European Luxury Goods

Initiation of Coverage

2-EQUAL WEIGHT

Tickers:	LUX.IM LUX IM
Price:	EUR 20.60
Price Target:	EUR 24.00
FTSE WEU ex-UK	354.93
ITMIB30	35562.00
Sector View:	1 - POSITIVE

Luxottica

Compelling story…but we are not the only ones to "see" this…

Initiating coverage with a 2-Equal weight rating and a EUR 24 price target.

- Luxottica is the leader in both the industry verticals in which it operates: premium eyewear manufacturing and optical retailing. This advantageous position provides the company with a clear competitive advantage versus its peers, in our view.
- Moreover, the company seems well positioned to benefit from recent market share wins, synergy benefits from its acquisition of the Pearle Vision retail brand in North America, and the repositioning efforts of its LensCrafters and Sunglass Hut brands. However, we believe such positives to be well understood by the market.
- Although the shares are 16.5% below our current share price target, there are 1-Overweight rated stocks in our Luxury universe that trade on average 23.1% below our current fair value estimates. Furthermore, should the market's current fears of a US recession be realized, we believe that of all of the stocks in our universe, Luxottica is the most geared towards such concerns.

FY Dec, EUR	2005A	2006E	2007E
Revenue (m)	4371	4765	5222
Net Income (m)	342	418	504
EPS Adjusted	0.76	0.92	1.11
Consensus	N/A	N/A	N/A
EV/Revenues	N/A	2.17	1.93
EV/EBITDA	N/A	10.89	9.02
P/E	27.3	22.4	18.6

Market Data	
Market Cap (m)	9464
Shares Outstanding (m)	459.4
Float (%)	M/A
Net Div Yield (%)	N/A
Convertible	No
Shares per ADR	-

Financial Summary	
Five Yr. EPS CAGR (%)	16-
Return on Equity FY05 (%)	16.9-
Current BVPS	5.20
Net Debt (m current)	1435

Disclosure(s)

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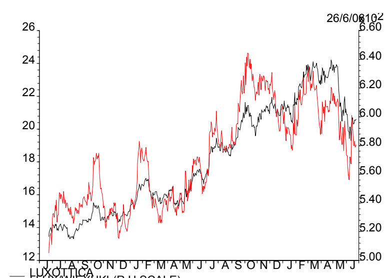
Performance	1M	3M	12M
Absolute %	-2	-13	22
Rel. Market %	-2	-6	11
Rel. Sector %	0	-12	13
52 Week Range	24.23 - 16.67		



Source: DATASTREAM

Company Description

Luxottica Group is the world's leading designer, manufacturer and distributor of prescription frames and sunglasses in the premium and luxury segments. Its distribution network covers all of the world's key markets, both wholesale and retail. The group's brand portfolio includes Luxottica Group's house brands such as Ray-Ban, Vogue, Persol, Arnette and Revo and license brands including Bulgari, Burberry, Chanel, Dolce & Gabbana, Donna Karan, Prada, Polo Ralph Lauren (as of Jan. 2007) and Versace. Management include Andrea Guerra (CEO), Enrico Cavatorta (CFO), Leonardo Del Vecchio (Chairman) and Luigi Francavilla (Vice-Chairman).

June 26, 2006

PLEASE SEE ANALYST(S) CERTIFICATION(S) AND IMPORTANT DISCLOSURES INCLUDING FOREIGN AFFILIATE DISCLOSURES BEGINNING ON PAGE 31

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Luxottica

(LUX.IM)

JUNE 26, 2006

CONSUMER

EXECUTIVE SUMMARY

The Luxottica story is a positive one…

Luxottica is the leading manufacturer of premium, luxury eyewear, owning the licenses to such high-profile names such as Chanel, Dolce & Gabbana, Polo Ralph Lauren (as of Jan. 2007), and Prada. It is also the leading retailer in two of the most important optical markets globally (North America and Asia-Pacific), with brands such as Sunglass Hut, LensCrafters, Pearle Vision, and OPSM. As leader in both of these industry verticals, the company has a clear competitive advantage, as its retail distribution strength is helping the company win further license contracts and take market share from its competitors.

We think it is also well positioned to benefit from positive industry fundamentals, which we believe will help underpin the sustainability of current sales growth. Such industry trends include: 1) ageing demographics, 2) the lack of penetration of eyewear in the Asian population despite vast medical need, and 3) premiumization in eyewear (notably sunglasses) driving growth in value.

Furthermore, following on the heels of a recent acquisition, the company has many synergies to achieve by integrating the Pearle Vision brand into its existing optical retail network. In addition, after initial efforts to reposition the LensCrafters and Sunglass Hut brands, Luxottica is set to start reaping the benefits of such strategy changes. Lastly, 2006 is the year in which the company will see large benefits from recent high-profile license contract wins. These are the key drivers of earnings momentum at the company this year (we forecast 22% earnings growth in 2006 vs. 2005) and we believe that the strength of the current management team will be instrumental in driving such value.

…but we are not the only ones to see this

Current consensus estimates are around c. 3-5% above management guidance. Therefore, like us, most market participants do not appear to doubt management's ability to exceed current targets. Furthermore, in recent weeks, management has stated that it was considering a potential upward revision to current guidance (and on the day of this announcement the shares were +6% (compared with +0.1% for the MSCI Pan-Euro index). While an increase to current guidance would be a positive event for the stock, we cannot rely on this event alone to be a positive catalyst for the shares, as consensus estimates already stood above the top-end of management's guidance range before this announcement.

Trading on a P/E of 22.4x 2006E and 18.6x 2007E, the stock is currently above both the European luxury industry average (19.3x 2006E and 16.9x 2007E) and the industry average for other peers within the optical industry (19.6x 2006E, 17.1x 2007E). We believe this premium sufficiently reflect its superior growth profile.

We believe that upside potential of 16.5% warrants a recommendation that current holders of the shares stick with their current positions. Relative to the other stocks in our coverage universe, the magnitude of upside potential that we see in Luxottica shares is close to 10% less than the upside potential that we see to our 1-Overweight rated stocks. Furthermore, should the market's current fears of a US recession be realized, we believe that of all of the stocks in our universe, Luxottica is the most geared towards such concerns.

Luxury Goods

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Brief History

Founded in 1961, Luxottica was a contract manufacturer for semi-finished products for the optical market

It was not until 1967 that the company began to manufacture complete eyeglass frames

Luxottica did not begin as a vertically integrated manufacturer and distributor. When Luxottica was formed in 1961, it only produced semi-finished parts for the optical market. Over time, the company began to develop the expertise to manufacture the entire finished frame and, in 1967, Luxottica started to manufacture complete eyeglass frames sold under the Luxottica brand name. It was not until the mid-1970s that the company made its first strides towards becoming a vertically integrated company with its acquisition of wholesale distributor Scarrone. Such small acquisitions of independent optical distributors continued in the early1980s.

Throughout the 1990s, Luxottica established its leadership position as a leading manufacturer of designer sunglasses, by buying reputable sunglass brands and winning numerous designer license agreements

Luxottica then made its foray into the optical retail segment by establishing its presence in the North American retail market. In 1995, it acquired US Shoe Corporation, owner of LensCrafters, which was the largest optical retail chain in North America. At the same time, the company expanded its efforts in the manufacturing of sunglasses. Seven years earlier, Luxottica had signed its first license agreement with fashion designer, Giorgio Armani (1988). This license was soon followed by agreements with several other leading high fashion brands. Throughout the 1990s it sought to obtain in-house brands and acquired various sunglass businesses. In 1990, it acquired Florence Line S.p.A., which owned the Vogue brand and in 1995, the company acquired some of the mid-to high end brands of Persol S.p.A. Four years later, in June 1999, Luxottica acquired the Global Eyewear Division of Bausch & Lomb Incorporated, whose portfolio included the Ray-Ban brand. This acquisition also provided the company with sunglass crystal lens manufacturing technology.

