail business, help me select the right vendors, frame manufacturers, negotiate for us. I do not want to have capital invested in my store or on the lab. Help me providing a lab service**. What better company to provide those services but Luxottica?

So we have a team today working with the wholesale team that actually services all our franchisees with special terms for our doctors, for our opticians within our store working with Giorgo and his team and some of the other partners in the lens manufacturing providing a comprehensive solution for doctors." – Srini Kumar, Head of Pearle Vision, Luxottica 2013 Investor Day, 08 October 2013

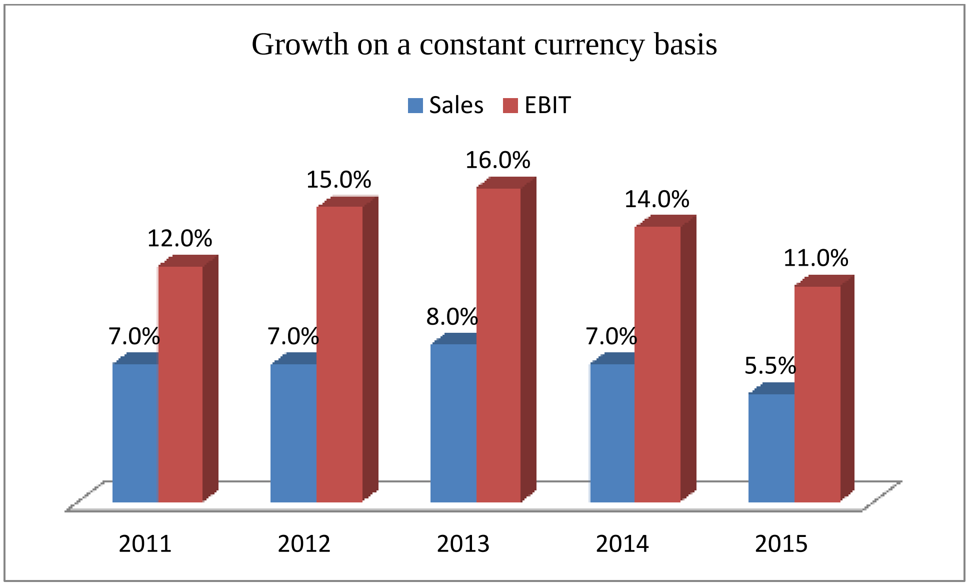
[24] "And then just a few words on the many other brands we've got, Pearle Vision is a trajectory to become the first and best franchise retail operator in the U.S. **We see opportunity to triple the number of franchisees over the next 5 to 10 years. We didn't have I think a very clear strategy probably a few years ago. Today I think we have a very clear strategy**. We want to make her the best franchise solution for great independent doctors who can keep their entrepreneurial spirit **but leveraging all the infrastructures, processes systems and skill set of the Pearle Vision team. So Pearle Vision is currently up, it's supply chain solution it's a brand new one**. We're transforming 31 different point of sale systems that we had in Pearle Vision in just one state of the art point of sale system, we will have supply chain the matches both inventory of lenses and frames. **We will guarantee huge power of negotiation vis-à-vis every manufacturer's, better marketing, better training, better traffic thanks to the in-network status with most of the assurances starting from VPS [ph],**, exciting moment at Pearle Vision as well." – Nicola Brandolese, President of Retail Optical of America, Luxottica 2015 Q4 Earnings Call, 02 March 2016

[25] "When we move to the international world, we all know how Luxottica has worked in the last three, four years on emerging markets at first. As we were commenting some weeks ago, we have been able in our wholesale business to reach an emerging market level of 13%, 14% on total of sales in emerging markets compared to the whole.

When you go in these countries you need economies of scale. You need scale. You need the fact that with one single brand most of the time it's impossible to establish your own and direct presence. We could have done it in the past, and we will continue to do it also with Oakley in some specific parts of the emergent markets world." – Andrea Guerra, Luxottica's former CEO, Luxottica and Oakley to Discuss the Completion of the Merger Conference, 15 November 2007

Quality

Luxottica Can Grows Earnings Faster than Sales



Luxottica has been growing its earnings 2x faster than its revenue for the last 5 years

- **Biggest Negative**:
  - Fixed cost is significant in the retail business
- **Michael Porter Questions**
  - (-) means low
  - (=) means medium
  - (+) means high
  - **For the industry**
    - Can the industry charge a high price?
      - (+) eyeglasses are available at all kinds of price
    - Does the industry have low costs?
      - (+) operating cost per sale is high for optical retailers
    - Does the industry have low need for assets?
      - (-) the industry has a lot of inventories
        - But the mark-up on inventory cost is high
  - **For the company**
    - Can the company charge a higher or lower price than the industry?
      - (+) Luxottica focuses on the premium segment

        - Does the company have higher or lower cost than the industry?
            - (-) Luxottica enjoy huge scale advantage
        - Does the company have more or less need for NTA than the industry?
            - (-) Luxottica has higher Sales/NTA than Safilo
                - Luxottica: 5.1
                - Safilo: 2.9
- Store model
    - Rent: 10% of sales
    - A new Pearle Vision center cost $200,000
        - And a licensing fee of $30,000
    - LC has on average 5 associates per shift (396)
    - No-lab LC store (594)
        - Can go into places that can't do $2 million in volume
            - But can do $1 million volume profitably
            - Low cost structure
        - Now has 1,000 full-service LC
            - Can add several hundred stores
            - $2 million stores can become $3 million stores
    - Sunglass Hut stores: 70-75 square meters (566)
        - More than half of stores are on single shift for labor
        - Average profitability per store in the States: 20%
    - 70-80% of Sunglass Hut stores has single coverage (744)
        - One person at a time
- Margin expansion
    - Retail
        - Retail margin normally increases as sales grows[1]
        - Luxottica stores are small in size
            - LensCrafters:
                - 4,000-4,500 square feet
                - Average 5 store associates per shift
            - Pearle Vision
                - 1,000-3,000 square feet
                - 3-5 employees per store
            - Sear Optical and Target Optical
                - 1,000-1,2000 square feet
                - 2-3 employees per store
            - Sunglass Hut

- 750-800 square feet
- 70-80% of Sunglass Hut stores has single coverage
  - One person at a time

- Costs include
  - Rent: 11% of sales
  - Depreciation: 4% of sales
  - Staff costs + other operating expenses: 37% of sales
    - Guess: staff costs are 25-30% of sales
  - => 16% retail EBIT margin
- Stores sells on average fewer than 20 eyeglasses a day
  - LensCrafters averages about $2 million annual revenue
    - Average frame cost $300
    - => sells 6,667 frames a year
  - Sunglass Hut averages about $740,000 annual revenue
    - Average frame sells for $150
    - => sells fewer than 5,000 frames a year
  - Higher volume will significantly reduce average cost of
    - Rent
    - Depreciation
    - Operating expenses
    - Staff costs (to a less extent than other costs)
      - Higher leverage of staff costs for small stores
        - Such as Sunglass Hut[2]
- If LUX stops investing in emerging markets retail networks, net margin would jump immediately to 10% or more[3]

- Wholesale
  - 2 drivers of wholesale profitability[4]
    - Scale
    - Mix and price
  - Need economies of scale to go in emerging markets[5]
    - Impossible to establish direct presence with one single brand
  - A lot of fixed cost in infrastructure
    - Supply chain
    - Marketing organization
  - Sales growth can help leverage SG&A expenses
- Rule-of-thumb: high single-digits sales growth => twice bottom-line growth[6]
- LUX stuck to its rule of thumb for 6 years in a row

        - From 2009 to 2015
        - Grow EBIT 2 times sales growth[7]
        - Growth on a constant FX basis
            - 2010
                - Sales: 7%
                    - 14% growth based on current FX
                - EBIT: no information
                    - 28% growth based on current FX
                - Net income: no information
                    - 35% growth based on current FX
            - 2011
                - Sales: 7%
                - EBIT: 12%
                - Net income: 13%
            - 2012
                - Sales: 7%
                - EBIT: 15%
                - Net income: 16%
            - 2013
                - Sales: 8%
                - EBIT: 16%
                - Net income: 20%
            - 2014
                - Sales: 7%
                - EBIT: 14%
                - Net income: 15%
            - 2015:
                - Sales: 5.5%
                - EBIT: 11%
                - Net income: 12%
    - Luxottica can keep expanding its margin
        - Gross margin is very high: 68%
- Luxottica is very profitable
    - Store model is profitable
        - Sunglass Hut
            - Invested capital: $100-200,000
            - A typical store has 700 to 900 SKUs

        - Sunglass Hut's inventory turns over about 4 times a year
      - Average revenue per store: $740,000
        - About $1,000,000 sales per square foot
        - => about 5 asset turnover
      - Sunglass Hut margin is better than retail average margin
        - 15%
      - => more than 75% ROIC at store level
      - More than 200 Sunglass Hut stores doing above $1 million[8]
        - These stores have even higher return
    - LensCrafter
      - Invested capital: $400,000-500,000
      - Average revenue per store: $2,000,000
        - About $450 sales per square foot
        - 5x asset turnover
      - Sunglass Hut margin is better than retail average margin
        - 15%
      - => more than 75% ROIC at store level
  - The whole operation has high return
    - Luxottica has high asset turnover
    - Inventory turnover is low
      - Retail stores turns inventories about 4 times a year
      - Wholesale business possible turn inventories about 3 times
      - => on average, Luxottica turns inventories 3.63x a year
        - By comparison, Safilo turns inventories 2x a year
          - Safilo has little retail revenue
    - But mark-up is high
      - Gross margin is 68%
      - => sales price is more than 3 times cost
      - => sales/average inventory is 11.3x
    - Luxottica collect cash quite quickly
      - Wholesale business collects cash in about 2 months
        - Sales/receivables is 5.8x
      - Retail business collects cash in less than 2 weeks
        - Sales/receivables is 28x
      - => Luxottica collects cash in less than 5 weeks
        - Sales/receivables is around 11x

        - Overall, Luxottica turn assets about 5x
            - Turnover can improve as same-store sales grows
    - Luxottica makes about 17% EBIT margin
        - => 85% pre-tax ROIC
- Luxottica is very cash generative
    - FCF/Net Income was about **103%**
        - From 2000 to 2015
            - Min: 7%
                - In 2007
                    - Due to upfront payment for 10 years of royalty to Ralph Laurent
                - Excluding 2007, min FCF/Net Income was **66%**
                    - In 2008
            - Max: 215%
                - In 2009
                    - Due to reduction of working capital built up in 2008
                - Excluding 2009, max FCF/Net Income was **149%**
            - Median: **103%**
            - Mean: 104%
            - Standard Deviation: 44%
            - Variation: 0.42
    - Over the last 15 years
        - Total Net Income: €6,619 million
        - Total FCF: €6,729 million
        - Total FCF/Total Net Income: **102%**
    - Over the last 10 years
        - Total Net Income: €5,034 million
        - Total FCF: €5,128 million
        - Total FCF/Total Net Income: **102%**
    - Over the last 5 years
        - Total Net Income: €2,992 million
        - Total FCF: €3,177 million
        - Total FCF/Total Net Income: **106%**
    - => Luxottica could achieve its organic growth without retaining any earnings
        - Thanks to its relentless focus on controlling net working capital
    - Sales/Average Receivables improved consistently
        - 2008: 8.03

                - (after acquiring Oakley)
            - 2011: 9.08
            - 2015: 10.96
            - The wholesale business improved cash collection every year
                - Sales/Average Receivables
                    - 2010: 4.1
                    - 2011: 4.3
                    - 2012: 4.8
                    - 2013: 5.4
                    - 2014: 5.6
                    - 2015: 5.8
                - In other words, Days Sales Outstanding declined
                    - 2010: 90 days
                    - 2011: 85 days
                    - 2012: 76 days
                    - 2013: 68 days
                    - 2014: 65 days
                    - 2015: **63 days**
    - Safilo achieved similar improvement
        - Sales/Average Receivables
            - 2005: 3.53
            - 2010: 4.00
            - 2015: 5.02
        - In other words, Days Sales Outstanding declined
            - 2005: 104 days
            - 2010: 91 days
            - 2015: 73 days
    - There can be room for further improvement
        - The industry still collects cash more slowly than the watch and skincare industry
            - Sales/Average Receivable
                - Safilo: 5.02 (73 days)
                - **Luxottica: 5.8 (63 days)**
                    - (wholesale business only)
                - Nike: between 6.50 and 7.61
                    - (or between 48 and 56 days)
                    - 6.50 = wholesale revenue/average receivables

            - 7.61 = total revenue/average receivables
        - L'Oreal: 7.39 (49 days)
        - Swatch: 8.05 (45 days)
        - Fossil: 8.06 (45 days)
        - Movado: 8.20 (45 days)
        - Estee Lauder: 8.44 (43 days)
- Luxottica was able to reduce inventories
    - Faster product introduction[9]
        - Product design is in 3D
            - More than 90% of tools are developed in-house
        - Overlap production of samples with the production of components of new frames
            - Right after testing => components are ready for assembly
    - Faster production[10]
        - Reinventing production methods/facilities every year
    - Optimize logistic networks
        - Reduced the number of DCs[11]
            - 2008: 31
            - 2010: 18
            - Wholesale and retail supply chains are fully integrated
        - Luxottica currently has 18 DCs
            - 11 in the Americas
            - 5 in the Asia-Pacific
            - 2 in Europe
        - Luxottica is focusing more and more on 4 main DCs[12]
            - Sedico, Italy
            - Atlanta, United States
            - Dongguan, China
            - Jundiaí, Brazil
            - These DCs incorporate highly automated order management systems
                - Service other DCs, or
                - Ship directly to customers
                    - Reducing delivery times
                    - Keeping stock levels low
        - The DC in Italy can ship directly to a vast number of key[13] accounts and department stores in the U.S.

            - No longer go through the DC in Atlanta
            - => better service, better availability and lower inventories
        - Luxottica is increasing capacity of first-level DC in Italy[14]
            - More than doubling the capacity in China
                - Will serve all Asia and Southeast Asia
            - Tripling the capacity in Atlanta
                - Will be the only DC in North America[15]
                    - Will close the DC of Oakley
                        - In Ontario, California
                        - And transfer to operations to Atlanta
            - These first-level DC will also fulfill e-commerce orders
    - STARS program retail partners reduce working capital
        - Improve revenue by 15-20%
            - With 15-20% less inventories
    - Higher sales at Luxottica's retail stores also improve inventory turnover
- There's a natural hedge against currency risk
    - US $ has a natural hedge between revenue and costs (1,010)
    - Didn't benefit from the dollar swing (1,033)
        - $ is about 50% of both revenue and expenses
    - % of revenue and costs dominated in different currencies
        - U.S. $
            - 55.1% of total revenue
            - 51.5% of total costs and operating expenses
        - Euro
            - 16.6% of total revenue
            - 21.7% of total costs and operating expenses
        - Other
            - 28.3% of total revenue
            - 26.8% of total costs and operating expenses
- 8 dimensions of quality
    - Relative size
        - Huge compared to customers
        - Huge compared to most lens suppliers
            - Except for Essilor
    - Focus
        - Luxottica is focused on the eyewear market
    - Customer engagement

        - Possibly high in sunglasses
            - They're fashion consumers
    - Cross-selling
        - Cross sell sunglasses to optical customers
    - Retention
        - High for optical stores
    - Words of mouth
        - No evidence
    - Reinvestment rate
        - Cumulated CapEx since 2000: €4,097 million
    - Stock's popularity

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[1] "**When sales are growing, we are normally able to increase our margin quite substantially**.

You should remember that LensCrafters had an operating income of about 12% before we acquired Sunglass Hut. Sunglass Hut, once acquired, was at 7.5%. The two Divisions together delivered, in 2002, more than 14%. So the increase was substantial, it was more than two percentage points every year." – Enrico Cavatorta, Luxottica's former CFO, Luxottica 2003 Q4 Earnings Transcript, 30 January 2004

[2] "We have always seen, and still it is like this, that LensCrafters is more profitable than Sunglass Hut. And we're changing probably our mind looking to the future. I really think, and we will talk in length about this, I really think Sunglass Hut is probably the biggest asset we have worldwide.

