BRYAN, GARNIER & CO

INDEPENDENT RESEARCH UPDATE

18th January 2017

Luxury & Consumer Goods

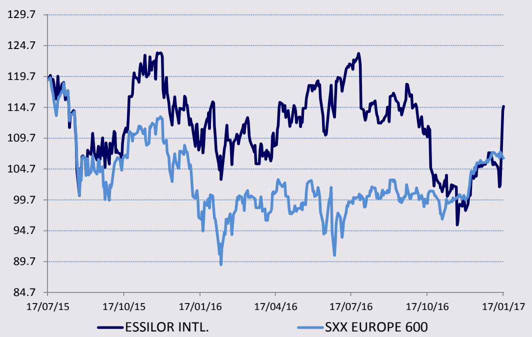
Essilor

EssilorLuxottica: corrective or progressive merger?

Fair Value EUR123 (price EUR114.85) **BUY**

Bloomberg	EF FP
Reuters	ESSI.PA
12-month High / Low (EUR)	123.5 / 95.6
Market capitalisation (EURm)	25,086
Enterprise Value (BG estimates EURm)	26,768
Avg. 6m daily volume ('000 shares)	529.8
Free Float	90.4%
3y EPS CAGR	9.9%
Gearing (12/15)	35%
Dividend yield (12/16e)	1.13%

YE December	12/15	12/16e	12/17e	12/18e
Revenue (€m)	6,716	7,092	7,737	8,236
EBIT (€m)	1,183	1,243	1,377	1,483
Basic EPS (€)	3.50	3.79	4.26	4.64
Diluted EPS (€)	3.57	3.86	4.34	4.73
EV/Sales	4.05x	3.77x	3.40x	3.14x
EV/EBITDA	21.5x	20.4x	18.2x	16.7x
EV/EBIT	23.0x	21.5x	19.1x	17.4x
P/E	32.2x	29.7x	26.4x	24.3x
ROCE	20.0	19.7	20.7	21.1



The announced mega-merger between Essilor and Luxottica will undoubtedly be a game changer within the eyewear industry. This perfect fit in terms of categories and distribution channels will create not only a leading player in lenses, frames and sunglasses categories (both offline and online). Although questions on LUX's minority shareholders and integration risks remain, a DCF simulation of EssilorLuxottica, including the PV of synergies of up EUR4.4bn, leads to a theoretical EUR23 gain vs. our FV on Essilor stand alone.

- **The combination of the two champions** (lenses for EI, frames and sunglasses for LUX) harbours significant revenue synergies and cross-selling opportunities in all categories and channels. Considering Essilor's leadership online and Luxottica's leading retail banners, EssilorLuxottica could be the first major player to implement an impactful omnichannel strategy. The NewCo has numerous growth opportunities in the US market (~54% of combined sales) and will certainly help Essilor to regain momentum there.

- **Significant synergies expected in the MT (BGe: EUR500m).** Whilst intra-group sales should be limited (LUX = ~2% of EI sales), the potential is substantial (BGe: EUR500m vs. guidance of EUR400-600m), with a balanced contribution between incremental revenue growth and cost savings: **1/** supply chain optimisation, especially the centralisation of Rx lab functions which is a margin enhancer for all players (GrandVision, Essilor, Luxottica) and **2/** sourcing and operating leverage on R&D expenses and other opex costs. If 100% of synergies are released. **We model a 12% potential accretive impact on EssilorLuxottica's 2021e EPS** and provided the exchange offer reaches a 100% acceptance rate (risk on LUX's minority shareholders).

- **Limited but existing risks surrounding this operation.** In our view, defining the final organizational structure below the CEO and Deputy-CEO functions will be the biggest challenge for the integration committee. Although Messrs Del Vecchio and Sagnières expect little anti-trust risks and to close the merger during H2 17, we believe that it might take a bit longer to win all regulatory approvals but this would not call into question the positive outcome of the deal. We would downplay any major governance risk as Mr Del Vecchio's stake would not go over 38% (31% if acceptance rate of 100%) and his voting rights would be capped at 31%.

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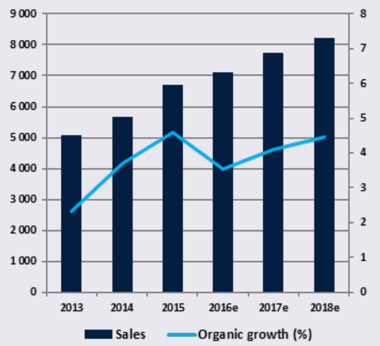
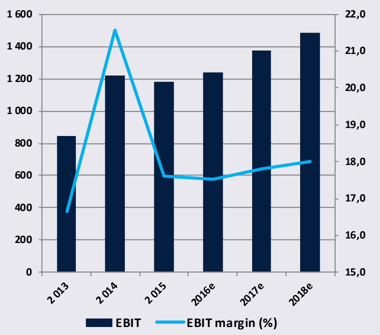




Company description

With 2015 sales of EUR6.7bn, Essilor is the global leader in ophthalmic lenses. The group still derives 78% of sales from mature countries (o/w 48% in North America). Emerging markets currently account for about 22% of sales. Essilor is listed in Paris and is in the CAC40 index. With free float of c.90%, the group has no key shareholders, although its employees nevertheless own 8.3% of the capital.

Income Statement (EURm)	**2013**	**2014**	**2015**	**2016e**	**2017e**	**2018e**
Revenue	5,065	5,670	6,716	7,092	7,737	8,236
Change (%)	*1.5%*	*12.0%*	*18.4%*	*5.6%*	*9.1%*	*6.5%*
Gross Profit	2,838	3,315	4,012	4,227	4,619	4,917
Contribution from operations	917	1,043	1,263	1,313	1,447	1,548
EBIT	843	1,222	1,183	1,243	1,377	1,483
Change (%)	*1.4%*	*45.0%*	*-3.2%*	*5.1%*	*10.8%*	*7.7%*
Financial results	(20.0)	(46.0)	(62.0)	(45.0)	(30.0)	(20.0)
Profits from associates	22.0	3.0	0.0	0.0	0.0	0.0
Pre-Tax profits	845	1,179	1,121	1,198	1,347	1,463
Tax	(199)	(193)	(308)	(313)	(357)	(388)
Minority interests	(53.0)	(57.0)	(55.5)	(58.3)	(61.2)	(64.2)
Net profit	593	929	757	826	929	1,011
Change (%)	*1.5%*	*56.7%*	*-18.5%*	*9.1%*	*12.4%*	*8.9%*