From 2001 to 2005, the company pursued an aggressive retail expansion strategy, which ultimately gave Luxottica a market leading position in the important optical markets of North America and Asia Pacific

From 2001 to 2005, the company pursued an aggressive retail expansion strategy, which solidified Luxottica's market leading position in the important optical market of North America and gave the group a leading position in the Asia-Pacific market. In April 2001, it acquired Sunglass Hut. One month later (May 2001), on behalf of its Eye Med Vision Care division, Luxottica acquired First American Health Concepts, which at the time was a significant player in the managed vision care industry in the United States. Two years later (August 2003), it acquired 82.57%[1] of OPSM, which gave Luxottica a market leading position (based on sales) in the prescription optical business in the Australian and New Zealand markets. With stores in Asia, OPSM also provided growth opportunities in the important Hong Kong optical market. In January 2004, Luxottica announced an offer to acquire Cole National. With the Cole National brands, the group resolutely became the leading optical retailer in North America. Luxottica then further strengthened its presence in China with two small acquisitions. The first acquisition, in July 2005, was of Xueliang Optical Technology Company, which had 79 stores catering to premium customers in Beijing. The second purchase was of Ming Long Optical in October 2005, which was the largest premium optical chain in the Guangdong province of China. These two Chinese acquisitions resulted in the group becoming the leading operator of premium optical stores in China.[2]

[1] Luxottica later acquired all remaining shares of OPSM in March 2005.

[2] Luxottica has recently announced 1) the acquisition of Shoppers Optical, a 74-store Canadian based optical chain that will result in Luxottica managing a total of 268 optical stores in China.

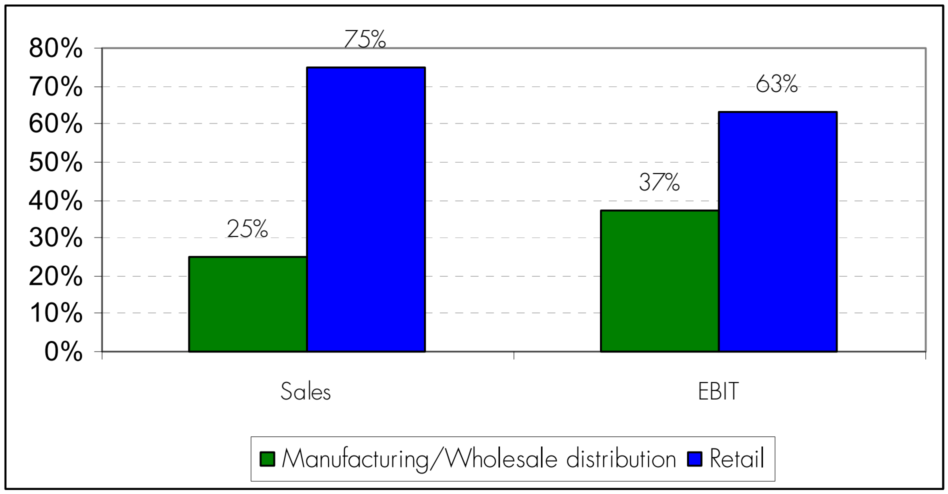
Over the past 45 years, Luxottica has transformed itself from a contract manufacturer of eyewear parts to the world leader in the design, manufacturing and distribution of premium prescription frames and sunglasses. Its vertically integrated wholesale and retail divisions operate in a symbiotic relationship creating a virtuous circle – whereby its strength in retail helps secure license wins in the manufacturing realm, while its strong portfolio of in-house and licensed eyewear brands help ensure that its retail stores have a diverse, premium selection for its customers.

[2] the acquisition of Modern Sight Optics, a leading premium optical chain that operates 28 stores in Shanghai, China. Both deals are still subject to regulatory approval.

Divisional Overview of Group

Luxottica today comprises two distinct divisions: 1) the manufacturing and wholesale division; and 2) the retail business. The wholesale/manufacturing division accounts for 25% of sales and c. 37% of EBIT and the retail division accounts for 75% of sales and 63% of EBIT (when adjusting for the 'inter-segment' portion – i.e. excluding wholesale finished products that are sold through the group's own retail network).

Figure 1: Luxottica Group – Net Sales & EBIT Breakdown by Division (2005A)



Source: Company data, Lehman Brothers estimates

Wholesale Division

Brand Portfolio

The wholesale division of Luxottica designs, manufactures, and distributes the company's in-house and licensed brand products. On the design/manufacturing side, the company possesses one of the leading portfolios of premium, designer brands (see Figure 2 for the group's brand portfolio).

Luxottica's brand portfolio used to be more dependent on key licenses, such as the Armani contract (which in 2002 represented 7.2% of consolidated net sales). However, recent license wins have resulted in a more diverse licensed portfolio, whereby no one license accounts for more than 5% of group net sales (Prada and Chanel currently post the highest level of sales among the licensed brand portfolio and each are less than 5% of consolidated net sales). Additionally, in the near term, we do not expect any major licenses to be lost as there are no major license contracts that are up for renewal in 2007.[3] Therefore, we do not expect much share price volatility relating to expiration of important license agreements.

Figure 2: Luxottica Brand Portfolio

House Brands	Licensed Brands
Arnette	Adrienne Vittadini*
Killer Loop	Anne Klein
Luxottica	Brooks Brothers
Persol	Bulgari
Ray Ban	Burberry
Revo	Byblos
Sferoflex	Chanel
Vogue	Dolce & Gabbana/ D&G
	Donna Karan/ DKNY
	Genny
	Moschino
	Prada/Miu Miu
	Polo Ralph Lauren
	Salvatore Ferragamo
	Sergio Tacchini
	Versace/ Versus

** license for US only*

Source: Company data, Lehman Brothers estimates

Manufacturing

The company has eight manufacturing sites worldwide, six in Italy and two in China. As of the end of 2005, 85% of production capacity was in Italy, while 15% was in China. However, over the next couple of years, production in China will likely double to 30%. As it is far cheaper to produce frames in China, we estimate that by doubling the production capacity in China (from 15% of production capacity to 30% of production capacity), this

[3] Note Luxottica will seek to purposely eliminate the contract of some smaller, less profitable brands.

factor alone will result in EUR 9m of annual savings to the company at the operating profit line. In 2006, we expect approximately 80% of production to be sourced from Italy and 20% of production to be sourced in China, enhancing wholesale operating income by approximately 2.0%.

Luxury brands will still be produced in Italy, in order to maintain their 'Made in Italy' cachet. However, we expect that the production of all of the group's private-label frames will be moved to China. Additionally, we expect some of the more sporty, "second derivative" branded frames to be made in China.

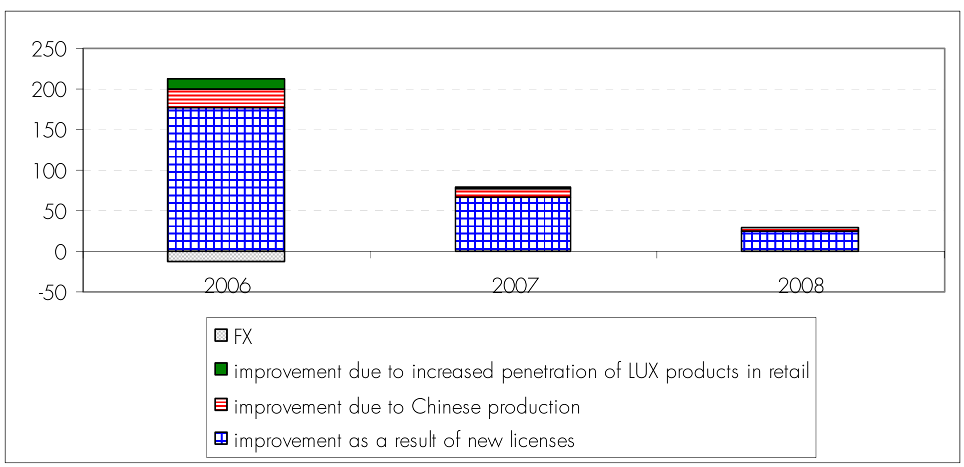
Distribution

To ensure the proper distribution of its eyewear, Luxottica has an extensive network of independent distributors, 29 wholly/partially owned distribution subsidiaries in major optical markets, and directly operated retail operations.[4] Reaching over 130 countries, this extensive distribution network allows the company to closely monitor the global market. It is, therefore, in a strategically optimal position to quickly interpret, analyze, and adapt to trends within the global optical market.

Operating Margins

Recent license wins will drive vast scale benefits in this division. We estimate that over the next couple of years (out to 2008), such license wins will drive the bulk of the operating margin improvement, with additional benefits coming from the move to outsource more production in China and the increased penetration of Luxottica products within its retail network.