What is also important to note about Sunglass Hut is, as you know, Sunglass Hut most of the time is one employee store. So the scale effect per single store is very important. We put [this bar of] $750,000 per store. The profitability at this level is huge. And we were able to get to at 10% of our store base above 750,000. We will see the objectives going on." – Andrea Guerra, Luxottica's CEO, Luxottica 2005 Q4 Earnings Call, 01 February 2006

[3] "**We always said one thing that if we wanted to have net profit at 10% in 2014, we just stop investing in emerging markets retail networks and we jump immediately to 10 and above**. I don't think that is a good move. I think we need to have a good combination of excellent return on capital and a little bit longer term and be sustainable." – Andrea Guerra, Luxottica's former CEO, Luxottica 2013 Investor Day, 08 October 2013

[4] "Luca Cipiccia, Analyst – Goldman Sachs: Yes. Thank you. Good afternoon. Just a couple of questions. One on wholesale. If you could give any idea on how the profitability is evolving, depending on the owned brands and the licenses? Assuming that you've been spending quite a bit on Ray-Ban on the new advertising campaign, I was trying to read how much of this 150 basis points is due to the licensed brands and how much was done through your own brands in this quarter and going forward? So that's the first question.

Andrea Guerra, Luxottica's former CEO: So regarding profitability in wholesale, I will give you a different answer. **I think the main two drivers of our profitability is scale on one side and mix and price on the other side**. **And this is related to both licenses or owned brands**. So it's more an organization which is evolving and improving as a whole and as I said we have seen efficiency all through the lines. **I mean we've seen efficiency in the manufacturing, the distribution network, in the sales costs. We spent more on advertising, SG&A is flat, price and mix were one-third of the growth. So everything is really improving in the wholesale world.**" – Luxottica 2007 Q1 Earnings Transcript, 24 April 2007

[5] "When we move to the international world, we all know how Luxottica has worked in the last three, four years on emerging markets at first. As we were commenting some weeks ago, we have been able in our wholesale business to reach an emerging market level of 13%, 14% on total of sales in emerging markets compared to the whole.

When you go in these countries you need economies of scale. You need scale. You need the fact that with one single brand most of the time it's impossible to establish your own and direct presence. We could have done it in the past, and we will continue to do it also with Oakley in some specific parts of the emergent markets world." – Andrea Guerra, Luxottica's former CEO, Luxottica and Oakley to Discuss the Completion of the Merger Conference, 15 November 2007

[6] "For the third year in a row, we are proposing a rule of thumb; this rule for the third year in a row, it's basically the same. So, you might say that we are a little bit boring. Yes, we are. But, of course, we would be pleased in the future to be boring and **achieving every year a high single-digits sales growth and achieve every year the disproportionate growth in our bottom line. And again, we believe that in 2012, we should be able to achieve twice as much our bottom line growth versus top line**." – Andrea Guerra, Luxottica's former CEO, Luxottica 2011 Q4 Earnings Transcript

[7] "Before going into the future let me spend less than a minute to celebrate another record year. We reached in 2015 €9 million in revenues. **No compromise between top and bottom line, even last year for the sixth year in a row we stick to our rule of thumb so we grow net margins, profitability and net margins two times top line**

and we had also a very, very strong free cash flow generation €770 million last year." – Massimo Vian, Luxottica's CEO, Luxottica 2015 Q4 Earnings Transcript

[8] "Sunglass Hut is growing fast. Hopefully, many of you have been in Times Square. Hopefully, many of you have been in Sydney, London with stores that are all well above $5 million. **And five years ago we had in North America 20 or 30 stores above $1 million. We have today more than 200 stores above one million**.

I think the Sunglass Hut team is fantastic, but **this is just reflecting what I was telling you before about premiumization in North America**, about the evolution of consumer habits and consumer wishes in North America about brands, about experience and about emotions." – Andrea Guerra, Luxottica's former CEO, Luxottica 2013 Q4 Earnings Transcript, 28 February 2014

[9] "**So when we talk engineering, we talk about the speed that we are gaining in new product introductions. So it means developing from the sketch to mass production faster our products, we gain weeks**. And we still are gaining and we are setting ourselves and target to gain more weeks. When we talk about our manufacturing we did a great job in the last years.

We gained many, many days and again although in some areas of the world we are reaching what we think is the great results. In other geographies mainly are related in our European plants, we can gain more days. So we can be closer to the customer in days.

When we go down then to logistics I mean the customer is identified. The product has a clear route where to go and is a matter of hours. So we have three different time frames and different tasks in the three different areas. So, let's spend a few words about our engineering activities, how we've been able to improve the time for product introductions.

The snapshot of 2009 show the three main blocks on 2009 represent the time it will take us from design, so product design, **everything is 3D design, worldwide, same standards, standardized**. Tool preparation as addressed previously the great majority and I will explain the numbers, and **more than 90% of the tools and the gauges are made in-house in our two huge engineering center in Italy and in China**. So more than 90% is basically everything we make in-house. **This is why we can reach those results.**

Then we have samples production and then we have mass productions, first run. So what we've been doing in 2010 thanks to rapid prototyping and being able to test the process we have very disciplined pace of product release, **we've been able to overlap**

the productions of samples with the production of components of new frames, in such a way that when we test the samples, fully tested and certified by our quality labs, we are already with our warehouses full of components for final assembly.

So to make this in parallel was not easy. We've been able -- we demonstrated very recently so in the last six months we achieved those results. **And we gained three weeks we are three weeks closer to the market**. Then again this year and the next year on what we want to focus in gaining time in the actual design and tooling making phases. So this is our challenge for 2011 and onwards. But doing that is one month closer to the market." – Massimo Vian, Luxottica's CEO, Luxottica 2010 Q4 Earnings Call, 01 March 2011

[10] "If we're faster for new product introduction that is not enough, I mean we have to be faster to replenish our stores. And this is why we're concentrating on manufacturing. In these slides, I mean the great job with the Italian plants in the last years, and again the **big opportunities of accelerations we have for the next two coming years both for metal technology gaining another 20% of lead time production and for acetate in Italy**.

I mean this change of speed. So you see incremental improvement up until now and big accelerations for the next two years. Because these results have been tested and already achieved in our operations facilities in Asia. **But we have our big operations in China, close to the Shenzhen area, near Hong Kong, and this is the improvement we've been able to achieve in the last four years.**

We completely changed our plans, and when I say completely I mean destroyed and basically rebuilt. Now we are reaching what we think is a close to the definitive footprint of our plan. We had the opportunity also to start from scratch because what you can see here is the layout of our newest plant, is a part of the layout of the newest plant, designed from scratch to be fastest, lean, very slim let me say.

So first on was in 2005 the first production, 2006, first piece. Now this plant is producing 26,000 frames a day. **From order to delivery is ten days, ten working days**. So this is what we call fast, has to be improved so we're not satisfied yet. **But definitely we've been able in this area to test and improve all the concepts we are going to implement in Italy, in our European facility for the next two years**. So we achieved a lot but we have great achievements ahead waiting for us both in metal technology and in plastic acetate technology.

Where this is bringing is, so this **is the challenge and the target we declare for the next three years, so '11, '12 and '13, we want to reduce our days of inventory by**

20% in the next three years. **New product introduction a lot faster, manufacturing and rebuild the network of our logistic distribution** that we didn't go deep this time maybe we will in the next time we will see.

I think we can do it. I mean this is what we declare. We have the ambition the thing that we are already best in class in our industry, but only the fact that **we are reinventing every year, I would say, even every six months, part of our facilities of our methods is a testimony from the fact that we want to be a leader on the way we engineer, we manufacture, and we distribute our products for a long time in the future**. I conclude this presentation." – Massimo Vian, Luxottica's CEO, Luxottica 2010 Q4 Earnings Call, 01 March 2011

[11] "Let me talk about supply chain or lead time, capacities to deliver the right credits at -- in the right locations, to the right customers. **We started this program in 2008 with 31 DCs in our global organization after the Oakley acquisition we are down to 23 today. We will be down to 18 by the end of 2010 the final target is to go down to nine**.

What is even important is not the number, even if that drives definitely the reduction in the costs of our logistic organization, but **the point that those nine DCs will be on the same order and sales management platform. So theoretically, we can sell out of any DC in any location. That will give us definitely a lower level of inventory to serve the same type of customer with a higher efficiency and service level to our customers**.

That will integrate in the same platform, wholesale and retail together. That is pretty unique. In the markets, you can find integrated supply chains in wholesale and operations, integrated supply chain in retail. **It's really unique to find the first wholesale and retail supply chain fully integrated, that is an example**.

Second example of integration is our US markets. You know that we are an insurance company in the US, that we produce lenses in the US, that we have three main different channels in the US, wholesale, retail and quite soon stores. It will be definitely a new world for our customers and our consumers, to leave a completely new experience as to an insurance claim that that will mean the sales of a new frame or the buy of the new lenses specific to the doctor visit adjusted.

So the integration of the different channels and divisions in one unique system will definitely give to our customer a completely new and unique experience in the eyewear business." – Carlo Privitera, Luxottica's CIO, Luxottica 2009 Q4 Earning Call, 02 March 2010

[12] "**Our distribution system, which serves both the retail and wholesale businesses, is globally integrated and fed by a centralized manufacturing platform**. The network linking the logistics and sales centers to the production facilities in Italy, China, the United States and Brazil provides daily monitoring of global sales performance and inventory levels to meet local market demand. **This system, comprised of 18 distribution centers with 11 in the Americas, five in Asia-Pacific and two in Europe**, is one of the most advanced and efficient in the industry and allows the Group to reduce worldwide logistics lead time year after year.

There are four main distribution centers (hubs) in strategic locations serving our major markets: Sedico (Italy), Atlanta, Georgia (United States), Dongguan (China) and Jundiaí (Brazil). They operate as centralized facilities incorporating a highly automated order management system, servicing other Group distribution centers or, in some markets, shipping products directly to customers, thereby further reducing delivery times and keeping stock levels low.

The Sedico hub was opened in 2001 and is one of the most technically advanced in the industry. In 2015, it managed approximately 20,000 orders per day, including eyeglasses and spare parts**. Sedico ships approximately 235,000 units daily to customers in Europe, the Middle East, Africa, select U.S. markets and to the Group's distribution centers in the rest of the world**, where they are then delivered to local customers. In addition, **Sedico manages customized services, such as Ray-Ban Remix, providing direct global deliveries of these products**.

The Atlanta facility, opened in 1996, has consolidated several North America based facilities into a single state-of-the-art distribution center, which is located close to one of the major airport hubs of the United States. It **serves both our retail and wholesale businesses in the North American market**. This facility manages up to 150,000 units per day.

The Dongguan hub was opened in 2006 and manages an average of 190,000 units per day. The growth in the Asia-Pacific region has made this hub a strategic part of the Group's distribution network. We continue to invest in ways to improve services and increase capacity in order to create even greater efficiencies in the region.

In 2013, **the Group opened a distribution center in Jundiaí, Brazil, close to São Paulo, which offers targeted distribution services to customers and serves the local market**." – Luxottica 2015 20F filing

[13] "This slide [slide 22] is about our logistic footprint. Of course we have grown, and as we grow, so do our logistics and distribution network. We grow in size, but then again we do not grow in complexity. **We are concentrating our efforts on our main**

Distribution Centers that are all around the world, located nearby and in some cases in the same building as our manufacturing platform. So in China, it is in the same building of our factories. In Italy it is in the same neighborhood, a few kilometers away from our main plant. In Ontario, California, it's close to the Foothill Ranch facility, and in Brazil, it is half an hour away from our plant.

We want to concentrate on those hubs because, going back to the results that Stefano commented on, regarding the ten days of DSI reduction last year, **if we move our inventory in this first level DC, we increase the service level because that is where have the maximum availability of our products. So, an increase in the service levels, as we can find any frame there, and we reduce the overall inventory**.
On top of that, **the new trajectory in the evolution of the overall worldwide logistics distribution is the direct shipment**, and we are already there. So this means that not only can we distribute through our DC within the continent, in the US, Europe and Asia, but **we can also jump from one continent to the other, and this is what we are doing**. **So for example, the DC in Italy ships directly to a vast number of key accounts and department stores in the US. So we no longer go through our Atlanta distribution center; we go straight to the address of the mall. Again, it means better service, better availability and lower inventories**. This has given us dramatic results, especially in luxury products made in Italy. So we do not need to position them everywhere; we keep as much as we can there in Italy and we go direct, which has again led to dramatic results.

I am happy to say that before the end of the year **we also approved all of the new investments for our new DC in China that we are starting to build now. It is one kilometer away from our factories. So in the existing center, we will expand our manufacturing and the new one will be a brand new building distribution centre**, which has now been launched. This will turn again into acceleration of our order cycles; as Stefano said, it is true for the past, but you do have to maintain expectations for the future. **A ten-day overall reduction in manufacturing and distribution lead time will again translate into acceleration of our inventory rotation, and this is our commitment**." – Stefano Grassi, Luxottica's CFO, Luxottica 2014 Q4 Earnings Transcript, 03 March 2015

[14] "We are launching the doubling of our distribution -- more than doubling the distribution center in Atlanta.

The real next challenge will be distribution in Italy, because **the more we will go back with that shipment from the source, the more the made in Italy products will be important, and we are planning to increase our first-level DC inventories in Italy. So after doubling, more than doubling, China and basically tripling our Atlanta**

DC, it will be the time for our retail in this year." – Massimo Vian, Luxottica's CEO, Luxottica 2015 Q2 Earnings Call, 27 July 2015

[15] "IT infrastructure I think you have heard about our IT infrastructure probably every minute in our speeches goes from wholesale digitalization from CRM, the investment on upgrade, our SAP platform is well over. We finished our five years' journey, I might say long time ago. Now we are upgrading to state of the art technology. Point of sales, insurances, digitalization of our channel of distribution and the link between our owned websites with our hard supply chain, in Luxottica days, in Ray-Ban.com, in Oakley.com, you can design your own product, assemble in Ray-Ban Remix, in Oakley custom product, your own product, your color, your initial, your stamps and get it delivered at home in three days on average globally. This is pretty amazing.

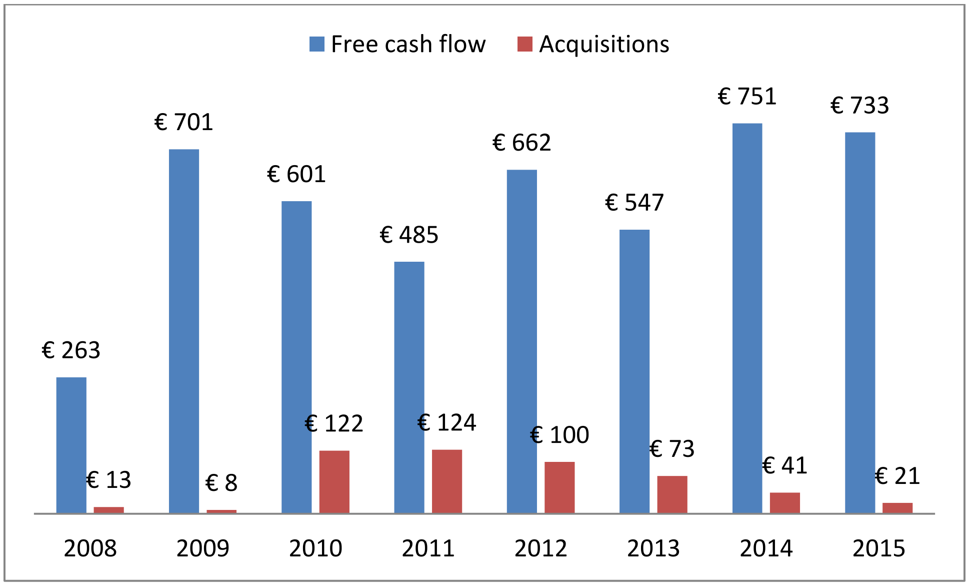
In order to do that we planned years ago a journey of evolution of our logistics distribution, I'm talking about hardware and software. So for those of you that were with us 3, 4 years ago we already were talking about the evolution of our Chinese distributions center. We were on our blocks ready for the start. The bang happened few months ago and **we are now building the new distribution center in Dongguan, It will serve all Asia and Southeast Asia** and it will be finished by the end of this year and **will be the highest traffic distribution center of the group in the next three years distributing millions, 10s of millions of frames to those geographies**.

At the same time we're concentrating our logistics hubs in North America and we are starting now with parallel timing plan of the Chinese hub, the new hub in Atlanta. **We are tripling the size of our distribution center**. The cycle be delivered before end of this year and as we already announced we **will close Ontario, California distribution center of Oakley and we will transfer all the operations into Atlanta and Atlanta will be only one and the only one distribution hub for North America and Mexico, U.S., Canada and Mexico, huge investment there as well**.

