EssilorLuxottica

EssilorLuxottica's first-quarter 2022 revenue

Transcript of the Management Call

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Questions from:

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Luca Solca, Bernstein

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Key Highlights

Stefano Grassi, Chief Financial Officer

Good morning and welcome to our first-quarter trading update. We are very pleased with the way we started 2022, despite some headwinds, like the COVID outbreak that hit several parts of the world and also the dramatic events related to the war in Ukraine.

But Q1 has been a quarter of strong growth for the Group, a quarter where our top line was up 38% on a reported basis, while on a *pro forma* basis we are looking at the second consecutive quarter of double-digit growth, with sales up 11.5% at constant currency and 15.7% at current exchange rate.

The key assets of the EssilorLuxottica Group are in healthy shape. All the regions posted solid growth in Q1, with EMEA and Latin America at double-digit pace, while North America was up 8% on top of a 6% in 2021 versus 2019 on a *pro forma* basis. Our key eyewear brands Oakley and Ray-Ban, they both posted double-digit growth in Q1. Our vision care assets that represent more than 75% of our revenue base, grew in excess of 9% at constant currency, thanks to a demand that continues to be strong, pretty much in all the regions around the world. Last, but not least, our sun business is back again with double-digit growth, very much led by our luxury portfolio.

Before we start our journey around the different geographies, let me give you just a quick flavor on how we performed on our two operating segments.

The Professional Solutions division posted top line slightly south of double-digit pace at 9.6% at constant currency in acceleration versus the fourth quarter trend at 6.8%, with North America on high-single-digit territory and both EMEA and Latin America at double-digit pace.

Our Direct to Consumer segment continued its outstanding performance, posting the fourth consecutive quarter on a *pro forma* basis at double-digit pace at 13.5% versus Q1 2021. Our brick-and-mortar comps were up double digits, our e-commerce business was up 9% versus 2021 and over 80% versus 2019 levels, proving once again that our multi-channel oriented strategy is definitely going in the right direction.

Now let's start our journey around the different geographies and on page 12 as usual let's start with North America. North America posted a growth in top line at about 8% at constant currency. The demand in the market is still there, probably a bit softer in the month of January, due to the spread of COVID cases around North America.

On the Professional Solutions side, overall growth in the quarter was in the high-single-digit territory for the frame business, with double-digit pace in key accounts, double digits in e-commerce partners, double digits in the sports channel, with a strong support from the sun business that was up, again, double digits thanks to our luxury brand portfolio support. On the lens side of the business, our branded portfolio reported solid growth in Q1, also supported by the new Transition XTRActive and by Varilux that during Q1 posted a top line up in the mid-single-digit territory.

Moving now to retail, the overall comps were in the low-single digit, with Sunglass Hut performing in mid-single-digit territory, led by our international store locations as the US border reopened to international tourists during the latter part of the fourth quarter. While LensCrafters was actually on the low-single-digit territory, with a soft start in January due to the Omicron cases and a tougher comparison base during the last two to three weeks of March as we anniversary the stimulus pack in the US and a strong acceleration of the vaccination campaign in Q1 2021.

Let's touch on e-commerce, our e-commerce business was south of double digits with our three key branded eyewear websites, Oakley.com, Sunglasshut.com and Rayban.com, they all posted double-digit growth during the course of Q1.

Now let's move to EMEA. EMEA posted a remarkable acceleration in the top line. On a *pro forma* basis EMEA posted a first half of 2021 negative 1%, in the second half of the year, last year, we were up 8.5% versus 2019 and now in the first quarter 2022 our top line grew 18% with both Professional Solutions and Direct to Consumer at a double-digit pace.

On the Professional Solutions side, Spain, Germany, UK, Eastern Europe, and Turkey, they all delivered double-digit growth, also helped by a favorable comparable base, while Italy and France were respectively flat and at low-single digit during the course of Q1. Our branded lens portfolio grew at the mid-single digit, driven by price mix, with Eyezen, Varilux and Transition, very much leading the way in Q1. On the frame side we posted double-digit growth, led by a strong sun business, even in Europe, and by a strong delivery of both our Ray-Ban and our Oakley brand.

If we now move to retail for a second, comps were in excess of 25% compared to the first quarter of 2021, clearly the COVID restrictions that, if you remember applied last year in Europe, created some easy base of comparison that more than offset, I would say, the headwinds deriving from the uncertainty of the war in Ukraine. In Europe all our main banners, Générale d'Optique, GrandOptical, Apollo, Salmoiraghi & Viganò and Sunglass Hut, they all posted double-digit growth, mainly driven by volume, with the price mix as a nice add-on.

