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CORPORATE PARTICIPANTS:
Alessandra Senici
Andrea Guerra
Enrico Cavatorta
Q&A

Alessandra Senici

Thank you, operator. Good afternoon and thank you for joining us today. Here with me are Andrea Guerra and Enrico Cavatorta.

Before we begin, first I have a couple of quick items to cover. As a reminder, a slide presentation which we will informally follow during this call is available for download from our website under the "Investors/Presentation" section. This presentation includes certain non-IFRS financial information within the meaning of Regulation G under the US Securities Exchange Act. Further information, including additional information required by Regulation G, is also available in Luxottica Group's press release relating to its results for the second quarter of 2014, which may be found on our website, under the "Investors/Press releases" section. This conference call is being recorded and is also available via audio webcast from our website.

During the course of today's call, certain projections and other forward-looking statements may be made regarding Luxottica Group's future financial performance or future events. We wish to caution you that such projections or statements are based upon current information and expectations and actual results may differ materially from those projected in the forward-looking statements. You can read more about such forward-looking statements on page two of the slide presentation.

We also refer you to our filings with the SEC and Italian securities authorities. These filings contain additional information concerning factors that could cause actual results to differ materially from those contained in management's projection or forward-looking statements.

We will begin with our CEO, Andrea Guerra.

Andrea Guerra

Good afternoon, Alessandra. Welcome to all of you. Welcome to our quarter two business review. We are pretty happy with our performance. As soon as some external factors, like weather in the United States, moved out of the picture, we have been able to go back to our usual rhythm. Q2 is a very important period for us and we have been able to perform. Not everything in the outside world was easy, was favorable.

1) Currencies - Still today currencies are a little bit of an issue, Enrico will provide some more details, but things are improving. Things are improving because of our actions, prices changes in many different countries. And on the other side because, looking forward, the comparison base will ease during the next couple of quarters.

2) Sunshine and Summer in Europe, especially Mediterranean Europe, have not been very strong so far, but in any case, we have been able to obtain the performance that we had in mind. The American consumer is not really today attracted by consumer goods, but frequently much more by higher tickets, like cars, houses. In any case, we have been able to reach our performance.

We have done well in North America, plus 4%. Considering that in the period we have closed approximately 30 stores in Sears, and at the same time we are constantly moving on with the conversion of existing Pearle Vision stores from corporate to franchising, another 41 corporate stores that we were able to move to franchising in this quarter. So, plus 4% is really an outstanding result for the period.

In Europe, plus 8%: double digits in Emerging Europe, high single digit in Continental Europe and slightly negative in Mediterranean Europe.

Great performance in emerging markets at over 20% with some great peaks in our important markets, namely Brazil, China, India, Turkey. China is moving and moving fast. China is growing for us. We have been working hard for the last six years educating, building, investing, and now the last six-eight quarters in China have been constantly accelerating. Sun, wholesale, optical retail, all have had outstanding performance in the period. I would say that China has finally discovered our industry and we are happy to see the results of all our efforts.

Profitability jumped to our peak in the quarter, happy to see this. Free cash flow was another record, well above €300 million. So, I think that all in all, considering Q2 being an important quarter for us, we are happy with the performance.

Enrico Cavatorta

Thank you, Andrea. Let me say it is easy to comment on a quarter like this. We had very solid growth, strong growth all across markets and geographies, and also the profitability results were fully in line with our estimates and with our expectations.

We have achieved 7% constant ForEx growth in the quarter and this comes on top of growth that was close to 10% last year in the same quarter. So the two year performance is really amazing, I mean 5 percentage points have been the negative effect coming from currencies. We will see them a little bit more in detail in a minute. So on a reported basis, we have grown 2%.

By division, particularly impressive again is the growth of our wholesale business, up double-digits. And let me recall that last year wholesale delivered 14% growth. So again, the two year performance is really outstanding.

Retail better than Q1, comps were +4.8%. We were able to turn LensCrafters back into the positive field, +1%. Sunglass Hut was again basically in the double-digits area. China, still in the double-digits area and even optical retail in Australia, with a mid-single digit growth of approximately 3.5%, was better than the first quarter.

So all across, there was improvement in our sales results, in all markets and divisions.

Now looking a little bit at the currency in more detail, in those graphs that you see on slide #7 of the presentation, why we believe in the second half of the year we are expecting a much lower negative effect from the currency. Those are the four major currencies for our Group, so the US Dollar, the Australian Dollar, the Brazilian Reais and the Chinese Renminbi and their exchange rate against the Euro. And you see here the exchange rate, the average exchange rate per quarter that we had last year. What we had this year in Q1 and Q2 and basically if the exchange rate in the second half remains at the same level of today, you will see what is going to be the effect.