Figure 3: Operating margin improvement (bp) as a result of 4 factors



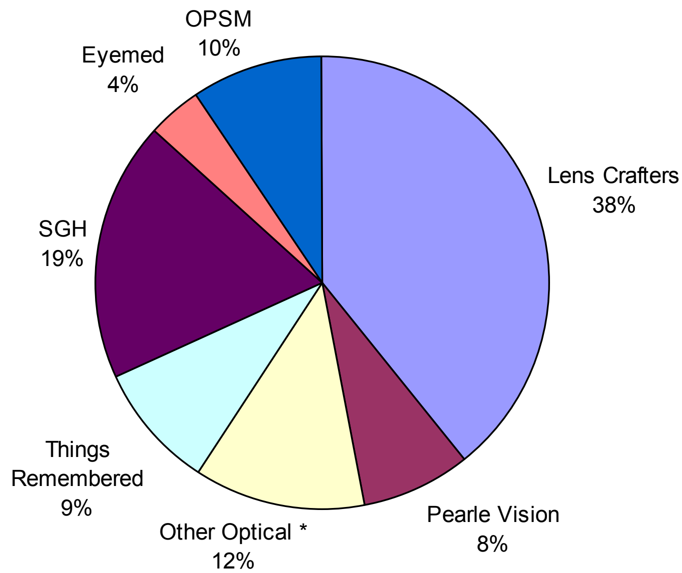
Source: Lehman Brothers estimates

[4] Note, however, that the directly operated retail stores are activities of the Retail division of the Group.

Retail Division

Luxottica's retail presence is mainly located in the North American and Asian markets, the two largest optical markets in the world. We estimate that the divisional revenues are split out as per Figure 4.

Figure 4: Estimated Retail Revenues by Brand, 2005



** Includes: Sears Optical, BJ's Optical and Target Optical.*

Source: Lehman Brothers estimates

LensCrafters

LensCrafters appeals to the discerning, fashion-conscious customer

With 894 retail locations, LensCrafters is the largest optical retail chain in North America, based on revenues. Each retail store has an independent licensed optometrist and laboratory on-site, which allows customers to conveniently receive their prescription eyewear in approximately one-hour. Since early 2004, Luxottica has increased the content of premium, luxury brands within its LensCrafters stores, in an effort to target the higher-ticket, more profitable segment of the optical market. This repositioning of the brand towards a slightly more discerning, fashion-conscious consumer has recently been supplemented by a new logo and new store concepts which will be rolled out across half of the LensCrafters network over the next 3-5 years. The new stores have a sleeker, more modern design, appealing to the fashionable customer. Such repositioning efforts have thus far been successful in driving a marked increase in average ticket per customer.

Pearle Vision

Pearle Vision emphasizes the doctor-patient relationship and attracts customers who value eye care over fashion

Acquired with the Cole National business in 2004, Pearle Vision has further improved Luxottica's leadership position in the North American optical market. However, rather than cannibalizing LensCrafters' sales, the Pearle Vision brand is a good complement to the Luxottica retail portfolio in North America. It appeals to an entirely different customer. Pearle is positioned as the "trusted eyecare" brand. With a brand motto of "Nobody cares for eyes more than Pearle," this brand emphasizes the doctor/patient relationship and attracts customers who appear to value eye care over fashion.

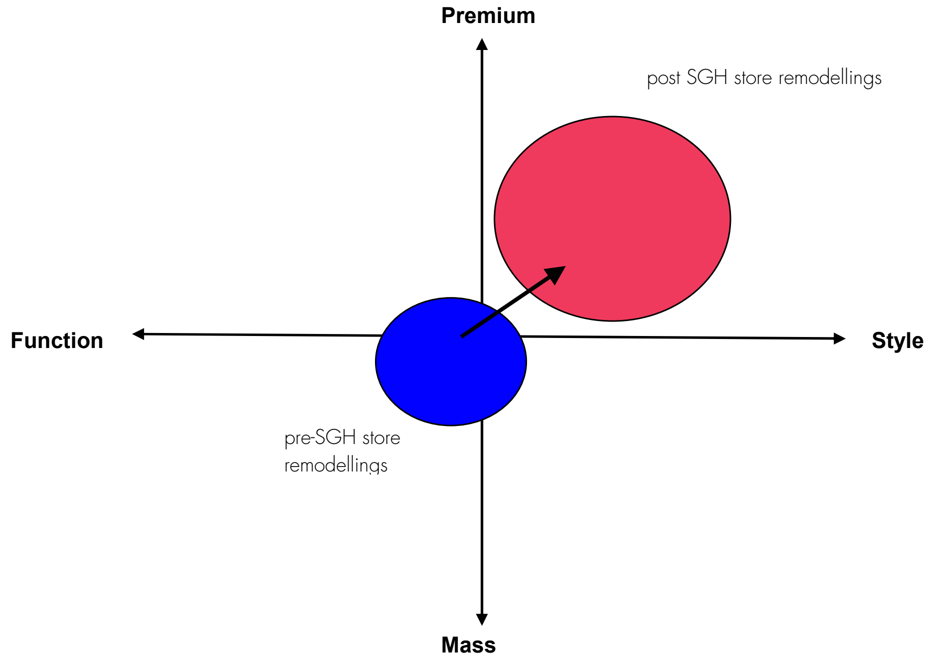
While revenue growth is a clear focus in the near term, Luxottica management is targeting improved profitability at Pearle Vision. One of the major cost-cutting initiatives at Pearle has been to take the laboratories out of the store and instead utilize LensCrafters' extensive laboratory network. Pearle Vision's laboratory needs will be serviced by the closest central laboratory in the region. When Luxottica acquired Cole, just under two years ago, Pearle Vision had negative operating income. Having only restored profitability to this brand in 2005 (LB estimate operating income of c. 2.4% was achieved in the last full year), Luxottica is now targeting double-digit operating income by 2007. The cost base at Pearle Vision location is much lower than that of a LensCrafters store; thus each Pearle Vision store requires a lower sales threshold in order to achieve double-digit profitability. In light of current cost cutting initiatives and management's previous track record with LensCrafters, we believe that management's 2007 double-digit margin goals are achievable.

Sunglass Hut (SGH)

Sunglass Hut repositioning moves this retail brand up the value chain

The face of SGH is rapidly changing. Whereas previously the stores were made to appeal to the sportier, male segment of the population, the SGH brand is taking new shape and trying to lure more fashion-oriented female customers. In an effort to change this brand image, Luxottica has embarked on an aggressive store remodeling program, updating the stores to be more modern and to appeal more to a more style-conscious consumer. By the end of 2006, 45% of the SGH network will have been phased over to the new format. This will be 66% complete by end-2007 and 84% complete by the end-2008. In addition, the company plans on opening over 100 stores per year through 2008. Many of these new stores will be in higher fashion areas in North America (e.g. coastal regions, Sunbelt region in the US). Despite the fact that at the end of 2005 only 20% of the store network had been updated the group has already begun to reap the benefits of this store update program. Remodeled SGH stores have shown comp sales which are 7-10% above the average.

Figure 5: SGH Repositioning – Moving up the Value Chain



Source: Lehman Brothers estimates

As a result of recent efforts to move Sunglass Hut up the value chain, Luxottica has already seen a 300bp improvement in profitability in FY 2005. This has been driven by a number of factors including: 1) store remodeling program which has driven higher revenue per store, 2) the closure of a number of unprofitable stores, including many Watch Station stores (all of which will eventually be closed according to Lehman Brothers estimates), and 3) an improved assortment in the stores (e.g. higher fashion, premium content).

It is crucial to understand the profitability scale effect at Sunglass Hut. Most of the stores are quite small in terms of square footage, thus the operating costs involved are quite low, as most stores only have one employee working in the store at a time. Therefore, virtually all of the increased revenue per store, driven by moving up the value chain, falls straight to the bottom line.

