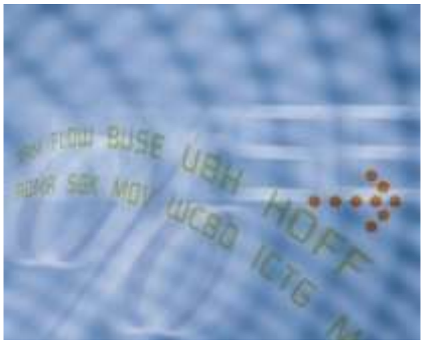

Gradient INTERNATIONAL

Research Alert BIT:YOOX

ANALYST: ROBERT KENNEDY | 12 JULY 2011

YOOX S.p.A.
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Italy
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INDUSTRY	*Internet Retail*
PRICE	*EUR12.32 (07/11/11)*
MARKET CAP	*649.4 million*
ENT. VALUE	*649.1 million*
P-E RATIO	*77.04*
EV/REVENUE	*2.8*
DEBT/EBITDA	*0.0*

Earnings Quality Thesis

We are initiating coverage of YOOX S.p.A. with a grade of D based on a combination of fundamental, quality-of-earnings, and executive-behavior concerns. Although the company has consistently grown revenue at a rapid pace, margins have been pressured in recent periods. At the same time, increases in inventory and advances to suppliers have led to a significant buildup in both operating and total accruals. Additionally, we note that executive divestitures have increased to record levels over the past two quarters. Finally, YOOX trades at a premium relative to peers and historical levels. Taken together, these concerns lead us to believe that YOOX may face an elevated risk of future share-price underperformance.

EARNINGS QUALITY GRADE *Scale A - F* **D**

Spike in operating and total accruals *pg 4*

In the most recent TTM period, net income increased 55.7% YOY to €8.8 million. At the same time, cash from operations and free cash flow fell 136.5% YOY and 287.1% YOY to -€5.6 million and -€22.0 million respectively. As a result, total accruals grew to 28.8% of average total assets, compared to -5.2% just one year earlier. Similarly, operating accruals increased to 37.7% of average current assets, compared to 1.6% a year earlier. The build in accruals stems from a number of sources, including growth in inventory, capital expenditures, other trade receivables and other current assets.

Inventory and other assets grow faster than revenue grows *pg 6*

Inventory as of 03/31/11 increased 67.4% YOY to €81.3 million, while quarterly (TTM) revenue increased 38.6% (29.6%) YOY. According to comments by management, the increase in inventory will support future revenue growth, yet inventory to forward revenue expectations increased more than 600 basis points YOY. Other assets increased 292.6% YOY and 68.5% sequentially to €12.3 million. According to a breakdown in the 2010 annual report and comments from an investor relations representative, the primary driver of other asset growth is advances to suppliers (for both goods and services).

Valuation metrics indicate YOOX trades at a significant premium *pg 11*

Shares of YOOX appear to trade at a premium to the company's historic valuation multiples. Shares also appear to trade at a premium relative to peers based on these same metrics. For example, EV to revenue is 33.2% higher than YOOX's trailing six-quarter average and is 26.1% (54.3%) above the peer mean (median). Similarly, EV to EBITDA is 55.0% above YOOX's trailing six-quarter average and 31.5% (41.5%) above the peer mean (median). Considering our concerns regarding quality of earnings and executive behavior, we question the sustainability of this premium.

Company Background and Introduction to the Thesis

Company Background

YOOX SpA is engaged in the online retail of fashion and design brands. The Company operates its multi-brand segment (76.3% of TTM revenue) through online stores yoox.com and thecorner.com. Yoox.com is a virtual store offering collections by designers, end-of-season clothing and accessories, vintage collectibles, capsule collections, and an assortment of books, design, and art objects. Thecorner.com is a virtual space showcasing a selection of artisans and brands for men and women. Each brand has its own virtual store, including editorials and video content. The company also designs and manages mono-brand online stores for fashion brands (23.7% of TTM revenue). YOOX offers online platform, global logistics, customer care services, and a range of Web marketing and consulting services.