So just a few numbers, for the euro/dollar, basically we are expecting a much lower devaluation of the dollar in Q3 and a neutral effect in Q4, and also for the Brazilian Reais where we had 19% and 12% devaluation respectively in Q1 and Q2. Basically in the second half, it should be a neutral effect. And for the Australian dollar we had a 17% and 10% devaluation in the first half, we should even expect a positive effect during the second half.

All of this translates into our P&L. In terms of sales impact, in the first half, we lost 5 percentage points and that translated into a loss of 50 bps, half of a percentage point, in terms of operating margin. In this slide you see that our expectation for the second half is much, much lower. We expect to lose one percentage point and basically there should be a break even effect or just a minor loss of 10 bps in our operating income, so bringing the average impact for the year to around 3% on sales and 30 bps on operating margin.

So unless there is another sudden shake-up in currencies that we don't expect now, and if again the currencies remain at today's level against the euro, these are the effects that you might expect for the second half and for the total year. So a much better result than what we have seen in first half.

Looking at our margin, as Andrea mentioned, we achieved record profitability and record cash flow. In terms of profitability, at the Group level we had growth of 80 bps on a reported basis, 110 bps at constant currency. And again, let me recall that last year in the second quarter we had a growth of 120 bps at constant currency. So, on a two-year basis, we have a 2.5 percentage point higher margin for the Group at constant currency. So, I think this is impressive growth.

And again, wholesale clearly outperformed retail, 110 bps here and 50 bps in retail. That, in any case, we see as a very outstanding result if you consider that basically most of our retail is in North America where we had the lowest growth of all. So, 50 bps improvement at constant ForEx in retail was really the effect of severe cost control and good management.

Net margin, we are at a record all-time high with 11.4%. In the famous magic year 2007 which used to be the record for the highest second quarter net margin, we achieved 10.7%. So, we are well above that effect, and clearly we are on track with - or even better than - our expectations for our year-end results.

Looking at cash, 321 million. Again, we never had such a result in our history in the quarter, 321 million, so basically we were able to maintain our net debt at the same level as we had at the end of March to slightly above €1.4 billion, despite the fact that we paid €308 million of dividends during the quarter. So, 321 million was the free cash flow.

Let me say we had some positive non-recurring items in the tax area and coming from stock option exercise. That non-recurring or unusually high positive effect was in the region of €50 million to €60 million. So, in any case with €270 million, €260 million this would have been a record quarter in any case.

Working capital control, again, has been one of the key drivers. We were able to reduce our DSO quite significantly, five days. We were up one day last year. So it has been partially helped by the fact that last year it was a weak quarter for DSO. While DSI was outstanding, 17 days, last year we were flat. Basically, this comes after an already very good quarter that we had in Q1, you may recall we had 17 days also in Q1. So the long awaited efficiency and reduction in inventory this year is fully coming through. On payables, we are close to the limit, so we are steadily improving, so yet another day to the metrics.

Finally, our rule of thumb was fully achieved, growth at constant ForEx in the first half was up 6% in sales, 11% in operating income and 13% in net income. So, fully in line with our famous rule of thumb that is proving to be valid also this year.

Andrea Guerra

Thanks Enrico. Looking at the revenue roadmap, basically in all regions we see an acceleration in Q2.

Beginning with wholesale North America, the story continues, a journey which is well balanced between brands, businesses, Rx and Sun and channels of trade. So happy to see it continuing and really being able to plan for other quarters and years at this kind of speed.

Western Europe shows steady growth also considering a very high base of Q2 2013 (+10%). So happy to be able to keep up with our positive performance in Western Europe.

Emerging markets, as I already talked about it, nothing else to be added, happy to see a plus 21% and a plus 23% a year ago. So we had a little bit slower start. We added that probably we made some shipments at the end of 2013, as soon as inventory was sold, immediately our rhythm was back to normal performance.

Retail North America, as Enrico was saying, accelerated. So, we are happy with that. And the same thing we could say about Optical Australia, we are fully in line with what we wanted to achieve this year and emerging markets like-for-like are growing pretty fast in retail as well.

When we look at North America specifically, obviously we are back with wholesale and three-year cumulative growth has been above 40% and I think that there is a long way to go.