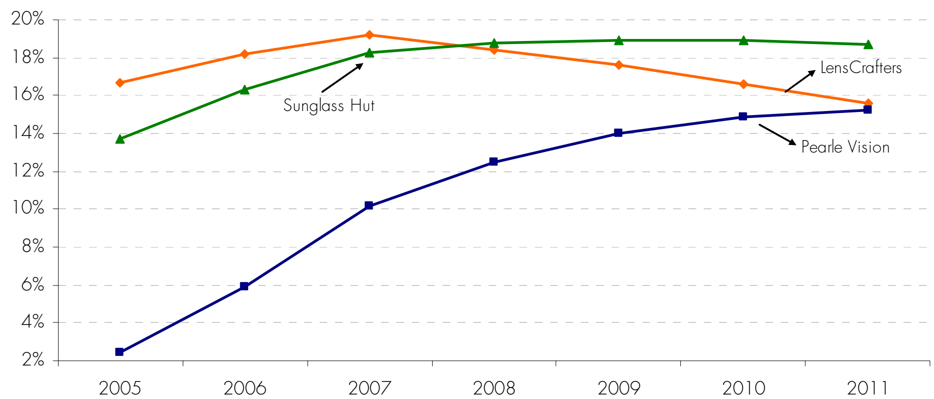
EyeMed

EyeMed operates vision care plans to corporates and government agencies in the United States, reaching over 120 million members in the United States. The acquisition of Cole National's managed vision care (MVC) business has propelled Luxottica to the number two position in the MVC market. This entity is particularly crucial in driving more traffic through the group's North American retail network. According to the company, approximately 25-30% of Luxottica's optical retail sales is MVC-related business. The company will seek to maintain this 25-30% level across its optical retail businesses.

Operating Margins

Over our forecast horizon, the majority of operating margin improvements within the retail division will be driven by Sunglass Hut reaping the benefits of its more premium positioning, given its relatively fixed cost base. Furthermore, from 2007 onwards, we expect big improvements in profitability at Pearle Vision to offset smaller declines in the overall operating margin at LensCrafters (we forecast margins at LensCrafters to peak in FY 2007). However, in this year (2006) specifically, improvement in the operating margin at LensCrafters will still continue to be a big driver of improved profitability as the company continues to increase average sales per store on a relatively similar cost base.

Figure 6: Our estimates of 3 main Retail Brand Operating Margins in US



Source: Lehman Brothers estimates

Investment Conclusion: 5 Points to Consider

#1: Competitive Advantage as Industry Leader in Optical Eyewear & Sunglass Segment

Premium Eyewear Manufacturer: Relative to other eyewear manufacturers, the group has one of the strongest brand portfolios focusing on the premium eyewear segment (refer to Figure 2).

Luxottica is a clear leader in the two industry verticals in which it operates

Leading Retailer of Optical Eyewear and Sunglasses: Luxottica is now the leader in the world's most important optical markets of North America and Asia-Pacific. In addition, Sunglass Hut is the largest sunglass store chain in the world, with a leading presence in North America and Australia.

Figure 7: Retail presence (in number of stores) by Brand and by Region (2005A)

Retail Store Netork	North America	Europe	Hong Kong	Australia	New Zealand	China	TOTAL
LensCrafters	894						894
Pearle Vision	375						375
Pearle Franchising	462						462
Sears Optical	960						960
Target Optical	246						246
BJs Optical	143						143
Sunglass Hut	1556	109		182			1847
old OPSM brands (1)			65	473	38		576
Things Remembered	664						664
Xueliang Optical (2)			68			77	145
Ming Long Optical (3)						133	133
TOTAL	5300	109	133	655	38	210	6445

(1) includes three brands: OPSM, Laubman & Pank, and Budget Eyewear
(2) Number of stores at time of acquisition. Acquired in July 2005, and therefore, not included in Luxottica's official 2005 portfolio of retail stores. Included in above chart for illustrative purposes only.
(3) Number of stores at time of acquisition. Acquired in Oct 2005 and therefore, not included in Luxottica's official 2005 portfolio of retail stores. Included in above chart for illustrative purposes only.

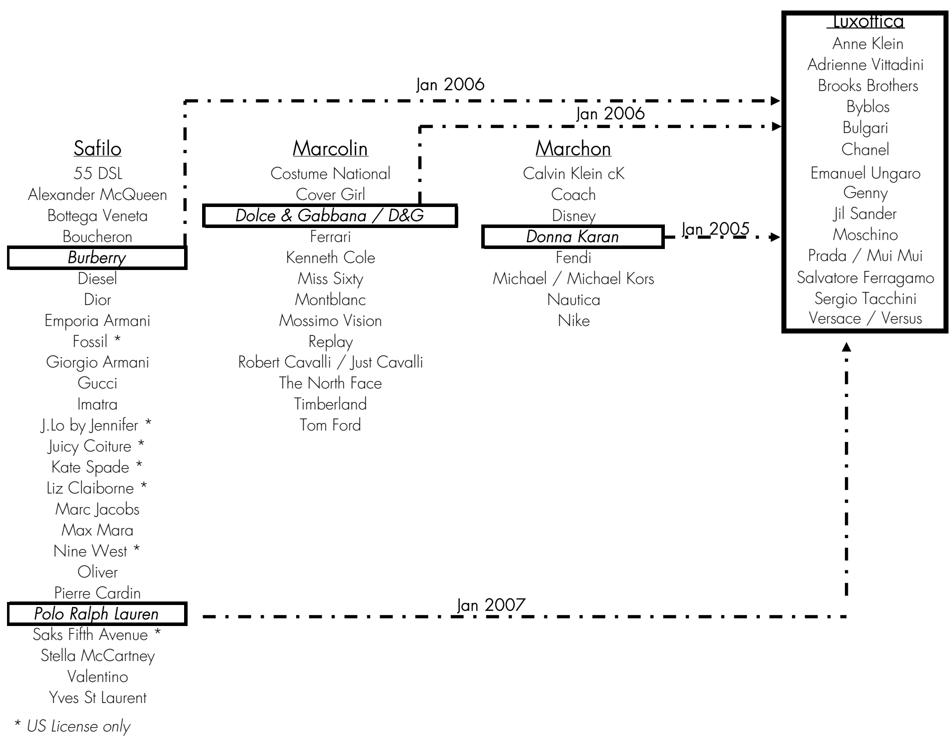
Source: Company data, Lehman Brothers estimates

In addition to being the premier retailer of optical eyewear and sunglasses, Luxottica has an extensive network of independent distributors and 29 wholly/partially owned wholesale distribution subsidiaries in major optical markets. Reaching over 130 countries, this extensive distribution network allows the company to closely monitor the global market. It is, therefore, in a strategically optimal position to quickly interpret, analyze, and adapt to trends within the global optical market.

The wholesale division has been winning major, high-profile licenses; in part, these contract wins are the fruits of the company's extensive distribution platform

Its distribution prowess affords further symbiotic benefits to the wholesale manufacturing business. Since 2003, the wholesale manufacturing division has been winning more high-profile licenses (e.g. Versace, Prada) and taking market share vis-à-vis its main competitors in the premium eyewear segment (e.g. Donna Karan, Burberry, Dolce & Gabbana, Polo Ralph Lauren). Luxottica is winning these contracts in large part due to the strength of its distribution network. And as the retail might of the group has only just become stronger with transforming retail acquisitions in North America and Asia, we expect Luxottica to continue to win contracts from other fashion brands vying to gain widespread appeal in these fast-growing markets. Furthermore, the market for designer eyewear and sunglasses continues to grow, as luxury, fashion brands seek to leverage the strength of their current brands and extend their product ranges in a quick and economically efficient way. As these luxury brands continue to expand into the optical eyewear and sunglass segment, we believe that Luxottica will win a disproportionate share of future contracts.

Figure 8: Luxottica has won 4 major licenses in the past 2 years

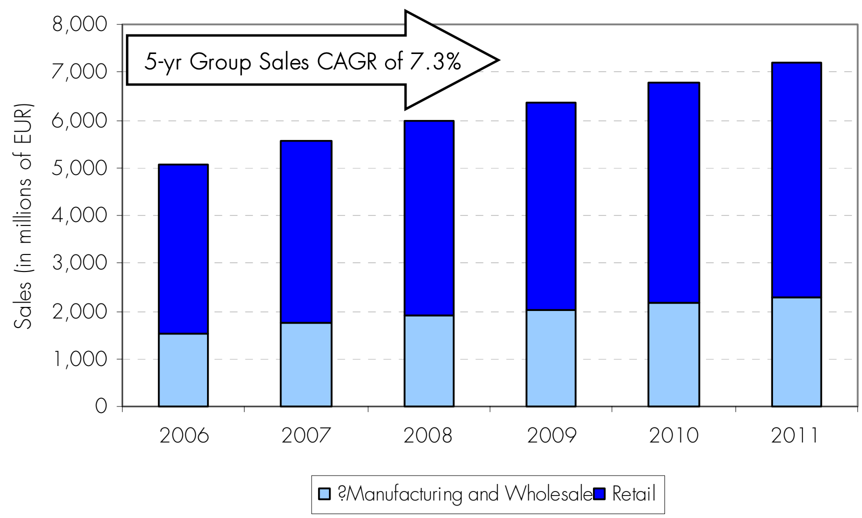


Source: Company data, Lehman Brothers research

#2: Positive Industry Trends to Underpin Sustainability of Sales Growth

Our estimates incorporate a 5-year compounded annual growth rate (CAGR) in sales of 8.2% in the manufacturing and wholesale division and a 5-yr sales CAGR of 6.9% within the retailing division.