Cash Flow Statement (EURm)						
Operating cash flows	912	1,022	1,245	1,274	1,415	1,487
Change in working capital	69.0	(10.0)	51.0	67.2	115	89.1
Capex, net	285	232	327	284	309	329
Financial investments, net	330	1,836	765	248	271	288
Dividends	218	228	251	244	278	299
Other	129	188	143	0.0	0.0	0.0
Net debt	369	1,821	2,113	1,682	1,240	759
Free Cash flow	558	800	867	923	991	1,069

Balance sheet (EURm)						
Cash & liquid assets	791	626	466	897	1,339	1,820
Other current assets	2,240	2,536	2,806	2,951	3,199	3,392
Tangible fixed assets	998	1,154	1,200	1,484	1,793	2,123
Intangible assets	2,476	4,668	5,295	5,295	5,295	5,295
Other assets	1,072	1,805	2,204	2,204	2,204	2,204
Total assets	7,577	10,789	11,971	12,831	13,831	14,834
LT & ST debt	1,174	2,447	2,579	2,579	2,579	2,579
Other liabilities	2,362	3,082	3,300	3,461	3,738	3,951
Shareholders' funds	4,041	5,260	6,092	6,791	7,514	8,303
Total liabilities	7,577	10,789	11,971	12,831	13,831	14,834
Capital employed	4,690	7,195	8,067	8,418	8,842	9,261

Financial Ratios						
Contribution margin (% of sales)	18.10	18.40	18.80	18.51	18.70	18.80
EBIT margin (% of sales)	16.64	21.56	17.61	17.52	17.80	18.01
Tax rate	23.55	16.37	27.48	26.17	26.50	26.50
Net margin	11.71	16.39	11.27	11.65	12.00	12.28
ROE (after tax)	15.79	18.91	13.27	12.90	13.03	12.77
ROCE (after tax)	24.28	16.88	19.95	19.68	20.70	21.15
Gearing	9.13	34.62	34.68	24.77	16.50	9.14
Pay out ratio	33.67	34.43	32.24	33.65	32.23	32.77
Number of shares, diluted	213,057	214,820	216,583	218,112	218,112	218,112

Per share data (EUR)						
EPS	2.78	4.32	3.50	3.79	4.26	4.64
Restated EPS	2.87	3.05	3.57	3.86	4.34	4.73
% change	*2.4%*	*6.2%*	*17.0%*	*8.3%*	*12.4%*	*8.9%*
BVPS	11.10	11.01	10.92	10.85	10.85	10.85
Operating cash flows	4.28	4.76	5.75	5.84	6.49	6.82
FCF	2.62	3.72	4.00	4.23	4.54	4.90
Net dividend	0.95	1.05	1.15	1.30	1.40	1.55

Source: Company Data; Bryan, Garnier & Co ests.

1. In a stronger position to address the eyewear industry

“*Think About Your Eyes*” in the US: awareness-raising campaign on UV exposure

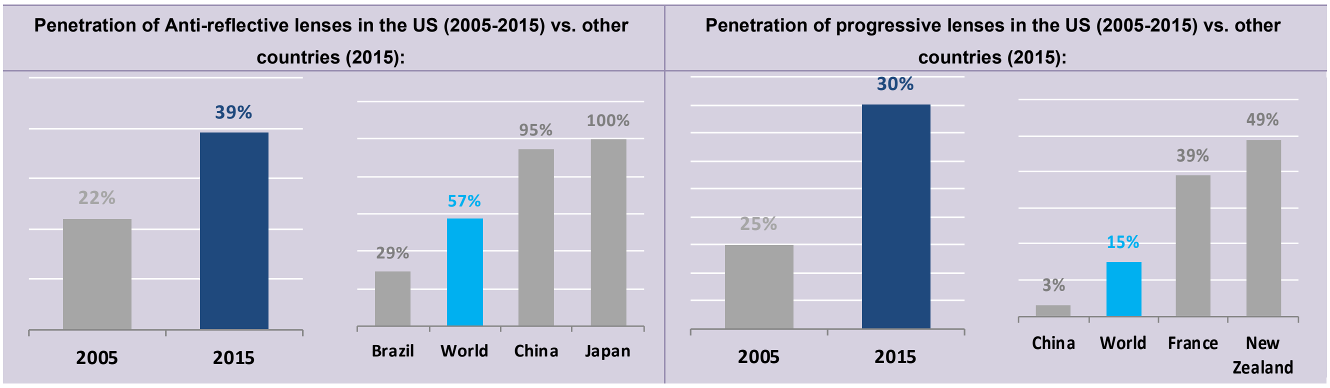
Source: Think About Your Eyes

Just four years after the kick-off of common discussions, Essilor and the Delfin family holding company announced yesterday morning the signing of an agreement to combine Essilor and Luxottica. The merger of the two champions (namely lenses for Essilor, frames and sunglasses for Luxottica) is perfectly complementary in terms of R&D, categories and distribution channels and will therefore, increase the competitive position for the NewCo EssilorLuxottica.

During the conference call yesterday, Essilor CEO Hubert Sagnières repeated several times that Essilor and Luxottica shared a common mission statement, which is to correct and protect risks to visual health across the globe, though high-value products. Hence joining their forces will help them to educate consumers more quickly and to address unmet vision needs across the globe.

The US example is very interesting: the industry players regrouped under the Vision Council have launched several awareness campaigns to educate consumers (e.g.: *Think About Your Eyes* in the US), allowing for a gradual move upmarket. At the same time, Satisloh (Essilor) supplied A/R-coating machines to LensCrafters (Luxottica) to offer the “1H Service” to its customers. These collaborations have contributed to increase penetration of anti-reflective lenses (and progressive lenses) in the US market, as shown in the two graphs below.

Fig. 1: Value-added lens penetration increased in the US between 2005 and 2015 but substantial growth potential remains:



Source: Essilor; Bryan, Garnier & Co ests

1.1. They are very complementary as Essilor and Luxottica were not playing on the same field

Besides the different categories (lenses for Essilor and sunglasses/frames for Luxottica), both groups have a strong presence in different channels, especially in the US:

- **Essilor** has a good exposure to optical chains (Walmart, Costo, etc.) but we believe that the French group has stronger ties with independent optometrists/opticians than Luxottica. In recent years, the French group has decided to build closer relationships with end customers through its websites and by acquiring several doctor alliances (Vision Source, PERC/IVA and Optiport). Essilor now has over 30% market share within this channel.
- **Luxottica:** was naturally more focused on its own retail chains (LensCrafters, Sunglass Hut, etc.) as its US retail accounts for 80% of North America sales (vs. 20% for Wholesale). As an

example, the Italian group could bring its retail expertise to Essilor teams, in order to anticipate market fluctuations and consumption changes better.

