S&P Global
Ratings

RatingsDirect®

Research Update:

Luxottica Ratings Raised To 'A/A-1' On Completion Of Combination With Essilor; Outlook Stable

Primary Credit Analyst:
Maxime Puget, London (44) 20-7176-7239; maxime.puget@spglobal.com

Secondary Contact:
Nicolas Baudouin, Paris (33) 1-4420-6672; nicolas.baudouin@spglobal.com

Table Of Contents

Research Update:

Luxottica Ratings Raised To 'A/A-1' On Completion Of Combination With Essilor; Outlook Stable

Overview

- The combination of Essilor (optical lens manufacturing) and Luxottica (eyewear producer) is effective from Oct. 1, 2018, now that all necessary regulatory approvals and boards' approvals have been obtained.
- The new group, EssilorLuxottica, should benefit from world-leading positions in lenses and eyewear (frames, glasses), with a wide and complementary product range and a vertically integrated business model from design to retail stores. Still, we see some integration risks, notably in terms of corporate culture.
- We forecast the group to generate free operating cash flows (FOCF) of €1.7 billion-€2.1 billion annually, with adjusted debt leverage of 1.5x-1.9x over the next two years. We see the group as generating steady cash flow but likely to pursue external growth opportunities.
- We are therefore raising our long- and short-term issuer credit ratings on majority-owned subsidiary Luxottica Group SpA to 'A/A-1' from 'A-/A-2'. We are also raising our issue ratings on Luxottica's senior unsecured debt to 'A/A-1' from 'A-/A-2'.
- The stable outlook reflects our view that the group's operating performance will likely be supported by its leading global market positions and its wide product range.

Rating Action

On Oct. 2, 2018, S&P Global Ratings raised its issuer credit ratings to 'A/A-1' from 'A-/A-2 on Italian eyewear maker Luxottica Group SpA. The outlook is stable.

We removed the issuer credit ratings from CreditWatch, where we had placed them with positive implications on Jan. 18, 2017.

We also raised our issue ratings on Luxottica's senior unsecured debt to 'A/A-1' from 'A-/A-2'.

Rationale

Our upgrade of Luxottica Group SpA and related entities mirrors the rating we have today assigned to its new parent company EssilorLuxottica (A/Stable/A-1). We view Luxottica Group SpA as a core entity of EssilorLuxottica. We equalize its credit rating with that of the group because we believe that EssilorLuxottica would support the financial obligations of Luxottica and its related entities if needed.

We believe the combination of the optical lenses and frames activities should enable the group to maintain a world-leading position in its business segments, which have positive growth prospects. We see potential integration risks, notably in terms of corporate culture and on execution of the business strategy while the senior management structure has yet to be fully defined.

We calculate that the combination is relatively credit neutral because we assume that debt leverage should remain between 1.5x-1.9x over the next two years despite a potential €2.8 billion cash outflow from the new parent to buy out entities that have a minority stake in Luxottica.

Outlook

The stable outlook reflects our view that Luxottica's credit quality mirrors that of new parent, EssilorLuxottica, and should be supported by a stable operating performance with solid FOCF generation overall over the next two years. We believe the group should benefit from stable cash flow generation thanks to its leading global positions in growing product categories like lenses and frames, as well as its wide product range and the vertical integration of the business model. That said, we see some integration risks, notably in its corporate culture and increasing competitive pressures in the U.S.

The current rating assumes EssilorLuxottica will maintain adjusted debt to EBITDA of about 1.5x-2.0x and FOCF to debt of 25%-40%.

Downside scenario

Any downgrade would be triggered by a similar weakening of the parent company's credit standing.

Rating downside could arise from a sharp and sustained increase in debt leverage due notably to acquisitions. We would also view negatively a sustained decline in operating performance and free cash flow generation, which could arise from heightened competition entailing loss of market share and pricing pressures in key growing markets like the U.S. or China.

Overall, we could lower the ratings if Luxottica's credit metrics weakened sustainably such that adjusted debt to EBITDA rises to over 2.0x and FOCF to debt declines to below 25%.

Upside scenario

Any upgrade would be triggered by a similar strengthening of EssilorLuxottica's credit standing.

Rating upside would most likely arise from management taking a conservative stance on acquisitions and shareholder remuneration, such that adjusted debt leverage remains below 1.5x over the next two years. We think this is unlikely to occur because we understand that EssilorLuxottica's business strategy is to grow externally in new distribution channels and geographical markets.

Over the longer term we could also raise the ratings should the group exhibit a strong and lasting track-record of high revenue growth and above-par profitability. We would also need to see evidence of the group overcoming combination-related integration risks (notably relating to corporate culture, management of key customers, and integration of supply-chain and IT) and continuity in terms of strategic direction.

Other Credit Considerations

Group rating methodology

We assessed subsidiary Luxottica Group SpA as a core entity of EssilorLuxottica and aligned its issuer credit ratings with that of its parent company at 'A/A-1'. This is based on our view that Luxottica is highly unlikely to be sold given its central position in the group's business strategy to be a global player in frames and sunglasses; that Luxottica accounts for about 50% of the group's revenues and earnings; that it shares the same corporate name; that it has been operating successfully for more than 10 years; and is expected be fully integrated within the new group.

Subordination risk

We raised our issue ratings on the senior unsecured debt of Luxottica to 'A/A-1' in line with Luxottica's issuer credit rating, which itself mirrors that of parent company EssilorLuxottica. We see limited structural subordination in the new group's debt structure and note that most of Luxottica's debt matures by 2020.

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016

- Criteria - Corporates - Industrials: Key Credit Factors For The Branded Nondurables Industry, May 7, 2015
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Lens And Eyewear Manufacturer EssilorLuxottica Rated 'A' On Combination With Luxottica; Outlook Stable, Oct. 2, 2018

Ratings List

Upgraded; CreditWatch/Outlook Action

	To	From
Luxottica Group SpA		
Issuer Credit Rating	A/Stable/A-1	A-/Watch Pos/A-2
Senior Unsecured	A	A-/Watch Pos

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm

(46) 8-440-5914; or Moscow 7 (495) 783-4009.