Figure 9: Luxottica Sales Growth, 2006-11 estimates



Source: Lehman Brothers estimates

Due to positive trends within the optical industry (both prescription and sunwear), we believe that our top-line growth forecasts will remain solid, in spite of cyclicality in consumer spend. The three main positive trends driving this view are: 1) ageing demographics, 2) low penetration rates of corrective lenses in Asia, and 3) premiumization in eyewear.

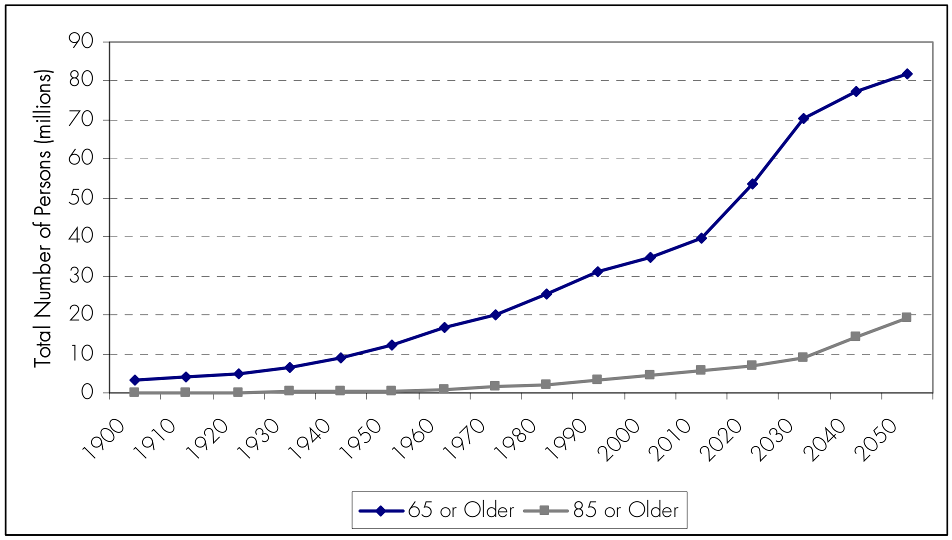
1) Ageing Demographics

Population ageing across the world is a phenomenon that will continue to be a main feature throughout the first half of the 21st century. Consider the following statistics:

As optical industry titan, Luxottica should disproportionately benefit from medical need that will arise for eyewear, due to aging populations globally

- According to the World Health Organization, nearly two-thirds of all older people (aged 60 and over) are living in the developing world.
- By 2025, this number will be 75%.
- In the developed world, the very old (aged 80+) is the fastest growing population group.
- In the US alone, the US Census Bureau estimates that during the period from 2000 to 2020, the number of people aged 65 or older will have grown by more than 50% (Figure 10).

Figure 10: US ageing population – number of persons by age group, 1900-2050



Source: U.S. Census Bureau, Decennial Census Data and Population Projections

We believe that such statistical data underscores the increasing medical need that will arise in the optical industry. In light of Luxottica's retail division having clear leadership positions in key markets such as North America, Hong Kong and China, Luxottica should markedly benefit from such trends.

2) Asian population presents vast medium-to-long growth opportunity for Luxottica

The Asian population has a genetic predisposition to myopia (near-sightedness); however, despite this elevated medical need, only 18% of the Asian population is wearing corrective lenses

Asian populations have a genetic predisposition to myopia (near-sightedness), due to a slightly different curvature of the eyeball. Scientific research suggests that the prevalence of myopia may exceed 70% in Asian countries (vs. 25% of the US population).[5] The genetic predisposition towards myopia among Asians is further intensified by environmental factors such as eye strain caused by extensive reading, activities that requires close focusing, working with computers, and emotional stress.

Despite the elevated medical need for corrective lenses in Asia, only 18% of the Asia-Pacific population wears corrective lenses. This compares to a 63% penetration rate of corrective lenses among the North American population.[6] As disposable income in Asian countries (notably China) rises, we believe that the penetration rate of corrective lenses will increase and close the gap between the percentage of population requiring corrective lenses and the actual percentage of the population actually using corrective lenses. Again, such trends should disproportionately benefit Luxottica as it currently has the biggest retail network in mainland China and Hong Kong.

[5] *Harvard Medical School Publications, "The Neural Basis of Myopia" by Elio Raviola, M.D., PhD., and Torsten N. Wiesel, M.D.*

[6] www.essilor.com

3) Premiumization in sunglasses set to drive growth in value

Premiumization is evident across many consumer categories, including eyewear. This rings particularly true in the sunglasses segment, where designer brands have reached into triple-digit price points with little price resistance from consumers. The two trends of 1) conspicuous consumption; and 2) mass-market consumers trading up have only heightened demand for designer frames. Sunglasses are no longer just an aid to help shield your eyes from the sun, but they have also emerged as a major fashion accessory. We believe that this trend will continue, thereby driving growth in value in the sunglasses segment. In addition to continued "trading up" within this segment, consumers are purchasing sunglasses more frequently, shortening the average replacement cycle.

It is important to note however that the sunglass segment is more cyclical than the prescription frame business, and therefore highly dependent upon healthy economic conditions and strong consumer confidence. While this trend of premiumization in eyewear does not make the company more immune to the cyclicality of the segment, we do believe that a slowdown in spend will simply mean fewer sunglass purchases per year (i.e. increased replacement cycles) rather than "down-trading" to more inexpensive, unbranded eyewear.

With a leading portfolio in luxury eyewear, we believe that Luxottica will reap benefits of this increased trend towards premiumization in eyewear, in spite of cyclical fluctuations that we currently factor into our forecast horizon.

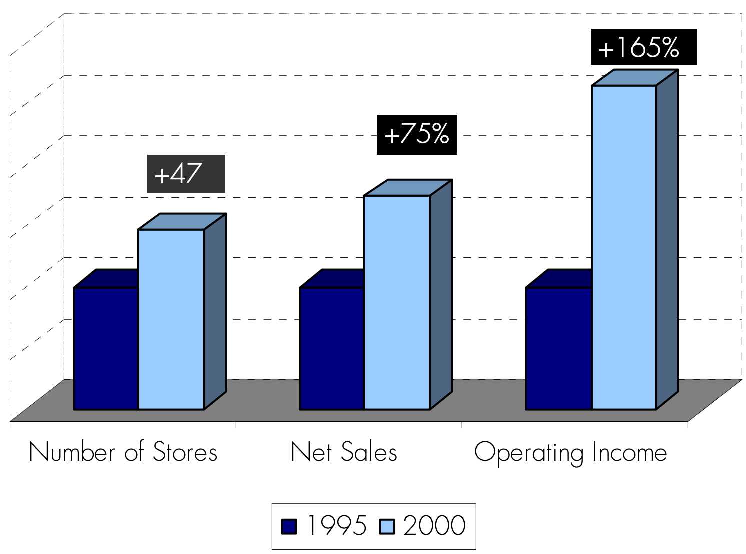
#3: Proven Track Record in Operational Execution

The 2006 fiscal year has been deemed by the company as the "year of execution." This is the period in which the company will begin to realize in full the synergies that will arise from the integration of the ex-Cole National businesses with the rest of the Luxottica businesses. Management has set forth some fairly aggressive targets for the business, which include 8-10% organic sales growth at constant exchange rates and 18-20% EPS growth (following a year in which EPS grew 18.5% despite the ex-Cole National businesses having a dilutive effect on retail margins). While such goals are achievable due to the sheer scope of tangible synergies that can be extracted by combining the two businesses, we believe that the company can exceed them due to the strength of the current management team.

