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Q&A

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**Alessandra Senici**

Good afternoon and thank you for joining us today. Here with me are Andrea Guerra and Enrico Cavatorta. Before we begin, 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 "Investor Relations", "Presentations" 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 first quarter of 2013, which may be found on our website, under the "Investor Relations", "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 or 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 projections or forward-looking statements.

We will begin with our CEO, Andrea Guerra.

**Andrea Guerra**

Thanks Alessandra. Welcome to Q1 Luxottica business review. The first quarter of the

year is always pretty significant in psychological terms, probably not the most important quarter from a profit and loss point of view, but as I usually repeat, we need to start the year in a proper manner. We are happy. We are happy about how the first quarter finished and I also must say that we have seen a good April so far. So we are now psychologically ready for the usually important sun season.

Just to summarize the quarter: above expectations, our top five fast growing markets, Brazil, Mexico, Turkey, India and China growing fast and steadily and above our expectations. Again, above expectations: Continental Europe, France, Germany, UK, Nordics, really fast and solid. On par with expectations: North America, total sales +4% in US dollars on top of a +9% last year, we're happy. February was negative and nervous; January, March and April much better, with good results.

Below expectations: Mediterranean Europe, excluding Italy. In Italy, we were basically neutral to slightly negative. It was tough in Spain. Regarding Mediterranean Europe, this has been the worst quarter of the year. We had planned it this way, but it turned out to be worse than expected. Q2 will be much better than this.

In terms of our businesses, we are happy to score wholesale at +9% on top of a +12% and basically no Armani in the picture yet.

Looking at Armani, excellent launch, happy about it, with good PR events globally, regionally and locally. We're targeting, more or less, about €130 million for 2013. We've done basically 10% of it in the first quarter, so it will be much more visible in Q2 and Q3. Profitability was up; cash flow was neutral. We're ready for the big season. Enrico.

### **Enrico Cavatorta**

Thank you, Andrea. Let's have a quick look at the key financials of the quarter. Our net sales on a reported basis grew by 4% and there was a slight negative impact from exchange rates. So excluding that impact, our growth was +5.6%.

The negative impact came not from the US dollar, that was basically in line with last year, at \$1.32 versus the €, last year it was \$1.31, so a very marginal negative impact, but the negative impact came from other important currencies that impacted our wholesale division, in particular the Brazilian Real was 12% softer than a year ago and the Japanese Yen was 15% weaker than a year ago.

If I look at the balance of the year, I would expect similar adverse negative effect from exchange rates. As far as the Euro/Dollar exchange rate concerns, in the nine-month period ending December 31, 2012, the average exchange rate was \$1.27; so stronger than the rate today.

Having said that, our Q1 compares nicely versus the strongest quarter of 2012. Total sales, FOREX excluded, were up 11% last year and on top of it we delivered 5.6% growth. This has been true in both wholesale and retail. Our wholesale segment grew 9.3% excluding FOREX and this is on top of last year's performance, again excluding FOREX, that was positive by 12% and again it was the best quarter in 2012.

In retail, 3.7% comps; this comes on top of last year comps that were at 6.5%, so it's close to double-digit comps on a two-year basis. Again, let me remind you that last year's Q1 was the strongest quarter of the year for retail as well. Now, focusing on the retail division, we had very good performance in Australia, again the Australian comps were close to

double-digit. China, in the double-digit area, came on top of double-digit growth last year, and LensCrafters was up 3.6%, which is on top of +5% last year. So, all in all, I would say that considering the tough comparison with last year's strong first quarter, this year we are very happy with the results.

If I turn to operating profitability, we grew overall 40 basis points on a reported basis and 60 basis points if I exclude the currency effect. This comparison is with 2012 on an adjusted basis. The reported numbers last year were lower because we had the restructuring charge in the Australian business. Let me remind you, last year in Q1 we had a charge of €22 million to operating income and of €15 million to net income due to the restructuring of our Australian business and that was the adjustment, we have no adjustments in the Q1 2013 numbers.