Introduction to Gradient's Thesis

Our concerns with YOOX S.p.A. center on the following issues:

- **Margins shrinking despite sales growth:** Despite significant growth in revenues, both gross and operating margins have contracted for multiple quarters, including Q1 2011, when gross (operating) margin fell 128 (234) basis points YOY.

- **Significant increase in accruals:** While TTM net income increased on a YOY basis, quarterly cash-flow metrics declined YOY, as both CFOA and FCF turned negative. As a result, total accruals increased to 28.8% of average total assets as of 03/31/11, compared to negative accruals just a year earlier.

- **Spike in capital expenditures relative to depreciation expense:** The ratio of capital expenditures to depreciation and amortization expense increased 423.1% YOY to 2.03 because of a significant increase in capital expenditures and a high level of "in-progress" assets, which are not currently depreciated. Once the large buildup in "in-progress" assets comes online, we expect depreciation expense to increase.

- **Rise in inventory levels:** Inventory increased 67.4% YOY, compared to quarterly (TTM) revenue growth of 38.6% (39.6%). Although management attributed inventory growth to expansion initiatives, we note that inventory to forward revenue expectations also increased dramatically.

- **Growth in other trade receivables:** Although trade receivables due from customers grew slower than revenue, other trade receivables increased 54.1% YOY and now represents 58.1% of gross trade receivables for the period ended 12/31/10. At the same time, the allowance for impairment fell 64.0% YOY.

- **Changes in composition of other assets:** Other current assets increased almost 300% YOY and almost 70% sequentially. In addition, a number of other asset components have been growing much faster than other components, including other non-trade receivables and advances to suppliers.

- **Executive divestitures:** Executive sales in the first two quarters of 2011 were larger than any other quarter in company history, as four executives combined to sell 467,884 shares for a market value of €4.6 million.

- **Valuation concerns:** Compared to peer valuation multiples, YOOX appears to be trading at a premium ranging between 9.5% and 56.0% depending on the metric used. Additionally, YOOX's current valuation multiples are between 33.2% and 61.8% higher than the historical average multiples for the company. Considering the nature of our concerns, we question if this premium is sustainable.

Gross and Operating Margin Fall Despite Revenue Growth

GROSS MARGINS DECLINE FOR THIRD STRAIGHT QUARTER

For the quarter (TTM) ended 03/31/11, revenue increased 38.6% (39.6%) YOY to €69.7 million (€233.7 million). Revenue has increased at a similar pace (above 30%) in every quarter of available YOY data (since 03/31/09). In contrast with this trend, quarterly gross margin has fallen for the past three consecutive quarters. In the most recent quarter, three-month (TTM) gross margin fell 128 (79) basis points YOY to 35.9% (38.8%). On the Q1 2011 conference call, management attributed the change in gross margin to higher revenue contribution from the Fall-Winter Collection on yoox.com, which "is marked by higher promotion."

Similarly, quarterly operating margin has fallen for three out of the last four quarters. In the most recent quarter, three-month (TTM) operating margin fell 234 (2) basis points YOY to 4.1% (6.3%). In addition to changes in gross margin, this appears to be driven by higher G&A expenses and fulfillment costs, which increased 52.3% YOY and 47.5% YOY, respectively. Management attributed much of the growth in costs to an increase in non-cash incentive-plan expenses, although operating margin still declined even after excluding these costs.[1]

These trends in margins are surprising considering the rapid growth in revenue that we would expect would leverage fixed costs. The lower gross margin may indicate that management has become increasingly promotional in order to drive top-line growth. Additionally, the decline in operating margin indicates that costs are increasing even faster than revenues—suggesting that the company's rapid growth may not be sustainable.

[1] Management stated that EBITDA margin including incentive plan costs fell from 7.8% in Q1 2010 to 6.2% and Q1 2011 .Excluding these costs, EBITDA margin fell from 8.3% to 8.0%.