It is important to remember the track record of the group in realizing merger synergies. When Luxottica acquired LensCrafters in 1995, the LensCrafters' business had operating margins of 9%. In just five years time, the company was able to get operating margins up to 14%. Over that same time period (1995-2000), Luxottica increased the number of stores by 47%, net sales increased by 75%, and operating income grew by 165%. Furthermore, operating margins have improved even more since 2000; we currently estimate LensCrafters' 2005 operating margin to be just under 17%. Such high margins are best in-class among specialty retailers.

Strong track record with LensCrafters gives credibility to management's stated targets of achievable synergies that will arise from integration of Cole National businesses, in our view

Figure 11: LensCrafters' improvement five years after acquisition by Luxottica



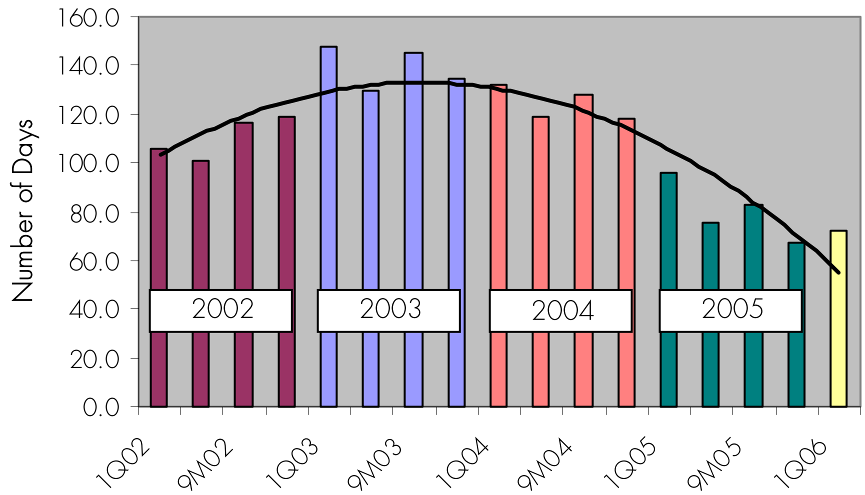
Source: Company data

In the time that Luxottica has owned LensCrafters, it has substantially increased the business, without letting costs get out of control and therefore without sacrificing margins. We believe that such operational execution can be replicated as the company integrates the Pearle Vision business into the current Luxottica framework.

A detailed analysis of the company's working capital performance shows that it has effectively halved its cash conversion cycle in the two years from end-2003 to end-2005

Furthermore, the current management team has already shown its strength in driving efficiency and instilling a 'lean' mentality throughout the business. This is evidenced in the strong improvement in working capital that the company has been able to achieve in recent years. A detailed analysis of the company's working capital performance shows that it has effectively halved its cash conversion cycle in the two years from end-2003 to end-2005. Luxottica's cash conversion cycle has improved from 134.5 days at the end of 2003 to 67.4 days at the end of 2005. Such a remarkable performance is due, in part, to the company collecting its outstanding receivables more quickly. However, much of the improvement stems from Luxottica's ability to decrease planning cycles, allowing the company to reduce inventories significantly and thereby turn its stock more frequently.

Figure 12: Luxottica's Improvement in Cash Conversion Cycle



Source: Company data, Lehman Brothers estimates

#4: However, consensus is well aware of the company's strengths…

The 2006 guidance set forth by the company is based on constant exchange rates. Our estimates conservatively assume that the average exchange rate for 2006 is 1.27 US$/EUR (this assumes that the average 2H rate is 1.30). Even based on this less favorable exchange rate, we still comfortably arrive well within management's stated guidance of at net sales of EUR 4.77B, EPS of EUR 0.93 (EPS diluted EUR 0.92). We therefore believe that management will comfortably exceed current guidance for this year. Furthermore, given the strong cash generation that we expect in FY 2006, management will easily reach their 1.4x-1.3x net debt/EBITDA target.

Figure 13: Luxottica's 2006 Guidance

- ✓ Consolidated Net Sales: €4.7B – €4.8B, representing 8%-10% organic sales growth
- ✓ EPS: €0.89 – €0.91, representing 18%-20% earnings growth
- ✓ Net Debt/EBITDA of between 1.4x-1.3x

Source: Company data, Lehman Brothers research

However, this should not come as a surprise to investors closely following the stock. Consensus estimates are currently above management guidance at the EPS level. We believe that this is because most investors and sell-side analysts are content with the company's strong competitive positioning within the industry and management's ability to deliver (and exceed) on stated targets. Furthermore, the CEO has recently announced that it is considering a potential upgrade to its current outlook for fiscal year 2006, based on strong 1Q results and the first 2 months of the 2Q being positive.

> "At Luxottica Group's Annual General Meeting held today in Milan, chief executive officer Andrea Guerra, commenting on results for fiscal year 2005 and the first months of the current year, indicated that Group results for the first quarter as well as for April and May were positive. Consequently, the Group will consider updating its outlook for fiscal year 2006 when it releases consolidated results for the second quarter of 2006 at the end of July."
>
> *–Luxottica Press Release dated 14 June 2006*

On the day that this press release was issued by the company, the shares rose 6% (compared with +0.1% for the MSCI Pan Euro index). We believe that this 6% move is more than what management will up guidance to at the half-year stage (27 July 2006). That said, we recognize that some of this share price appreciation reflects the market's realization that recent share price concerns were overdone.

#5: Valuation: While absolute upside is compelling, risk/reward profile is less attractive relative to our 1-Overweight rated stocks

In deriving our price target, we utilize a discounted cash flow (DCF) methodology. Our key assumptions include: 1) 6% long-term sales growth, 2) a terminal growth rate of 2.5%, and 3) a WACC of 7.7%. This valuation methodology yields a fair value of EUR 25.3 per share. We have applied a 5% liquidity discount, to account for the small free float (26.5%), resulting in a price target of EUR 24.0 per share.

Figure 14: Lehman Brothers Discounted Cash Flow Analysis

LUXOTTICA DCF		Forward Estimates				Long Term Forward Estimates						
In millions of EUR		2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Terminal
Net Sales		4765	5222	5628	6004	6364	6746	7151	7580	8035	8517	
% Growth		9.0%	9.6%	7.8%	6.7%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	
EBITDA		950	1,116	1,215	1,298	1373	1453	1537	1626	1720	1819	
% Growth		19.4%	17.4%	8.9%	6.8%	5.8%	5.8%	5.8%	5.8%	5.8%	5.8%	
EBIT		735	876	956	1016	1077	1141	1210	1283	1360	1441	
% Growth		24.4%	19.1%	9.2%	6.2%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	
Tax Rate		37.0%	37.0%	37.0%	37.0%	37.0%	37.0%	37.0%	37.0%	37.0%	37.0%	
NOPAT		463	552	602	640	678	719	762	808	856	908	
Depn & Amort	5%	215	240	259	282	296	311	327	343	360	378	
Change in WC	2%	60	(32)	(20)	(18)	(18)	(19)	(19)	(20)	(20)	(20)	
Operating Cash Flows		738	760	842	904	956	1011	1070	1131	1197	1266	
Capex		(238)	(261)	(253)	(270)	(286)	(304)	(322)	(341)	(362)	(383)	
Unlevered FCF		**500**	**499**	**588**	**634**	**670**	**708**	**748**	**790**	**835**	**882**	**17396**
Discount Rate		7.70%	7.70%	7.70%	7.70%	7.70%	7.70%	7.70%	7.70%	7.70%	7.70%	7.70%
Projection Year		1	2	3	4	5	6	7	8	9	10	10
Discount Factor		93%	86%	80%	74%	69%	64%	59%	55%	51%	48%	48%
PV of unlevered FCF		**464**	**430**	**471**	**471**	**462**	**454**	**445**	**437**	**428**	**420**	**8285**
y-o-y % change in FCF			-7%	10%	0%	-2%	-2%	-2%	-2%	-2%	-2%	

Assumptions	
Long term sales growth	6.0%
Operating leverage (if any)	0.0%
Terminal growth rate	2.5%
Terminal (EBTIDA) multiple	11.0x

Terminal Value	
Sum of PV of FCF	4,482
PV of Terminal Value	8,285
TV as a % of Total Value	65%

Implied Fair Value Calculation	
Enterprise Value	12,767
Net Debt/ (Cash)	1,242
Equity Value	11,526
Number of shares	455
Fair Value per share	25.3
Liquidity discount (5%)	1.3
LB PRICE TARGET	**24.0**

Source: Lehman Brothers estimates

Our current share price target offers 16.5% upside potential from current levels. While this may appear attractive on an absolute basis, relative to the other stocks in our luxury universe, this represents close to 7 percentage points less upside potential than the 1-Overweight rated stocks in our sector (which offer an average of 23.1% upside potential). Furthermore, should the market's current fears of a US recession be realized, we believe that of all of the stocks in our universe, Luxottica is the most geared towards such concerns. Barring any major macroeconomic changes (e.g. currency, US consumer spending slowdown, terrorist-related shocks) which would prompt changes to our current estimates, we would revisit our rating on this stock were the shares to trade down to 19 EUR per share (7.8% lower than current levels) .