- **Towards a genuine omnichannel strategy:** like in other Consumer segments, we believe that the perfect convergence of offline and online channels will be the successful model as most consumers are still reluctant to buy Rx lenses online (online is only 4% of total optical distribution). Hence the combination of Luxottica's retail presence and Essilor's online websites to build up an omnichannel strategy could be a game-changer.

- **The deployment of the Framedream project could accelerate:** in the US, the prescription labs are responsible the assembly of spectacles (lenses + frames) but independent opticians/optometrists nonetheless need to order the lenses and frames from the different manufacturers, complicating the logistics and impacting their WCR. Backed by its 125 labs in the US, **Essilor has launched a new service enabling the simultaneous ordering of lenses and frames, thereby becoming the sole point of contact for its customers.** This paid-for service will naturally simplify opticians/optometrists' supply chains and improve their WCR. It is, however, important to stress that Essilor bears no inventory risk since the frames will be purchased on a just-in-time basis);

Fig. 2: Complementary categories and distribution networks:

	Key success factors	ESSILOR (SEEING THE WORLD BETTER)	LUXOTTICA
Ophthalmic Lenses	R&D / Brands / Supply chain	+++++	+
Sunglasses/ Frames	R&D / Brands / Supply chain	+	+++++
Distribution	Scale / Diversified channels	++ (online)	++++ (retail + online)

Source: Company Data

EssilorLuxottica will run an impressive brand portfolio in all categories and in all channels. Essilor was already carrying out an effective multichannel strategy in ophthalmic lenses but it can now replicate it in sunwear thanks to the influx of Luxottica's premium and high end brands, as shown on the graph below.

Fig. 3: Complementary Brand Portfolio in all categories:

Source: Company Data

Although Essilor has dramatically increased its presence in sunwear over the past years (2016e revenue: ~EUR890m), overlap with Luxottica are quite limited:

1. **U.S: Essilor** was mostly present in the Readers category through FGX (Foster Grant, etc.) and owns a fast-growing performance brand (Costa). Hence there is no cannibalization risk with **Luxottica** which only operates in the premium and high end price segments whilst Oakley has a different customer base than Costa, which could be distributed by Sunglass Hut in the near future.

2. **China:** like in the US, Essilor runs three successful mid-tier brands (Bolon, Molsion and Prosun) which do not compete with Luxottica's brand portfolio that is exclusively composed of premium and luxury brands. We see some distribution synergies as these mid-range brands could offer a more affordable offering for LensCrafters (China) and Sunglass Hut (China and South-East Asia).

The table below highlights the complementary sun brand portfolio of the NewCo: Essilor owns four of the top 15 brands worldwide (value/mid-tier brands) whilst Luxottica will bring four additional brands that operate in the premium (Ray-Ban, Oakley) and high end (Dolce&Gabbana, Prada) segments. Consequently, the group's leadership in sunwear will be strengthened.

Fig. 4: Clear Leadership in the Sunglass Industry:

We own 4 of the top 15 sun brands worldwide	Volume (in million of pairs)	Global/ Regional/ Local
Ray-Ban	>25	G
Foster Grant	**>12**	**R**
Oakley	~10	G
Maui Jim	~4	R/G
Bolon, Armani	**>2.5**	**L/R**
Chili Beans	~2.5	L
Polaroid, Gucci, Carrera, Dolce & Gabbana Prada, Police, Dior, **Costa, Molsion**	1 to 2	G/L
Small selective/Small local/Fast-growing brands		G/L/R
TOTAL	**~600**	

Source: Company Data

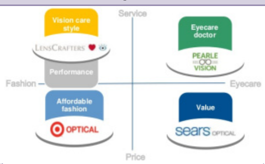
1.2. Low operational risks: two groups that know each other very well

Although each operates in specific segments of the optical market, the two global leaders have the same objective: to promote access to vision care through innovation and high-quality products in order to shift the optical market to more high-end products. Several partnerships have been entered into between Essilor and Luxottica (the main ones are listed on the next page on Fig. 5:) to actually accomplish this task of improving vision care.

In North America, Essilor is the largest lens supplier for Luxottica's optical chains (principally LensCrafters), and Satisloh has delivered anti-reflective coating machines in over 400 LensCrafters stores, where an exclusive "1-hour anti-reflective coating" service is offered, which contributes to a shift upmarket of corrective lenses.

In view of these various commercial relationships**, we estimate that Luxottica accounts for c.2% of revenue.** This share will certainly be considered as intra-group sales within the NewCo and is taken into account in our synergy plan.

Fig. 5: The three main partnerships between Essilor and Luxottica:

	Retail Optical North America	Eyebiz	EyeMed
		OPSM	eye Med
Region/Market	U.S.	Australia-NZ	U.S.
Implications for Essilor	- Essilor is Luxottica's largest lens supplier (~30% of total NA lens purchases) - Satisloh (Essilor) provided AR coating machines in over 400 LensCrafters stores to offer the "1-hour AR coating" service	- Eyebiz is a JV 70%-owned by Essilor which provides lens manufacturing, finished lenses and fitting services for OPSM, the largest optical retailer in A-NZ	- In 2013 EyeMed decided to open its network to some independent 3'Os which chose Essilor as their main supplier (lab services procurement, supply of products)
Estimated sales (EURm)	- ~EUR130m (>2% of sales)	- ~EUR40-50m (~0.7-0.8% of sales)	- N/A but the ramp up of this partnership is a significant key growth driver

Source: Company Data, Bryan, Garnier & Co ests

2. Talking about numbers

2.1. A quick reminder of transaction terms

The combination of Essilor's and Luxottica's businesses will consist of:

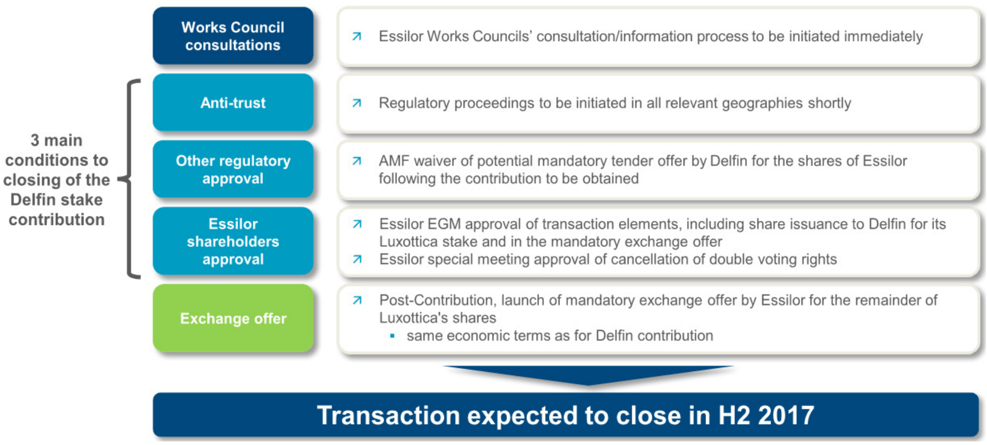
(i) Delfin, the family holding of the Del Vecchio family will bring its 62% stake in Luxottica to Essilor, in return for newly-issued Essilor shares to be approved by the Essilor shareholders meeting, on the basis of the Exchange Ratio of 0.461 Essilor shares for 1 Luxottica share (implying ~5% discount based on Friday's closing prices).