Sunglass Hut, great momentum, another 8.5% comps, and I would say that this is a good mix between units and value and even in a world today of pretty big discounting and promotions in the United States our full line, full price Sunglass Hut achieved a great performance in Q2.

LensCrafters is back to positive, as Enrico said, led by a strong customer conversion rate and we will go through some more details pretty soon.

Sunglass Hut, many things are proving right: the business model, the stores, the experience, I would say that it’s a great business model. We know how to manage it. Consumers are responding. One thing to point out is the great performance of the online in-store combined experience. This has been now managed only in North America for the last 15, 16 months, it has been well thought out, well planned, well executed. Basically a +10% like-for-like in Q2 [worldwide] is an important achievement and one of the great bricks of this performance, of this achievement is the ability that we have been able to build in this consumer experience between digital and store base.

LensCrafters encouraging, a lot of signs, the numbers, but even other KPIs allow us to be encouraged, four months of positive comps with pretty regular weeks, a number of plans moved to execution. The single point to be highlighted is people’s motivation and engagement, happy to see so many people proud to be in LensCrafters in the last survey we did in May, +10% in happiness and engagement. A lot of things happening, a lot of plans happening and I think that we will be constantly even better.

We talked about the Euro; we talked about summer in Mediterranean Europe and nothing else to be added.

Regarding emerging markets, some numbers, there are also some shifts in shipments from Q1 to Q2, as we said. Turkey has been great. We were implementing SAP last year.

China another +28%, India +24% and the big Brazil +17%. So, really happy to see how in the last six years Luxottica thought about these countries, wished to become domestic, invested in adopting business models, brands, people, culture, infrastructure and we are achieving the results we wished.

We are now in Q3. I think that the positive momentum is continuing. The order portfolio is good. Our Luxottica Days, that is a full month of buying season in Lake Como, is doing pretty well and I would say that we started well. Obviously, we wish a very long Mediterranean summer now. So, let’s hope that summer in all sense is around us, with us, with also some days of holidays.

Thank you and waiting for your questions.

Q&A session

OPERATOR: We will now begin the question and answer session. The first question is from Bassel Choughari of Berenberg. Please go ahead.

BASSEL CHOUGHARI: Well hello, a couple of questions from me, please. The first one is on China, maybe you can share with us what are the best performing brands. Is it more luxury or is it more the Ray-Ban and Oakley? The second question is on ForEx. Now, you seems to be looking for an impact on net sales of minus 1% in the second half of the year, I believe this is going to be excluding where all the pricing measures you’ve been taking. So net-net, should we expect no negative impact on the Group top line? And the last one is maybe on Southern Europe, maybe if you can share a couple of numbers for maybe Italy, Spain and Portugal please? Thank you.

ANDREA GUERRA: So in China, I would say obviously as usual, Ray-Ban is the captain, the category captain, but it’s a well balance between Vogue, Ray-Ban and Oakley, and I would say some of the luxury brands, which are more popular today in China. So moving from Burberry to Prada, I would say Tiffany, Dolce & Gabbana I would say these are the strong leaders of our Chinese growth.

ENRICO CAVATORTA: Regarding ForEx you are exactly right, the 1% impact on sales is simply the difference between the current ForEx and constant ForEx. So, excluding the impact on price increases that clearly would help our performance. Let me again repeat, we are not predicting any particular exchange rates for the second half. Simply those estimates are based on the fact that the exchange rate remains at today’s level for the next five months.

OPERATOR: The next question is from Daniel Hofkin of William Blair & Company. Please go ahead.

DANIEL HOFKIN: Good evening. Just first question is regarding Sunglass Hut and if I am reading this correctly, it looks like the North America was almost as strong as global, altogether 8.5% versus 10%. Am I reading that right?

ANDREA GUERRA: Yes, you are.

DANIEL HOFKIN: Okay. And so for, let's say, either way you want to take that, on the transaction count side of that, is transaction count less than half of the total like-for-like increase at this point, where price mix is greater than half?

ANDREA GUERRA: Do you want an immediate answer or you've got other questions?

DANIEL HOFKIN: I have a couple other questions, so that would be one and I guess within the transaction count, is your footfall still kind of like we are seeing in general with mall traffic where foot traffic is generally flat or down, but you are seeing higher conversion rate. I just want to understand what the dynamic is there, if that's continuing? My next question is just a quick question regarding the Chanel license, the press release refers to renewability through 2020. Just to be clear, is that, I mean that's something that could continue to be renewed presumably beyond that as well, right? I mean, in other words, it's a longstanding license for you.