Appendix 1: Financial Statements

Figure 15: Luxottica Group Profit and Loss Account

Luxottica Group Dec Yr End *all financial statements in accordance with US GAAP* EUR million except per share data			Lehman Brothers Estimates				
	2005	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Income Statement							
Net Sales	**4,371**	**4,765**	**5,222**	**5,628**	**6,004**	**6,377**	**6,783**
Cost of Sales	(1,381)	(1,495)	(1,619)	(1,759)	(1,884)	(1,993)	(2,128)
Gross Profit	2,990	3,270	3,603	3,870	4,120	4,384	4,655
Selling and Advertising	(1,910)	(2,056)	(2,220)	(2,439)	(2,612)	(2,750)	(2,948)
General and Administrative	(478)	(479)	(508)	(474)	(492)	(572)	(603)
Total Operating Expenses	(2,388)	(2,535)	(2,728)	(2,913)	(3,104)	(3,323)	(3,551)
Income from Operations	**603**	**735**	**876**	**957**	**1,016**	**1,061**	**1,104**
Other Income (Expenses) - net	(45)	(53)	(61)	(48)	(39)	(32)	(14)
Income before provisions for income taxes	558	682	814	908	976	1,029	1,090
Provisions for Income Taxes	(206)	(252)	(301)	(332)	(356)	(370)	(392)
Income before minority interests	352	430	513	577	620	659	697
Minority Interests	(9)	(11)	(9)	(10)	(11)	(11)	(12)
Net Income	**342**	**418**	**504**	**567**	**609**	**647**	**685**
EPS Basic	0.76	0.93	1.12	1.25	1.35	1.43	1.52
EPS Diluted	0.76	0.92	1.11	1.24	1.34	1.42	1.50
Weighted Average Number of Shares (thousands)							
Basic	450	452	452	452	452	452	452
Diluted	453	455	455	455	455	455	455
Dividend	0.29	0.35	0.43	0.49	0.54	0.57	0.60
Payout Ratio	*38.4%*	*38.5%*	*39.0%*	*39.5%*	*40.0%*	*40.0%*	*40.0%*
Effective tax rate	*37.0%*	*37.0%*	*37.0%*	*36.5%*	*36.5%*	*36.0%*	*36.0%*

Source: Company data, Lehman Brothers estimates

Figure 16: Luxottica Group Balance Sheet

Luxottica Group
Dec Yr End
all financial statements in accordance with US GAAP
EUR million except per share data

		Lehman Brothers Estimates					
	2005	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Balance Sheet							
Dec Year end (EUR thousands)							
ASSETS							
Cash and Cash equivalents	372	372	372	372	372	372	772
Receivables	508	546	562	606	646	686	730
Inventories	404	415	441	479	513	543	579
Prepaid Expenses and Other	93	100	104	113	120	128	136
Assets held for sale	11	-	-	-	-	-	-
Deferred tax assets	94	100	104	113	120	128	136
Total Current Assets	1,482	1,534	1,584	1,682	1,771	1,856	2,353
Property Plant and Equipment	735	816	900	962	1,022	1,085	1,153
Intangible Assets - net	2,695	2,637	2,575	2,507	2,435	2,359	2,277
Investments	16	16	16	16	16	16	16
Other Assets	46	34	40	37	39	38	38
Total Other Assets	2,757	2,688	2,631	2,560	2,490	2,412	2,331
Total Assets	**4,974**	**5,037**	**5,114**	**5,204**	**5,283**	**5,354**	**5,837**
LIABILITIES & SHAREHOLDERS EQUITY							
Short Term Debt	387	124	-	-	-	-	-
Accounts payable	292	316	351	381	408	432	461
Accrued expenses and other	393	429	470	507	540	574	610
Accrual for Customers' right of return	8	13	16	17	18	19	20
Income taxes payable	133	191	131	141	150	159	170
Total Current Liabilities	**1,214**	**1,073**	**967**	**1,045**	**1,117**	**1,184**	**1,261**
Long Term Debt	1,420	1,296	1,136	784	409	15	-
Other Long Term Liabilities	372	375	392	422	450	478	509
Total Long Term Liabilities	**1,792**	**1,671**	**1,528**	**1,206**	**859**	**493**	**509**
Minority Interests in Consolidated Subsidiaries	**13**	**15**	**13**	**13**	**13**	**13**	**15**
Shareholder's equity	**1,954**	**2,278**	**2,607**	**2,940**	**3,294**	**3,663**	**4,052**
Total Liabilities & Shareholders' Equity	**4,974**	**5,037**	**5,114**	**5,204**	**5,283**	**5,354**	**5,837**

Source: Company data, Lehman Brothers estimates

Figure 17: Luxottica Group Cash Flow Statement

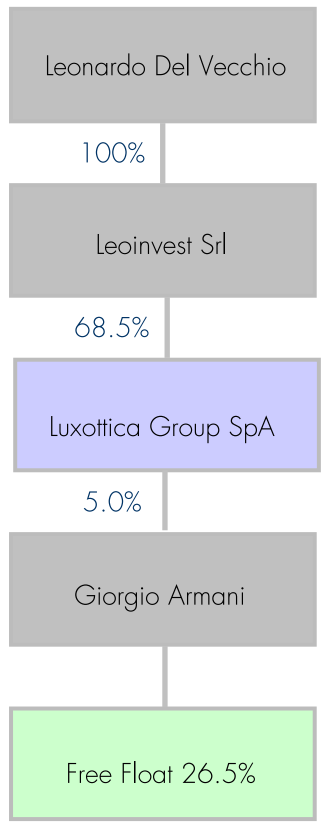
Luxottica Group
Dec Yr End
all financial statements in accordance with US GAAP
EUR million except per share data

		Lehman Brothers Estimates					
	2005	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Cash Flow							
Dec Year end (EUR thousands)							
Net Income	**342**	**418**	**504**	**567**	**609**	**647**	**685**
Minority Interests	9	(11)	(9)	(10)	(11)	(11)	(12)
Depreciation and Amortisation	194	215	240	259	282	300	319
Other Accrual Adjustments	(57)	(1)	1	4	4	4	4
Changes in NWC	**135**	**60**	**(32)**	**(20)**	**(18)**	**(17)**	**(20)**
Cash Provided by Operating Activities	**623**	**682**	**705**	**801**	**867**	**923**	**977**
Capex	(228)	(238)	(261)	(253)	(270)	(287)	(305)
Acquisitions	(87)	(60)	-	-	-	-	-
Net Investments	144	10	-	-	-	-	-
Additions (Disposals) of Intangible Assets	(4)	-	-	-	-	-	-
Cash Used in Investing Activities	**(176)**	**(288)**	**(261)**	**(253)**	**(270)**	**(287)**	**(305)**
Debt Proceeds	373	-	-	-	-	-	-
Dept Repayments	(628)	-	-	-	-	-	-
Dividends	(103)	(131)	(160)	(195)	(222)	(242)	(257)
Other	(0)	-	-	-	-	-	-
Cash (used in) provided by financing activities	**(358)**	**(131)**	**(160)**	**(195)**	**(222)**	**(242)**	**(257)**
Effect of translation adjustments in cash	-	-	-	-	-	-	-
(Decrease) increase in cash and cash equivalents	**89**	**263**	**284**	**352**	**375**	**394**	**415**
Cash and equivalents, beginning of year	257	372	635	920	1,272	1,647	2,041
Effect of exchange rates	26	-	-	-	-	-	-
Cash and cash equivalents, end of year	**372**	**635**	**920**	**1,272**	**1,647**	**2,041**	**2,455**

