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Holland Views – EssilorLuxottica – Price: €114, MCap: €50bn

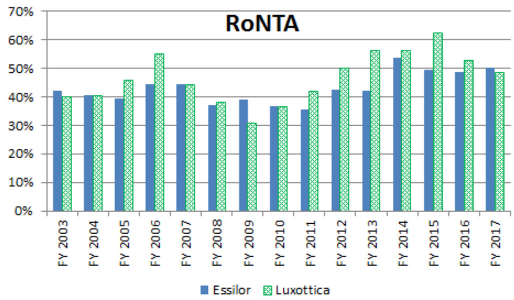
Through the looking glasses

EssilorLuxottica is no headline bargain (PE of 20-25x). However recent disquiet between its managers bought the share price low enough for us to take a look. We like what we found.

Introducing EssilorLuxottica (E-L), a new Holland Franchise:

- Pre-merger, E-L as independent businesses, had great track records of growth (organic and acquired) and high returns. Luxottica also had a maverick owner-manager at the helm (who today still owns 32% of E-L equity). After a multi-decade roll-up, this newly merged business dominates the eyewear market with quasi-monopoly positioning.

  Fig.1: Excellent return on capital



Source: Holland Advisors

- Eyewear is a very unique product that is both a medical device and a fashion accessory, both key for pricing power and margins. The product enjoys regular replacement cycles.
- The industry operates as an ‘agency model’, i.e. ophthalmologists are ‘agents’ in the eyewear buying process. We love the agency model (Howden/William Demant).
- Most health organisations agree that there is an under-served worldwide myopia “epidemic”. This means structural demand growth for the €100bn eyewear market.
- E-L is unique in the industry as it is vertically integrated with manufacturing, owned brands (Ray-Ban, Oakley, Varilux, etc.) and vast in-house retail and wholesale scale.
- Its unmatched scale brings cost and distribution advantages (aka ‘moat’) and an ability to invest in innovation. Its brands bring pricing power as likely will, in time, its merger.

  ..and yet, the regulators saw fit to approve the merger of the world’s dominant frame maker (Luxottica) with the dominant lenses maker (Essilor). We explain why later.
- Many blindly assume this market is ripe for e-commerce disruption and we address this issue head on too noting that the most prominent US disruptor has 90 stores!
- E-L shares trade on c.20x adjusted PE post synergies (c25x consensus 2019) – not the starting depressed multiple we normally like. Even so, given the low capital needs and excellent returns, our compounding model suggests, with plausible top line growth of 5% and some op leverage, the shares could still compound at c.11%. With reinvestment, that could stretch to c.13%. We are interested. A lower share price would make us more so.

In this note, we address five key areas of interest to us:

1. A quasi-monopoly in an opaque, unregulated, market

In this section, we make the following points:

1. The global eyewear market is a **fragmented and complex market**
2. Despite E-L's dominance, **this mega-merger passed anti-trust without conditions**.
3. In-house Optometrists play a key role as **intermediaries** in the eyewear buying process.

1. A fragmented and complex market

To bastardise Buffett's aphorism:

It's not that we like monopolies but we like the pricing power they bring.

Global eyewear is a **fragmented and complex market** that requires medical expertise (optometrist professionals who act as agents), technical lens laboratories, bespoke fitting, fashion brands, high-volume manufacturing and fast logistic services. One of the conclusions from the E-L anti-trust investigation was that the market's opacity caused delays in the investigation i.e. **that this is not a well analysed or quantified market (**at least in the EU). To us as investors, this is a good thing.

We think E-L is a price maker, as befits a market leader that demonstrably understands the power of scale, distribution and especially brands (it either owns or has licensed the majority of luxury eyewear brands).

The global eyewear market is worth c.$100bn and is, by any standards complex in terms of distribution and fragmentation. The US retail eyewear market is dominated by retail chains (LensCrafter, Pearle Vision and Sunglasses Hut are all Luxottica owned) and the supermarket chains. In Europe, there are fewer similar scale chains – Specsavers, VisionExpress and GrandVision being prominent – but independent opticians are far more prevalent.

Fig.2 below shows the EU anti-trust assessment of E-L's market share position in Europe before the deal was approved. As mentioned, in the fragmented European marketplace, E-L sells mainly wholesale, whilst in the US, E-L enjoys Luxottica's longstanding position as the largest optical retailer[1] through its ownership of LensCrafter, Pearle Vision and Sunglasses Hut chains.

To view the remainder of this in-depth report, please contact Andrew Hollingworth, Andrew@hollandadvisors.co.uk for a complete PDF copy.

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