S&P Global
Ratings

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Summary:

Twin Set - Simona Barbieri S.p.A.

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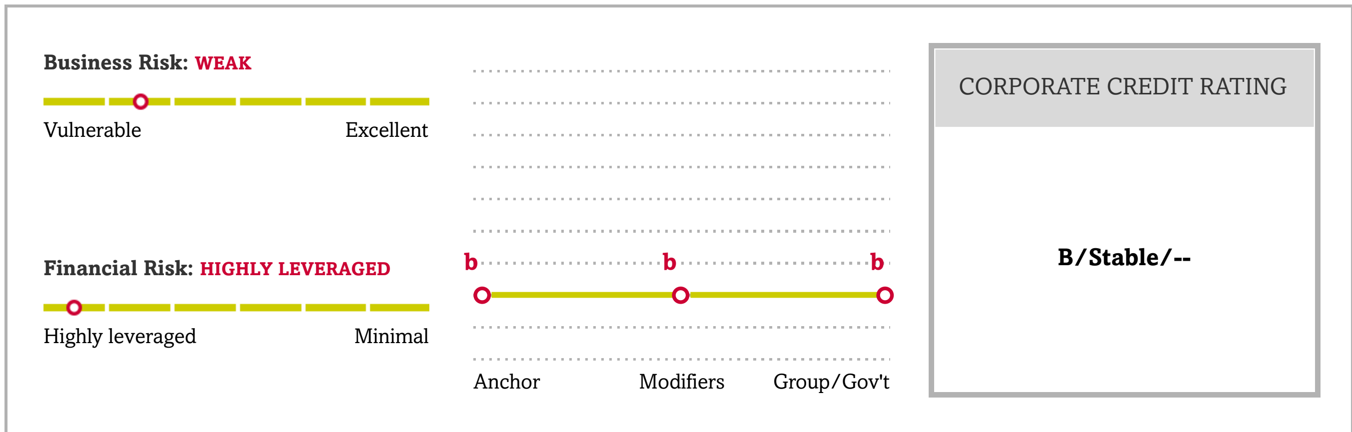

Rationale

Business Risk: Weak	Financial Risk: Highly leveraged
• Dependence on fashion trends and consumer sentiment relating to the medium- and high-income women's consumer segment. • Small scale of business and limited geographic diversification, as shown by our revenue forecast for 2017 of about €250 million, of which about 60% is generated in Italy. • Increasing brand awareness and a solid market position in Italy, but execution risk related to retail expansion and replacement of the designer and founder Simona Barbieri. • A wholesale segment that provides stable margins and robust cash flow generation. • Moderate growth in recent years and over the medium term with improving profitability, thanks to a focus on cost control and a more prudent expansion strategy.	• Improving credit metrics, although constrained by the scale and inherent volatility of the business, which increases the risk of a rapid deterioration of the financial risk profile. • Sizeable amount of cash on the balance sheet, providing a liquidity buffer. • Financial risk assessment capped at highly leveraged, due to financial sponsor ownership characterized by inherently aggressive financial policy. • Positive, albeit modest, free operating cash flow (FOCF), owing to growth in earnings and adjustable expansionary capital expenditure (capex).

Outlook: Stable

The stable outlook on Italy-based fashion retailer Twin Set Simona Barbieri S.p.A. (Twin-Set) reflects S&P Global Ratings' expectation that over the next 12 months, the company will continue to post moderate sales growth while maintaining a stable S&P Global Ratings-adjusted EBITDA margin of about 24%, given management's initiatives to concentrate on restoring operating efficiency rather than aggressive expansion of its chain of stores. Twin-Set's adequate liquidity should, in our opinion, enable it to withstand potential temporary operating setbacks. At the same time, we expect EBITDA interest coverage will remain comfortably above 2x.

We also anticipate FOCF will be slightly positive but below 2016's exceptional level, since we forecast a more moderate effect from working capital improvements and slightly growing capex.

Downside Scenario:

We would take a negative rating action if poor execution or weaker trading, due to market competition, resulted in operating performance deviating significantly from our forecast. This could lead to a decline in profitability to about 20%, on a S&P Global Ratings-adjusted basis, for a prolonged period, and deterioration of liquidity and credit measures, such as EBITDA interest coverage declining below 2x or FOCF falling toward zero.