Source: Company data, Lehman Brothers estimates

Appendix 2: Luxottica Group Shareholding Structure

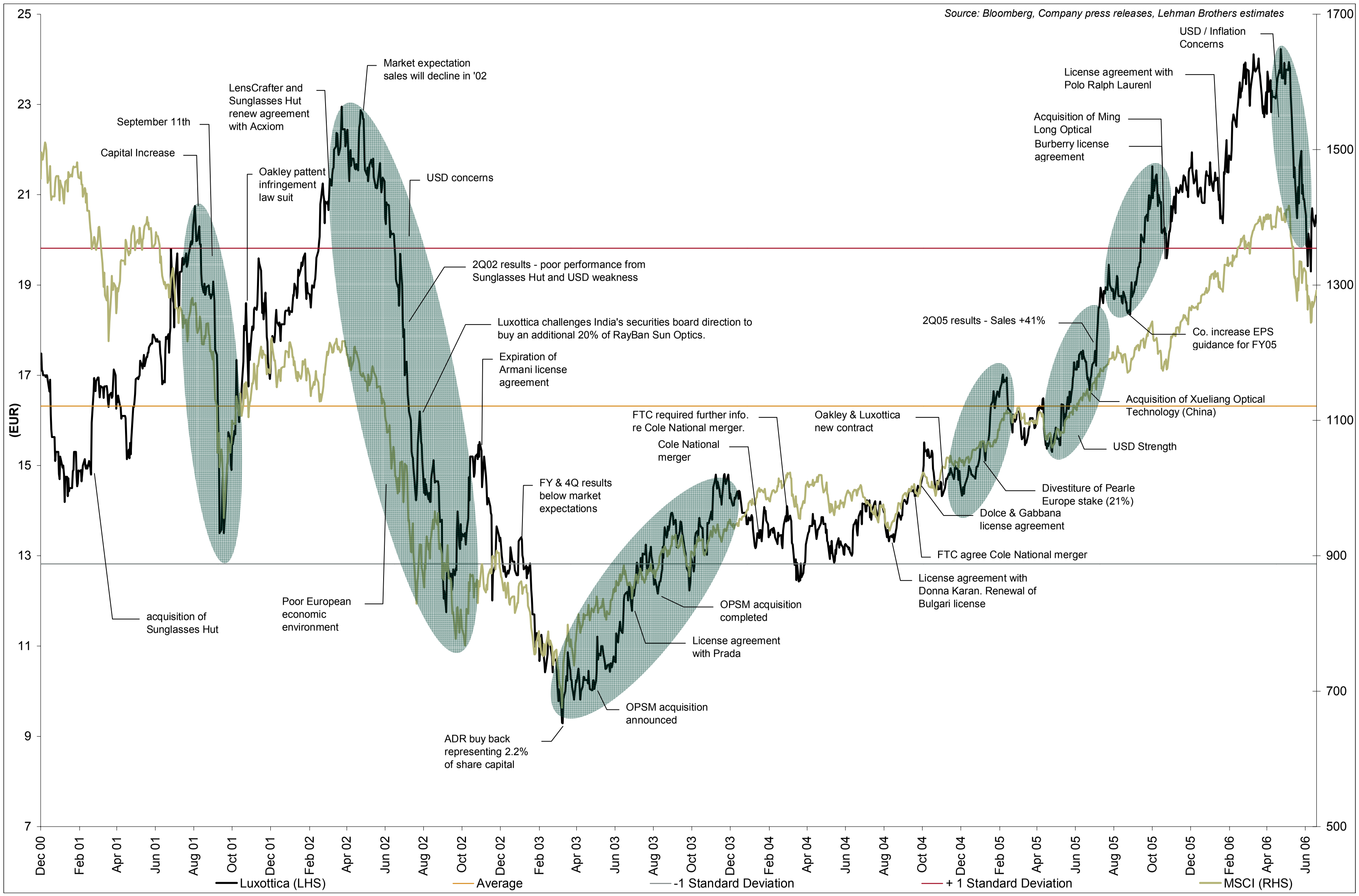
Figure 18: Luxottica Group Shareholding Structure



Source: Company data, Lehman Brothers estimates

Appendix 3: Luxottica Time Line

Figure 19: Luxottica Share Price Performance Relative to MSCI Pan-European Index



Source: DataStream, Company Data, Lehman Brothers estimates

Appendix 4: European Luxury Goods Valuation

Figure 20: European Luxury Goods Valuations Table

	Curncy	Share Price	EV/Sales 2006	EV/Sales 2007	EV/EBITDA 2006	EV/EBITDA 2007	P/E 2006	P/E 2007	Dividend Yield 2006	Dividend Yield 2007
LVMH *	EUR	74.10	2.57x	2.33x	10.78x	9.36x	19.12x	16.34x	1.83%	2.14%
Richemont *	SFR	52.85	3.64x	3.24x	11.39x	10.10x	15.56x	14.25x	2.47%	2.63%
Richemont (Luxury)*	SFR	33.26	2.00x	1.74x	9.54x	8.05x	16.84x	14.83x	n/a	n/a
Swatch *	SFR	199.00	2.12x	1.92x	9.55x	8.23x	17.75x	15.59x	1.62%	1.74%
PPR **	EUR	97.45	0.84x	0.78x	13.00x	11.33x	18.48x	15.71x	3.01%	3.25%
Bulgari ^	EUR	8.55	2.60x	2.39x	13.09x	11.65x	19.16x	16.72x	3.24%	3.72%
Burberry ^	GBp	425.00	1.31x	1.57x	5.27x	6.30x	18.87x	16.31x	1.73%	2.03%
Hermès ^	EUR	66.60	4.25x	3.88x	13.82x	12.44x	26.26x	23.78x	1.37%	1.55%
Tod's ^	EUR	56.74	2.82x	2.50x	11.74x	9.96x	25.35x	21.43x	2.11%	2.57%
European Average			**2.3x**	**2.1x**	**10.3x**	**9.2x**	**19.3x**	**16.9x**	**2.11%**	**2.42%**
Bausch & Lomb ^	USD	48.54	0.86x	0.83x	8.30x	7.75x	16.38x	14.17x	1.03%	1.13%
Essilor ^	EUR	77.20	2.99x	2.78x	13.40x	12.42x	24.10x	21.78x	1.42%	1.57%
Luxottica ^	EUR	20.60	2.21x	1.96x	11.08x	9.18x	22.42x	18.61x	1.72%	2.10%
Oakley ***	USD	16.02	1.48x	1.42x	11.91x	8.30x	17.88x	18.20x	0.94%	0.94%
Safilo ^	EUR	3.36	1.28x	1.16x	7.42x	6.36x	17.23x	12.92x	0.83%	0.92%
Eyewear Average			**1.8x**	**1.6x**	**10.4x**	**8.8x**	**19.6x**	**17.1x**	**1.19%**	**1.33%**
Coach ***	USD	28.50	4.84x	4.07x	13.50x	11.20x	20.61x	17.19x	0.00%	0.00%
Polo Ralph Lauren ^	USD	54.55	1.44x	1.27x	8.59x	7.58x	18.86x	16.99x	0.37%	0.37%
Tiffany ***	USD	32.74	1.78x	1.64x	10.89x	9.88x	18.19x	16.17x	0.00%	0.00%
US Average			**2.7x**	**2.3x**	**11.0x**	**9.6x**	**19.2x**	**16.8x**	**0.12%**	**0.12%**
Total Average			**2.2x**	**2.0x**	**10.4x**	**9.1x**	**19.4x**	**16.9x**	**1.49%**	**1.69%**
Market Cap weighted Average			**2.6x**	**2.4x**	**11.3x**	**9.9x**	**19.4x**	**16.9x**	**1.65%**	**1.85%**

* *Lehman Brothers Luxury estimates*
** *Lehman Retail estimates*
*** *Lehman US estimates*
^ *Consensus estimates - Reuters*

Source: Reuters, Lehman Brothers estimates

Important Disclosures

Rating and Price Target Chart: Luxottica

Not Available

Analyst Certification:
We, Janice Davies and Richard Stroud, hereby certify (1) that the views expressed in this research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this report and (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views contained in this report.

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