(ii) Then Essilor will make a mandatory public exchange offer to acquire all of the remaining issued and outstanding shares of Luxottica pursuant to the same Exchange Ratio and with a view to delist Luxottica`s shares.

Following the transaction, Delfin should own 31% if all Luxottica' minority shareholders tender their shares in the Public Offer. However, if some of them prefer to hold their shares, Mr's Del Vecchio's stake will be up to 38% **but consequently, there is a risk of higher minority interests within LuxotticaEssilor.** It is worth noting that in any case, voting rights of Mr Del Vecchio would be capped at 31% and double voting rights are cancelled.

Last but not least, Mr Del Vecchio should receive an AMF waiver of potential mandatory tender offer by Delfin for the shares of Essilor.

Fig. 6: Next steps in the merger process:



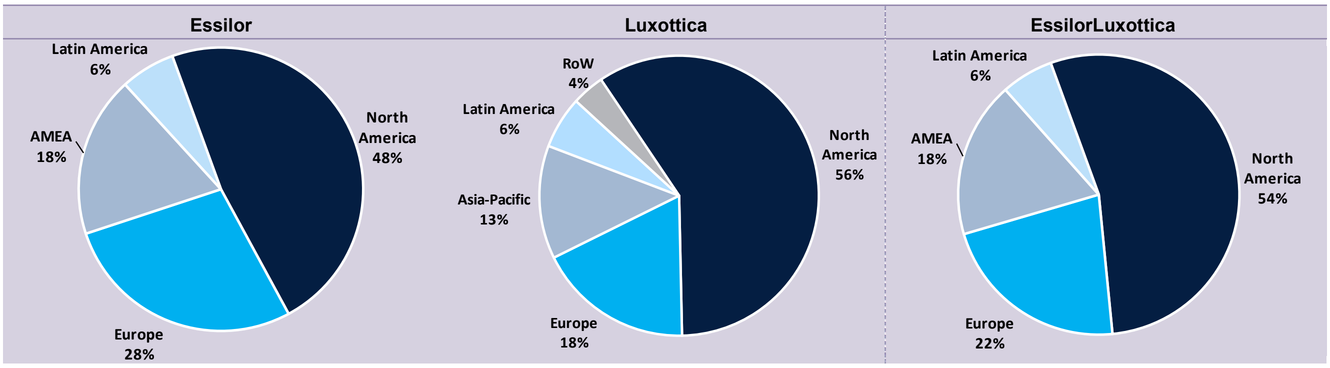
Source: Company Data

2.2. NewCo consolidates its positions in key markets

Indeed, the three pie charts below show that the revenue breakdown would not dramatically change following the merger *(rhs chart)* but the NewCo will essentially strengthen its footprint in key markets such as the **US** (~54% of sales) and **Europe** (22% of sales).

It is worth noting that as Essilor's exposure to **emerging markets** is higher than Luxottica's (respectively ~22% and ~15% % of total revenue), the latter could probably benefit from Essilor's broader presence in China (~8-9% of sales vs. ~3% for Luxottica).

Fig. 7: Sales breakdown prior/after the merger:

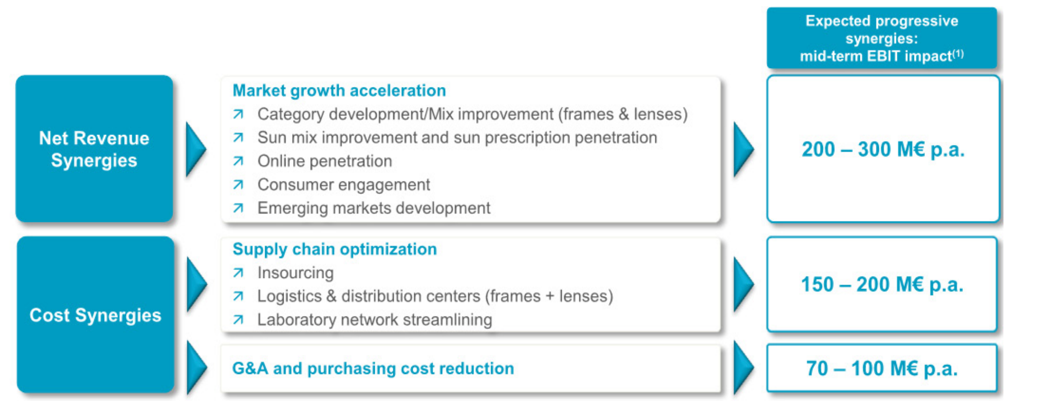


Source: Company Data; Bryan, Garnier & Co ests.

2.3. Half of the savings to arise from revenue synergies

CEO Hubert Sagnières confirmed that the NewCo should generate **revenue and cost synergies of between EUR400m and EUR600m p.a.** (EBIT impact net of M&A costs) in the medium term, of which 50% would be derived from incremental revenue growth *(cf. Fig. 8:)*, which is explained by the complementary presence in terms of categories and distribution channels discussed earlier.