This year's 60 basis point increase at the total Group level comes on top of a 110 basis point improvement that we delivered last year. So I would say we are fully in line with our year-end target in Q1. The 60 basis point improvement is more or less equal in both wholesale and retail. If we exclude the negative impact of exchange rates, we have grown in the half percentage point region. In wholesale, we should mention that, as Andrea said, Armani has yet to contribute. We had some sales, but the profitability contribution of Armani in the first quarter was very limited because we accrued most of the start-up costs in Q1. So, I would expect a higher increase in wholesale operating profitability in the coming quarters as compared to the first one.

In retail, the 50 basis point improvement excluding FOREX comes on top of a 120 basis point increase last year. We are at an all-time high record in our established business, North America is back to an all-time high profitability and in Australia in particular, if I look at absolute profitability, I must say that we have tripled the profitability in Australia during the last two years, very happy with the performance in our established retail business.

Net income grew by 10% on 2012 adjusted numbers, again not considering the Australian restructuring last year, and by more than 20% on a reported basis. Let me say that with this improvement in net margin that generated an additional 40 basis points, it's the fourth year in a row that we've been growing our margin, in four years we have grown 2.5 percentage points, we were at 6% in 2009. And since then, in absolute terms, we have doubled the profit, we were at less than 80 million four years ago, we are now in the 160 million region. The increase in net income as compared to operating profitability was also due to a sharp decline in our financial expenses on an year-over-year basis, and this was partially due to the planned debt repayments that were made in 2012, taking advantage of our stronger financial position.

To close with free cash flow, as you know, Q1 is not one of our strongest quarters in terms of free cash flow generation. As a matter of fact, it's normally the weakest of the year. Last year we were able to deliver €36 million of positive free cash flow, this quarter we are flat. There are a couple of reasons behind this performance. One is the timing difference in when we make minimum royalty payments to certain of our licensees, and so this time swing between years adds an unfavorable effect in 2013 as compared to 2012 of approximately €50 million.

The second reason is that in working capital, while we are still delivering an increasing performance in receivables and payables, two days and one day respectively, we have yet

to see an improvement in inventory. As a matter of fact, our inventory increased by eight days in Q1 as compared to a year ago and by five days like-for-like excluding the Alain Mikli consolidation. This is because we are still seeing the negative impact of the SAP introduction in our manufacturing plants in Italy and the Armani launch. We would expect to see inventory days going down starting in the next quarter.

Having said that, let me remind you that during Q1 we also paid for our two transactions, €93 million for Alain Mikli and €45 million for the capital injection in Salmoiraghi & Vigano. As a results, we have seen our debt increase from slightly below €1.7 billion to slightly above €1.8 billion, but leverage marginally increased from 1.2x to 1.3x EBITDA. Let me remind you that during 2013 we have debt that will mature in the amount of €240 million but our cash on hand at the end of March is €580 million. So we already have available all the cash needed to make these debt payments before their maturity. Thank you.

### **Andrea Guerra**

Thank you, Enrico. Going back to our revenue roadmap; basically it's what I was saying at the beginning of our presentation. Looking at North America wholesale, basically it's a constant gain of market share, I could say that the same thing happens in many other regions of the world. So, the only thing really to add about our roadmap is Australia, Enrico was alluding to it, and I would say that basically we announced a year ago, actually 15 months ago, all our plans and projects. And, I think we have been faster than what we projected, and our comps are growing fast, and I would say the brand is healthy. I think that this is the most important thing to say regarding Australia.

So moving our focus to the different parts of the world, North America, we said that January really started strong, in February we had some slowdowns and March and April I would treat them as just one month, because, in the end, with the Easter shift you never know what is good and what is bad, but March plus April was better than February in terms of average growth rate. In terms of wholesale I already said that it's probably the third or fourth year in a row that we are gaining market share. Luxury is doing well, Oakley and Ray-Ban are doing really excellent. LensCrafters is on its way, it's solid and probably we have an opportunity to deliver better results in the quarters going forward.

In Sunglass Hut, obviously we would have all wished and dreamt for double-digit comp growth four years in a row. Our friends in Sunglass Hut still think that they can deliver a wonderful fourth year in a row. I would say that looking at 2013 and considering that, for the first time after two years, we had a real winter in the United States, to be at +5.5% comp, I think it's a remarkable result, really remarkable.