We're expanding our Italian [indiscernible] as well, so this is the year of logistical distribution. And **we are well ahead of the expansion I told you of the dot com increase % of sales, [indiscernible] again 7% in three years those frames will be distributed a lot, lot faster than the one that traditionally we would distribute today**. Our infrastructure will be operational starting January '17, it's huge investments it's for the future and it's for the speed and efficiency of our chains." – Massimo Vian, Luxottica's CEO, Luxottica 2015 Q4 Earnings Call, 02 March 2016

Capital Allocation

Luxottica Will Probably Only Make Small Acquisitions of Retail Chains in New Markets



Since 2008, Luxottica spent less than 11% of its free cash flow on acquisitions

- **Biggest Negative**:
  - Some acquisitions in emerging market didn't perform very well
- Luxottica's core strategy: cut out the middlemen
  - Leonardo Del Vecchio put it: "Getting into as much direct contact as possible with the market"[1]
- Del Vecchio Started Luxottica in 1961
  - Produced parts for eyeglass framers
    - Including Safilo
- He realized that there were far more profits in producing the entire frames[2]
  - => made the whole frames
    - Presented the first collection of prescription eyewear
      - In 1971
- He decided to become a distributor of his own frames for the same reason
  - LUX was lowering cost and raising quality
  - But distributors were just fattening their profit margins
    - Instead of passing on the savings to the retailers
- In early 1990s, chains were importing more and more frames from the far east[3]
- Luxottica saw acquiring LensCrafters as the only solution[4 5]

- Luxottica introduced its pricier brands into LensCrafters stores
    - Try to get people upgrade their purchases at LensCrafters
    - Customers appear willing to pay more for eyeglasses
        - Even if their insurance doesn't fully cover them
- Created a boutique atmosphere at LensCrafters to sell eyeglasses at boutique prices
    - LC updated its image with a contemporary design[6]
        - Combines style and functionality
        - Make the store inviting and easy to shop
        - Reinforces LC's brand image
        - Give the store more curb appeal
            - Stand out better
        - Allow complete visibility of the interior space
            - Fashioned in brushed aluminum
            - The façade has a sleek, slightly high-tech look
        - Strategically placed graphics convey strong product and services messages
    - Departure from the standard, almost utilitarian appearance of LC's previous prototype[7]
        - New format had
            - Maple wood flooring and cabinetry
            - Blue carpeting
            - Comfortable seating
            - Warmer, softer look
    - Create a wall display system
        - Allow shoppers access to a good amount of product
        - Frames sit on small nose plugs
            - Are displayed on the world directly in front of the customers
        - Others are displayed in stylish floor units
        - => showcase and accentuate the product
            - Previously, all of the frames at LC were displayed in cases
- Luxottica acquired LensCrafters despite backlash from retailers
    - LUX was concerned about the 3 O's[8]
        - Opticians
        - Opthalmologists
        - Optometrists

            - Competitors told the 3 O's: "look at those horrible Luxottica people- they've become your competitors"
            - An independent retailer might still have to sell clients an Armani frame
                - But he could afford to drop other non-designer LUX lines
                    - Nobody asks for by name
                    - There are many other frame makers out there
        - Luxottica hoped to raise visibility of Luxottica products
            - Through retail presence
                - Backed by advertising campaigns
                    - Aimed at getting American to become more fashion conscious about eyewear
            - Then independent retailers may return to Luxottica[9]
- Luxottica succeeded
    - % of LensCrafters revenue come from Luxottica products
        - 1995: 5%
        - 1996: 43%
        - 2002: 76.3%
        - 2015: over 90%
    - LensCrafters grew strongly
        - 1994: $706 million
        - 1996: $905 million
        - 1997: over $1 billion
        - 1998: $1.11 billion
        - 1999: $1.3 billion
        - 2013: $1.8 billion
        - Today: probably over $2 billion
    - Luxottica was also correct about getting back retail partners
        - Wholesale business in the U.S. was slow for a long time[10]
            - From 1995 to 2005
            - Some retailers weren't very happy
                - LUX didn't service them anymore
        - But Luxottica began to re-work on wholesale in 2005, 2006
        - Since 2007, U.S. wholesale has grown faster than U.S. retail
            - In $, average annual sales growth rate was
                - Wholesale: **14%**
                    - 2007: $407 million
                    - 2015: $1,169 million

        - Retail: **2.9%**
            - 2007: $3,761 million
            - 2015: $4,719 million

- The acquisition of LensCrafters was a huge success
    - Luxottica paid $1.4 billion for U.S. Shoe
        - U.S. shoe owned LensCrafters and a footwear business
    - Luxottica sold the footwear business to Nine West
        - For $600 million
    - => net price paid for LensCrafters: $900 million
    - Today LensCrafters is doing around $2 billion revenue
        - Over $300 million EBIT
    - Cash flow from LensCrafters also allowed Luxottica to
        - Acquire Ray-Ban
        - And then Sunglass Hut
    - Without the acquisition, the industry might be very different
        - Firms may solely compete on price
- Luxottica acquired Ray-Ban
    - In 1998
    - From Bausch & Lomb
    - Luxottica paid $655 million
        - But there was a dispute afterwards
        - The dispute was resolved in 2002
            - Luxottica received a price reduction of $42 million
            - => net price paid for Ray-Ban: **$613 million**
    - Bausch & Lomb mismanaged Ray-Ban
    - When Luxottica acquired Ray-Ban in 1999[11]
        - Ray-Ban shades were sold for as low as $29
        - Available everywhere from gas stations to drugstores
        - Manufacturing was scattered across the globe
            - Mexico
            - China
            - Ireland
        - Ray-Ban frames fell apart 4 times faster than those of Luxottica's other frames
    - Luxottica fixed the brand
        - Brought production to Italy
            - Improved quality

- Pulled Ray-Ban out from 13,000 retail outlet[12]
- Stopped selling for 1.5 years
- Gradually raised price
  - The starting price for a pair of Aviator
    - 1999: $29
    - 2000: $79
    - 2002: $89
    - 2009: $129
    - 2014: $149
- Re-launched Ray-Ban Wayfarer
- Introduced Rx line[13]
  - Become the biggest Rx brand
  - Now account for 30% of the brand revenue
- Reached out to female consumers
  - Female consumers account for 50% of Ray-Ban revenue

- Today, Ray-Ban accounts for **26.8%** of Luxottica's revenue
  - €2.4 billion
  - => retail revenue is well over €3 billion
- Wholesale EBIT margin is 22%
  - Ray-Ban's margin is well over the average
  - => Ray-Ban contributes more than $528 million EBIT

- Luxottica acquired Sunglass Hut
  - In 2001
  - Sunglass Hut at the time was the dominant retailer of premium sunglasses
    - Hold 50% market share in the U.S.
  - Within weeks of the acquisition
    - Luxottica demanded price cuts from suppliers
  - All ten accepted the terms except Oakley
    - Oakley represented 25% of SH's sales
  - Oakley tried to negotiate but Luxottica refused
  - Luxottica drastically cut orders from Oakley
    - Oakley had to slash its financial projections for 2001
    - Oakley's share declined by 37% within a day
  - Several months after, the two companies reached an agreement
    - LUX could obtain preferred pricing terms from Oakley
      - It purchases certain minimum quantities

        - Or Oakley's products accounted for at least 15% of Sunglass Hut's total retail sales in the U.S.
  - Luxottica finally acquired Oakley
    - In 2007
  - Luxottica gradually sell more of its products through Sunglass Hut
    - (like with the acquisition of LensCrafters)
    - % of Sunglass Hut revenue come from Luxottica products
      - 2001: 14.3%
        - Less than Oakley
          - Oakley represented 25% of Sunglass Hut sales
      - 2002: 35%
      - 2003: 35.1%
      - 2004: 58.5%
      - 2005: 61.9%
      - 2015: over 90%
  - Luxottica turned Sunglass Hut into a fashion retailer
    - Sunglass Hut was historically very strong in sport and classic[14]
      - Appealed to more male customers
      - But weak in the fashion area
        - This segment was dominated by department stores
    - Luxottica transformed Sunglass Hut into a high fashion brand[15]
      - Upgrade the store format
        - Make it more tasteful
      - Put more of its products into Sunglass Hut
        - A great lineup of fashion brands
      - Attract more female fashion-oriented consumers[16]
  - Luxottica continued opening Sunglass Hut stores
    - The number of stores was 1,734 at the time of the acquisition
      - Increased to 3,006 in 2015
  - Today Sunglass Hut is doing about €2 billion revenue
    - Over €300 million EBIT
    - Luxottica paid only €558 million
- Luxottica acquired Oakley
  - In 2007
  - Oakley is the second biggest sunglasses brand
    - Is the sunglasses of choice for athlete
  - Luxottica paid

            - **$2.25 billion**
                - $2.1 billion equity
                - $150 million net debt
            - The price was 11.3 times estimated Oakley EBITDA for 2008
                - But Luxottica expected €100 million annual operating synergies
                - => the price was less than 7x EBITDA
        - Oakley enjoyed double digit growth almost every year after the acquisition
        - Today Oakley contributes about €1 billion revenue
            - About **€220 million EBIT**
        - Luxottica financed the acquisition using debt
            - Has paid most of the debt ever since
                - Net debt was
                    - 2007: €2,850 million
                    - 2015: €942 million
- Luxottica acquired Cole National
    - In 2003
    - Luxottica paid about €661 million
        - (including debt)
        - But later sold
            - 20% of Pearle Vision Europe
                - For €144 million
            - Things Remembered
                - For €160 million
        - => The effective price was **€357 million**
    - The acquisition gave Luxottica
        - Pearle Vision
        - Sears Optical
        - Target Optical
        - BJ Optical
    - The result of the acquisition was mixed
        - Cole's vision revenue was $919 million (€750 million)
            - (in 2003)
            - EBIT was $25 million (€20 million)
            - EBIT margin was only 2.7%
        - Luxottica quickly improved Pearl Vision's margin to double digit
        - But
            - Closed BJ Optical

        - Sears Optical declined along with the host stores
            - Contribute little revenue today
        - Pearle Vision footprint shrank
            - In 2007
                - 470 owned stores
                - 405 franchised stores
            - In 2015
                - 112 owned stores
                - 420 franchised stores
    - Only Target Optical grew[17]
        - Number of stores:
            - 2007: 304
            - 2015: 389
            - Intend to increase the number of store to 1,000
        - Target Optical posted 6 consecutive years of double-digit comparable store sales growth[18] [19]
    - Luxottica believes it can triple the number of Pearle Vision franchisees
        - Over the next 5 to 10 years
        - Now has a clear strategy: the best franchise solution for independent doctors
            - Leveraging all the infrastructures, processes systems and skill set of PV team
        - Franchisees are doctors[20]
            - They want to take care of eyes
            - But they're in the retail business
            - They want someone to help with[21]
                - Select the right frame manufacturers
                - Negotiate for them
                    - With manufacturers
                    - With insurers
                - Provide a lab service
                - Marketing
                - Provide a supply chain solution
    - Luxottica also plans to bring the franchising model to international markets
    - It's unclear how successful Pearle Vision and Target Optical will be
    - But Luxottica got adequate return from the acquisition

            - Paid only **€357 million**
            - For €750 million
                - The revenue base might have declined
                - But Luxottica improved margin to double digit
        - Total optical retail revenue in the U.S. is about **€2.8-2.9 billion**
            - Or $3-3.2 billion revenue
- Other acquisitions are mostly of optical retailers
    - Luxottica tries to get retail presence in a market
        - And then build from there
    - The most significant acquisition was of OPSM
        - In 2003
        - Luxottica paid an aggregate price of AUD 580 million
            - **Or €327 million**
            - 8x expected EBITDA
        - OPSM had
            - 481 stores in Australia
                - 35% market share
            - 34 stores in New Zealand
            - 80 stores in Hong Kong
            - 12 stores in Singapore
            - 12 stores in Malaysia
        - It's unclear whether the acquisition was a failure
            - Luxottica managed
                - Sell more products through OPSM
                    - 5% of frames sold by OPSM were Luxottica frames
                        - Before the acquisition
                    - Today: 89%
                - Improved profitability in Australia/New Zealand
                    - Similar to the level of LensCrafter's profitability
                - Built up retail business in Asia-Pacific
                    - Rebranded stores in Hong Kong as LensCrafters
                    - Expand the presence in China with 3 acquisitions
                        - In 2005
                        - For an aggregate of €63 million
                            - Xueling
                                - Paid €21 million
                                - 79 stores in Beijing

        - Ming Long Optical
            - Paid €29 million
            - 278 stores in Guangdong
        - Modern Sight Optics
            - Paid €13 million
            - 28 stores in Shanghai
    - But the business struggled since the financial crisis
        - Some discount retailers entered and gained market share
        - 35% is perhaps too much for a premium optical retailer
        - The number of stores in Australia/New Zealand has declined to 333
            - Down from 481
    - Optical retail in Australia today contributes about €300-350 million
        - 4% of total revenue
    - Total optical retail revenue in Asia-Pacific: €455 million
        - Sunglass Hut stores contributes less than €205 million
            - 308 stores
            - Stores might do less than €,665 annual revenue
                - Worldwide average: €665,000
        - Total retail revenue in Asia-Pacific: €660 million
        - => optical retail revenue: €660m – €205m = €455m
    - Luxottica might get an adequate financial return
        - Total investment in Asia-Pacific: €390 million
            - OPSM: €327 million
            - 3 chains in China: €63 million
        - Today's revenue: €455 million
            - €300-350 million in Australia
        - Optical retail margin: lower than 15%
            - But probably double digit
- Other acquisitions were small
    - Multiopticas International S.L.
        - In 2009
        - Luxottica paid about €135 million
        - Got 390 stores in
            - Chile
            - Peru
            - Ecuador

        - Columbia
    - Tecno
        - In 2012
        - Paid €103 million
        - => LUX can become a domestic player
            - Avoid tariff
            - Can target the premium segment with an average price of €100-200 per frame
            - LUX has focused on the luxury segment
                - €300
            - Can cut 1/3 off shipping times for products
                - The production plant is in Campinas
                    - Close to Sao Paulo
    - Sun Planet
        - In 2012
        - Paid €24 million
        - Got 120 sunglass retail stores
            - 90 in Spain
            - 30 in Portugal
            - These stores were rebranded as Sunglass Hut
    - Alain Mikli
        - €91 million
        - A luxury Sunglass Hut brand
        - Revenue: €55.5 million

- Outlook:
    - Luxottica is unlikely to make big acquisitions
    - Luxottica is interested in getting a retail presence in new markets
        - Makes small acquisitions[22]
        - And build from there
    - Luxottica can build a premium niche in each market
        - Change consumers' attitude towards optical eyeglasses
            - And the wholesale business will follow
    - There was talk about merging with Esillor
        - Essilor is the biggest lens manufacturer
            - 41% worldwide market share
        - Essilor's CEO approached Luxottica to do a deal[23]
            - In 2013

            - Essilor wanted to get access to consumers
            - Luxottica saw little benefits
                - And closed the talks after a few months
    - Luxottica may most excess cash in dividends
        - Current dividend payout rate is about 50%
        - Since 2007
            - Total EPS: €8.59
            - Total dividend: €4.66
                - => **54%** payout rate
        - But Luxottica reduced debt over the period
            - Net debt was
                - 2007: €2,850 million
                - 2015: €942 million
        - Luxottica didn't have to retain earnings to grow in the past
        - Even if it can't reduce working capital in the future
            - Pre-tax ROIC is 85%
                - And will increase as Luxottica expand margin
            - => 55% after-tax ROIC
                - Needs to retain only **11%** of earnings to support 6% growth
        - Current leverage is very low
            - Only €942 million net debt
            - There's space for an increase in dividend payouts[24]
                - On a permanent or temporary basis
        - In 2015
            - EPS: €1.67
            - Luxottica paid
                - €0.72 ordinary dividend
                - €0.72 extraordinary dividend
            - Net debt still declined slightly
                - 2014: €952 million
                - 2015: €942 million

[1] "**At the heart of Del Vecchio's strategy has been a desire to grow by cutting out the middlemen, or as he himself prefers to put it, "getting into as much direct contact as possible with the market."** Unlike most of his competitors, Del Vecchio points out, "Luxottica's success to date has been based on total vertical integration." Over the course of three decades, he has transformed his business from

an eyeglass-frame parts supplier to a full-frame manufacturer to a global distributor. And with the acquisition of LensCrafters-the world's biggest optical chain-Del Vecchio is venturing straight into retailing, much to the dismay of the owners of the independent American optical stores who carry his Luxottica frames and now see him as a direct competitor." – *Italy's Gem of a Giant*, Jonathan Kandell, World Business, September 1996

[2] "Married in his early twenties, **Del Vecchio set up his own mold shop, producing parts for eyeglass framers. In 1961 he moved to tiny Agordo, in the foothills of the Dolomite Mountains in northeastern Italy, and started Luxottica**. He chose Agordo largely because the local authorities were giving out land free to entrepreneurs in the hopes that they would create desperately needed jobs and provide tax revenue. The Dolomites and the Veneto plains just to the south were also centers of the Italian optical industry, offering Del Vecchio's tiny, fourteen-worker factory easy access to customers.