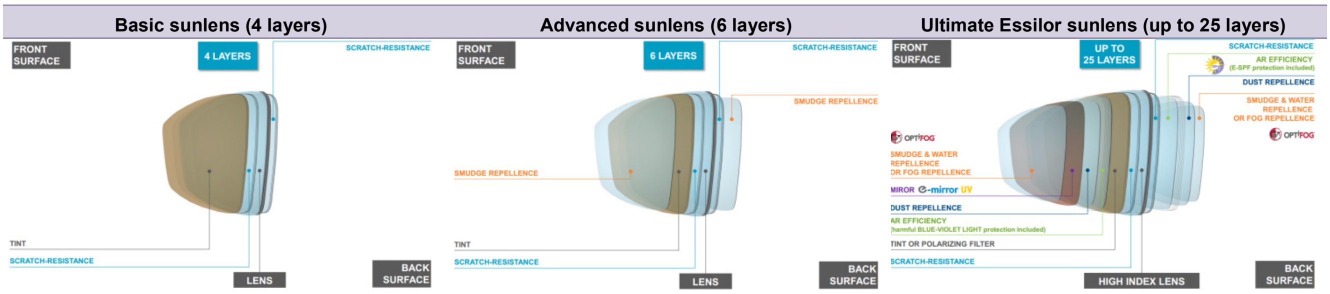
Fig. 8: Medium term synergy plan:



Source: Company Data

A major cross-selling opportunity in clearly to encourage Rx lenses wearers to also adopt prescription sunglasses. All players have tried to increase this category (e.g.: **Essilor**, **GrandVision** with Solaris corners inside optical stores, **Luxottica** with LensCrafters + Sunglass Hut POS @ Macy's) but with limited impact so far as only 10% of eyeglass wearers are using prescription sun lenses vs. a potential of ~50% according to Essilor. But if Luxottica and Essilor combine their respective expertise, this should lead to a higher penetration rate going forward.

Fig. 9: Essilor: innovation and multicoating also in sun lenses:



Source: Company Data

We also believe that implementing an omnichannel strategy could release significant revenue synergies in North America where Essilor had three online platforms (Coastal, EyeBuyDirect, FramesDirect) and Luxottica owns leading brick-and-mortar chains. There are already examples of optical players that have adopted this multi-channel approach to overcome the consumers' reluctance to buy prescription glasses online:

- **Mister Spex** (2015 revenue of ~EUR100m) was a pure online retailer but the strategy changed in 2011 when it partnered with independent opticians in Germany-Austria-Switzerland (550+ today) and has even opened its first eyewear shop in Berlin in February 2016.

- Its German competitor **Brillen.de** (2015 sales over EUR30m, EBITDA of ~EUR2m) has adopted this hybrid system since its launch in 2012 and it is now working with over 700 affiliated opticians across Germany, Austria, the UK and Spain.

- The fast-growing U.S. brand **Warby Parker** (2015 revenue >USD100m vs. USD35m in 2013) also went from pure online to multi-channel with the opening of its retail location in 2013. It now runs 35 stores in the U.S. and one in Canada.

Cost synergies of only EUR220-300m? Not surprising in our view

The excellent management of the supply chain is one of the keys to Essilor's and Luxottica's leadership, as they constantly work on improving it (reduction in lead time, complexity reduction, productivity gains, etc.).

Although some synergies are likely in sourcing, distribution centres and IT systems, the latest Essilor Field Trip in the US confirmed our belief that the two groups' logistics chains could not be entirely combined **as different logistics chains and plants are required for corrective and sunglasses lenses.** Indeed, Essilor has kept its sunglasses business separated from its other activities (three dedicated plants for sunglasses manufacturing) as customers' needs are quite different: "mass customization" for Rx lenses, "mass production" for plano sunglasses.

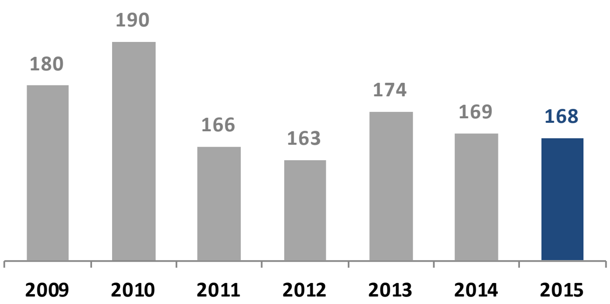
Centralisation of the prescription labs is going to generate significant synergies

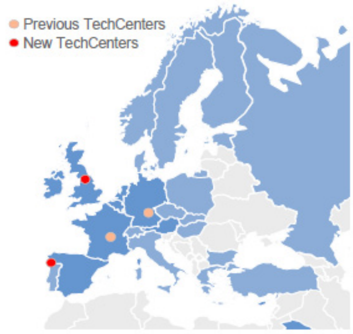
In early 2016, Luxottica announced the construction of three large prescription labs world-wide: **1/** Atlanta to cover North America, **2/** China to address the LensCrafters stores in China and Hong Kong and **3/** Sedico (Italy) to serve the stores in Europe (including Salmoiraghi & Vigano in which Luxottica purchased the outstanding shares last November).

This strategy of centralising prescription lab functions (edging, mounting and even assembly of the spectacles in some cases) **is also shared by Essilor and GrandVision**, as shown in Fig. 10: on the following page. The rationalisation in the number of regional labs at **Essilor** is a consequence of the concentration of volumes and the growth in export labs (notably in Mexico) while **GrandVision** has generated material efficiency and productivity gains thanks to the industrialisation of the mounting phase.

Fig. 10: Essilor and GrandVision are concentrating the activity volume of their labs:

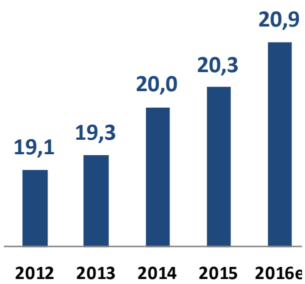
Essilor's Rx labs in North America (2009-15):	GrandVision's four "TechCenters" in Europe:





Source: Essilor, GrandVision

Adjusted EBITDA margin of the G4 region at GrandVision (% of total sales):



Source: Company Data; Bryan, Garnier & Co ests

The strong increase in profitability for GrandVision's G4 region (= Western Europe excluding Italy), illustrated in the chart on the left, effectively coincides with the ramp-up of its TechCenters which handle nearly 70% of the lens volumes sold in the zone. This centralisation will thus procure two main advantages for Luxottica:

(iii) Efficiency gains in the supply chain: the densification of volumes will mean an increase in productivity, shorter handling periods and an improvement in quality (=> fewer returns) will be positive for the gross margin rate;

(iv) Increased retail profitability: initially the central lab will cover the LensCrafters @ Macy's points of sale but, in time, we see the other LensCrafters stores closing their in-house labs, enabling a reduction in store size (savings on rents and staff costs). LensCrafters in particular should see its profitability increase (operating margin of 16%-18%e).

2.3.1. PV of synergies could reach up to EUR4.4bn

Since both groups expect a closing during H2 17 (optimistic deadline in our opinion considering the regulatory proceedings which often take time), we have simulated a gradual ramp up of synergies starting in 2018 to reach EUR500m p.a. in 2021, which is exactly in the middle of the EUR400-600m range communicated by Essilor. This EUR500m scenario amounts to ~17% of the EUR3bn EBIT.