ANDREA GUERRA: So, regarding Sunglass Hut US, I would say that 65% to 70% is units and the remaining part is brand mix and polarized mix. In terms of traffic, obviously Q2 improved compared to Q1, but I would say yet today especially mall traffic in the US is not exactly a winning point. And on the other side, as for all retailers in the United States traffic is a little bit down, conversion is extremely up. This is also as we all know a different way of American consumer behavior. So, browsing much more at home and going much more direct, and having a destination in their purchases. So traffic improved, still slightly down and obviously conversion, looking through the numbers, is pretty high.

Our Chanel renewal, this is the third time we are renewing an agreement with Chanel. We used to have a three-year agreement. Now we moved it to six. We are happy about that. Obviously, it's a long-term partnership, it's a long-term relationship. But, at the end of the six years, we are all obliged to go back, and renegotiate not much terms and conditions because that is not the issue with Chanel, but the business plan, the exclusivity and everything we need to do to preserve that wonderful brand.

DANIEL HOFKIN: Okay. So, theoretically it could be similar to how it was just renegotiated now. It could be renegotiated at 2020 or whenever that would be again theoretically?

ANDREA GUERRA: Yeah, sure.

DANIEL HOFKIN: Okay. And then, lastly on LensCrafters, can you just discuss what your expectations are, let's say the next, you know 6, 12 months would you expect some of your convenience value initiatives, targeted initiatives to begin to show a greater impact during that timeframe?

ANDREA GUERRA: I am sure. Today I can say that I am sure. Obviously, then we will go month-by-month. We have been doing a pretty bold move right now. Now, it's back-to-school. As you all know it's a pretty promotional period. We have good deals in store, but we think the time has come to go with a very strong eye care message: "the doctor is in" with a number of things around it. So, we are now not out with and shouting a message of 50% off lenses, but talking about the roots of the brand, talking about eye care, talking about service, talking about our great doctors, and the initial feedback is good.

DANIEL HOFKIN: Great. Best of luck in the third quarter. Thank you.

OPERATOR: The next question is from Cedric Lecasble of Raymond James. Please go ahead.

CEDRIC LECASBLE: Yes, good evening. I have two questions actually regarding the wholesale business. There was some volatility in emerging markets that you explained after Q1 it was a question of phasing. Are you sure today that we came back for some time to let's say this 20% growth that you already had last year or is it subject to potential volatility in the coming quarters? Could you help us with that? And the second question is on Southern Europe. We've had a lot of volatility here, how do you explain beyond comparison basis, do you expect any improvement in the coming quarters? Thank you.

ANDREA GUERRA: So, I wouldn't talk about volatility in emerging markets, I mean if we go back probably five years, we always had an average of between 15% and 25% positive. And we were pretty direct and transparent telling you that probably some people had that achievement of a 1 million units, 2 million units, $50 million. So, I think that we over-shipped a little bit in Q4 2013. But I mean, we are back, and I don't see volatility.

Southern Europe is a different story. So, obviously, this period is not just linked to a macro, but is also linked to Sun, and I would say and I mean anyone living in Southern Europe could testify that we are not seeing too much Sun. And in any case, we have been able to achieve in Western Europe that +4%, in Europe, +8% and barely positive in Mediterranean Europe, on top of a +10% a year ago.

CEDRIC LECASBLE: Thank you.

ANDREA GUERRA: Thank you.

OPERATOR: The next question is a follow up from Bassel Choughari of Berenberg. Please go ahead.

BASSEL CHOUGHARI: Hello, just another one from me. You often talk about online; can you please share a couple of numbers on the online performance for the quarter, please?

ANDREA GUERRA: The numbers in online have been stellar. So, I would say between +40 and a +50 between the different brands and moving on with the plans that we have talked about, yet small numbers, a little bit like China some years ago. So, it's probably things that are not yet visible in our big numbers, but if we continue with this pace probably in 2015 and for sure 2016 online will become a big part of our growth opportunities.

BASSEL CHOUGHARI: Thank you. And just one last question, please, on the pricing. Have you passed on all the price increases you wanted to and do you expect more price increases this year? And maybe you can give us an idea of, you know, the impact on the top line of these measures? Thank you.

ANDREA GUERRA: Everything we had to do is there. If we look at constant exchange rates and we look at the growth of wholesale, I would say that this impacted for at least 20% of our growth and this effect will be a little bit bigger in Q3 and Q4 and Q1 of next year.

BASSEL CHOUGHARI: Thank you very much.

ANDREA GUERRA: Pleasure.