It didn't take him long to figure out that there were far more profits in producing the entire frames than in selling parts to manufacturers. For the same reason, in the 1970s he decided to become a distributor of his own frames. "**We were lowering our costs and raising our quality**," Del Vecchio told an Italian publication a few years ago. "**But our distributors were just fattening their profit margins instead of passing on the savings to the retailers**." Luxottica now owns or controls nineteen distributors and subsidiaries throughout Europe, the Americas, and Asia, delivering more than 14 million frames a year to retail stores and opticians around the world and earning Luxottica a net income of $99.2 million in 1995." – *Italy's Gem of a Giant*, Jonathan Kandell, World Business, September 1996

[3] "**The Del Vecchios say they were motivated by concern that big chains such as LensCrafters, which has more than 600 stores, were dominating the American optical market and selling too many cheaper, Asian-made frames instead of pricier brands such as the Luxottica labels.** The chains controlled 35 percent of the market, yet only 10 percent of Luxottica's sales were through them.

"**The LensCrafters operation represents 'insurance' for Luxottica's growth far beyond the next five years**," Leonardo Del Vecchio informed shareholders in his latest annual report.

But until now, Luxottica and LensCrafters seem to have aimed at different segments of the United States market. **LensCrafters' success is due mainly to its strategy of going after budget-conscious consumers** and those clients who purchase their prescription glasses through Medicare or health insurance plans that will not cover the cost of more upscale frames. **Luxottica, on the other hand, has been raising its**

profit margins by going after increasingly affluent consumers. Thus, as a proportion of total Luxottica sales, designer frames have climbed from 38 percent in 1991 to more than 58 percent in 1995. And sunglass frames now account for almost 40 percent of total sales-up from only 12 percent in 1991.

Luxottica has been introducing its pricier brands into LensCrafters stores. Eventually all these outlets will have Luxottica sunglass and prescription-frame display spaces. "**They are obviously trying to get people to upgrade their purchases at LensCrafters**," says MarieChristine Keith, an analyst with HSBC James Capel's London office who keeps tabs on Luxottica**. Although it's not at all clear yet, she adds, customers appear willing to pay more for eyeglasses, even if their insurance doesn't fully cover them.**" – Italy's Gem of a Giant, Jonathan Kandell, World Business, September 1996

[4] "**Analysts said today that Luxottica was forced to pursue the acquisition in part because of the recent growth of the low end of the eyeglass frame market, a growth that Lenscrafters fueled by selling cheap frames imported from Far Eastern countries like China and Taiwan**. With its products aimed primarily at the middle to upper end of the market, Luxottica was forced to step in to reverse the trend." – *Luxottica to Acquire U.S. Shoe for $1.4 Billion*, John Tagliabue, 18 April 1995

[5] "To buy U.S. Shoe, which also owned optical retail chain LensCrafters and women's apparel retailer Casual Corner, Del Vecchio paid $1.4 billion, most of it in cash. **Until then he'd had no direct retail experience. But the acquisition, he believed, was the only way to prevent Luxottica from being squeezed by discount chains like Wal-Mart--even if it meant competing with his best customers, small opticians then providing 90% of his sales. "I would have risked a lot more sitting back,"** he says. He sold the shoe business to Nine West for $600 million and took Casual Corner private, turning it over to his eldest son, Claudio." – *Tough Guy*, Luisa Kroll, Forbes, 04 February 2002

[6] "LensCrafters, the nation's largest retail optical chain, has updated its image with a contemporary design that combines style and functionality. **In addition to making the store inviting and easy to shop, the new look is intended to reinforce LensCrafters' brand image.**

"**Our main objective was to bring a stronger design image to the store. We also wanted to make the message conveyed by LensCrafters stores more consistent with its brand advertising**," says Michael Schuster, president, Michael Schuster Associates Inc., Cincinnati, which executed the design in cooperation with the Cincinnati-based LensCrafters, which operates 620 stores nationwide.

The updated design also reflects the increased competition in mall-based retail optical stores.

"**We needed to give the store more curb appeal**," Schuster says, "**so that it would stand out better and look more inviting to shop.**"

To that end, **the storefront has been opened up, allowing complete visibility of the interior space**. **Fashioned in brushed aluminum, the facade has a sleek, slightly high-tech look that enhances LensCrafters brand image and updated positioning**. Strategically placed graphics convey strong product and services messages.

"**The openness at the lease line works to invite the consumer into the store**," says Jim Hennessey, vp, store design, LensCrafters" – *LensCrafters Polishes Image with Style*, Marianne Wilson, Chain Store Age, October 1996

[7] "**The new interior offers a departure from the standard, almost utilitarian appearance of LensCrafters' previous prototype. Maple wood flooring and cabinetry, blue carpeting and comfortable seating give the store a warmer, softer look. Some fixtures are accented with maple laminates; others with metal**.

"**The idea was to create a customer-friendly environment to buy technical products that reduces anxiety and promotes service**," Schuster explains. "One of the ways we accomplished this was by combining such high-tech design elements as stainless steel with more residential ones."

The retailer's signature colors-blue and red-accent the space and are featured on the floor fixtures. The strong graphics program communicates products, available services and helps educate consumers.

…

One of the most crucial components of the new design was **the creation of a wall display system that allows shoppers access to a good amount of product. Frames sit on small nose plugs and are displayed on the wall directly in front of the customer. Others are displayed in stylish floor units**.

"**The new fixturing is designed to showcase and accentuate the product**," Schuster says. "Previously, all of the frames at LensCrafters were displayed in cases."" – *LensCrafters Polishes Image with Style*, Marianne Wilson, Chain Store Age, October 1996

[8] "**A bigger worry for Luxottica is the reaction of independent retailers-including opticians, ophthalmologists, and optometrists (known in the trade as "the three o's")**-to the Italian giant's entry into their business. "Luxottica's rivals have had a field

day telling the three o's: `**Look at those horrible Luxottica people-they've become your competitors**,'" says Constance Maneaty, a Bear Stearns analyst. "**An independent retailer might still have to sell clients an Armani frame, but he can afford to drop other nondesigner Luxottica lines, which nobody asks for by name**."

Maneaty's comments are echoed by some retailers, small and large. "**We're dealing more with lines other than Luxottica's, and I know of other optometrists and opticians who have also cut back their Luxottica orders**," says David Bierbrier, the proprietor of Optometric Arts, an optical store in New York's World Financial Center.

"**Nothing personal, but it doesn't make sense for us to support a competitor, so we don't buy from Luxottica anymore**," says Tom Greenberg, chairman of Vision Plaza, a New Orleans-based optical chain with stores in Louisiana and Mississippi. "**It wasn't a difficult decision, because there are many, many other frame makers out there.**"

Luxottica is hoping to woo back the defectors by mounting an advertising campaign throughout the United States that will supposedly benefit the entire optical industry. The campaign is **aimed at getting Americans to become more fashion-conscious about eyewear and spend more money on both sunglasses and prescription spectacles.**" – Italy's Gem of a Giant, Jonathan Kandell, World Business, September 1996

[9] "Claudio Del Vecchio, who runs Luxottica's operations in North America, acknowledged that **Luxottica faced opposition from independent retailers but said the company would seek to use Lenscrafters' marketing strength to raise the visibility of Luxottica products, thus helping the independents as well**.

"**Until we can prove this, not all may follow us**," he said." – *Luxottica to Acquire U.S. Shoe for $1.4 Billion*, John Tagliabue, New York Times, 18 April 1995

[10] "As we said and I will repeat this, this is not our numbers; this is numbers that are given from different sources. And this is about premiumization of sunglasses. This is about premiumizations of lenses and this about baby boomers coming in the Optical reality.

So when we go and look to a part, an asset of our business where we have done a wonderful job in the last years is the wholesale part. So I will take care of that. **Many of you heard how we have been slow for a long time between '95 and 2005, we basically went to sleep. We didn't really tackle wholesale. Why was that?**

Because we had acquired LensCrafters in '95. We had a little bit of people not very happy between our customers and we gave it up.

We didn't service them anymore. We didn't -- be proactive anymore. We were not happy. We were not nice. We were not efficient. We were not, nothing. We began to re-work on wholesale in 2005, 2006; took some years to take it back to where we wished and now it's three, four years of rapid, fantastic, wonderful growth. Is this finished? Absolutely, not." – Andrea Guerra, Luxottica's former CEO, Luxottica 2013 Investor Day, 08 October 2013

[11] "**When Luxottica acquired Ray-Ban from Bausch & Lomb, Ray-Ban shades sold for as little as $29 and were available everywhere from gas stations to drugstores. Manufacturing was scattered across the globe from Rochester, New York, to China and Ireland**. Luxottica executives took the drastic step of shutting down production for six months between 1999 and 2000 to purge the market of low-quality shades.

Luxottica switched production to Italy, primarily to Agordo, where the company also has its product-development headquarters, and immediately ramped up manufacturing for numerous existing Ray-Ban models, including Predator (made famous in the movie "Men in Black"), Shooters and Caravan. But the company knew that the biggest potential lay in its two iconic models: Aviator and Wayfarers." – Ray-Ban Hopes to Party Like It's 1983 by Relaunching Its Wayfarer Shades, Christina Passariello, Wall Street Journal, 27 October 2006

[12] "**When Luxottica bought Ray-Ban, it says, the brand's frames fell apart four times faster than those of Luxottica's other brands. In 2000, Luxottica consolidated production of Ray-Ban sunglasses from four outdated facilities in different areas of the world to a state of the art facility in Italy**, where Luxottica manufactured other brands in its portfolio. Northeast Italy is known as a hub for premium eyewear, with the added benefit of proximity to quality parts suppliers.

Convenience stores and gas stations are not the best avenues for cultivating an upscale image. So Luxottica made the painful decision to exit 13,000 points of sale in the early 2000s, sacrificing revenue in the short term in the belief that would pay off later. The company was making eyewear for luxury names like Bulgari, Chanel and Armani, so it already had ins with high-end stores. **By 2004, Luxottica was able to leverage the improved reputation of Ray-Ban to command higher prices again, selling the shades at Neiman Marcus and Saks Fifth Avenue. In 2000, a year after the acquisition, the starting price for a pair of Aviators was $79. Two years after that, that had risen to $89**. **And by 2009**, as Ray-Ban started using newer materials like lightweight carbon fiber and more sophisticated lens technology, **the entry price**

had reached $129."We needed to clean the market of many pieces of low-quality, old Ray-Bans and clean up the distribution," says Volpetti." – *How Ray-Ban Brought Its Brand Back from the Brink*, Phil Wahba, Fortune, 27 January 2016

[1313] "In 2000, all of Ray-Ban sales were for non-prescription sunglasses. Luxottica, tapping its core strength in the prescription-sunglasses area, brought Ray-Ban into its "optical" business three years later. **Fast forward to 2015, and some 30% of Ray-Ban revenues come from prescription glasses, which are generally pricier and more profitable**." – *How Ray-Ban Brought Its Brand Back from the Brink*, Phil Wahba, Fortune, 27 January 2016

[14] "We are -- **we have definitely increased our mix not just in what we put in the store but what consumers are buying, and we are now above 50% of our sales, our Luxottica product and that's a dramatic improvement from pre-acquisition** and again the happy thing is that is not only building our profitability, but it's what the consumer wants and even though the market maybe a little bit soft, I **think Sunglass Hut historically did not have a strong fashion off and very strong in sport, very strong in classic, but kind of weak in the fashion area**. So, that's the part of the market that I think **we're taking, and we know that from the department stores and other that have historically dominated that segment although a bit soft right now**. I think we're feeling a little bit of share but really repositioning so I thought is something for everybody not just for young sport oriented male." – Kerry Bradley, COO of Luxottica Retail, Luxottica 2003 Q3 Earnings Call, 29 October 2003

[15] "In 2006 we are going to continue our journey of building style credibility for Sunglass Hut. Again, **remember five years ago Sunglass Hut was really a sport brand for males. We are transforming the brand**. It's an evolution, but we're transforming it into a brand that keeps that base. We're not sending people away. **But we're attracting the female fashion-oriented customer**, and that is what has clearly fueled our growth. We are going to keep that going in 2006. **We will be remodeling with our new designs that are much more upgraded, much more tasteful, that female fashion feels good in**. **By the end of the year, almost half, 45% of our stores, will be fully updated. That is up from only about 20% today.** We know that when we do these remodels we see about an 8% lift in sales immediately from that, and then sustain it. So it's very important that we give the stores a great look.

But beyond those existing stores we're going to be opening new stores aggressively. **We have got 120 new store openings planned. We are really following the East Coast, the West Coast, and the Sunbelt. That is the areas that we have found are most productive, highest average dollar volume, and most receptive to this fashion message**. So the vast majority of our stores will be in those parts of the country. We will also be evaluating acquisition opportunities to see if that is a faster way to achieve our objectives.

We will also continue to penetrate and push fashion brands. We have not finished **yet. We have a great lineup of fashion brands, but Dolce & Gabbana will really be making a difference this year. We will be going fashion in the 40% to 50% range. Again, five years ago, fashion was below 20% of the sales at Sunglass Hut**. So you can see what kind of a transformation we have made, and we will continue that." – Kerry Bradley, COO of Luxottica Retail, Luxottica 2005 Q4 Earnings Call, 01 February 2006

[16] "Jeff Marsh, Analyst: Just one last question. When you separate the sun business within Hut, looking at the active market versus the fashion or design market, how is the performance of each?

Kerry Bradley, COO of Luxottica Retail: Well, they're all healthy, but **the fashion market is on fire for us. Again, it plays right into Luxottica's strengths**. We had a great Q4 with Versace, with Chanel, the introduction of Prada. The fashion brands that are Luxottica's strengths are on fire, and **we've actually expanded our number of what we call high-fashion stores**.
What we're finding is that our sport and classic business, which historically appealed more to the male customer, is just fine, it's healthy. We're attracting new female customers with our fashion emphasis. So really turning Sunglass Hut into a brand for both men and women, when it was much more a male brand in the past." – Luxottica 2003 Q4 Earnings Call, 30 January 2004

[17] "Target, our host, is a serious company. I mean they got a robust online experience. They do $72 billion last year w**e're in 331 of their 1,770 stores in North America. And we're very excited to be able to grow with them to up to 400 stores by 2016. In fact our intentions are to triple the size of Target Optical by 2018**." – Mark Weikel, CEO – Retail Optical North America, Luxottica Investor Day, 08 October 2013

[18] "Target Optical is an amazing story. **It is its fifth consecutive year of double-digit comps. An amazing story, amazing profitability, amazing top-line growth, and the relationship with the host, Target, again has never been as strong as it is today. They agreed to finally allow us to open new stores in existing Target stores**. It is the first time Target, as host, has allowed us to open stores modifying the existing Target stores, which is great. We will open more than 35 stores this year, and this is thanks to the great performance achieved over the last five years, thanks to the great profitability that we also bring to Target as the host. **The profitability per square foot is really interesting also for them**. So, great value for money for the guests, great personalized customized fun, and an easy and simple experience in this space." – Adil Mehboob-Khan, Luxottica's former CEO, 2014 Q4 Earnings Call, 03 March 2015

[19] "**Target Optical, another amazing story we deliver in 2015, the six consecutive year of double digit comps, double digit sales**. **We opened the highest number of stores ever, over 40 stores this year** but the relation is going so well that we're doubling up for 2016 so **we're expanding Target up to another 80 new stores in 2016 and we're doubling that up as well on e-commerce for Target Optical**. The relationship is going great, profitability is going great, sales are going great, satisfaction is over the roof. We enjoy the highest net promoter score for this simpler, faster, enjoyable optical we had experienced, very excited about what the team is doing and the good news is **that by the end of 2016 with approximately 500 stores we will just be in 25% of the host locations**. So still amazing headroom for growth, excited." – Nicola Brandolese, President of Retail Opticals of America, Luxottica 2015 Q4 Earnings Call, 02 March 2016

[20] "**Genuine eye care from your neighborhood doctor, a promise that was started 50 years ago**. Most important words, eye care first, glasses second. Take care of the eyes guess what, you're going to buy the glasses. That's what we stand for. That's what this revolution or of getting back to its roots is all about.