In accordance with the group's guidance, we have modelled a balanced contribution between revenue synergies and cost synergies, as shown in the table below. We assume a tax rate of 30% (vs. 34% for Luxottica and 26.5% for Essilor) and a WACC of 6.5% (vs. 6.9% currently for Luxottica and 6.3% for Essilor). These assumptions would leave us with a EUR4.4bn PV of synergies.

Fig. 11: PV of synergies (assuming EUR500m after Year 4):

EURm	Revenue Synergies	PV	Cost Synergies	PV	Total PV
Year 1 (2018)	63	39	63	39	**77**
Year 2	125	72	125	72	**145**
Year 3	188	102	188	102	**204**
Year 4 & beyond	250	1,965	250	1,965	**3,930**
Total	**-**	**2,178**	**-**	**2,178**	**4,356**

Source: Company Data; Bryan, Garnier & Co ests.

Furthermore, we simulate the accretive impact this merger would have on the NewCo's EPS by factoring in the same scenario with regard to the gradual ramp-up of synergies between 2018 and 2021. Based on the two group's diluted EPS and the newly-issued Essilor shares, the new EssilorLuxottica entity should have approx. 440m shares.

In the **first scenario**, we model EUR500m of synergies (50% revenue / 50% costs) in 2021, leading to an **EPS accretion of 12%**. In the **second scenario**, we get to EUR250m of synergies that are only derived from cost savings (hence no revenue synergies), which would **only be 6% accretive to EssilorLuxottica's EPS.**

These estimates assume a 100% acceptance rate of the exchange offer to acquire outstanding shares of Luxottica. Naturally, they would be materially different in the case of a lower acceptance rate (higher minorities that would dilute EssilorLuxottica's EPS).

Fig. 12: Estimated EPS accretion based on the synergy potential:

EUR per share	2018e		2019e		2020e		2021e	
	EI	EI+LUX	EI	EI+LUX	EI	EI+LUX	EI	EI+LUX
EPS if 100% of synergies	4.64	4.93	5.08	5.56	5.56	6.23	6.09	6.84
Accretive impact (%)	-	***6%***	-	***9%***	-	***12%***	-	***12%***
EPS if 50% of synergies	4.64	4.83	5.08	5.36	5.56	5.93	6.09	6.44
Accretive impact (%)	-	***4%***	-	***6%***	-	***7%***	-	***6%***

Source: Company Data; Bryan, Garnier & Co ests.

2.3.2. Our theoretical impact on our FV on Essilor

Thanks to incremental revenue synergies and a favourable category mix (Luxottica's exposure to sunwear), we believe that EssilorLuxottica would be able to maintain an organic growth trajectory of between 5.5% and 6% over the 2018-2021 period, net of the intra-group restatements between Essilor and Luxottica. Then, as for all our DCF valuations we gradually reduce this growth to move towards our growth rate to infinity of 2.5%.

The improvement in the group's profitability should be fuelled by "self-help" drivers such as the operating leverage (mainly at Luxottica), cost savings and cost synergies. From 2021, we leave the profitably at around a normative level of 20%. Our calculations are both based on a WACC of 6.5% which factors in a cost of equity of 6.9% (risk-free rate of 1.6%, risk premium of 7% and beta of 0.75x).

Based on a complete release of synergies (100%) and on a 100% acceptance rate of the exchange offer to acquire outstanding shares of Luxottica the addition to our current stand-alone Essilor FV (EUR123) would be around EUR23.

Fig. 13: DCF valuation:

EURm	2017e	2018e	2019e	2020e	2021e	2022e	2023e	2024e	2025e	2016e
Operating CF if 100% of synergies	**1 998**	**2 202**	**2 567**	**2 670**	**2 916**	**3 045**	**3 129**	**3 212**	**3 291**	**3 370**

PV of terminal value	46,003
+PV of future cash flows (2017-26)	19,889
= Enterprise Value	**65,892**
Net debt (2017e)	1,636
Other liabilities	1,033
Minority interest	390
Financial assets	174
Theoretical value of equity	**63,008**
Number of shares (m)	440
Theoretical FV per share (EUR)	**143**

Source: Bryan, Garnier & Co ests

Like in the previous page, the second scenario only models 50% of the synergy potential (EUR250m from 2021) and a 100% acceptance rate of the exchange offer to acquire outstanding shares of Luxottica. The addition to our current stand-alone Essilor FV would be EUR13.

Fig. 14: DCF valuation:

EURm	2017e	2018e	2019e	2020e	2021e	2022e	2023e	2024e	2025e	2016e
Operating CF if 50% of synergies	**1 998**	**2 202**	**2 480**	**2 539**	**2 741**	**2 870**	**2 954**	**3 037**	**3 116**	**3 195**

PV of terminal value	43,614
+PV of future cash flows (2017-26)	19,018
= Enterprise Value	**62,632**
Net debt (2017e)	1,636
Other liabilities	1,033
Minority interest	390
Financial assets	174
Theoretical value of equity	**59,747**
Number of shares (m)	440
Theoretical FV per share (EUR)	**136**

Source: Bryan, Garnier & Co ests

3. Questions surrounding this deal

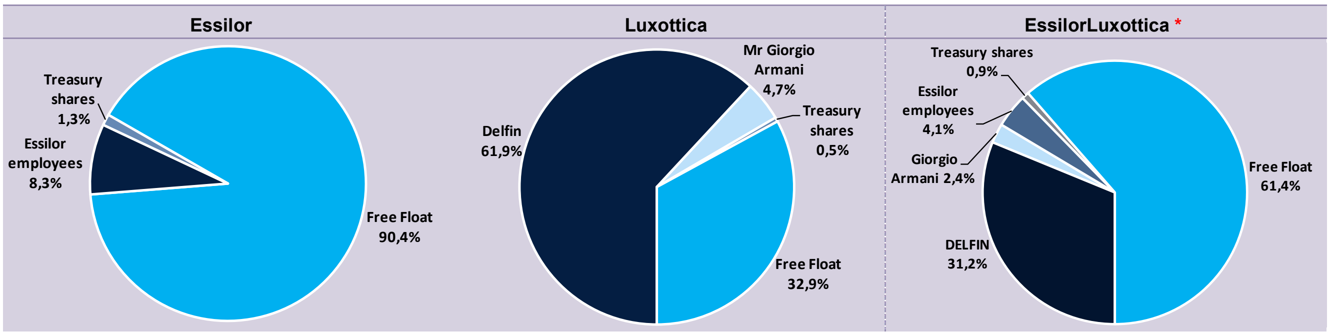
3.1. What about Mr Del Vecchio's future influence?