Europe, we said it, three different speeds: Continental Europe, great; Mediterranean Europe, lousy; Eastern Europe, fantastic. As I said, on one side it's obviously challenging, I would say that there is a lot to consider, also how we shipped a year ago compared to this year. I am not worried, obviously Spain will not improve to be positive, but this is by far our most negative quarter. One very small item of good news in some of these countries: Greece in the past couple of months is positive, Italy is still positive, and I am quite optimistic about Italy going forward. I will remind you that Italy represents more or less 4% and Spain less than 2% of Group sales.

Emerging markets: Brazil +30%, Turkey +25%, China +20%. I think that Brazil is really showing us that all the efforts we have put on the ground there in 2012 are beginning to

payoff. The integration is finalized, now it's basically business as usual, Ray-Ban is starting in the Brazilian factory as we speak, getting ready for the new sun season that will start in October. Sunglass Hut now reached 25 stores in Brazil, and the comp growth is really fast. So, I think that Brazil is well positioned for the future.

China, as you see, has shown a steady growth, like-for-like and with a larger perimeter in wholesale and retail. We don't see any slowdown, we lead the industry, we have today a strong team, good people, great culture, we are comfortably waiting for the big demand wave to come. We are ready for it and China will be stronger in the years to come.

In terms of prescription, I think that, if we are solid in our growth, if we have performed well even during Q1 2013 and through all 2012 in Continental Europe it is because we have really performed well in the prescription side of the business. This is exactly what we told you two months ago. We all love sun, sun, it's easy, but the prescription market is larger. We told you that by 2020 another half a billion people will wear prescription glasses in the world, in emerging markets and in mature markets. We are growing fast on one side and on the other 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 levels in the prescription side of our business we have again improved, we are happy, and this is really an important asset.

The Armani launch, we have worked hard, we have been across the world, across regions, in all the cities of the world. I think that it has been an important continuous event in the last couple of months. It's over. The big expenses are over. Now, it's sales and margins. We have gone back to Armani's roots, making sure that Armani is strong and brilliant and hot again, so far so good. In Q2 and Q3, we will see the benefits of this.

So I think that Q1 was a really solid start. We are extremely happy with how we performed during this first initial four months. We are ready for the big season. We are waiting for the long sun season to come. In Milan, it's not exactly Spring today, but in many other cities of the world it's Spring and we are ready for that.

With this, thank you for listening and now it's your turn. If you have questions or comments, here we are, ready to listen. Thank you and I'll turn the call back to the operator.

### **Q&A Session**

OPERATOR: Excuse me; this is the Chorus Call conference operator. We will now begin the question and answer session. The first question is from Mr. Daniel Hofkin of William Blair & Co. Please go ahead, sir.

DANIEL HOFKIN: Hello, good afternoon. I just had a question. I guess, first, if you could describe the trend, to what degree - you know - you indicated the things were better since February, can you quantify that a little bit more in terms of what you saw in March and April so far?

ANDREA GUERRA: Yes, sure. So as we said and I think that we had a number of weeks during March already describing how the Q1 was trending, basically January was above average. I would say February was basically negative. March and April, again, were obviously above average or else we wouldn't have made that kind of performance in Q1.

And as I said, I prefer to consider March and April together because with the Easter shift you never know how to look at it.

DANIEL HOFKIN: Okay. You had some gross margin improvement again, and I'm curious if you can just discuss between our...I guess as an organization or between retail and wholesale, did both divisions experience that?

ANDREA GUERRA: Yes, they did. And I would say that it's marginal, it's Q1. I think that what we're basically doing in terms of price points on one side and efficiency on the other side will continue, but I would say that they have been pretty marginal and just at the beginning of the year.

DANIEL HOFKIN: Okay. And then as you think about the rest of the year, where do you expect still more in the way of retail operating margin or more wholesale given the Armani rollout in terms of operating margin expansion?

ANDREA GUERRA: As we previously stated, I think that 2013 will allow us first of all to see wholesale improving operating margins due to scale, Armani and some efficiency projects that we have been managing in the last six to nine months. Secondly, I think that in retail we will continue, on one side, to invest in emerging markets retail and Sunglass Hut expansion that will cost some bit of margin during 2013, but on the other side, Australia plus LensCrafters plus US Sunglass Hut will help us to see an expansion of retail profitability as well.