Table 1. Revenue and Margin Trends
(EUR in millions)

Quarter Ended:	03/31/11	12/31/10	09/30/10	06/30/10	03/31/10
3M revenue	€69.7	€63.5	€54.2	€46.3	€50.3
TTM revenue	€233.7	€214.3	€196.2	€180.5	€167.4
3M gross margin	35.9%	43.0%	36.9%	39.7%	37.2%
TTM gross margin	38.8%	39.4%	39.5%	39.7%	39.6%
3M operating margin	4.1%	11.8%	4.1%	4.5%	6.4%
TTM operating margin	6.3%	7.0%	5.4%	6.0%	6.3%
Change YOY:					
3M revenue	38.6%	39.7%	41.0%	39.2%	43.4%
TTM revenue	39.6%	40.8%	46..2%	46.5%	47.9%
3M gross margin	-128	-184	-8	58	99
TTM gross margin	-79	-24	NA	NA	NA
3M operating margin	-234	522	-271	-58	173
TTM operating margin	-2	144	NA	NA	NA

Negative Free Cash Flow; Elevated and Growing Accruals

CASH FLOWS DIVERGE FROM NET INCOME, CAUSING A BUILD IN ACCRUALS

During the TTM period ended 03/31/11, net income (net income plus stock-based compensation) increased 55.7% (81.9%) YOY to €8.8 million (€13.5 million). In contrast though, TTM cash from operating activities fell 136.5% YOY to -€5.6 million. TTM free cash flow fell even further, dropping 287.1% YOY to -€22.0 million.

As a result of divergent trends in cash flows and earnings, both operating and total accruals have spiked significantly over the past year. In the TTM period ended 03/31/11, operating accruals rose to 37.7% of average current assets, compared to just 1.6% a year earlier. Similarly, total accruals grew to 28.8% of average total assets, compared to -5.2% a year earlier. The growth in accruals increases our concern regarding the negative trends in gross and operating margin. If these accruals had been expensed on the income statement, margin trends would have been much worse than reported. Instead, we expect the increase in accruals to provide incremental margin pressure as accruals unwind.

As we will discuss in the following section, the growth in accruals is attributable to a number of sources including growth in capital expenditures, inventory, receivables, and other assets.

Table 2. Recent Trends in Cash Flow and Accruals
(EUR in millions)

	03/31/11	12/31/10	09/30/10	06/30/10	03/31/10
TTM NI (exl. Stock option expense)	€13.5	€12.9	€9.2	€8.6	€7.4
TTM CFOA	-€5.6	-€0.5	€5.1	€8.2	€15.3
TTM FCF	-€22.0	-€11.9	-€0.9	€3.0	€11.7
Operating Accruals/ACA	37.7%	30.0%	20.3%	17.3%	1.6%
Total accruals/ATA	28.8%	21.5%	10.2%	6.2%	-5.2%
Change YOY:					
TTM NI (exl. Stock option expense)	81.9%	123.7%	79.8%	56.7%	74.9%
TTM CFOA	-136.5%	-102.7%	12.5%	35.9%	855.1%
TTM FCF	-287.1%	-176.8%	-157.3%	25.4%	-752.9%
Operating Accruals/ACA	3,611	3,465	701	799	-1,300
Total accruals/ATA	3,400	3,459	455	82	-1,668

Growth in Capital Expenditures Outpaces Growth in Depreciation Expense

CAPEX GROWTH COULD FORESHADOW INCREASE IN DEPRECIATION EXPENSE

Part of the growth in total accruals is a result of the recent spike in capital expenditures. In the TTM period ended 03/31/11, capital expenditures increased 867.0% YOY to €9.2 million. Management attributed the growth in capital expenditures to a number of initiatives, including "the investment in technology and in the automation of distribution platform in Bologna as well as a minor portion due to new offices in Milan and the expansion of the Bologna offices and start-up of operation in China" (Q1 2011 conference call). As a result of the jump in capital expenditures, the level of CAPEX relative to D&A expense has increased dramatically. In the TTM period ended 03/31/11, CAPEX to D&A expense increased 423.1% YOY to 2.03, which is well above the trailing 10-quarter average of 0.79. In the long run, the ratio of capital expenditures to depreciation must revert to 1.0.