Now that was one differentiation. Today's market place is about brands being differentiated. Differentiate or die is what people say. So we have done that. But we also within Luxottica want to differentiate it in another fashion, a differentiation on what we call a business model differentiation. And what was that? It's called franchising.
…
Second, if you build a franchising business founded on listening to the operator and making them successful based on their profitability we called it unit economics, you have an asset light scalable model. So that -- the next journey where we put together putting governance models, listening to our franchisees and doctors and making it a doctor-centered brand.

So what were the doctors looking for? We went to optometry schools and listened to them, listen to the 3rd year students and the 4th year students. What were they telling us? They were telling us "**Pearle vision. Wow. You guys are taking back to genuine care. Help us run a business. We are doctors. We want to take care of eyes**." What did that mean? Well**, we're on the retail business, help me select the right vendors, frame manufacturers, negotiate for us. I do not want to have capital invested in my store or on the lab. Help me providing a lab service**. What better company to provide those services but Luxottica?

So we have a team today working with the wholesale team that actually services all our franchisees with special terms for our doctors, for our opticians within our store working with Giorgo and his team and some of the other partners in the lens manufacturing providing a comprehensive solution for doctors." – Srini Kumar, Head of Pearle Vision, Luxottica 2013 Investor Day, 08 October 2013

[21] "And then just a few words on the many other brands we've got, Pearle Vision is a trajectory to become the first and best franchise retail operator in the U.S. **We see opportunity to triple the number of franchisees over the next 5 to 10 years. We didn't have I think a very clear strategy probably a few years ago. Today I think we have a very clear strategy**. We want to make her the best franchise solution for great independent doctors who can keep their entrepreneurial spirit **but leveraging all the infrastructures, processes systems and skill set of the Pearle Vision team. So Pearle Vision is currently up, it's supply chain solution it's a brand new one**. We're transforming 31 different point of sale systems that we had in Pearle Vision in just one state of the art point of sale system, we will have supply chain the matches both inventory of lenses and frames. **We will guarantee huge power of negotiation vis-à-vis every manufacturer's, better marketing, better training, better traffic thanks to the in-network status with most of the assurances starting from VPS [ph]**, exciting moment at Pearle Vision as well." – Nicola Brandolese, President of Retail Optical of America, Luxottica 2015 Q4 Earnings Call, 02 March 2016

[22] "Well, all the time, you know, **in emerging markets we make moves that don't really make the headlines because we are working wholesale and retail. And, you know, we look at acquisitions that may be of small chains that can give us either a real estate presence or that can allow us to, you know, pave the way for some of our retail business models, like Sunglass Hut**." – Adil Khan, Luxottica's former CEO said in an interview with Bloomberg TV, 27 October 2015

[23] "Essilor, led by French-Canadian chairman and chief executive Hubert Sagnierès, 60, approached Luxottica around three years ago to do a deal, according to insiders. **The French group, which then was focused on healthcare, saw a combination as a way to get access to consumers. Luxottica saw little benefit and "closed the talks after a few months", says one person familiar with the matter.**

Today, Essilor is almost finished becoming a consumer-facing company. **If a deal with Luxottica does not materialise, bankers and industry executives suggest Essilor could look to a smaller manufacturer such as Safilo**, the Italian maker behind Polaroid and high-end eyewear maker for Céline, Dior and now Swatch.

If Essilor managed a buyout of Safilo, it would "be a game-changer for the industry", says one industry insider, because it would put Essilor and Luxottica in direct competition.

Safilo is the industry's third-largest player with €3bn in sales, increasingly squeezed between the titans, says Citi's Mr Baragiola. But its chief executive, Luisa Delgado, a former head of P&G in the Nordics and a board member of Ikea, is representative of the new blood coming into the eyewear industry.

Since becoming chief executive in 2013, she has begun moving group manufacturing back from China to Padua in Italy as the company seeks to carve out an independent future as a high-end manufacturer.

In addition to producing expensive eyewear for designer brands, Ms Delgado is also pushing into the lower priced but rapidly growing "mass cool" segment. There, glasses usually retail for around €100 or less, putting them in reach of millennial spenders. "It is like [clothing retailer] Zara, which had you buying maybe three pairs of trousers when you really only needed one," she explains.

Ms Delgado says she is not in takeover talks, but adds: "We are constantly looking around like all companies to see something that is interesting, or not."

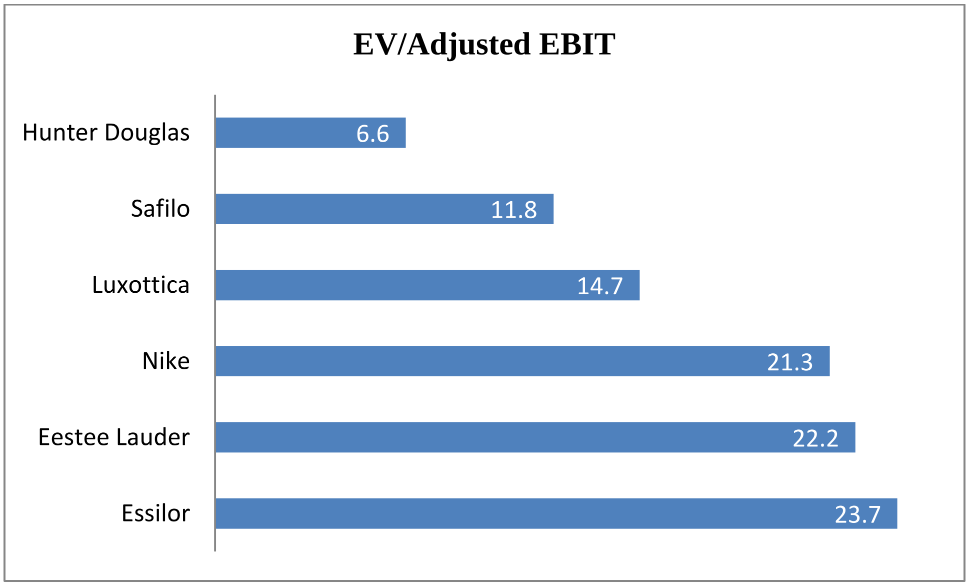
If Safilo opts to be a buyer, analysts speculate that it could consider smaller manufacturers such as the US's Marchon, or Italians De Rigo and Marcolin as possible targets." – *Luxury eyewear in the spotlight as brands focus in on sector*, Rachel Sanderson, Financial Times, 08 April 2016

[24] "I would say our dividend payout policy change depends on our financial strategy and financial leverage more than from our management change. And I think we already commented to that in the past quarters, **given the progressive deleverage of our Group. Clearly, there is space for an increase in dividend payouts on a permanent or temporary basis. Let's say it could even be an extraordinary dividend or a permanent payout**. And this will be discussed by the Board.

And as I mentioned in the past, this, given the level of deleverage we have today, is -- **I would say it's more likely than not that there will be a dividend payout increase**. But again, this depends on our financial strength more than from this management change." – Enrico Cavatorta, Luxottica's former CEO, Luxottica Call on Management Structure, 01 September 2014

Value

Luxottica Deserves 27x Owner Earnings



Luxottica is trading at 34% discount to Nike, Estee Lauder and Essilor

- **Biggest Negative**:
  - Luxottica isn't a value stock
- Key inputs
  - Number of shares: 480.51 million
  - Share price: €45.01 ($50)
  - Cash: €928 million ($1,030 million)
  - Debt: €1,870 million ($2,057 million)
  - EV: €22,570 million ($24,827 million)
  - Normal EBIT: €1,531 million ($1,684 million)
  - EV/Normal EBIT: **14.74x**
  - Effective tax rate: 37%
    - Italy statutory tax rate is 31.4%
    - Luxottica historically paid 37% tax rate
      - 56% of Luxottica's business is North America
      - Retail account for 80% of the business in North America
        - Retailers in the U.S. has to pay
          - Federal income tax
          - State income tax
        - => may have to pay 40% or more

        - Tax rate may decline in the future as
            - Wholesale grows faster than retail in the U.S.
            - Luxottica does more business in emerging markets
- Peers include
    - Nike (NKE)
        - The dominant premium sporting goods company
        - Revenue by geography
            - North America: 45%
            - Western Europe: 19%
            - Central & Eastern Europe: 5%
            - Greater China: 10%
            - Emerging Markets: 2%
        - Revenue by products
            - Footwear: 60%
            - Apparel: 28%
            - Equipment: 5%
            - Other: 7%
        - Nike's Sales CAGR was:
            - Since 2000: 8.5%
            - Since 2005: 8.3%
            - Since 2010: 10%
        - Most of growth was organic
        - Nike's EBIT margin is stable about 13-14%
            - Doesn't enjoy margin expansion
        - Nike's EBIT/NTA: 50%
        - Nike's current valuation:
            - Share price: $57.87
            - Market cap: $97,495 million
            - EV: $94,444 million
            - EV/S: 3.09
            - EV/ EBIT: 22.62
            - EV/Owner Earnings: 21.34
    - Estee Lauder (EL)
        - EL makes quality skincare, makeup, fragrance, and hair care products
        - Its well-known brand names include
            - Estee Lauder

            - Aramis
            - Clinique
            - Origins
            - MAC
        - It’s also the global licensee for fragrances and cosmetics for
            - Tommy Hilfiger
            - Donna Karan New York
            - DKNY
            - Michael Kors
            - Tom Ford
        - Revenue by geography
            - The Americas: 42%
            - Europe, the Middle East and Africa: 38%
            - Asia-Pacific: 20%
        - Revenue by products
            - Skin Care: 42%
            - Makeup: 40%
            - Fragrance: 13%
            - Hair Care: 5%
        - EL’s Sales CAGR was:
            - Since 2000: 6.2%
            - Since 2005: 5.5%
            - Since 2010: 6.7%
        - EL spent about 10% of income in acquisitions
        - EL’s EBIT/NTA is about 60%
        - EL’s EBIT/NTA: 50%
        - EL’s current valuation:
            - Share price: $94.40
            - Market cap: $34,856 million
            - EV: $35,708 million
            - EV/S: 3.31
            - EV/ EBIT: 22.23
            - EV/Owner Earnings: 22.23
    - Essilor (EPA:EI)
        - Essilor is the largest lens producer
            - Has **41%** global market share

            - Next competitors are
                - Hoya: about 20% market share
                - Carl Zeiss: about 8% market share
        - Essilor account for 75% of the industry's total R&D
            - (According to Essilor's 2014 full-year result presentation)
        - % of Luxottica's retail lens merchandise comes from Essilor
            - 2004: 9.9%
            - 2005: 10%
            - 2006: 15%
            - 2007: 15%
            - 2008: 12%
            - 2009: 9%
            - 2010: 26%
            - 2011: 25%
            - 2012: 31%
            - 2013: 31%
            - No information for 2014 and 2015
                - The % might have declined
        - Revenue by geography
            - North America: 48%
            - Europe: 28%
            - Asia/Pacific/Middle East/Africa: 18%
            - Latin America: 6%
        - => quite similar to Luxottica's geographic mix
    - Essilor's EBIT/NTA is about 50%
    - Since 2002, Essilor's constant currency growth was
        - Organic: 4.8%
        - Organic + acquisition: 9.7%
        - (Luxottica's constant currency growth was 6.6%)
    - Essilor spent 86% of its income in acquisitions
        - Since 2004
            - Total net income: €5,555 million
            - Total net cash spent in acquisitions: €4,776 million
        - Essilor's current valuation
            - Essilor's current valuation:
                - Share price: €121.75 ($134)

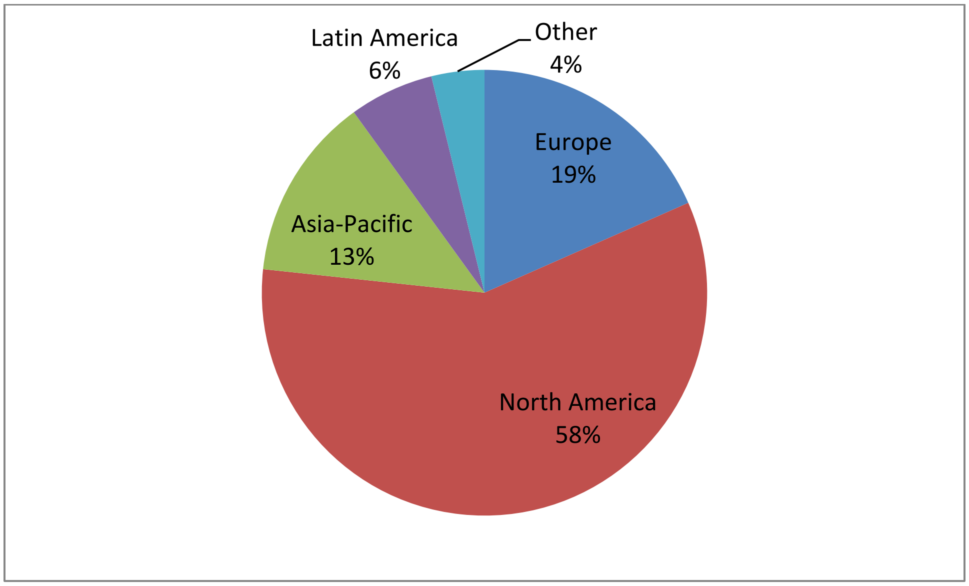
            - Market cap: €26,354 million ($29,253 million)
            - EV: €28,762 million ($31,638 million)
            - EV/S: 4.28
            - EV/ EBIT: 24.31
            - EV/Owner Earnings: 23.69
- Hunter Douglas (AMS:HDG)
    - Hunter Douglas is the leading manufacturer of premium window blinds and shades
        - Has about 40% market share in the U.S.
        - Has a vertical integrated model like Luxottica
        - Sells to small dealers
    - HDG's revenue by geography
        - North America: 4a3%
        - Europe: 38%
        - Latin America: 9%
        - Asia: 7%
        - Australia: 3%
    - HDG is in cyclical business
        - Margin was
            - 5-7% in bad years
            - 13-14% in good years
            - Averaged 11%
    - EBIT/NTA averages about 20%
    - Hunter Douglas's current valuation:
        - Share price: $48.25 (€43.47)
        - Market cap: $1,678 million
        - EV: $1,960 million
        - EV/S: 0.77
        - EV/ EBIT: 8.07
        - EV/Owner Earnings: 6.62
- Safilo (BIT:SFL)
    - Safilo is Luxottica's direct competitor
        - Safilo has license for
            - Banana Republic
            - Boss
            - Céline
            - Dior

        - Fendi
        - Fossil
        - Marc Jacobs
        - Kate Spade
        - Swatch
        - Tommy Hilfiger
- Safilo is the second biggest frame manufacturer
    - Revenue: €1,279 million
- Safilo has a history of losing big license
    - (mostly to Luxottica)
    - Lost Ralph Laurent
        - In 2006
        - 10% of Safilo's revenue
    - Lost Armani
        - In 2011
        - 15% of Safilo's revenue
- Safilo will lose Gucci this year
    - Gucci does about €350 million
        - 27% of Safilo's revenue
    - => we adjusted Safilo's sales and EBIT in peer comparison
        - This might not be accurate
        - Safilo might lose some operating leverage
- Safilo wasn't able to grow since 2004
    - 2004 revenue: €945 million
    - 2015 revenue: €1,279 million
        - Adjusted for the loss of Gucci: €929 million
- Safilo's EBIT/NTA: 19%
- Safilo has a lot of debt
    - So it wasn't distribute many cash to shareholders
    - Had to issue shares in 2010
        - Increased the number of shares by 4 times
- Safilo's current valuation:
    - Share price: €6.7 ($7.37)
    - Market cap: €420 ($462 million)
    - EV: €541 million ($595 million)
    - EV/S: 0.58
    - EV/ EBIT: 11.75