OPERATOR: The next question is from Domenico Ghilotti of Equita. Please go ahead.

DOMENICO GHILOTTI: Good afternoon. My first question is on your store footprint. We have seen in the second quarter basically same store sales exceeding the constant exchange of growth in retail. So you are probably pruning some stores. Should we expect this trend to continue also in the second half?

ANDREA GUERRA: So as I said at the beginning, this is a normal thing we are doing especially on two banners. One banner is not closing stores, but it's moving corporate stores to franchising on our strategy for Pearle Vision and we still have at least another 20, 30 stores per quarter in the next probably year. In terms of Sears, it's a constant search for a good balance. So, also depending on what Sears is doing in terms of its store base, we're closing between 40 and 50 stores a year, and this was a particularly strong quarter of closures for Sears. So, I would expect 50 stores per year to be closed in Sears in the next couple of years out of approximately 700.

DOMENICO GHILOTTI: Okay, thank you. And then I have a question on the financial cost, and just a clarification on the explanation of the increase in financial cost compared to the previous quarter, previous year in spite of declining debt?

ENRICO CAVATORTA: Our financial charges are basically stable, because most of our debt is at fixed cost. I would say 90% of the debt is at fixed cost, because during the last couple of years, we took advantage of declining interest rates in order to fix also our debt. Our gross debt is stable, because it's now basically composed of the three bonds that we have outside and one remaining bank facility and the balance is just increased cash. And today the return of our cash on hand is clearly minimum, just a little bit above zero, due to the level of interest rates and due to the fact that our financial policy is quite prudent in terms of use of cash. So, that's why you could expect to see the financial charges to remain pretty stable.

DOMENICO GHILOTTI: So the real question is, how do you want to use the cash in hand?

ENRICO CAVATORTA: There are a number of options that the Board is considering and we will consider in the near future.

DOMENICO GHILOTTI: Okay, thank you.

OPERATOR: The next question is from Francesca Di Pasquantonio of Deutsche Bank. Please go ahead.

FRANCESCA DI PASQUANTONIO: Yes, good evening. I have two questions please. The first is on the LensCrafters initiative, whether you are expecting any impact on profitability. So, what are your thoughts around that? And the second is, to understand a little bit better what has driven the improvement in the wholesale margin which was quite impressive? Thank you.

ANDREA GUERRA: Regarding LensCrafters, if we go back to when we were not happy of the top line performance, we have been always able to increase profitability by 20, 30 bps every quarter. So, I would say that is the expectation we have today. It's not a problem of profitability with LensCrafters, it's an issue of top line. This is where we are focused. And there will be things we are doing that we will continue to do even in terms of allowing all our consumers that love the LensCrafters experience to come in and be happy with the price they find. So, we will have some shift in pricing as we said, as we are testing, and as we are moving on. So, we will continue also to be more efficient and therefore balancing some lower unit price with some good actions on labor, on efficiency of our labs, on many different things in the LensCrafters portfolio and profit and loss. And therefore, I think that we can keep on growing profitability of LensCrafters up by 20, 30 bps a year, but the real thing is, we want to go back to a top line which is not just positive but it's in the region of 3-4%.

On the wholesale margin, I would say, it's scale. I would say it's the mix between units and price. And the third aspect is, we are also comparing this Q2 with an industrial efficiency which is much higher compared to a year ago. Keep in mind that a year ago we were launching in the market Armani, which has been a huge effort.

FRANCESCA DI PASQUANTONIO: Yeah.

ANDREA GUERRA: And on the other side, we were in the start-up phase of SAP in all Luxottica factories exactly 18 months ago.

FRANCESCA DI PASQUANTONIO: Okay. Can I have a follow up on LensCrafters please? The transfer acceleration do you think or do you expect to see in Q3?

ANDREA GUERRA: I don't want to enter in this thing. I say we improve and then we go a little bit worse, but we are doing everything we need to do to improve the underlying performance of LensCrafters in the next period and as we said we are optimistic.

FRANCESCA DI PASQUANTONIO: Okay.

ANDREA GUERRA: Thank you.

FRANCESCA DI PASQUANTONIO: Thank you.

OPERATOR: Ladies and gentlemen, there are no more questions registered at this time.

ALESSANDRA SENICI: Thank you for listening to this call. I just wanted to say that we are pleased to offer some of you tomorrow morning at our Luxottica base in Lake Como. As for those who unfortunately will not be able to join us, we wish really a pleasant summer break. Thank you very much. Have a good afternoon and evening. Bye-bye.