Similarly, purchases of intangible assets have increased, rising by 171.8% to €7.2 million for the TTM ended 03/31/11. According to the 03/31/11 interim financial report, acquisition of intangible assets relate mainly to "investments in multi-year development projects … for specific projects aimed at the on-going development of innovative solutions for the creation and management of online stores." If we include the purchase of intangible assets in our definition of capital expenditures, the ratio of CAPEX and acquisition of intangibles to D&A expense has increased 146.2% YOY to 3.62.

The growth in CAPEX has led to a significant build in "in-progress" PP&E that is not yet being depreciated. Once these capital assets come online, we believe YOOX will face a significant increase in depreciation expense, which will likely weigh on operating margin in future periods. As of 12/31/10, the company had €4.2 million of in-progress tangible assets (or 30.8% of total PP&E) that are not yet online and therefore are not yet being depreciated. In-progress PP&E was not disclosed for the 03/31/11 quarter, but based on current trends we believe in-progress assets are still a large portion of PP&E. For example, net PP&E at the end of Q1 2011 increased 57.4% sequentially (and 262.6% YOY) to €13.2 million. Over the same period, intangibles with finite life increased 17.1% sequentially (and 115.2% YOY). At the same time, quarterly depreciation and amortization increased just 4.7%, or €66,000, sequentially, indicating that a large portion is still likely considered in-progress. We estimate that if all of the in-progress PP&E[2] had been completed during the most recent quarter, three-month (TTM) depreciation would have increased by €0.7 million (€2.9 million).[3]

Looking forward, management estimates that capital expenditures in 2011 will total €22 million, indicating €17.9 million in CAPEX over the remaining three quarters of the year (or roughly €6.0 million per quarter). Based on average depreciation rates, we estimate that total depreciation expense could increase by €5.8 million annually. We believe that once these assets come online in future quarters, we estimate that depreciation could increase by as much as €8.8 million (or 3.1% of forward 2011 revenue estimates) on an annual basis. These increased costs, in addition to any recurring fixed costs involved with operating these assets, have the potential to continue to pressure margins going forward.

Table 3. Capital Expenditure Trends (EUR in millions)

	03/31/11	12/31/10	09/30/10	06/30/10	03/31/10
TTM capital expenditures	€9.2	€5.4	€1.4	€1.2	€0.9
TTM purchase of intangibles	€7.2	€6.1	€4.6	€3.9	€2.6
TTM D&A expense	€4.5	€3.7	€3.1	€2.8	€2.4
TTM CAPEX/TTM D&A	2.03	1.44	0.46	0.43	0.39
TTM CAPEX + purchase of intangibles/TTM D&A	3.62	3.06	1.91	1.81	1.47
Change YOY:					
TTM capital expenditures	867.0%	661.2%	68.6%	-11.3%	-34.6%
TTM purchase of intangibles	171.8%	177.7%	110.2%	77.0%	35.7%
TTM D&A expense	84.9%	71.4%	61.9%	49.9%	33.6%
TTM CAPEX/TTM Depr.	423.1%	344.0%	4.2%	-40.8%	-51.1%
TTM CAPEX + purchase of intangibles/TTM D&A	146.2%	130.9%	22.6%	-4.5%	-20.9%