Moving to Asia-Pacific now, top line up 3% at constant currency. In Asia, we posted the best performance during the last five quarters on a *pro forma* basis. South East Asia and Japan they were all double digits, while our performance in Greater China was flat, with Professional Solutions at mid-single digit, with strong delivery of the Stellest lenses that during the course of the first quarter sold more than half of the Stellest lenses that we sold in the entire 2021 in China. And this remarkable delivery happened despite the severe consequences of COVID related restrictions that impacted Hong Kong as well as Mainland China. And just to give you an idea, in Hong Kong over 95% of our store base in the month of March was impacted by either closure or severe traffic decline due to local restrictions for COVID. That number is 75% in Mainland China, so a material impact, disruption I would say, due to the COVID restrictions in China.

In Australia retail, we had a strong rebound in Sunglass Hut, thanks to the reopening up to tourism with Australians that now can move around the different states. While our OPSM business, our optical retail business in Australia, decelerated in the negative territory due to a soft January due to the COVID case build up and the month of March that was impacted by severe floods. But we have confidence that during the course of the second quarter things will progressively improve.

The last region for today is Latin America and it is actually the best performer of all the regions, 21% in top line growth at constant currency. Both Professional Solutions and Direct to Consumer posted double-digit growth, with Brazil, Mexico, and Argentina, all of them at double-digit pace.

In Brazil that, as you well know, is our largest country, we grew close to 20% in our B2B channel, with lenses that were up at the high-single digit, with our branded lens portfolio that posted double-digit growth. And our frame business was up in excess of 30% compared to the first quarter of 2021.

Let's touch on retail where our comp sales were double digit on both optical and sun retail chains, with double digits in GMO and the growth that for all the main GrandVision chains in the region was double digit.

And now we have finished our journey around all the different geographies and let's move to our Q&A session.

Questions & Answers

Susy Tibaldi, UBS

Hi, good morning, thank you so much for the presentation. I will stick to two questions.

So, the first one would be on the US market, which is the area where you are facing the toughest comps, so it is reasonable to assume that we are seeing a - let's say - deceleration there which in reality is a normalization. But can you help us understand to where this level of normalization is taking us? Is it fair to assume that in Direct to Consumer you are maybe seeing around low-single-digit growth, whereas the Professional Solutions is outperforming? So maybe overall the US is growing around low-to-mid-single digit, something along those lines? It would be very helpful to know because it is a very important market for you. You are doing a lot in terms of work within the business with synergies, etc., so if you can give us an indication of what kind of growth you are starting to see from the second part of March and in April, it would really, really help us.

The second question is on inflation and supply chain. So, inflation clearly is pretty high everywhere in the world, but in your case specifically the verticalization really helps. But what kind of inflation are you seeing? Are you still comfortable that you can offset it internally, or are you considering also potentially raising prices on some parts of your portfolio at some point during this year? Thank you.

Stefano Grassi, Chief Financial Officer

Good morning, Susy. Let me take your two questions. The first one on the US. As you pointed out, we have a tougher comparison base in the US, very much due to the few things that we mentioned before: the acceleration of the vaccination campaign in 2021 and the stimulus pack that was announced during the latter part of March 2021. What we see in the US from a shipment perspective, on the Professional Solutions side, it is still a performance that I would define as solid. There is a bit of a timing difference between April and May due to the different timing of shipments. From a retail perspective, I would say we are happy with the trend, it is aligned with our expectation, considering the fact that we have a tougher base of comparability.

With respect to inflation, we feel the impact of inflation, like anybody else in the market. We mentioned last time that inflation, it is on labor, it is on shipping costs, and, in a way, it is on raw materials and obviously utilities. But if I had to look at our first quarter, that inflationary impact has been broadly and largely managed within our profit and loss. I do expect, probably, that between the second and the third quarter there is going to be a bigger hit on the inflationary trend. And then, probably, in the latter part of 2022 we are going to see a normalization of that.

Elena Mariani, Morgan Stanley

Hi, good morning, Stefano, I will stick to two questions as requested.

