Aeffe

MEDIOBANCA SECURITIES

03 August 2010 | **Branded Goods** | **Change in recommendation**

Price: € 0.342 Target price: € 0.42

Neutral (from Underperform)

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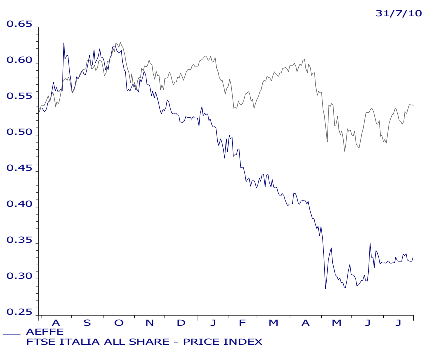
	2008	2009	2010E	2011E	2012E
EPS Adj. (€)	0.07	-0.19	-0.16	-0.12	-0.05
DPS (€)	0.01	0.00	0.00	0.00	0.00
BVPS (€)	1.54	1.33	1.17	1.05	0.99
EV/Ebitda(x)	6.6	nm	nm	nm	17.0
P/E adj (x)	20.7	nm	nm	nm	nm
Div.Yield(%)	0.5	0.0	0.0	0.0	0.0
OpFCF Yield(%)	<0	<0	<0	<0	<0

Source: Mediobanca Securities



Source: DATASTREAM

Market Data	
Market Cap (€ m)	35
Shares Out. (m)	107
Main Shareholder (%)	Ferretti Fam (61.8%)
Free Float (%)	38.2%
52 week range (€)	0.62-0.29
Rel Perf vs FTSE Italia All Share (%)	
-1m	-7.4%
-3m	-4.8%
-12m	-38.9%
21dd Avg. Vol. ('000)	95
Reuters/Bloomberg	AEF.MI / AEF IM

Material signs of recovery

A reassuring performance in Q2

Q2-10 results showed material signs of recovery both at the top line and at operating level, where the group reported a smaller loss than expected. Q2 revenues were + 7.2%, resulting from an acceleration in retail (+12.5%) and a remarkable recovery in wholesale (+7.5%). The loss of €2.3m at EBITDA level was much better than our forecast of a €7m loss, since the group is delivering its cost cutting program, with €7m of costs savings achieved in H1. This, together with positive financial income of €1.6m in Q2, mostly thanks to currency gains, puts the bottom line at €-4.6m in Q2 vs. €-12m in our estimates.

Closer to EBITDA break-even by YE-10

The start of Q3 was pretty good, with the retail business performing as well as in H1. The final F/W10 order backlog is +2% Y/Y and following €7m savings achieved in H1 put the company full on track with its targets of €10-15m savings by YE10. We now project 2010 sales -2% to €212m and a loss of €3m at EBITDA level (vs. previous -€5m). We have every confidence that in 2011 AEFFE will report a small profit at EBITDA level, thanks to the operating leverage and the full benefits of cost-cutting actions feeding through. The S/S2011 selling campaign is just beginning, and better visibility on this is unlikely until November. We consider AEFFE's high leverage to be the real reason for concern: we welcome the group's decision to rationalize its DOS network, cashing in some gains from the disposal of some stores but the related amount (a few million Euros) is still insignificant compared with a total debt now at around €100m.

Rating upgraded to NEUTRAL: TGT price at €0.42 p.s.

Based on our updated valuation (2010 EV/sales multiple at 1.35x where we apply a 40% discount, in line with the historical average, to better capture the smaller size of the company, together with its low profitability and above-average financial risk) we obtain a TGT price of €0.42 p.s.. Material signs of recovery at the top line give us greater confidence for the remainder of the year, and we consider the group's prospects for 2011 to be significantly better. We see limited downside to our estimates, which point to a valuation close to market prices. For this reason, we are upgrading our recommendation from UNDERPERFORM to NEUTRAL, with a target price of €0.42 per share.

A reassuring Q2

AEFFE's Q2-10 results were weak overall but showed material signs of recovery both at the top line and at operating level, where the group reported a smaller loss than expected.