Increases in Current Assets Drive Elevated Accruals

Inventory Increases Twice as Fast as Revenue Increases

For the past three quarters, inventory growth has outpaced quarterly revenue growth. For example, in the most recent quarter, inventory grew 67.4% YOY to €81.3 million, compared to three-month (TTM) total revenue growth of 38.6% (39.6%) YOY and multi-brand revenue growth of 38.1% (33.9%).[4] As a result, inventory to three-month total (multi-brand) revenue increased 2,010 (2,692) basis points YOY to 116.7% (153.8%). On a TTM basis, inventory to total (multi-

[2] In-progress PP&E as of 12/31/10 plus growth in total PP&E.
[3] Calculated by multiplying in progress PP&E by the implied average depreciation rate during FY2009 and FY2010.
[4] According to the annual report, all inventory carried on the balance sheet is related to the multi-brand Websites yoox.com and thecorner.com.

brand) revenue increased 579 (914) basis points YOY to 34.8% (45.6%). TTM DSI increased 3.7% YOY to 140 days while three-month DSI increased 15.9% YOY to 138 days.

In the Q1 2011 conference call, management explained this growth by saying, “this result can be mainly attributed to the increase in stock needed to support future growth of the multi-brand line.” To account for expected growth, we can compare inventory levels to future revenue expectations. Specifically, the current consensus sell-side revenue estimate for 2011 is €280 million.[5] The ratio of current inventory to forward 2011 full-year revenue expectations is 29.0%, compared to 03/31/10 inventory to 2010 revenue of 22.7%, indicating this ratio has increased 638 basis points YOY. Therefore, while some of the inventory growth is likely attributable to future growth expectations, it does not appear to be the only factor driving higher inventory levels.

This outsized growth in inventories may foreshadow continued gross and operating margin troubles at YOOX. In addition, if revenue growth slows, management may have difficulty reducing the relatively high levels of inventories without resorting to significant markdowns or promotional activity.

Table 4. Inventory Trends
(EUR in millions)

	03/31/11	12/31/10	09/30/10	06/30/10	03/31/10
Inventory	€81.3	€76.3	€66.1	€58.5	€48.6
Inventory to 3M revenue	116.7%	120.01%	122.0%	126.5%	96.6%
Inventory to 3M multi-brand revenue	153.8%	160.2%	156.6%	164.6%	126.9%
Inventory to TTM revenue	34.8%	35.6%	33.7%	32.4%	29.0%
Inventory to TTM multi-brand revenue	45.6%	46.6%	43.7%	45.5%	36.5%
DSI	140	138	135	134	135
3M DSI	138	153	143	128	119
Change YOY:					
Inventory	67.4%	62.2%	43.4%	34.7%	19.5%
Inventory to 3M revenue	2,010	1,663	204	-426	-1,935
Inventory to 3M multi-brand revenue	2,692	2,724	1,165	750	-1,177
Inventory to TTM revenue	579	470	-67	-285	-690
Inventory to TTM multi-brand revenue	914	873	236	-81	-623
DSI	3.7%	-5.6%	-14.4%	-19.8%	-26.7%
3M DSI	15.9%	6.4%	-1.8%	-7.0%	-26.4%

[5] Management does not provide forward guidance but said they were comfortable with the sell-side consensus estimate during a roadshow in May 2011.

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OTHER TRADE RECEIVABLES SURPASSES 50% OF TOTAL TRADE RECEIVABLES

Total trade receivables increased 20.2% (39.2%) YOY for the period ending 03/31/11 (12/31/10), growing slower than revenue growth. More notably, however, the company's "other trade receivables" increased 54.1% YOY to €5.5 million as of 12/31/10.[6] As a result, other trade receivables now represent 58.1% of total trade receivables. According to company's 2010 annual report, other trade receivables refer to "receivables from Online Stores, chiefly for the provision of services. This item includes … set-up fees paid to the Group by Strategic Partners for whom the Group designs and creates Online Stores. They are measured according to fees accrued in the year based on the stage of service completion." Based on this, we believe these receivables are related to the mono-brand segment, which saw quarterly revenue increase 57.7% YOY for the quarter ending 12/31/10.