The first one is on the other regions into the second quarter, so could you just indicate briefly which sort of trends you have seen at the beginning of the second quarter? Anything to flag in terms of changing consumer sentiment? Are people trading down to lower price points? You have mentioned that Asia was a bit weaker than expected in the first quarter, but you expect things to improve into Q2, and are you already seeing that in April? And what about EMEA, as you know there is a big debate around consumer sentiment holding up, so we are all keen to hear whether you are seeing any change in trends in to the second quarter?

And then my second question is going back on the margin outlook, putting together inflation, synergies coming through and a situation that is definitely unstable from a macro perspective. Could you confirm that you are still comfortable in saying that you are going to see an EBIT margin improvement in 2022?

And do you expect some GrandVision synergies to come through already in 2022? I have seen that there has been a change in management happening, so perhaps you are going to start to implement quite a few initiatives already this year? Thank you.

Stefano Grassi, Chief Financial Officer

Good morning, Elena, we will go through your two plus one questions. Let me start from the trend at the beginning of Q2. When I look at our trends overall I think we have a pretty solid shipment trend, for example in Europe, and this is true for frames and lenses. For the rest of the world really nothing major to report, with the obvious exceptions of Russia and China. I do not see consumers trading down, as a matter of fact, price mix is still there. In retail, we have a solid optical performance worldwide and we have a strong sun business. So, all in all, we have an expectation of growth for the month of April.

The second question pertained to the margin outlook. Yes, if you remember during the last call, we talked about the fact that we are obviously not guiding for the year, for 2022. But what you can expect for this year is a story of top line growth and margin expansion. And we are still confirming that.

Clearly, with GrandVision we are at the beginning of a journey, a journey on which we know the job that needs to be done, a journey that has started already with respect to synergy workstreams and a journey that now sees in place a new leadership, which I believe is going to overall accelerate the execution of our synergy realization.

Luca Solca, Bernstein

Thank you very much indeed. There is a lot of debate about the impact of COVID-19 restrictions in China and, as you are on the ground, and you have quite a broad distribution there, could you tell us, are you seeing the impact on traffic from the COVID-19 restrictions? And do you see a rebound in traffic once these restrictions are lifted? I am getting mixed reviews on this point, with consumers potentially continuing to be concerned that they could be on the wrong side of the contagion and affected by further restrictions, and so, traffic rebounds are not as sharp as we saw last year for example.

On the value-added products which you are developing on many different fronts, starting with myopia management, but then looking at prescription sunglasses and many others, what metrics do you monitor and how do you see this shift to more value-added products developing across the various markets, if you could go through the main geographies? Thank you very much indeed.

Stefano Grassi, Chief Financial Officer

Thank you, Luca, and good morning. Let me answer your questions here. First of all, the COVID impact in China: we did not see a rebound of traffic, so we are still going through severe traffic decline over there. I think that is probably widespread around China with really a handful of exceptions. But if I look at the glass half full, at the same time I have a good source of optimism, for example looking at the Stellest performance during the course of the first quarter. Stellest's performance is very reassuring, clearly we saw a deceleration in the month of March, due to the restrictions. But it tells me that the demand and the market for vision care products, for myopia solutions, is still there.

And that leads me nicely to the second question you asked around value added products, in particular lenses. We look at the overall lens portfolio on a geography by geography basis, but in particularly we look at our branded lens portfolio. And I am glad you asked this question because for example during the course of the first quarter, we are generally seeing our branded lens portfolio outpacing the unbranded lens portfolio. And so, we are obviously looking at the different lenses that we have in our portfolio, and we are looking at how much our clients are trading up from unbranded to branded lenses. This is something that we clearly monitor, and we observe and see in many parts of the world.

Veronika Dubajova, Goldman Sachs

Hi. Good morning, guys, and thank you for the call and for taking my questions. I have two, please.

One is, Stefano, I guess maybe just excluding China, and I know the business is pretty messy and volatile at the moment, but if you struck out China, I am just curious if you can comment to the exit growth rate at the end of March, or April growth, to the extent that you can give us some reassurance that the momentum that you have seen through the quarter has continued and maybe was it higher or softer at the end of the quarter versus the quarter on average and where you see April shaking out? Just anything you can say on that, even if you do not want to comment on April, but maybe just the March exit growth rate, ex China, would be very helpful.

And then my second question is just a follow up on the guidance comment you have made. I think, back in March, your comment on the margin improvement is it would be, sort of, on aggregate consistent with the average you would have to achieve to get to that mid-term guidance, I am just curious if you are still confident in that shape of the margin progression, or if the current environment should mean that we should be rethinking that phasing of that margin improvement up to the 19% to 20%? Thank you.