Specifically, the 7.4% drop in group revenues in H1 means there was a 7.2% increase in Q2, resulting from an acceleration during the quarter in retail (+12.5% following +9% in Q1) and a remarkable recovery in wholesale (+7.5% vs. -22% in 1Q). Although all regions contributed to these results, the strongest positive performances were reported by the domestic market (+8.3% in Q2) and Russia (+14.7% and contributing around 7% of group revenues in the quarter), whereas by brand Moschino and JP Gaultier drove the growth (+9.6% and +10% respectively), the latter helped mainly by an easy comparison base (-37% in Q209). We would also highlight the slightly positive performance recorded by both Alberta Ferretti and Pollini (+1.2% and +1.9% respectively), given that these brands have not achieved growth since Q408 and Q407 respectively.

On group profitability, following the negative top-line performance and the fact that in H1 the group opened seven outlets, negatively affecting the gross margin, the loss of €2.3m at EBITDA level was much better than our forecast of a €7m loss. The main reason is that the group is delivering its cost cutting program, with €7m of costs savings achieved in the half, fully on track with its full-year target of €10-15m in savings overall.

This, together with positive financial income of €1.67m in Q2, mostly thanks to currency gains, puts the bottom line at €-4.6m in Q2 vs. €-12m in our estimates.

As regards the group's financial leverage, net debt at end-June was pretty stable vs. Q1-10 at €95.6m, and was €8m above YE09. The only issue worth noting is some deterioration in working capital management. NWC was 26% of LTM sales vs. 24.2% in H109, mostly due to receivables and inventories.

AEFFE: Q2/H1 2010 revenues breakdowns

BY BRAND	2Q 10A	2Q 09	Y/Y ch.	1H 10A	1H 09	Y/Y ch.
FERRETTI	8.4	8.3	1.2%	21.4	22.9	-6.6%
MOSCHINO	25.2	23.0	9.6%	59.6	58.7	1.5%
JP GAULTIER	1.1	1.0	10.0%	5.5	7.7	-28.6%
POLLINI	5.4	5.3	1.9%	12.9	16.8	-23.2%
OTHERS	1.5	1.2	25.0%	3.5	5.0	-30.0%
BY MARKET						
ITALY	17.9	16.5	8.3%	44.1	46.4	-5.0%
RUSSIA	3.0	2.6	14.7%	6.1	7.3	-16.8%
REST OF EUROPE	7.5	7.7	-2.7%	22.3	23.8	-6.3%
JAPAN	8.4	3.1	174.9%	8.3	8.2	1.6%
US	3.2	3.6	-12.2%	9.4	9.1	3.2%
REST OF THE WORLD	4.9	5.3	-7.2%	12.8	16.4	-22.1%
BY CHANNEL						
WHOLESALE	21.6	20.1	7.5%	63.2	73.2	-13.7%
RETAIL	16.2	14.4	12.5%	31.9	28.8	10.8%
ROYALTIES	3.8	4.3		7.8	9.1	
GROUP REVENUES	**41.6**	**38.8**	**7.2%**	**102.9**	**111.1**	**-7.4%**

Source: Mediobanca Securities

AEFFE: Q2/h1 2010 results

	2Q 10E	2Q 09	2Q 10A	Y/Y ch.	A/E	1H 10E	1H 09	1H 10A	Y/Y ch.	A/E
Sales	40.7	38.8	41.6	7.2%	2.2%	102.0	111.1	102.9	-7.4%	0.9%
Ebitda	-8.0	-11.0	-3.8	nm	nm	-6.5	-7.2	-2.3	nm	nm
% margin	neg	neg	neg			neg	neg	neg		
Ebit	-11.9	-13.7	-7.0	nm	nm	-13.8	-12.4	-8.9	nm	nm
% margin	neg	neg	neg			neg	neg	neg		
Pre-tax profit	-13.0	-14.5	-6.3	nm	nm	-15.1	-14.2	-8.5	nm	nm
Net profit	-12.1	-9.7	-4.6	nm	nm	-13.8	-10.0	-6.3	nm	nm
Net profit restated	-12.1	-9.7	-4.6	nm	nm	-13.8	-10.0	-6.3	nm	nm

Source: Mediobanca Securities

Change in estimates

As regards current trading, the management affirmed that the start of Q3 was pretty good, with the retail business performing as well as in the first part of the year. It also affirmed that the final F/W10 order backlog is 2% up on previous collections.

In terms of costs, in the conference call management once again confirmed its strong commitment to cost control, and the €7m savings achieved in H1 make us fully comfortable with the company targets of €10-15m for FY10.