There is no need to remind that the central and strategic role played by Mr Del Vecchio within the Italian group and the "governance crisis" experienced by Luxottica since September 2014 with three management "shake-ups" in 15 months had provoked fears of many investors, impacting negatively the Luxottica's share price.

Considering that Mr Del Vecchio would become EssilorLuxottica's largest shareholder with 31-38% of the shares (voting rights capped at 31% though), some concerns arise over the future governance stability and the influence Mr Del Vecchio might have within the new entity.

Four main reasons can be offered to allay these fears: **(i)** Hubert Sagnières (future Vice-Chairman and Deputy CEO of EssilorLuxottica) will have equal powers to Mr Del Vecchio (Chairman and CEO), **(ii)** the Board of Directors would be divided fairly between members appointed by Essilor (eight) and members appointed by Luxottica (eight), **(iii)** he told *Corriere della Serra* in an interview that he would remain Chairman for three years and then shareholders would decide whether to keep him on or to choose a successor and last but not least **(iii)** we do not believe that Mr Del Vecchio will be as involved in the day-to-day business as he was at Luxottica since EssilorLuxottica's headquarters will be in Paris

Fig. 15: Shareholding structure prior/after merger (if 100% acceptance rate of the exchange offer):



* *if 100% acceptance rate of the exchange offer*

Source: Company Data; Bryan, Garnier & Co ests.

3.2. Any-anti-trust issues?

Messrs. Sagnières and Del Vecchio are both confident on securing a positive approval for the deal from the anti-trust authorities, justified by: **(i)** a global market share of only 15% following the merger and **(ii)** Essilor's open economic model (e.g. Essilors' US labs are often major clients of Zeiss or Hoya) which prevents the optical market from anti-trust or price-fixing risks.

We believe that particular care from anti-trusts authorities will be taken on last this point, particularly in the premium and high end price points where we estimate that both groups have market share positions of over 40% in lenses and frames. This is why obtaining all these regulatory approvals might take some time and **we believe that management might be a bit too optimistic regarding a possible closure of the deal during H2 17.**

Admittedly, the opticians' first reaction that is to fear a hegemonic situation from EssilorLuxottica is understandable, but we believe that the Group will strive to convince them (and antitrust authorities) that the level of service would increase, a larger customer base will enjoy this wide selection of brands whereas prices could be adjusted in some categories and for specific brands:

1. **Shorter lead times and a faster speed to market:** combined logistics and a more centralized Rx lab process should lead to shorter lead times. Since EssilorLuxottica could become the optician' single point of contact for frames and lenses, the assembly of frames and lenses could be faster, hence a higher level of service for customers.

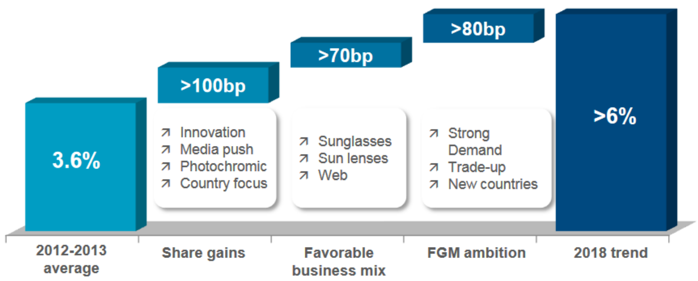
2. **A wider selection of brands:** as discussed earlier, the complementary brand portfolio and distribution channels would imply a wider choice of products and brands for both Essilor and Luxottica customers.

3. **Competitive pricing strategy?** Opticians could even enjoy some price adjustments as some of the efficiency and productivity derived from a more centralised supply chain (especially the Rx lab streamlining) could be reinvested in prices. We believe that this measure could demonstrate that EssilorLuxottica is not locking the market but on the contrary, bringing the eyewear industry upwards in a sustainable and profitable way for its shareholders.

3.3. What about Essilor's medium term targets?

The two downwards revisions to 2016 targets in the second half of the year showed that, despite effective control over strategy and its execution in most of the businesses/categories, Essilor's growth was not immune to macroeconomic conditions. Essilor's LFL growth should approach 3.5% in 2016 versus 'around 5%' foreseen at the beginning of the financial year. As a result, it will be even more difficult for the group to achieve its 6% LFL target in 2018 *(see Fig. 16: below)*, especially given a more volatile and less buoyant macroeconomic environment in some key markets (US, China, Brazil).

Fig. 16: Initial levers contributing to the acceleration in LFL growth:



Source: Company Data (CMD June 2014)

We are not sure that Essilor will provide us with an update at the FY16 results presentation on 17th February and we admit that investors' attention has now shifted to the merger with Luxottica. Considering Luxottica's higher exposure to the sunglass market (~70% of sales) that is growing faster than prescription lenses and the revenue synergies expected by this deal, **we believe that EssilorLuxottica would be able to accelerate LFL growth in the near future**, at a faster pace than Essilor stand alone.

3.4. The integration risk might be the biggest challenge

The leadership at the helm of EssilorLuxottica is crystal clear: **1/** Mr Del Vecchio will become Chairman and CEO, **2/** Mr Sagnières will serve as Vice-Chairman and Deputy CEO with equal powers than as Mr Del Vecchio, **3/** the BoD will be equally composed of eight members from Essilor and eight members from Luxottica.

Yet, question marks remain concerning the rest of the organizational structure having in mind that **Essilor** has three COOs (Laurent Vacherot, President and COO since 7th December, Paul du Saillant and Jean Carrier) whilst **Luxottica** had four members belonging to the top management team *(cf. Fig. 17: next page)*. We remind that appointments in NewCos are quite complicated, as shown by the failed Publicis-Omnicom merger and by the difficult negotiations between Lafarge and Holcim.

Furthermore, even if we admit that both groups had a deep experience in integrating acquisitions but this is the biggest deal in their history. Moreover, Essilor and Luxottica have a strong corporate culture which must be taken into consideration in order not to provoke any talent flight amid the most talented managers, which could delay the complete integration of both groups.

Fig. 17: The four main members of the management team:

			
Massimo Vian	**Paolo Alberti**	**Nicola Brandolese**	**Stefano Grassi**
CEO for Product & Operations *=> He refers to Mr Del Vecchio*	**Executive Vice President Wholesale** *=> He refers to Mr Del Vecchio*	**President Retail Optical Americas** *=> He refers to Mr Del Vecchio*	**Chief Financial Officer** *=> He refers to Massimo Vian*
Joined LUX in 2005	**Joined LUX in 2009**	**Joined LUX in 2012**	**Joined LUX in 2007**
- Jan 2015: appointed CEO for Product and Operations **- 2010-14:** Group Chief Operations Officer **- 2007-10:** Operations Director for Asia **- 2005-07:** Head of Industrial Engineering Division	**- 2009-present:** Executive Vice President Wholesale *Prior to joining LUX, he held various assignments at Bulgari, L'Oréal, Johnson & Johnson and P&G*	**- Jan 2014:** appointed President of Retail Optical of Americas **- 2012-14:** Group Business Development Director and Chief Digital Officer *Prior to joining LUX he held various assignments at News Corp. and the Boston Consulting Group*	**- Oct 2014:** appointed Chief Financial Officer **- 2012-14:** Group Controlling & Forecasting Director **- 2008-12:** Group Controller of the Retail business **- 2007-08:** Finance Manager of Luxottica Retail North America

Source: Company Data; Bryan, Garnier & Co ests.