Stefano Grassi, Chief Financial Officer

Good morning, Veronika. So, let me address your two questions here. First question, with respect to the growth trend that we see. The overall trend in March was positive, and we were happy with that. We were clearly seeing the headwinds in the US, but the overall number for March is a good one, even excluding China or including China.

With respect to the confidence in the margin progression, the confidence is there. Absolutely. I think we confirmed the guidance and, again, as I mentioned before, we do have 2022 as a year of margin expansion and top line growth. That is how we see it.

Cédric Lecasble, Stifel

Thank you for taking my questions. I have two.

So, the first one on the independent ECPs in the US, you mentioned a slight slowdown and tougher comps for technical reasons. I would be interested in the behavior between the traffic, average basket, what you observe for these clients, and how long do you think the softer performance due to comps could last in 2022? In other terms, how long was the boost last year and what should we expect for this category?

And the second question is on GrandVision in Europe. Could you be maybe a little more explicit between the banners, kind of mid range, and the banners, kind of value range? Did you see any disparity between the banners? You said all were positive, but could you be maybe a little more explicit? Thank you very much.

Stefano Grassi, Chief Financial Officer

Good morning, Cédric, and let me take your questions here. The first question on ECPs, we see a slowdown, a deceleration in the first quarter on the ECP channel but, just as a reminder, I mean, the ECP channel has been the driver of our growth, of our structural growth, in the US for at least the last four quarters. So, it is a natural deceleration, I would say, on the channel that has been continually performing, and I would say to many extents, exceeding our expectations in the US. I think the job that we are doing is going into the right direction: more engagement with our ECPs on the key program that we have in place, the EssilorLuxottica 360. Just last year, we added more than 2,000 ECPs into the EssilorLuxottica 360 program; when we have ECPs engaged in this program, we do see that there is a continuous improvement of the penetration, shares, and growth of the ECP, first of all, and clearly on our side. We need to work on that direction. Some of the programs that we have in place are going into the direction of engaging ECPs. And, when we have the engagement of the ECPs, the direction is definitely going into the trend that we expect to see.

With respect to GrandVision in EMEA, the trend is positive. It is double digit. And I do not see much of a difference between mid range and value range in terms of the performance for the GrandVision banners in EMEA.

Julien Dormois, BNP Paribas Exane

Hi. Good morning, Stefano, and thanks for taking my questions.

I would be interested, first, to get a quick update on the traction that you see from your latest product introductions, most specifically on Ray-Ban Stories but also maybe Stellest ex China. So, if you could provide us with some data points here that would be very helpful?

And my second question revolves around the M&A landscapes and what do you see at the moment in terms of availability of targets, the prices that are being asked for by the sellers, and also how should we see the M&A trend in the coming months and quarters? Should we see a pick-up in bolt-on deals now that you have closed GrandVision and a couple of other large deals? Is it on the agenda for 2022 or should we expect more in 2023?

Stefano Grassi, Chief Financial Officer

Good morning, Julien. First question around latest product introduction and their performance. We had a pretty solid pipeline, I would say, between the end of last year and early this year, of new products that were introduced in the market. Products, that are actually taking new geographies, going into new markets, hitting new consumers. Transitions XTRActive is a pretty good story now in the US where we have, you know, the launch and it is giving very promising results so far. Stellest in China, I mean, in a single quarter despite all the uncertainties that we were discussing before with Luca, we are experiencing a first quarter where we sold more Stellest lenses than what we did in the first half of last year. So, excellent result I would say and no reason to believe that things could go anything different because Chinese consumers do understand the benefit of myopia solutions. With respect to Ray-Ban Stories, we are building up a category. So, it is a journey. That journey, for us, is, on one side, a geographical expansion of Ray-Ban Stories. As a matter of fact, in the last few months, we have enlarged the number of countries in which we made the product available. And, obviously, there is the newness, and that is important. It is a build-up of a category that is giving pretty reassuring results.

With respect to M&A, bolt-on would be part of our growth trajectory, as we said many times. We do deals that make sense for us from a strategic standpoint at the right price, and this is obviously the strategy that we are going to undertake in 2022 and the following years.

Piral Dadhania, Royal Bank of Canada

Hi. Good morning, Stefano and Giorgio. Just two brief ones.