We have updated our 2010 estimates to take account of the final figure for F/W2010 backlog orders (+2% vs. +4% in our estimates) and some rebound in retail (projected now up in the mid single digits). This results in total sales down 2% in 2010 to €212m vs. -4% to €208m previously, and a loss of €3m at EBITDA level, or almost half the amount previously expected (-€5m), and around €17m of net loss at the bottom line (vs. -€19m previous). This implies that we now expect €1m loss at operating level in H2 vs. previous estimates of €1.4m profit as we have incorporate the dilution on gross margin for H2-10 coming from less profitable sales from the outlets opened in H1.

We now have every confidence that in 2011 the group will report a small profit at EBITDA level. This will be helped by the operating leverage resulting from a recovery at the top line and the full benefits of cost-cutting actions feeding through. As regards the former, it should be borne in mind that the S/S2011 selling campaign (which should provide a good proxy for wholesale performance in H1-11) is just beginning, and better visibility on this is unlikely until November (this figure is usually disclosed during the Q3 earnings season). However a good sell-out of the S/S collections should enable wholesale clients to be more optimistic and therefore more generous in placing orders for the forthcoming selling campaign

We still consider the group's high leverage to be the real reason for concern given that, according to our current projections, the company is unlikely to get back to generating positive FCF from operating activities until 2012. In addition, we see limited scope for other corporate actions to bring cash into the group. On this subject, we welcome the group's decision to rationalize its direct retail network, concentrating its retail presence in the major fashion street in Milan, Via Montenapoleone, from two stores to one selling space only (which will display both "Alberta Ferretti" and "Philosophy by Alberta Ferretti" collections, currently sold in two different stores). This might ensure some gains from the related key moneys. However, the net impact of this action is likely to be just a few million euros, an insignificant amount compared with a total debt now in the region of €100m.

AEFFE: Change in estimates (2010-119

	2009A	2010E			2011E		
		OLD	NEW	DIFF%	OLD	NEW	DIFF%
REVENUES	217.0	208.5	212.1	1.7%	218.9	222.7	1.7%
Chge%		-3.9%	-2.3%		5.0%	6.8%	
EBITDA	-13.0	-5.0	-3.3	nm	-0.3	1.4	nm
Margin (%)	-6.0%	-2.4%	-1.6%		-0.2%	0.6%	
EBIT	-27.1	-19.7	-18.0	nm	-15.5	-13.8	nm
EBIT margin (%)	-12.5%	-9.5%	-8.5%		-7.1%	-6.2%	
NET PROFIT	-20.1	-19.2	-17.5	nm	-14.8	-13.3	nm
Chge%	nm	nm	nm		nm	nm	
EPS	-0.19	-0.18	-0.16	nm	-0.14	-0.12	nm
Chge%	nm	nm	nm		nm	nm	

Source: Mediobanca Securities

Valuation update

We have updated our valuation, which is based on a sector comparison of EV/sales multiples for 2010 (1.35x). We still consider it fair to apply a 40% discount to this figure, in line with the historical average, which better captures the smaller size of the company, together with its low profitability and above-average financial risk. We now expect a higher net debt figure (€100m vs. previous €90m).

In our previous valuations, our target price was set applying an additional 20% discount to the equity fair value, reflecting the poor visibility on the group's sales performance for the current year and the execution risk of the ongoing cost-cutting actions. We believe that these factors no longer apply, but the high leverage is still a pending risk for the group, particularly as there is no prospect of a positive EBITDA until at least 2012.

Material signs of recovery in both retail and wholesale in H1 give us greater confidence for the remainder of the year, and we consider the group's prospects for 2011 to be significantly better.

We see limited downside to our estimates, which point to a valuation close to market prices. For this reason, we are upgrading our recommendation from UNDERPERFORM to NEUTRAL, with a target price of €0.42 per share.

AEFFE: TGT Price calculation

2010 EV/SALES sector multiples	1.35x
Discount	40%
Fair Multiple	0.8x
SALES	**212.1**
ENTERPRISE VALUE	171.8
DEBT YE-10	-101.2
MINORITIES	-25.3
MARKET CAP (€m)	45.4
FAIR VALUE (€ per share)	**0.42**

Source: Mediobanca Securities

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Price: € 0.342 **Target price: € 0.42** **Neutral (from Underperform)**