DANIEL HOFKIN: Okay. Thank you very much.

ANDREA GUERRA: Thanks Dan.

OPERATOR: The next question is from Bassel Choughari of Berenberg. Please go ahead.  
BASSEL CHOUGHARI: I have three questions please. The first one is on Armani and the wholesale margin. Where do you expect the wholesale margin to move in 2013? The second question is on US retail, Essilor was saying recently that the installation of the anti-reflective machines at LensCrafters might take longer than expected. Could you help us understand the implication here? And then on your retail margin, is there any negative impact from Pearle Vision, and, if yes, could you please put a number on this? And last question on China please, can you explain what percentage of growth is coming from sun and which part is coming from optical please? Thank you.

ANDREA GUERRA: Here I am, in terms of wholesale margin, I think that during 2013 on one side, we have the integration of Alain Mikli which will obviously cost some money. On the other side, we've got Armani. And thirdly, yet positively, this is the second year in Brazil, so we expect margin growth in the region of the 50-100 bps for the full year. In terms of US retail and anti-reflective machines, I do not know if I have to explain to you, what this means for Essilor or for us, I mean there is a plan for the anti-reflective machines in LensCrafters, we are following the path and I think there is no change in our plans. So probably, I didn't understand your question properly. Retail margins, Pearle Vision margins are expanding and this is due to the constant transformation of Pearle Vision to a franchising organization from one managing corporate stores. So we are losing some top line but gaining in our bottom line. In China, I would say that the expansion is 30% sun and 70% prescription.

BASSEL CHOUGHARI: Thank you. Just on LensCrafters because initially my understanding was that, you will get the second part of anti-reflective machines in LensCrafters stores in 2013 and it seems like this might be spread now over 2014 as well. So, is that something new on your side or just that was your initial plan?

ANDREA GUERRA: So our initial plan was to cover between 2012, 2013, and 2014 all our most important stores and this is what we are doing.

BASSEL CHOUGHARI: Thank you very much.

ANDREA GUERRA: Thank you.

OPERATOR: Your next question is from Domenico Ghilotti from Equita SIM. Please go ahead.

DOMENICO GHILOTTI: Good afternoon. I have a couple of questions. The first is on wholesale, if you can help, I don't understand how much of the growth at constant currency was from volumes and how much from price mix? The second question is on the Australian retail business, you mentioned that the absolute profitability is up, but how far are you from the margins, so the peak margins you had in the past?

ANDREA GUERRA: I would say that in terms of wholesale it's a continuation of what we did in the last two quarters. So in the last two quarters again we were able to expand our price and value, and I would say that we kept on doing that, I would say 75% to 80% are volumes, 20% to 25% is price mix, obviously at a fixed currency. In terms of Australia, I think that we are 18 months away from the peak, hopefully we will be able to reach that peak, the expansion was substantially in Q1, and I think that we will do better in the next three quarters.

DOMENICO GHILOTTI: Okay, thank you. And just a follow-up on your target for wholesale in Western Europe, you are a bit late here, but obviously you have Armani, do you think that you can catch up for the target, thanks to Armani also in Western Europe in wholesale, I mean?

ANDREA GUERRA: I will have a bold proposition: yes, we will do it.

DOMENICO GHILOTTI: Okay, thank you.

OPERATOR: The next question is from Julian Easthope of Barclays Capital. Please go ahead.

JULIAN EASTHOPE: Yeah, thank you very much, and good evening, Andrea, Enrico and Alessandra. And I have three questions, if I may. The first one is, just on the implications of the weather that you alluded to in the US and from manufacturing Europe, I guess from that Sunglass Hut had 5.5% growth, which is a bit lower than you have been expecting, while still is very good growth. I just wondered if there have been...if there is that much of a sensitivity to the sun, and whether or not sun ultimately leads your sales or whether they just shifted as and when the sunshine comes you actually tend to get a boost when that comes through? And the second question, a quick one. The setup costs for Armani are they material or are they relatively small? And lastly, could you just update us in terms of

pricing increases that you have put through and you are planning to put through please?  
Many thanks.