At the same time, we note that allowance for impairment on trade receivables fell from €220,000 a year ago to €80,000 despite the growth in receivables. As a result, the ratio of allowance for doubtful accounts to total trade receivables fell from 3.2% to just 0.8% (a decline of 234 basis points) in one year. According to an investor relations representative, "It was not necessary to make any further provisions to the allowance for impairment in 2010, but the allowance was used as a result of the 'write-off' of several receivables that had already been impaired." Based on this explanation, we question whether the reserve should have been increased (or at least replenished) if the company is taking write-downs during the period.

YOOX reports an additional form of receivables (that are not included in total trade receivables) classified within "other assets" that also increased dramatically in 2010, as discussed in further detail in the following section.

Table 5. Trade Receivable Trends
(EUR in millions)

	03/31/11	12/31/10	09/30/10	06/30/10	03/31/10
Trade receivables	€8.9	€9.4	€7.5	€5.7	€7.4
AR to 3M revenue	12.8%	14.8%	13.8%	12.3%	14.8%
AR to TTM revenue	3.8%	4.4%	3.8%	3.2%	4.4%
DSO	12.2	12.5	11.5	10.6	10.8
3M DSO	12.0	12.1	11.1	13.0	12.9
Change YOY:					
Trade receivables	20.2%	39.2%	113.8%	103.0%	74.8%
AR to 3M revenue	-197	-6	470	387	266
AR to TTM revenue	-62	-5	121	88	68
DSO	12.8%	23.0%	29.1%	28.4%	20.5%
3M DSO	-6.8%	17.8%	48.2%	33.6%	21.1%

[6] We are unable to determine if this trend occurred in Q1 2011 because the data are not disclosed on a quarterly basis.

CERTAIN COMPONENTS OF "OTHER ASSETS" SPIKE IN 2010

Other assets have increased significantly in recent quarters, growing almost 300% YOY to €12.3 million as of 03/31/11. Other assets are made up of numerous items, including other receivables, advances to suppliers, and prepayments/accrued income. The breakdown of these other assets was not disclosed in the quarterly filings for 03/31/11 but was disclosed on an annual basis (for the period ended 12/31/10). As shown in Table 6 (next page), the largest component of other assets was other receivables, which increased 234.3% YOY to €3.4 million and increased more than 1,400% on a two-year basis. The company's most recent annual report explains these other receivables (not to be confused with other trade receivables, discussed in the receivables section) as "mainly credit notes from suppliers who still need to refund money to the Company and advance payments to suppliers for the purchase of goods for which invoices have not yet been received (e.g. payments on order, pre-payments)." [7]

Another component of other assets that increased dramatically was "advances to suppliers" (separate from advance payments in other receivables), which grew from just €3,000 as of 12/31/09 to €0.5 million as of 12/31/10. The 2010 annual report explains these advances as "payments on account to providers of services purchased in 2010 for which the providers have yet to provide the service." According to investor relations, the difference between these advance payments and the advance payments included in other receivables is that these payments are made for services, while the payments included in other receivables are made for the purchase of goods.

Although we do not know why suppliers are now requiring advance payments (for both goods and services), our concern over this change is heightened in light of the significant rise in inventory levels.[8] In general, a shift toward higher upfront payments may be a sign that suppliers are increasingly concerned about the collectability risk. According to investor relations, these advances have been made to multiple suppliers, indicating it is not just one supplier that may have these collection concerns.

All other components (broken down in Table 6, next page) increased 55.8% YOY to €3.4 million because of an increase in amounts due from acquirers,[9] prepayments/accrued income, and tax receivables. Since 12/31/10, total other assets increased 68.5% sequentially. Although we are unable to determine the exact breakdown of other assets, investor relations disclosed that the sequential growth from 12/31/10 to 03/31/11 was largely the result of "extraordinary advance payments to suppliers of merchandise."[10] Considering the size of sequential

[7] At the same time as the significant growth in other receivables, allowance for impairment remained unchanged at €221,000. Additionally, according to footnotes in the annual report, €216,000 of the allowance for impairment relates to a loan paid to a "Greek tax representative, which is deemed unrecoverable." This means that there is almost no allowance for doubtful accounts relating to these other receivables, despite the dramatic growth.