Upside Scenario:

We consider an upgrade unlikely in the next 12 months, owing to the business' modest scale, which in our view limits the group's ability to cushion any adverse market conditions. We could, however, consider a positive rating action if Twin-Set were able to strengthen profitability in absolute terms and solidify its market position and international footprint. Any upward rating movement would be contingent on an enduring improvement in credit metrics, notably with funds from operations (FFO) to debt comfortably above 12% and meaningful FOCF. Any upgrade would also hinge on a commitment to a more conservative financial policy, such that we viewed the overall likelihood of releveraging beyond the level in our base case to be remote.

Our Base-Case Scenario

Assumptions

- Italian GDP growth of about 1.2% in 2017 and 1% in 2018.
- Slightly negative like-for-like sales over 2017, compensated by new store openings and positive dynamics in the wholesale segment, which should result in growth of about 1.5%-2.0%. For 2018, we expect growth to pick up a bit because we anticipate the stores opened in 2017 should start contributing more as they become more mature, and that there will be a moderate rebound in like-for-like sales.
- A reported EBITDA margin of 17%-18% over the forecast period (2017-2018), which corresponds to an S&P Global Ratings-adjusted margin of 24%-25%. We anticipate a stable margin thanks to higher revenue volume, with effective cost-control efforts by the management however mitigated by challenging market conditions and pricing pressure.
- Approximately €15 million-€20 million of annual capex.
- Reported FOCF of €3 million-€8 million annually.
- We anticipate that Twin-Set will cover the expected payout to Ms. Barbieri from its cash balances and internally generated cash flows.

Key Metrics

	2016a	2017f	2018f
Adjusted EBITDA (mil. €)	59	59-62	62-65
Funds from operations to debt	12%	14%-16%	14%x-16%
EBITDA interest coverage	3.7x	Above 3.5x	Above 3.5x

a--Actual. f--Forecast.

Business Risk: Weak

Our assessment of Twin-Set's business risk profile reflects our view of the retailer's exposure to the apparel industry--which we regard as cyclical and competitive, and with limited barriers to entry--as well as to fashion risk. We believe meaningful industry secular and cyclical headwinds have to some extent offset the company's various operating initiatives and we expect these challenges to continue through 2017 and 2018.

Our assessment further reflects the group's relatively limited size compared with that of rated peers in the same sector and geographic exposure to Italy, where it generated 61% of its revenues in 2016. Additionally, we expect GDP growth in Italy to remain moderate over the next few quarters, limiting like-for-like growth through 2017 and 2018, although we anticipate a small rebound of like-for-like sales in 2018. This will be partly compensated by the group's intention to expand in its home market and internationally.

Also, we see some execution risks related to the evolution of Twin-Set's business model into a more retail-oriented group, and reducing contribution from its wholesale operations. We believe this will result in a larger fixed-cost base that could weigh on margins if sales growth declined. Additionally, the departure of founder and designer Simona Barbieri, and her replacement with new designers, could in our view change the group's traditional brand image and

put the company at risk of losing loyal long-standing customers. On the other hand, we understand that the aim is to broaden the group's customer base by reaching a more international audience.

Mitigating these risks, in our view, is the group's good track record of gradually decreasing its reliance on the domestic market and its clear positioning in affordable luxury. Additionally, we believe that the shift toward a more retail-oriented business model will allow the group to have more control over its brand image and pricing policy, which in turn is likely to boost gross margins and profitability.

Furthermore, even though the retail expansion will increase the share of fixed costs in the medium term, we consider that the group can secure its EBITDA margin, thanks to a still material contribution of wholesale and franchise business, and an increasing contribution from shoes and accessories, which we understand generate higher margins. As a result, we anticipate that Twin-Set will continue posting above-average profitability margins, in line with its historical track record, which is a key support for the rating.

Financial Risk: Highly leveraged

Twin-Set's financial risk profile is constrained by its operating leverage and limited scale, which make it vulnerable to a rapid decline in earnings leading to higher financial leverage, as experienced in 2014.