Profit & Loss account (€ m)	2008	2009	2010E	2011E	2012E
Turnover	295	217	212	223	234
Turnover growth %	0.5	-26.3	-2.3	5.0	5.0
EBITDA	34	-13	-3	1	9
EBITDA margin (%)	11.6	nm	nm	0.6	3.7
EBITDA growth (%)	-22.9	-137.8	-74.4	-142.1	nm
Depreciation & Amortization	-12	-14	-15	-15	-16
EBIT	22	-27	-18	-14	-7
EBIT margin (%)	7.4	nm	nm	nm	nm
EBIT growth (%)	-35.2	-224.1	-33.7	-23.4	-49.4
Net Fin.Income (charges)	-7	-4	-4	-4	-4
Non-Operating Items	0	0	0	0	0
Extraordinary Items	0	0	0	0	0
Pre-tax Profit	15	-31	-22	-18	-11
Tax	-6	7	2	2	5
Tax rate (%)	42.4	22.9	9.3	11.2	41.0
Minorities	-1	4	2	3	1
Net Profit	8	-20	-18	-13	-6
Net Profit growth (%)	-49.9	n.m	-12.8	-24.0	-57.4
Adjusted Net Profit	8	-20	-18	-13	-6
Adj. Net Profit growth (%)	-49.9	n.m	n.m	n.m	n.m

Balance Sheet (€ m)	2008	2009	2010E	2011E	2012E
Working Capital	73	68	71	76	81
Net Fixed Assets	250	236	227	217	206
Total Capital Employed	324	304	298	293	287
Shareholders' Funds	165	143	126	112	107
Minorities	31	27	25	23	22
Provisions	61	46	46	46	46
Net Debt (-) Cash (+)	-67	-88	-101	-111	-112

Cash Flow Model (€ m)	2008	2009	2010E	2011E	2012E
Cash Earnings	21	-10	-5	-1	9
Working Capital Needs	-22	6	-3	-4	-5
Capex (-)	-17	-4	-5	-5	-5
Financial Investments (-)	-5	0	0	0	0
Dividends (-)	-2	-1	0	0	0
Other Sources / Uses	-3	-12	0	0	0
Ch. in Net Debt (-) Cash (+)	-28	-21	-14	-10	-1

Multiples	2008	2009	2010E	2011E	2012E
P/E Adj.	20.7	nm	nm	nm	nm
P/CEPS	7.5	nm	nm	nm	4.0
P/BV	1.0	0.4	0.3	0.3	0.3
EV/ Sales	0.8	0.7	0.6	0.7	0.6
EV/EBITDA	6.6	nm	nm	nm	17.0
EV/EBIT	10.3	nm	nm	nm	nm
EV/Cap. Employed	0.7	0.5	0.5	0.5	0.5
Yield (%)	0.5	0.0	0.0	0.0	0.0
OpFCF Yield (%)	<0	<0	<0	<0	<0
FCF Yield (%)	<0	<0	<0	<0	<0

Per Share Data (€)	2008	2009	2010E	2011E	2012E
EPS	0.07	-0.19	-0.16	-0.12	-0.05
EPS growth (%)	-54.3	n.m	n.m	n.m	n.m
EPS Adj.	0.07	-0.19	-0.16	-0.12	-0.05
EPS Adj. growth (%)	-54.3	n.m	n.m	n.m	n.m
CEPS	0.20	-0.09	-0.04	-0.01	0.08
BVPS	1.5	1.3	1.2	1.0	1.0
DPS Ord	0.01	0.00	0.00	0.00	0.00

Key Figures & Ratios	2008	2009	2010E	2011E	2012E
Avg. N° of Shares (m)	107	107	107	107	107
EoP N° of Shares (m)	107	107	107	107	107
Avg. Market Cap. (€ m)	159	62	35	35	35
Adjustments (€m)	0	0	0	0	0
Enterprise Value (€ m)	226	150	137	147	148
Labour Costs/Turnover	21%	29%	31%	31%	30%
Depr.&Amort./Turnover	4%	7%	7%	7%	7%
Turnover / Op.Costs	1.1	0.9	0.9	0.9	1.0
Gearing (Debt / Equity)	34%	51%	67%	82%	88%
EBITDA / Fin. Charges	5.2	nm	nm	0.3	2.0
Net Debt / EBITDA	1.9	nm	nm	>10	>10
Cap.Employed/Turnover	110%	140%	141%	131%	123%
Capex / Turnover	6%	2%	3%	2%	2%
Pay out	10%	0%	0%	0%	0%
ROE	5%	nm	nm	nm	nm
ROCE (pre tax)	7%	nm	nm	nm	nm
ROCE (after tax)	4%	nm	nm	nm	nm