[8] The increase in inventories YOY was only partially offset by an increase in trade payables.

[9] Refers to credit card and gift card receivables.

[10] Held in other receivables.

growth in other assets (€5.0 million), we believe that advances have continued to increase at an unprecedented rate. This indicates that either 1) an increasing number of suppliers are requiring upfront payments, or 2) the same number of suppliers are requiring larger upfront payments. Regardless, the growth in these accounts increases our level of concern.

Table 6. Other Assets Components
(EUR in thousands)

	12/31/10	12/31/09	12/31/08
Other receivables	€3,380	€1,011	€223
Allowance for impairment on other receivables	-€221	-€221	-
Advances to suppliers	€513	€3	€9
Travel and payroll advances to employees	€4	-	€2
Due from acquirers	€1,724	€1,197	€1,073
Prepayments and accrued income	€968	€548	€991
Tax receivables	€910	€659	€2,497
Hedging derivatives	€29	€15	€70
Total	€7,318	€3,213	€4,882
Change:			
Other receivables	234.3%	353.4%	NA
Allowance for impairment on other receivables	0%	N/A	NA
Advances to suppliers	17,000%	-66.7%	NA
Travel and payroll advances to employees	N/A	N/A	NA
Due from acquirers	44.0%	11.6%	NA
Prepayments and accrued income	76.6%	-44.7%	NA
Tax receivables	38.1%	-73.6%	NA
Hedging derivatives	93.3%	-78.6%	NA
Total	127.8%	-34.2%	NA

Executives Divest Shares at Record Pace

Two quarters of outsized executive sales

Thus far in 2011, four executives have combined to sell 467,884 shares for a market value of €4.6 million. As a result, the first and second quarter of 2011 represent the largest and second largest quarter of executive activity in company history. Sales in Q2 2011 (Q1 2011) were 1.7 (5.1) times larger than the next-closest quarter of executive sales in Q2 2010. According to investor relations, increased executive divestiture activity was the result of option exercises. Based on additional detail from investor relations, the options exercised in the quarter expired between 12/31/14 and 09/03/19, indicating that nearing option expiration was not a factor in the exercise activity.

As a result of the activity, the four executives combined to divest roughly 33.9% of their beneficial ownership on average.[11] The largest activity in 2011 came from Marco Di Pietro, who serves as the company's operations director. Di Pietro sold 346,632 shares for €3.1 million between 01/18/11 and 03/17/11, which represented the executive's largest activity at YOOX. As a result, Di Pietro divested roughly two-thirds of his total share and options holdings. Similarly, executive officer Giuseppe Guillot sold 102,456 shares for €1.3 million, which represented 61.0% of Guillot's available ownership. Based on the level of activity relative to historical averages and the significant level of divestiture relative to ownership levels, we believe executive sentiment may have turned negative during the first two quarters of 2011.

Table 7. 2011 Executive Activity

Name	Position	Date Range	Shares Sold	Average Selling Price	Market Value	Estimated Divestiture %
Giuseppe Guillot	Executive Officer	04/15/11–05/27/11	102,456	€12.28	€1.3M	61.0%
Gabriele Tazzari	CTO	04/01/11	13,000	€10.27	€0.1M	2.2%
Marco Di Pietro	Operations Director	01/18/11–03/17/11	346,632	€8.99	€3.1M	66.7%
Davide Di Dario	Head of Customer Care	02/11/11	5,796	€9.67	€0.1M	5.6%
Total/Average			**467,884**	**€9.75**	**€4.6M**	**33.9%**

Table 8. Historical Executive Activity

	Shares Sold	Market Value
Q2 2011	115,456	€1.4M
Q1 2011	352,428	€3.2M
Q4 2010	0	0
Q3 2010	0	0
Q2 2010	69,616	€0.4M
Q1 2010	6,000	€0.0M
Q4 2009	0	0