We acknowledge the steady improvement in credit metrics since 2015 and expect a stable trend in 2017 and beyond. This is based on our estimate of adjusted FFO to debt of about 12% in 2016, which we anticipate will gradually improve to 14%-16% over the next few years and the EBITDA plus rent coverage ratio--calculated as EBITDA plus rent over cash interest plus rent--will exceed 2x, ratios that are commensurate with our aggressive category.

We believe the company's FOCF will remain slightly positive over the next 12-24 months, despite an increase of expansionary capex during that period. In our view, the group has a generally prudent approach to expansion, which protects its FOCF generation and profitability.

However, given the company's financial-sponsor ownership, we still regard the financial risk profile as highly leveraged. This is because we believe the financial policy of the private equity owners is inherently aggressive, leading to a risk of further releveraging compared with our forecast levels. Additionally, we believe that the scale of the company and its geographic concentration contribute to volatility of earnings, which exacerbates the group's credit risk.

Our leverage calculation excludes the remaining balance of €80.5 million on a shareholder loan reported in 2016, which we understand from the legal documentation bears no cash interest and can be repaid only after full repayment of outstanding debt.

Liquidity: Adequate

Our liquidity assessment is supported by our forecasts for the company's sources of liquidity--including FFO, cash on hand, and access to debt facilities.

We view Twin-Set's liquidity as adequate. We calculate that liquidity sources will comfortably exceed liquidity needs by more than 1.2x over the next 12 months. We believe that net sources of cash will remain positive even if forecast EBITDA declines by 15%.

Principal Liquidity Sources	Principal Liquidity Uses:
• Cash and cash equivalents of more than €60 million; • Our forecast of FFO of about €25 million; and • Full availability of a committed revolving credit facility (RCF) of €10 million. We do not expect any drawing under the RCF over the coming years.	• Capex of about €15 million-€20 million. • Our conservative assessment of €20 million of working capital needs, due to temporary swings during the year. • Although not disclosed by management, we assume a one-time cash outlay of €10 million-€12 million related to the departure of Simona Barbieri.

Ratings Score Snapshot

Corporate Credit Rating

B/Stable/--

Business risk: Weak

- **Country risk:** Moderately high
- **Industry risk:** Intermediate
- **Competitive position:** Weak

Financial risk: Highly leveraged

- **Cash flow/Leverage:** Highly leveraged

Anchor: b

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** FS-6 (no additional impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Fair (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : b

- **Group credit profile:** b

Recovery Analysis

Key Analytical Factors

- The €150 million senior secured notes have an issue rating of 'B' and a recovery rating of '3'. The recovery rating is supported by the limited amount of prior-ranking liabilities, but undermined by the weak security package. Our indicative recovery prospects are in the 50%-70% range (rounded estimate, 60%).
- Our hypothetical default scenario assumes a weak macroeconomic environment in Italy and an increase in competition leading to higher mark-downs and deterioration of gross margins.
- We value Twin-Set as a going concern, given its attractive store locations and solid market position in the Italian niche market of affordable luxury apparel.

Simulated Default Assumptions

- Year of default: 2020
- EBITDA at emergence: €24 million
- Minimum capex at 3.5% of annual revenue, based on the company's historical trends and future expectations
- Implied enterprise value multiple: 5.0x
- Jurisdiction: Italy

Simplified Waterfall

- Gross enterprise value at default: €112 million
- Net enterprise value after administrative costs (5%): €107 million
- Value available for second-lien debt claims: €107 million
- Estimated second-lien debt claims: €156 million*^
- --Recovery rating: 3 (50%-70%; rounded estimate 60%)
- *All debt amounts include six months' prepetition interest. ^Includes €10 million super senior RCF assumed is 85% drawn.

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Corporates - General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria - Corporates - Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - General: The Treatment Of Non-Common Equity Financing In Nonfinancial Corporate Entities, April 29, 2014
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Retail And Restaurants Industry, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013

- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	Intermediate	Significant	Aggressive	**Highly leveraged**
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	**b/b-**
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

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