3.5. Don't forget Luxottica's minority shareholders

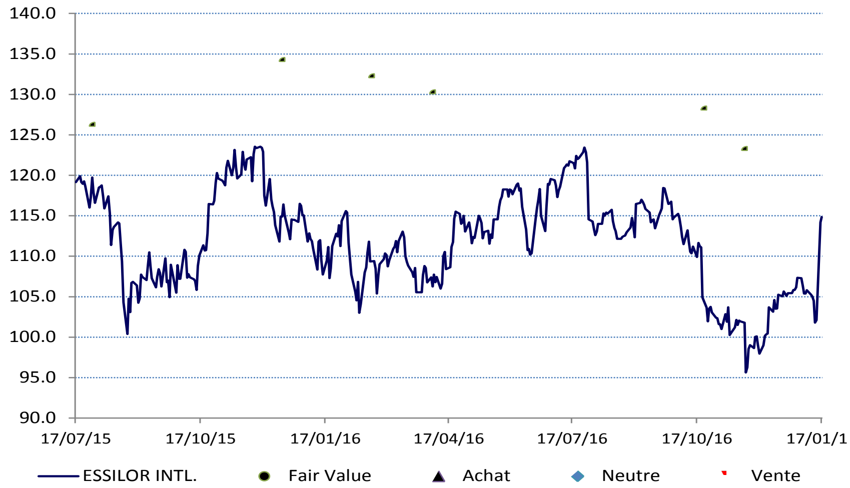
Once Delfin has brought its 62% stake in Luxottica to Essilor, the latter will make a mandatory public exchange offer to acquire all of the remaining issued and outstanding shares of Luxottica pursuant to the same Exchange Ratio and with a view to delist Luxottica`s shares.

Consequently, the likelihood that Essilor do not receive 100% of Luxottica's minority shareholders (32.9% excluding Mr Giorgio Armani's stake of 4.7%) exists. At this stage it is too early to know whether Essilor would let Luxottica listed (= higher minority interest within EssilorLuxottica) or offer a more favourable exchange ratio to convince these minority shareholders.

Hence there are some potential risks on: **(i)** our EPS accretions and synergies simulations and **(ii)** and on the theoretical FV impact on EssilorLuxottica.

Price Chart and Rating History

Essilor

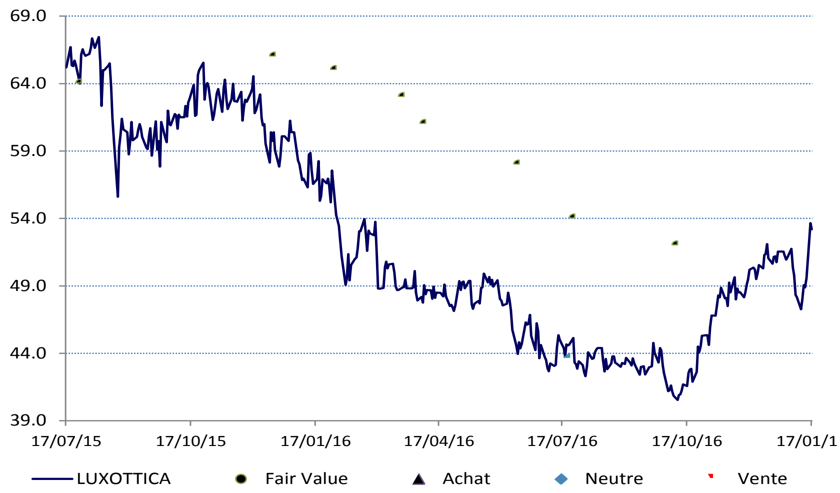


Ratings Date	Ratings	Price
27/10/2008	BUY	EUR33,545
06/06/2008	SELL	EUR40,38
30/04/2007	BUY	EUR44,3

Target Price Date	Target price
23/11/2016	EUR123
22/11/2016	Under review
24/10/2016	EUR128
07/04/2016	EUR130
22/02/2016	EUR132
18/12/2015	EUR134
31/07/2015	EUR126
22/04/2015	EUR124
16/04/2015	EUR120
20/02/2015	EUR110
16/02/2015	EUR108
13/01/2015	EUR104
18/06/2014	EUR96
02/04/2014	EUR99
10/01/2014	EUR102
10/09/2013	EUR98
23/05/2013	EUR96
01/03/2013	EUR85
16/01/2013	EUR80

Please see the section headed "Important information" on the back page of this report.

Luxottica



Ratings		
Date	Ratings	Price
26/07/2016	NEUTRAL	EUR44,64
13/10/2011	BUY	EUR20,35
29/09/2008	SELL	EUR16,56
27/06/2007	BUY	EUR28,58

Target Price	
Date	Target price
10/10/2016	EUR52
26/07/2016	EUR54
26/07/2016	EUR54
15/06/2016	EUR58
07/04/2016	EUR61
22/03/2016	EUR63
01/02/2016	EUR65
18/12/2015	EUR66
28/07/2015	EUR64
05/05/2015	EUR63
10/04/2015	EUR61
04/03/2015	EUR57
03/03/2015	Under review
20/01/2015	EUR53
09/01/2015	EUR50
18/06/2014	EUR46
10/01/2014	EUR45
23/05/2013	EUR44
30/04/2013	EUR41
04/03/2013	EUR38
16/01/2013	EUR35

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Stock rating

BUY

Positive opinion for a stock where we expect a favourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential upside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

NEUTRAL

Opinion recommending not to trade in a stock short-term, neither as a BUYER or a SELLER, due to a specific set of factors. This view is intended to be temporary. It may reflect different situations, but in particular those where a fair value shows no significant potential or where an upcoming binary event constitutes a high-risk that is difficult to quantify. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

SELL

Negative opinion for a stock where we expect an unfavourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential downside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

Distribution of stock ratings

BUY ratings 51,2% NEUTRAL ratings 35,6% SELL ratings 13,1%

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