            - EV/Owner Earnings: 11.75
- Luxottica is cheaper than peers
    - Hunter Douglas and Safilo are inferior
    - Only Essilor, Estee Lauder, and Nike are comparable
    - Essilor has low organic growth
        - And spend too much in acquisitions
    - => Essilor is worse than Luxottica
    - Estee Lauder has only 5-6% growth
        - And 50% EBIT/NTA
    - Nike can have better sales growth
        - but doesn't enjoy margin expansion
        - and has lower EBIT/NTA
            - 50%
    - These high quality peers trade at about 22-23x EBIT
    - Luxottica trades at only 14.74x EBIT
- Luxottica normally trades at high multiple
    - In most year, P/E ranges between 23 and 33
        - EV/EBIT ranges between 16 and 20
- Luxottica deserve 30x cash available for distribution to shareholders
    - Translates into 3.33% yield
    - Luxottica can grow sales by 5-6% in the long run
        - Margin expansion can result in 7-9% earnings growth
    - Even without margin expansion, expected return is 8.33-9.33%
- Luxottica deserves 27x owner earnings
    - Luxottica needs to retain only 10% to grow sales by 5-6%
    - 27x owner earnings is equivalent to 30x cash available for distribution to shareholders

Growth

Penetration of Premium Eyewear is Still Low around the World



Emerging markets represent only 23% of Luxottica's revenue

- **Biggest Negative**:
- Total market is growing
  - According to Essilor
    - (2015 Full Year Result Presentation)
    - 7.2 billion people
      - 4.5 billion need vision correction
      - 1.9 billion use vision correction
      - 2.6 billion don't
      - All need sun protection
        - Only 1.4 billion people use
    - Growth until 2030
      - Population: 8.2 billion
        - 0.9% growth
      - Urban population: 5 billion
        - 4 billion today
        - => 2% growth
      - Correction needs: 6 billion
        - 2.1% growth
      - Correction wearers: 2.9 billion

        - 3% growth
    - Myopia population: 2.7 billion
        - 3.3% growth
    - Presbyopia population: 3 billion
        - 2.5% growth
  - Luxottica and Euromonitor expects 30% growth in the market[1]
    - From 2014 to 2019
    - 2014: 900 million frames
    - 2019: 1.2 billion frames
    - Emerging market
      - 2014: 1/3 of the total market in terms of volume
      - 2019: almost half of the total market
    - Growth drivers
      - An additional 500 million vision correction wearers by 2020
      - Penetration: more people who need vision correction get vision correction
- Low penetration of premium around the world
  - In Sunglasses
    - According to Essilor
      - (2014 Investor Day presentation)
      - Luxury fashion: 12 million units
        - > $100 per pair
      - Performance: 26 million units
        - > $100 per pair
      - Entry/mid-tier: 510 million units
        - $5-100 per pair
      - => sunglasses over $100 represent less than 8% of total volume
    - In the U.S
      - 101.3 million pairs of Plano (Non-Rx) sunglasses were sold
        - (Source: Vision Council's Vision Watch Report)
        - In 2015
        - Total revenue: $3.93 billion
        - => $39 per pair
      - 80% of the market in the U.S. is still below $50[2]
        - 60% of Americans buy eyewear under $35[3]
      - A structural wave of people not buying sunglasses below $30 anymore[4]

        - Understanding that Oakley or Ray-Ban are better
      - Average women in the U.S. has
        - 21 pairs of shoes
        - 10 handbags
        - 4 watches
        - 2 pair of eyeglasses
- Premium penetration in optical eyewear lags that in sunglasses
  - Optical market: 2/3 of the total eyewear market volume[5]
    - LUX is exactly the opposite
      - Sell one RX frame for every two sunglasses
  - Prescription/Sun: 30/70 for Ray-Ban and Oakley
  - Another 0.5 billion people will wear prescription glasses in the world
    - (By 2020)
    - LUX is working to make prescription frames even more desirable[6]
      - In movies
      - In Hollywood
      - In TV
      - In PR
      - In education
- The industry is 200 years old, but it's new in the U.S.[7]
  - Prescription frames or sunglasses was a pure functional product
    - Today it's a functional relationship
    - But there's a huge emotional part on top of that
      - The way we choose our glasses is different
      - The way we choose what to wear on a Saturday compared to a Tuesday is different
  - Huge demographic wave
    - Baby boomers are into the optical industry
    - Millenials are into sunglasses
  - Premiumization
    - Americans have always been pragmatic and functional
    - Hollywood has changed
    - TV has changed
    - Things changed fast over the last 10 years
      - Who was Coach 10 years ago?
      - Who was Michael Kors 10 years ago?
      - Who was Tory Burch 10 years ago?

- Penetration of premium eyewear is very low in emerging market
    - Much lower than penetration of other premium and luxury product
        - 2011 weight of emerging markets
            - (Source: Luxottica 2011 presentation)
            - Experiential luxury: 48%
            - Fragrance: 48%
            - Personal luxury: 43%
            - Premium skincare: 37%
            - Premium sunglasses: 19%
            - Premium prescription: 16%
    - Emerging market account for only **23%** of Luxottica's revenue
    - Chinese represent 50% of the total luxury consumption in the world
        - But only 3% of Luxottica's revenue
        - In 2013
            - 20 million cars were sold in China
            - 1 million Audi and Mercedes were sold
            - But Luxottica sold only 1 million pair of eyeglasses[8]
- Sunglasses business will lead Luxottica's growth
    - Sunglass Hut will have **high-single-digit** growth
        - Continues to benefit from
            - Premiumization of sunglasses in the U.S.
            - Premiumization of sunglasses in emerging market
            - New store openings in emerging markets
                - Up to 1,000 stores in the next 3 years
- Optical retail in North America can grow **4-5%**
    - LensCrafters will grow 4-5%
        - Slightly outperform the market
        - Comparable store sales growth averaged about 3-4% in the past
            - Benefit from continuing premiumization
        - Luxottica will open up to **500** LensCrafters within Macy's
            - (current number of stores: **926**)
            - In the next 3 years
            - In high visibility traffic areas
                - Close to the already-present Sunglass Hut departments within Macy's
            - Shops will average about 1,000 square feet

        - (full-service LensCrafters stores average 4,000-4,500 sqft)
        - 500-700 square feet established for selling area
        - The remainder for doctor's office and exam areas
      - Prescriptions will be filled either by
        - Nearby LensCrafters
        - Luxottical Retail central labs
      - *Sustainable growth for LensCrafters: 5% (167)*
- Pearle Vision's future is interesting to watch
  - Pearle had been received a lot less marketing attention than LensCrafters
    - Example: spending in measured media in 2012
      - LensCrafters: $48.5 million
      - Pearle Vision: $14 million
  - Pearle Vision footprint shrank
    - In 2007
      - 470 owned stores
      - 405 franchised stores
    - In 2015
      - 112 owned stores
      - 420 franchised stores
  - Now it has a clear strategy: the best franchise solution for independent doctors
    - Leveraging all the infrastructures, processes systems and skill set of PV team
  - Franchisees are doctors[9]
    - They want to take care of eyes
    - But they're in the retail business
    - They want someone to help with[10]
      - Select the right frame manufacturers
      - Negotiate for them
        - With manufacturers
        - With insurers
      - Provide a lab service
      - Marketing
      - Provide a supply chain solution
  - Luxottica believes it can triple the number of Pearle Vision franchisees
    - Over the next 5 to 10 years

                - This growth will benefit Luxottica's wholesale business
    - Target Optical
        - 331 Target Optical (851)
            - Target has 1,770 stores in NA
            - LUX intend to triple the size of Target Optical by 2018
        - Target has **1,792** stores
            - Target Optical is in **389** stores
        - Target Optical posted 6 consecutive years of double-digit comparable store sales growth[11] [12]
            - Enjoys high net promoter scores for its concept
                - Fun
                - Fast
                - Simple
            - Expansion is accelerating
                - Opened over 40 stores this year
                - Will open another 80 stores in 2016
                - Luxottica's near-term target is to have 1,000 Target Optical
                    - And there can be more
- Optical wholesale in the U.S. can grow faster
    - Wholesale business in the U.S. was slow for a long time[13]
        - From 1995 to 2005
        - Some retailers weren't very happy
            - LUX didn't service them anymore
    - But Luxottica began to re-work on wholesale in 2005, 2006
    - Since 2007, U.S. wholesale has grown faster than U.S. retail
        - In $, average annual sales growth rate was
            - Wholesale: **14%**
                - 2007: $407 million
                - 2015: $1,169 million
            - Retail: **2.9%**
                - 2007: $3,761 million
                - 2015: $4,719 million
    - As premiumization continues
        - Luxottica's optical retail might not gain market share
        - But it may gain more wholesale business with independents
- => Luxottica's optical business in the U.S can grow **5-6%**
- Luxottica's optical business can have many years of growth in other countries

    - There's room for the premium optical retail
        - Americans are pragmatic
        - But Luxottica managed to move LensCrafter upscale
    - The franchise model is promising
    - Retail operations may create demand for premium optical eyeglasses
        - Benefit the wholesale operations
- Luxottica has been growing fast in emerging markets
    - Brazil
        - Brazil is a bit less than EUR 300 million revenue
    - China will be a long-term opportunity
        - Revenue was
            - 2008: €70 million
                - Sunglasses: €18 million
                - Optical: €52 million
            - 2011: €107 million
                - Sunglasses: €39 million
                - Optical: €68 million
            - 2013: €188 million
                - Sunglasses: €81 million
                - Optical: €107 million
            - 2014: €200 million
            - 2015: €230 million
    - India
        - Ray-Ban is synonymous with sunglasses in India
        - Wholesale revenue was
            - 2008: €18 million
            - 2011: €29 million
            - 2013: €40 million
        - Sunglass Hut stores
            - 2008: 1
            - 2011: 33
            - 2013: 60
    - Southeast Asia sales
        - Total revenue:
            - 2008: €14 million
            - 2011: €53 million
            - 2013: €75 million

            - Sunglass Hut stores
                - 2008: 9
                - 2011: 20
                - 2013: 37
- Luxottica believes that it can double the size of the company in 10 year
    - Without making acquisitions[14]
    - 7% growth annually
    - Make €15 billion revenue by 2024
- Our take: 7% organic growth can be difficult
    - But 6% organic growth is realistic
    - Reasoning:
        - Sunglasses can grow in the high single digit
            - **56%** of revenue
        - Optical business can grow **5-6%** in North America
            - Slower in Europe
            - Faster in emerging market
        - To achieve 6% total sales growth, Luxottica only needs
            - 6% growth in North America
                - 58.3% of total revenue
            - 4% growth in Europe
                - 18.4% of total revenue
            - 8% growth in emerging market
                - 24.3% of total revenue
            - 6%*58.3% + 4%*18.4%+8%*24.3% = **6.2%**
        - To achieve 5% total sales growth, Luxottica only needs
            - 5% growth in North America
                - 58.3% of total revenue
            - 4% growth in Europe
                - 18.4% of total revenue
            - 6% growth in emerging market
                - 24.3% of total revenue
            - 5%*58.3% + 4%*18.4%+6%*24.3% = **5.1%**
- For 6% sales growth, Luxottica needs to retain only 11% of earnings
    - Even less if it can reduce net working capital relatively to sales
    - 5-6% sales growth can result in 7-9% growth in EBIT
        - Thanks to margin expansion

[11] "First, let's talk about what legitimizes our ambition to continue on a steady growth pattern. The first, of course, is that we operate in a structurally growing industry. **In the next five years we expect a 30% growth in the market, from 900 million frames to 1.2 billion frames**. That is more or less the growth that we have seen in the past ten years, so it is not only growth, it is an acceleration of the pace of growth; in the next five years, the same growth we saw in the past ten.

The other thing to note is the colors of the pie chart [slide 32]. **Today, emerging markets account for approximately a third of the total market, and in five years' time we expect them to edge towards conquering almost half**, and that of course is a big driver of how we are going to chase opportunities in the future. It will be apparent in the next slide why emerging markets are going to be a big driver.

We have called these the secular growth drivers [slide 33]. Maybe I will call them the inevitable growth drivers, but the first one, the first big block here is demographics, and yes, demographics do have of course a big skew to emerging nations. **An additional 500 million vision correction wearers by 2020 is our estimate**. That is a very significant increase in users. Of course, also the profile is changing and our habits our changing. **We are spending more time in front of screens, more time in front of small devices in our hands, and that also drives an increased need to see well**.

The second block, penetration, is about the fact that there is still a gap, a significant gap, between the number of people that need vision correction and the number of people that get vision correction. I would not want you to see this only as a phenomenon of emerging nations. Only one in four clients in the US, potential users in the US, as adults have an eye test. When I look at children, one in 11 children gets an eye test before they start school, and if you look at the medical need it is about one in four who actually would find that they have some form of vision correction required. So it is not just a health issue, it is a learning opportunity, and it gives you a sense – by quoting our most developed market – of the opportunity and penetration that really exists everywhere." – Adil Mehboob-Khan, Luxottica's former CEO, Luxottica 2014 Q4 Earnings Call, 03 March 2015

[2] "So the trend to more sophisticated eyewear, to more functional eyewear, eyewear that performs at higher levels, is there and it is going to be a driver of growth for us. **80% of the market in the US, as you have seen we are so strong, is still below US$50, and that is not where we play**. There is a migration from that bucket to the bucket where we do play." – Adil Mehboob-Khan, Luxottica's former CEO, Luxottica 2014 Q4 Earnings Call, 03 March 2015

[3] "Definitely it is incredible to say **that North America continues to be one of our strongest emerging markets. As Adil said today, we are breaking that paradigm**

of Americans buying eyewear. 80% of Americans buy eyewear under US$50. In fact, some statistics say that even 60% of Americans buy eyewear under US$35**. I will show you how we are trying to break that paradigm in the charts to come." – Paolo Alberti, EVP Wholesale, Luxottica 2014 Q4 Earning Call, 03 March 2015

[4] "In terms of Sunglass Hut being structural cyclical, let me say that if we go back 9 years and we exclude 1 or let me say 18 months, we had double-digit positive comps. I think this is structural.

But even in structural, you have some cyclical. I mean we have gone through, I think, the worst reshuffle in years in United States. Can that rehappen? I'll ask you.
But I mean, I think this has been structural -- is **a structural wave of people not buying anymore Sunglass Hut sunglasses below $30 but understanding that the Oakley lenses that Ray-Ban, let me say, [mowaging] our better sunglasses than what they were wearing before.**

It's quite easy to prove it. It's quite easy to test it. It's quite easy to use it. So, I'm pretty confident that this is structural, but I've said this is structural ago as well." – Unidentified Company Representative, Luxottica 2010 Q4 Earnings Call, 01 March 2011

[5] "Just to give you the size of the possibility of the opportunity we have in front of us, **just consider that if the eyewear market makes two-thirds of its business with the optical category, in our Group, at the moment, we are exactly the opposite, in the sense that we sell one Rx frame for every two of sunglasses**. And this gives us the opportunity and the space for growth as we look ahead." – Paolo Pezzutto, Head of Global OmniChanel & Digital Marketing, Luxottica 2012 Q4 Earnings Call, 03 March 2013

[6] "**We all love sun. Sun, it's easy, but the prescription market is larger**. We told you that **by 2020 another 0.5 billion people will wear prescription glasses in the world** in emerging markets and in mature markets. We are growing fast on our side and **we are working in movies, in Hollywood, in TV, in PR, in education to make prescription frames even more desirable**. We are making our way and really I think that even in terms of service level on the prescription side of our business, we have again improved. We are happy, and this is really an important asset." – Andrea Guerra, Luxottica's former CEO, Luxottica 2013 Q1 Earnings Call, 29 April 2013

[7] "So I would start from the headline that we have given to this presentation because we could be surprised. United States is the largest optical market in the world. United States and North America is the largest market for Luxottica. Luxottica is the leader company of the world in this industry, so how can we say, how can we state, how can we define these two days as North America structurally growing market. And there are many different reasons, many different opportunities to see it.

We are working and leading a very strange industry**. This is a 200 years old, new industry. It's not a mature industry, not at all**. It's not an industry which is structurally saturated and constantly we have to invent a new path. **No, this is an industry which is completely new.** And there are at least four reasons why I define this as a very new industry.

The first reason is **the emotional connection between ourselves, between American consumers and these objects. Either they are prescription frames or sunglasses**, that relationship is completely new. **It was a pure, pure functional, pragmatic relationship.**
Today, **it is obviously a functional relationship, but added on top of that, there is a huge emotional part** which allows us to think about the way we choose our glasses is completely different, the way we wear sunglasses is completely different, the way we choose what to wear on a Saturday compared to a Tuesday is completely different. So, **all of this new emotional status around the relationship between glasses and consumers is allowing us to state that this is completely new industry.**

The second reason is there is a huge demographic wave, there is a huge social evolution, and there is a huge behavioral change. And I could define it very easily saying, "Look, baby boomers are into the optical industry today heavy and on the other side Millennials are into the sunglass market, new and heavy.