Most have been answered now, but I was just wondering, firstly, on Stellest again, you guys give some anecdotal data points, which is very helpful, and qualitative feedback, but we get many questions on what the actual quantitative contribution is to growth in China and Europe. Is that something you feel comfortable sharing with us at this point, maybe in terms of the size of the category or just in terms of the growth contribution in the two main markets in which it is launched? That would be very helpful to try and assess the future potential for that product.

And, secondly, just to come back to guidance, I think last year you provided financial guidance at the half-year results, which was July if I am not mistaken. I appreciate that the current operating environment is very challenging, but should we expect something a bit more nuanced and specific at the half-year or is this the sort of guidance framework that we should continue to work with for the rest of the year? Thank you.

Stefano Grassi, Chief Financial Officer

With respect to the Stellest lenses, and I would say myopia solutions in the broader sense, because now we need to assume a broader product range that will address myopia needs in the Chinese market, I would say the category is growing very fast. It is the fastest growing category within our lens portfolio. It is the major contributor to the growth in China and, obviously, no reason to believe that this is going to change.

With respect to the guidance: As we said, we have a mid-term guidance, a five-year outlook. That is the one that gives the proper perspective of what the company needs to do in the next five years in order to get to the 19% to 20% operating profit margin on an adjusted basis. So, that journey is what matters the most. We are in the middle of an important integration. We have several initiatives around the different geographies, and the direction that we are taking is very much summarized in the five-year outlook that we shared.

James Grzinic, Jefferies

Thank you. Good morning, Stefano and team. I have two quick ones.

The first one is, Stefano, I presume, just to clarify, your view on margins for the coming year is an ex-FX view, so we will need to obviously overlay what is happening hopefully in terms of the US dollar in particular.

And the second point is, is it worth touching on China in terms of your ability to continue to feed the machine from Dongguan, and then the extent to which you are still very comfortable of what is happening in terms of the pandemic there, that it will not affect your ability to maintain service levels into your operations globally?

Stefano Grassi, Chief Financial Officer

So, James, good morning. With respect to the guidance, the guidance is very much currency neutral. So, you do not have any tailwind or headwind expectations over the five-year outlook with respect to currencies. With respect to the sensitivity to the US dollar, in a swing of plus/minus 10%, you can expect 6-7% EPS impact on the Group.

With respect to China and impact on operations, the current situation has seen, for a few weeks, the closure of a couple of plants - more precisely, a mass production plant and a laboratory in the Shanghai area - but the fact that we are very diversified, that we have a very diversified manufacturing footprint, allowed us to redirect production and services in other locations. So, there has not been any material impact, broadly speaking, in our overall service level of supply chain.

Domenico Ghilotti, Equita

Good morning. The first question is on optical in North America. So, I saw the low-single-digit same store sales that you mentioned for LensCrafters and Target Optical, so I wondered how can you sustain momentum going into tougher comps for the rest of year?

And the second question is on the GrandVision integration. If you can share with us what has already been executed in terms of projects and workstreams?

Stefano Grassi, Chief Financial Officer

Good morning. Buongiorno, Domenico. With respect to optical in North America, clearly, we know that there is a tougher base. I think we need to work on the things we know how to do well. We need to continue to work on a pipeline of store renovation, which is quite ambitious, in 2022. And I think that direction is very important for us because we know every time we renew a store we see a lift in our performance. It is going really well for both traffic as well as doctor appointments, to be able to get into a new environment, into a new space, into new doctor rooms that have teleoptometry, and I think that is creating a different level of dialogue, a different level of consumer experience within LensCrafters. We are also getting people trained more properly. And, as a matter of fact, we do see an improvement in conversion, and that is, obviously, very important for us. So, I believe that, given also the lenses portfolio that we have available in LensCrafters, given the price mix that we see and continue to support our

performance over there, given the good reassuring performance on multiples, I think there is a lot of things that are under our control and we are executing properly.
In terms of GrandVision integration, there is a first thing on which we started working on day one, Domenico, and that is the assortment. We already have our team hands on into the lens and frames assortment in GrandVision, looking at the different banners, understanding where we can make adjustments, where it makes sense to create a different phasing of our products, within the GrandVision retail banners. And I would say that the results that we are seeing are pretty reassuring.

The other important area for us of focus is going to be, obviously, store renovation. We are going through the development of the store model for GrandVision and for the different banners, and, obviously, we will go through a progressive renovation process of the stores and the banners that actually do make sense.

All right, I guess we are done for today's call. I want to thank you for your participation and, obviously, we will catch up during the upcoming AGM on May 25. Have a good rest of the day.