ANDREA GUERRA: So, basically we didn't talk about weather. What I said was, finally we had winter. So the strange thing was 2012 and 2011, and we always talk about how good those winters were. So by definition, if there is a sunny day we are doing more, if there is not a sunny day, we are doing less. So we prefer to have more sunny days than more rainy days, I mean it's the opposite of our friends at Burberry. Having said that, I really do not know if it is pushed forward or if that day the people had \$150 in their hand and they spent it on something else, Sunglass Hut is more impulse so the more sunny days the more business we do. And probably a loss sale is a loss sale. But +5.5% on that kind of comps, as you said, I think it was really remarkable. Set up of Armani...set up costs, is it material? I would say it's not material, because it's a huge profit and loss. If we look at Q1 wholesale, probably it had an impact of €2 million to €3 million. But we were happy to have invested these millions of Euros in the education of our sales reps, PR events and launch with internal and external events. So I would say, it's a necessary investment for the long term. Price increases were over, we have some new ideas on some segments of the Oakley business, and we will see in the next two, three weeks what to do. So, Ray-Ban Rx is over, and I would say that we will see the effect in Q3/Q4, and the initial Oakley sun products increase is over and we are seeing already the effects. So we have another couple of quarters where we will see the effect of the Ray-Ban sun increases over a year ago and then they are over, and this is it, I would say.

JULIAN EASTHOPE: Thank you very much.

ANDREA GUERRA: Thank you.

OPERATOR: The next question is a follow-up from Domenico Ghilotti of Equita SIM. Please go ahead.

DOMENICO GHILOTTI: I have a question on the corporate costs, because I saw some underlying growing trend, and I wondered if it is just some volatile trend in the quarter or if you expect some structural increases in this item. And then well, I had a question on M&A, given the low leverage and given your M&A attitude, I wonder if you can update us on the opportunities on this front?

ANDREA GUERRA: So, I would say that...on your first question, it's basically only seasonal and we are talking about really few million euro swings. So there is not an issue. We are going through a project in the US, in which we will overall invest some money to allow our big brands to become bigger, to serve our consumers better, our customers better. And we will incur in some costs in Q2 and Q3. In terms of your last question, I don't remember it.

DOMENICO GHILOTTI: On M&A, it's the same usual question.

ANDREA GUERRA: M&A, I mean what we expect is there, we are active in Central and Latin America, we are active in South Asia. The guy that owns...the guys that own the brands we like, they know it, and let's see what happens in the next two, three months.

DOMENICO GHILOTTI: Okay, thank you.

ANDREA GUERRA: Thank you.

OPERATOR: The next question is from Flavio Cereda of Merrill Lynch. Please go ahead.

FLAVIO CEREDA: Hi, good afternoon to all. Two questions really, firstly, if I look at your selling expenses for the quarter, are they where you would have expected them to be or were you actually better on this front than perhaps you are expecting? And the other thing is, if you could give us a little more information on the royalty payments, the €50 million, which you highlighted? Thank you.

ANDREA GUERRA: Yes, in terms of your second question, I mean, we have some licenses in which we pay every couple of years, so every three years. This year, the one that we are paying every two and the one we are paying every three years happened all this year. So, you can ask this question in a year time, when we will have better free cash flow in Q1, because we'll have no payments next year. So it's pure calendar and mixing of two calendars together and basically it's some long time brands we have. In terms of selling, we've undergone a number of projects and we will see even more effects as a result in Western Europe in the quarters to come. I think the main effect you see here is due to our Australian recovery, and how we are moving there, and as we are moving above a certain kind of threshold, percentage costs really are immediately delivering a fantastic benefit to us.

FLAVIO CEREDA: Okay. Thank you Andrea, thank you.

ANDREA GUERRA: You're welcome.

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

BASSEL CHOUGHARI: Hello, it's me again. Just a question, I understand that Armani is keeping you pretty busy now, but by when do you think that will be fully up and running, and you would start looking for any other like big license? Thank you.

ANDREA GUERRA: So, we are always ready for new ideas. We are always looking at our portfolio with dynamic eyes. I think that in the next 18 to 24 months, there are things that we like and there are things that we do not like, and we will act on both.

BASSEL CHOUGHARI: Thank you.

ANDREA GUERRA: Pleasure.

OPERATOR: Gentlemen, there are no more questions registered at this time.

ANDREA GUERRA: Have a wonderful and good evening. Thank you very much.