These are the two reasons why I feel this is a new industry, the connection, the choice, the wish of these two generations in those two segments of our industries are making a difference and will make a huge difference.
…
The third reason why I'm defining this industry as new **is the famous premiumization**. So we all know that the habits of **Americans have always been pretty pragmatic, pretty functional. And you can see how Hollywood has changed, how TV has changed**. It's easy to observe how people walking by the 10 gateway cities of United States 10 years ago and today are dressed. It's easy. It's easy to understand and read the statistics about malls and downtowns and look what are the brands occupying certain alleys of malls and certain streets downtown.

Who was Coach 10 years ago? Who was Tory Burch 10 years ago? Who was Michael Kors 10 years ago? And things are changing; changing fast in this environment and this is a constant and continuing evolution of the premuimization. And you know and I've been repeating this for my past decade or so, this is the wildest and biggest opportunity for us in premium Sun.

If you ask me, what is the market, which is the market, which is the region? This is the region. **And this is why we have invested, this is why we have begun 7 or 8 years ago, a complete transformation of what Sunglass Hut was. From being a destination of man functional lenses to never lose that, but add ladies. If you want to be in glamour, if you want to be in fashion, if you want to be sexy**, I mean, it's easier to go this direction or rather than that, but the most important thing is to hold on a home which hosts both.

And I think that this is keeping on. And what did we do in the last decade? Ray-Ban just started at the beginning of the decade. Then to the portfolio, we added Oakley. Then to the portfolio, we added Ralph Lauren. Then to the portfolio we added Tiffany. Then to the portfolio we added Tory Burch. Then to the portfolio we added Coach. That was so important, so critical in order to allow us to have the best portfolio to influence the American consumer in the premiumization journey.

I think all of these are very important factors why I'm defining this as a new industry in the United States.

The fourth reason is the technological breakthrough. It's huge. Think how just on lenses, easy lenses, AR, anti-reflection, United States was behind the world. Think about how the digital surfacing allowed a completely different way and perspective of Sun RX, or Sun prescription. Whoever was wearing sun prescription 10 years ago, you could spot them right away, very straight forward, very rectangular, very flat glasses.

Today, 80, 85% of what you see in Sunglass Hut is [RXable]. That's why, that's completely new. And we have a new generation coming into prescription wishing those kinds of glasses. So all of this allows me to say that we are in a new industry, if we can go, this says how I can go up but I cannot go behind." – Andrea Guerra, Luxottica's former CEO, Luxottica 2013 Investor Day, 08 October 2013

[8] "**What if I were to tell you that last year in China, 20 million cars were sold? What if I were to tell you that one million of those very close to the number of glasses that we sell and I wouldn't tell you their exact number but one million of those were between Audi and Mercedes**?

So if you think about that that's the same number of glasses that we sell, you can imagine what our potential can be but I'm still not criticizing your numbers but you know that there's an exploitation of growth which is amazing." – Paolo Alberti, EVP – Wholesale, Luxottica 2013 Q4 Earnings Call, 28 February 2014

[9] "**Genuine eye care from your neighborhood doctor, a promise that was started 50 years ago**. Most important words, eye care first, glasses second. Take care of the eyes guess what, you're going to buy the glasses. That's what we stand for. That's what this revolution or of getting back to its roots is all about.

Now that was one differentiation. Today's market place is about brands being differentiated. Differentiate or die is what people say. So we have done that. But we also within Luxottica want to differentiate it in another fashion, a differentiation on what we call a business model differentiation. And what was that? It's called franchising.
…
Second, if you build a franchising business founded on listening to the operator and making them successful based on their profitability we called it unit economics, you have an asset light scalable model. So that -- the next journey where we put together putting governance models, listening to our franchisees and doctors and making it a doctor-centered brand.

So what were the doctors looking for? We went to optometry schools and listened to them, listen to the 3rd year students and the 4th year students. What were they telling us? They were telling us "**Pearle vision. Wow. You guys are taking back to genuine care. Help us run a business. We are doctors. We want to take care of eyes**." What did that mean? Well**, we're on the retail business, help me select the right vendors, frame manufacturers, negotiate for us. I do not want to have capital invested in my store or on the lab. Help me providing a lab service**. What better company to provide those services but Luxottica?

So we have a team today working with the wholesale team that actually services all our franchisees with special terms for our doctors, for our opticians within our store working with Giorgo and his team and some of the other partners in the lens manufacturing providing a comprehensive solution for doctors." – Srini Kumar, Head of Pearle Vision, Luxottica 2013 Investor Day, 08 October 2013

[10] "And then just a few words on the many other brands we've got, Pearle Vision is a trajectory to become the first and best franchise retail operator in the U.S. **We see opportunity to triple the number of franchisees over the next 5 to 10 years. We didn't have I think a very clear strategy probably a few years ago. Today I think we have a very clear strategy**. We want to make her the best franchise solution for great independent doctors who can keep their entrepreneurial spirit **but leveraging all the infrastructures, processes systems and skill set of the Pearle Vision team. So Pearle Vision is currently up, it's supply chain solution it's a brand new one**. We're transforming 31 different point of sale systems that we had in Pearle Vision in just one state of the art point of sale system, we will have supply chain the matches both inventory of lenses and frames. **We will guarantee huge power of negotiation**

vis-à-vis every manufacturer's, better marketing, better training, better traffic thanks to the in-network status with most of the assurances starting from VPS [ph], exciting moment at Pearle Vision as well." – Nicola Brandolese, President of Retail Optical of America, Luxottica 2015 Q4 Earnings Call, 02 March 2016

[11] "Target Optical is an amazing story. **It is its fifth consecutive year of double-digit comps. An amazing story, amazing profitability, amazing top-line growth, and the relationship with the host, Target, again has never been as strong as it is today. They agreed to finally allow us to open new stores in existing Target stores**. It is the first time Target, as host, has allowed us to open stores modifying the existing Target stores, which is great. We will open more than 35 stores this year, and this is thanks to the great performance achieved over the last five years, thanks to the great profitability that we also bring to Target as the host. **The profitability per square foot is really interesting also for them**. So, great value for money for the guests, great personalized customized fun, and an easy and simple experience in this space." – Adil Mehboob-Khan, Luxottica's former CEO, 2014 Q4 Earnings Call, 03 March 2015

[12] **"Target Optical, another amazing story we deliver in 2015, the six consecutive year of double digit comps, double digit sales**. **We opened the highest number of stores ever, over 40 stores this year** but the relation is going so well that we're doubling up for 2016 so **we're expanding Target up to another 80 new stores in 2016 and we're doubling that up as well on e-commerce for Target Optical**. The relationship is going great, profitability is going great, sales are going great, satisfaction is over the roof. We enjoy the highest net promoter score for this simpler, faster, enjoyable optical we had experienced, very excited about what the team is doing and the good news is **that by the end of 2016 with approximately 500 stores we will just be in 25% of the host locations**. So still amazing headroom for growth, excited." – Nicola Brandolese, President of Retail Opticals of America, Luxottica 2015 Q4 Earnings Call, 02 March 2016

[13] "As we said and I will repeat this, this is not our numbers; this is numbers that are given from different sources. And this is about premiumization of sunglasses. This is about premiumizations of lenses and this about baby boomers coming in the Optical reality.

So when we go and look to a part, an asset of our business where we have done a wonderful job in the last years is the wholesale part. So I will take care of that. **Many of you heard how we have been slow for a long time between '95 and 2005, we basically went to sleep. We didn't really tackle wholesale. Why was that? Because we had acquired LensCrafters in '95. We had a little bit of people not very happy between our customers and we gave it up.**

We didn't service them anymore. We didn't -- be proactive anymore. We were not happy. We were not nice. We were not efficient. We were not, nothing. We began to re-work on wholesale in 2005, 2006; took some years to take it back to where we wished and now it's three, four years of rapid, fantastic, wonderful growth. Is this finished? Absolutely, not." – Andrea Guerra, Luxottica's former CEO, Luxottica 2013 Investor Day, 08 October 2013

[14] "**The statement that we don't need to do M&A is really because to reach our double-the-company in the next 10 years goal, we need to grow just above a 7 percent growth year-on-year**.

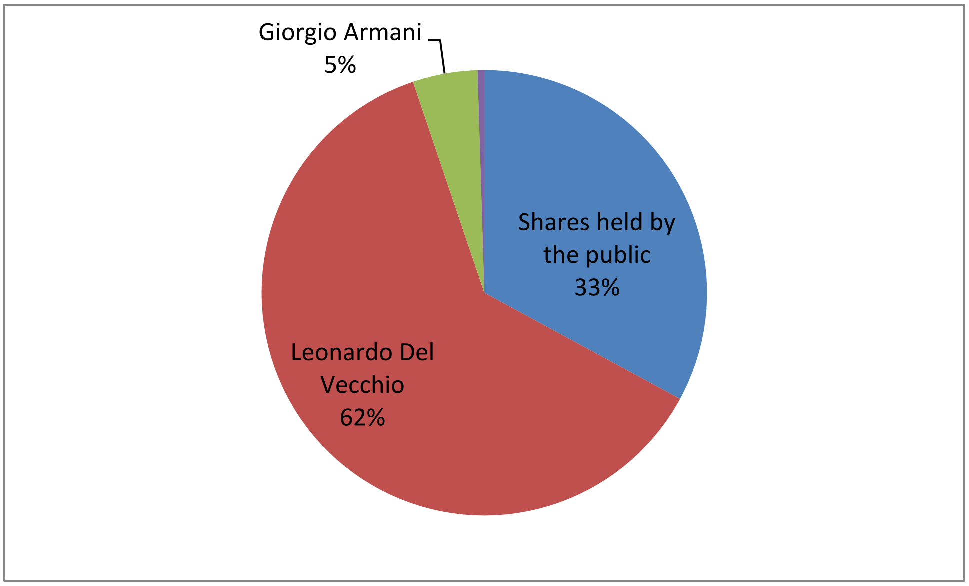
And if you look at our pedigree, our track record, we're more or less at that level right now. So I believe we can get there without the need for an acquisition. Of course, it gets harder and harder to grow, you know, 7 percent a year as you get bigger.

We have a billion in cash and our debt position is very good. **So, you know, I understand that from the outside we look ready to pounce on the acquisition front. But we can afford to do that judiciously**. And it's not really sort of a prep for a buyback.

We are looking at options. But **we don't have a gun at our head on acquisitions**. If we have good deals and good options, we will take them." – Adil Khan, Luxottica's former CEO said in an interview with Bloomberg TV, 27 October 2015

Misjudgment

Management Succession is Uncertain at Luxottica



Leonardo Del Vecchio control 61.9% of Luxottica's outstanding shares

- **Biggest Negative**:
    - Leonardo Del Vecchio is now 80 years old
- Uncertainty about succession at Luxottica cause investor concerns
    - Luxottica changed 3 CEOs in 18 months
        - Investors are concerned that Leonardo Del Vecchio could leave the company with weak management[1]
    - The saga started in September 2014
        - Luxottica fired its highly respected CEO, Andrea Guerra
            - Andrea Guerra
    - Del Vecchio handed all executive powers to Mr. Guerra
        - In 2004
        - Guerra was only 38 years old then
        - He was seen one of Italy's best young executives and marketing experts
    - Del Vecchio became far less involved in the operations of the company
        - Rarely attended board meetings
        - Gave Guerra latitude to make major strategic decisions
    - Guerra did a good job at running Luxottica
        - More than doubled sales over his 10-year tenure

- But there was clash between him and Del Vecchio[2]
  - Rumors:
    - Guerra struck a deal with Google
      - But didn't consult with Del Vecchio
      - => Del Vecchio was bristled
    - There was rumors Guerra would join Matteo Renzi's cabinet
      - Renzi is Italy's Prime Minister
      - He's a long-term friend of Guerra
      - => strengthen Del Vecchio's doubts that he couldn't fully trust his CEO
  - According to Del Vecchio
    - Guerra didn't share his ambitious plan[3]
      - Wants to double sales in the next 10 years
- Del Vecchio told Guerra that he wanted a Co-CEO structure
  - Guerra didn't accept
  - He resigned in September 2009
- Del Vecchio went ahead with the plan
  - Two CEOs
    - A CEO of Market hired from outside
    - A CEO of Operations promoted from within
  - CEO of Market ensures that LUX's potential is realized across[4]
    - Developed and new markets
    - Geographies and
    - Distribution channels
  - CEO of Operations guarantee the balance of growth with efficiency
    - Profit margins
    - Cost management
    - Capital allocation
- Enrico Cavatota was appointed as CEO of Operations
  - Cavatota had been Luxottica's long-time CFO
  - Stefano Grassi became Luxottica's CFO
    - He had worked side by side with Enrico at Luxottica for 5 years
- Cavatota quit a few week later
  - Due to disagreements with Del Vecchio
    - Over the independence of the company's management
  - Rumor: Del Vecchio's wife tried to increase her influence within Delfin[5]
    - Delfin is the family holding company

            - Holds 61.9% of Luxottica’s shares
        - Nicolletta Zampilla is Del Vecchio’s 2nd and 4th wife
            - Remarried in 2010
        - Her increased influence within Delfin annoyed many of Luxottica’s executives
- Luxottica’s long-term COO replaced Cavatota
    - Massimo Vian
        - He led product innovation
        - And developed Luxottica’s accelerated supply chain[6]
- Luxottica hired Adil Mehboob-Khan as CEO of Markets
    - Mehboob-Khan is a 27-year veteran from Procter & Gamble
- The new management structure
    - Vian is responsible for products and operations
    - Mehboob-Khan is responsible for markets
    - The corporate functions are shared between the two
- In January 2016, Luxottica announced that Mehboob-Khan was leaving
    - Del Vecchio will assume Khan’s position on an interim basis
        - Del Vecchio wanted more direct control over the markets division
            - Oversees strategy in
                - Emerging market
                - Digital development
                - E-commerce
        - He plans to strengthen the business
            - Then paves the way for a new successor
- Del Vecchio has always planned to leave the company to his managers[7]
    - His eldest son Claudio Del Vecchio was once Co-CEO of Luxottica
        - (with his father)
        - Until 2000
    - Claudio didn’t want to stay under his father’s shadow
        - He left
        - Now he’s the owner and chairman of Brooks Brother
    - Claudio was a Luxottica’s director
        - But his tenure ended
    - It’s said that Luxottica is what Del Vecchio loves most in his life
        - He’s aware of his family’s complex situation
        - He has 6 children from 3 different relationships

- He's worried about possible legal battles over the control of the company[8]
- => he spoke with advisers about a possible solution
  - Family members would receive dividends
  - But wouldn't have a direct say on decision making in Luxottica
  - New independent directors would join the board of Delfin
    - To ensure Luxottica's independence
- His stake in Luxottica will be distributed
  - Equally to his 6 children
    - 12.5% each
  - 25% to his wife
    - Nicolletta Zampilla
  - This was a big change from the previous plan
    - Distribute equally to his 6 children only
      - 16.67% each
- His successor is among Luxottica's younger management[9]

- How does U.S. traffic mall trend affect Luxottica?
  - Weakening mall traffic won't hurt LensCrafters[10]
    - It's a destination
    - People book a visit with a doctor days before
      - They go to LensCrafters for an eye check
      - And LensCrafters tries to convert the visit into a sale
  - Declining mall traffic may hurt Sunglass Hut[11]
    - Sunglasses are highly impulse purchase
    - In Q1 2016, Sunglass Hut's comp sales growth in North America: -1%
      - Main reason: weakness of touristic traffic
      - 15% of chain sales are exposed to touristic traffic
        - Posted double digit negative traffic
        - Close to double digit negative comp
      - Other stores showed positive comps
    - Lower mall traffic can be offset by higher conversion
      - Into store visit
      - Into sales
    - Penetration of premium sunglasses is still low[12]
      - 80% of American buy eyewear under $50
        - 60% of Americans buy eyewear under $35

- We're confident of Luxottica's long-term growth because of emerging market
    - Warren Buffett bought Coca Cola for the same reason
    - But it could be harder to duplicate success from U.S. in the rest of the world than we expect
    - It can be easy to sell premium sunglasses in emerging market
        - Sunglasses are naturally considered a fashion item
        - Sunglasses are sold as a whole package of frame and lenses
            - Brand is a guarantee of quality
                - Durability of the frame
                - Clarity of the lenses
                - Quality of the coatings
            - People just have to pick the style they like
    - It's more difficult for optical frames
        - Optical eyeglasses are originally a medical item
        - The relationship between consumers and the product is functional
        - The purchase process emphasize this functional relationship
            - People choose the frame they like
                - They try on and find the best looking frame for them
                - Most don't really care about brand
            - Then they choose lenses among available options
                - Based on features of the lenses
                - They don't know much about lens brands
                    - Essilor has been trying to raise brand awareness
                        - Spend about €130m each year in advertising prescription brands
                            - Varilux
                            - Transitions
                            - Crizal
        - Luxottica has to drive demand for designer frames
            - Through Hollywood
            - Through its stores
            - => much more difficult than selling coke
- But we may underestimate the premiumization of optical frames
    - People wear eyeglasses on their face
        - For 15-16 hours a day
    - Eyeglasses are the most visible fashion accessory

  - Why should people care more about brand of their shoes than brand of their eyeglasses?
  - Attention tends to move from one fashion category to another
    - Branded apparel in the 2000s
    - Handbag recently
  - It can be eyeglasses someday
- We may also underestimate the potential in emerging market
  - Luxottica succeeded in making LensCrafters upscale in the U.S.
    - A very pragmatic market
  - The relationship between consumer and products is much more emotional
    - In other markets
    - Asian crave for western brand is strong
      - A Prada frame might be the first item they buy from the brand
- Our judgment of Luxottica's quality might be biased
  - Buffett bought Coca Cola because of potential growth outside the U.S.
    - We're excited about Luxottica for the same reason
  - Luxottica has always traded at high multiple
    - In most year, P/E ranges between 23 and 33
      - EV/EBIT ranges between 16 and 20
    - High multiple may cause us to
      - Overestimate Luxottica's quality
      - Think that Luxottica is cheap
        - Even though it's not trading at a low multiple
          - It's trading at 22x after-tax owner earnings

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[1] "**Shares in Luxottica Group SpA fell sharply Monday amid concerns that the reassertion of control by founder Leonardo Del Vecchio could leave the Italian eyewear maker with a weak management structure at a time of intensifying competition and slowing sales growth**.

Late Friday, the company, which owns the Lenscrafters, Sunglass Hut, Ray Ban and Oakley brands, said that Adil Khan, one of its two co-chief executives, was leaving the company . Mr. Del Vecchio, Luxottica's 80-year-old majority owner, will assume Mr. Khan's executive powers on an interim basis, possibly until 2017." – *Luxottica Faces Tumult After Co-CEO Departs*, Manuela Mesco, Wall Street Journal, 01 February 2016

[2] "**Mr. Del Vecchio in 2004 handed over all executive powers to Andrea Guerra. He remained chairman, but rarely attended board meetings, people close to the company said, leaving Mr. Guerra to face investors and giving him wide latitude**

to make major strategic decisions and close deals that helped Luxottica more than double its profit and grow into a [euro]17.6 billion, or $22.3 billion, company.

Mr. Guerra was able to heal a rift that had opened in early 2000s between Mr. Del Vecchio and designer Giorgio Armani over key strategic decisions regarding the Armani eyewear license, according to a person close to the matter.

But by 2014, the relationship between Messrs. Del Vecchio and Guerra began to fray. Mr. Del Vecchio, who wanted to return to the management of his company, bristled after not being consulted before Mr. Guerra struck a much-ballyhooed deal with Google Inc. on its high-tech glasses, Google Glass.

In February, Mr. Guerra took a full day to deny interest in joining the cabinet of Italy's new prime minister, Matteo Renzi--a delay that strengthened Mr. Del Vecchio's doubts that he couldn't fully trust his CEO, say people familiar with the situation.

The next month, Mr. Del Vecchio told Mr. Guerra that he wanted to return to the company and establish a new model with two CEOs reporting to him. In response, Mr. Guerra resigned in September. **Mr. Del Vecchio appointed Finance Director Enrico Cavatorta as new CEO, but Mr. Cavatorta quit a few weeks later due to disagreements with Mr. Del Vecchio over the independence of the company's management.**

The resignations sparked a boardroom rebellion. One independent director, Roger Abravanel, tried to convince Mr. Del Vecchio to take a step back.

"I'll never do that," replied Mr. Del Vecchio, according to a person close to the board. Instead, he took over all executive powers on an interim basis until two new CEOs were found.

Mr. Abravanel resigned in response. The rest of the board agreed to let Mr. Del Vecchio go ahead with the plan but warned him more directors would quit if the owner didn't fill the positions by month's end." – *Luxottica Appoints Co-CEO to Calm Furor*, Manuela Mesco, Wall Street Journal 22 October 2014

[3] "In an interview with the Financial Times, **Mr Del Vecchio says Mr Guerra had not shared his "ambitious plans" for the group, including further rapid expansion**.

"I want to grow in the next 10 years even more than in the past 10 years. My aim is that in the next 10 years we will celebrate having double the revenues than we

have now," said an animated Mr Del Vecchio at Luxottica's newly opened headquarters - a bright white tower in central Milan.

…

Eyewear sales are growing fast in new markets in South America and in established markets such as the US where they have become a fashion accessory. Mr Del Vecchio sees his generation as another target. "People who are young like me," he smiles, "almost all of them carry sunglasses as I do. That will increase as people who are young like me increase."

However, he also sees the possibility of deals ahead.

"**We have done acquisitions, and we will continue to do acquisitions but for companies that do not cannibalise the shops that we already have and the interests that we already have. We would buy a chain that does something different for us**," he says.

"We want to grow very fast because we don't want anyone to be faster than us. We must run, we need to push the accelerator because we don't want anyone else to eat our food," he adds in Italian faintly accented from the northeast mountain region where Luxottica's manufacturing base is still located, surrounded by snow-capped peaks." – *Luxottica Chief Has Long-range Vision of Growth*, Rachel Sanderson, Financial Times, 03 September 2014

[4] "We now believe it's time to make a further big step, to put in place the necessary foundation for a new phase of growth and development, a phase that is consistent and coherent with the Company's existing strategic vision and direction.

However, without expectation for continuous growth in both traditional and new distribution channels, and without expansion into new geographies come new complexities and challenges as well, as new opportunities that we need to tackle. And **this new phase of growth is no longer suited to a single leadership role**. It requires a new governance model based on a redefined leadership with clear responsibilities, areas of expertise, and thoughts.

And, therefore, the evolution to a co-CEO leadership structure with distinct and complementary responsibilities will ensure stronger management of the Group which has rapidly increased its size, complexity, and global presence over the years, as you all know.

With this new management structure, **the CEO of Markets will focus entirely on ensuring that our potential across developed and new markets, geographies and distribution channels is realized**. At the same time this change will also allow us to look more **closely at profit margins, cost management, capital allocation and at how we can balance our objective of growing revenues with becoming even more efficient than today. And, as CEO of Corporate Functions, I will assume the responsibility of guaranteeing this balance**, and leading the Company in this direction." – Enrico Cavatorta, Luxottica's former CEO, Luxottica Call on Management Structure, 01 September 2014

[5] "**Mr Cavatorta's exit was probably prompted by the Del Vecchio family's growing desire to influence how the company is run. In particular, Nicoletta Zampilla, Mr Del Vecchio's wife, and Francesco Milleri, a family friend of hers, are thought to have increased their influence since Mr Guerra's departure**, annoying many of the firm's executives." – *Family Affairs*, Economist, 14 October 2014

[6] "Our new co-CEO model is structured in a different way what was announced in September. **Adil Mehboob-Khan will be responsible for markets, while I will be in charge for product and operations. Responsibility for corporate functions will now be shared between us**.

This structure perfectly complements both my and Adil's expertise across the value chain, and it allows us to better leverage our vertically integrated model. We're confident this is a logical [system]. It neatly shares responsibility for the two main strategic pillars of the business: product/operations and markets.

Today, we are also happy to announce the appointment of our new CFO**: Stefano Grassi. He is the natural successor to Enrico, having worked side by side with him for the past five years**. He is very highly regarded within the Company and for those of you who have not met him yet, I'm sure you will have the chance to do so in the coming months.

I've had the opportunity to speak with many of you in my role as Chief Operations Officer. During my nine years with the Group, I have led product innovation and developed Luxottica's accelerated supply chain [system]. Our expertise in these areas is something that set us apart from the competition and is a very significant contributor to our free cash flow generation as a business." – Massimo Vian, Luxottica's CEO, Luxottica 2014 Q3 Earnings Call, 29 October 2014

[7] "Luxottica Group SpA founder Leonardo Del Vecchio said he's not considered his children for management roles at the company, denying a report that such plans led to the departure of Chief Executive Officer Andrea Guerra.

"**I have never considered or even given the impression to anyone to involve my children or even my grandchildren in the management of Luxottica**," Del Vecchio said in an interview. "**Kids remain always kids and it's possible to fire an important executive, but it's not possible to fire one of your children**."

The 79-year-old billionaire, who started the Milan-based company in 1961 and still owns a 65 percent stake, was speaking after newspaper Il Sole 24 Ore cited him as saying that Guerra's exit made room for his family.

Del Vecchio has six children from three marriages, none of whom work for Luxottica. His eldest son, Claudio, 57, was co-CEO of the eyewear maker until 2000, though is now owner and chairman of the Brooks Brothers clothing chain in the U.S." – *Luxottica's Del Vecchio Says No Family Plan for Management Roles*, Daniele Lepido, 02 September 2014

[8] "**Mr. Del Vecchio has been concerned of late that the complex nature of his family could create legal battles over the control of the company in the future**, say people familiar with the situation. **The billionaire has been speaking with advisers about a possible solution in which family members would receive dividends but wouldn't have a direct say on decision making in Luxottica**.

New, independent directors would join the board of Delfin, the holding company that controls Luxottica, with the task of ensuring Luxottica's independence. But the family has yet to agree to a new arrangement." – *Luxottica Appoints Co-CEO to Calm Furor*, Manuela Mesco, Wall Street Journal 22 October 2014

[9] "Luxottica said Friday that family concerns that were raised in 2014--including the stakes that Mr. Del Vecchio's children will own in the holding company that controls the eyewear maker--are no longer an issue. **Mr. Del Vecchio has equally distributed stakes of the holding company to his children, who have no seats on the board or roles in the company, Luxottica said.**

In an interview on Saturday with Italian daily Corriere della Sera, Mr. Del Vecchio said his successor won't be chosen from among his children. "**I've already started to look into the company's" younger management, he said. "My successor is among them**," he added." – *Luxottica Faces Tumult After Co-CEO Departs*, Manuela Mesco, Wall Street Journal, 01 February 2016
[10] "You always please remember that inside malls where traffic might decline, **LensCrafters is a traffic destination. You don't enter a LensCrafters by chance. You book a visit with a doctor days before, and you plan your trip to the mall because you go to LensCrafters to get your eye check. And then you are in the store, and it's our ability to convert that eye exam into our sales.**" – Massimo Vian, Luxottica's CEO, Luxottica 2016 Q1 Earnings Call, 29 April 2016

[11] “Moving to retail, we are satisfied with the 2% comps in LensCrafters, which was achieved on top of a very strong comp base in Q1 last year. And let's not forget that Easter didn't help March.

In terms of operating performance for LensCrafters, I would say that conversion was the key driver. So thanks, really thanks, to the hard work that our LensCrafters' associates are doing every day in our store to serve in the best possible way our customers.

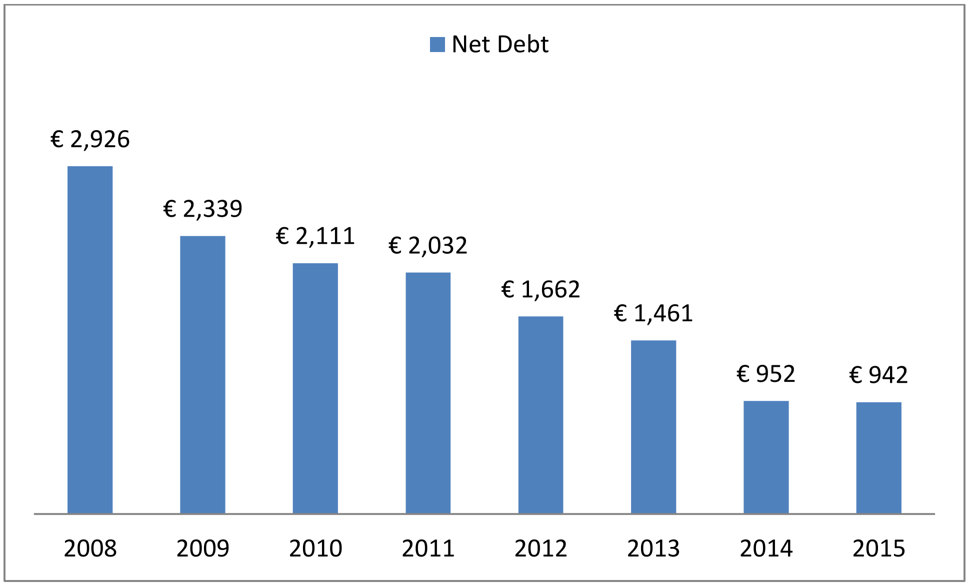
With respect to Sunglass Hut, I think the **weakness of touristic traffic is really the main driver of the minus 1% comp in Sunglass Hut North America**. We can see it. **We have approximately 100 stores generating approximately 15% of the chain sales that are clearly exposed to touristic traffic in North America, and those stores posted double digit negative traffic and close to double digit negative comps**.

Then we have stores that are located in states where there's no exposure to touristic traffic, and those stores, which are slightly less than 1,000, showed positive comps. The US consumer, in our reading, still enjoys to shop in Sunglass Huts.” – Stefano Grassi, Luxottica’s CFO, Luxottica 2016 Q1 Earnings Call, 29 April 2016

[12] “Definitely it is incredible to say that **North America continues to be one of our strongest emerging markets**. As Adil said today, we are breaking that paradigm of Americans buying eyewear. **80% of Americans buy eyewear under US$50. In fact, some statistics say that even 60% of Americans buy eyewear under US$35**. I will show you how we are trying to break that paradigm in the charts to come.” – Adil Mehboob-Khan, Luxottica’s former CEO, Luxottica 2014 Q4 Earnings Call, 03 March 2015

Future

Luxottica can Significantly Increase Dividends in the Future



Luxottica has reduced net debt to only €942 million

- **Biggest Negative**:
- In the next 5 years, Luxottica can grow revenue by 6% annually
  - €11,825 million in 2020
- Current margin is 17.3%
  - If margin expand to 19% in 2020
    - EBIT will be €2,247 million
      - => 8% annual growth in EBIT over the next 5 years
- Luxottica's net debt is €948 million
  - €928 million cash
  - €1,870 million debt
  - Cash is generating little interest income
    - Only €11 million last year
  - => net interest expense was €95 million last year
    - 10% of net debt
  - Net interest expense may decline in the next 5 years
  - But assuming no decline in interest expense
    - => earnings before tax would be €2,152 million
      - = €2,247 million – €95 million
    - => €1,356 million net income

        - Assuming 37% tax rate
      - => €2.82 earnings per share (EPS)
- Over the last 10 years
  - Total cash flow after CapEx and acquisitions were €3,143 million
  - Total net income: €5,034 million
  - => 62.5% of net income were available for
    - Returning to shareholders
    - Reducing debt
- Over the period, Luxottica acquired Oakley
  - For €1,491 million
  - This amount account for most of the different between net income and cash available for shareholders and creditors
- Luxottica won't likely to make acquisitions of such scale
- Total FCF over the last 10 years were actually 102% of total income
- => Luxottica can really payout 90% of its total income
  - And still support 6% growth
- => dividend payout can be 90%
  - 90% => €2.54 dividend
- Growth prospect will still be brilliant
  - 6% sales growth is realistic
- => Luxottica will still deserve 30x dividend in 5 years
  - €76 per share
- Luxottica will also generate more than €4 billion FCF over the next 5 years
  - Assuming it just accumulates cash => 8.32 accumulated cash per share
- => Luxottica will be worth about €84 per share by 2021
  - 13.3% return over the next 5 years
- Even if Luxottica maintain only 50% dividend payout rate
  - It can pay about €0.94 dividend per share
    - Based on current earning power
  - => over 2% dividend yield
    - Based on current share price of €45
  - EBIT growth can be in the 6-8% range
    - With or without margin expansion
  - => total 8-10% investment return