Shares Trade at Premium Relative to Historical and Peer Comparisons

Shares Trade at Significant Premium to Peers

Despite our concerns regarding earnings quality and executive-behavior trends, shares of YOOX trade at a significant premium the company's historic average range. Specifically, on an enterprise value-to-trailing revenue basis, shares of YOOX trade at a multiple of 2.73, compared to the trailing six-quarter average of 2.05, indicating an increase of 33.2% from the average. Similarly, the current EV to trailing EBITDA (EBIT) multiple is 55.0% (61.8%) above the trailing six-quarter average. While we have a limited number of periods in our sample, shares of

[11] Based on option grant data provided by investor relations. Excludes unvested options.

YOOX currently trade at their highest level on an EV to revenue and EV to EBITDA basis since the company's IPO in December 2009.

Additionally, as shown in Table 10, below, shares of YOOX appear to trade at a premium relative to similar online retail peers.[12] On an enterprise value-to-trailing (forward) sales basis, YOOX shares trade at a multiple of 2.73 (2.25), compared to the peer mean of 2.17 (1.68) and peer median of 1.77 (1.71), representing premiums of 26.1% (34.2%) and 54.3% (31.6%), respectively. Similarly, based on an EV-to-trailing (forward) EBITDA, YOOX's multiple of 37.14 (22.87) is at a premium of 31.5% (9.5%) compared to the peer mean. Finally, YOOX's trailing (forward) P/E ratio of 77.0 (58.8) trades at an 11.5% (23.7%) premium to the peer mean and a 56.0% (27.2%) premium to the peer median. These metrics, taken together, appear to indicate that shares of YOOX have much higher growth expectations built into share prices than peers. Considering our concerns, we question the sustainability of this premium.

Table 9. Historical Valuation Comparison

Date:	07/05/11	03/31/11	12/31/10	09/30/10	06/30/10	03/31/10	12/31/09	6-Qtr Avg.	Premium
EV/TTM Rev	2.73	2.29	2.44	2.08	1.55	1.84	2.09	2.05	33.2%
EV/EBITDA	387.1	29.24	27.64	22.86	16.07	19.09	28.83	23.95	55.0%
EV/TTM EBIT	43.00	32.25	31.75	24.48	17.3	20.89	32.77	26.57	61.8%

Table 10. Peer Valuation Comparison

Ticker	EV/TTM Rev	EV/FTM Rev	EV/TTM EBITDA	EV/FTM EBITDA	Trailing P/E	Fwd P/E
BIT: YOOX	2.73	2.25	37.14	22.87	77.04	58.78
AIM: ASC	4.93	3.30	49.59	33.79	163.28	58.61
OM:CDON	1.12	0.88	14.14	16.80	18.34	29.37
NILE	1.77	1.71	26.24	19.66	49.38	46.23
OSTK	0.27	0.26	14.07	11.33	37.46	44.69
Mean	2.17	1.68	28.24	20.89	69.10	47.54
% Premium	26.1%	34.2%	31.5%	9.5%	11.5%	23.7%
Median	1.77	1..71	26.24	19.66	49.38	46.23
% Premium	54.3%	31.6%	41.5%	16.3%	56.0%	27.2%

[12] Peer selection was based on publicly traded companies with similar business models within a similar market value range.

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Conclusion

We are initiating coverage on YOOX based on a number of fundamental, earnings quality, and executive-behavior factors. The company has faced margin contraction over the last three quarters despite significant revenue growth, suggesting an inability to leverage the company's growth. At the same time, there has been a dramatic build in both operating and total accruals, as net-income trends continue to improve yet cash flows turned negative. This divergence between net income and cash flow stems from growth in inventory, other trade receivables and advances to suppliers. Additionally, capital expenditures relative to depreciation expense is well above historical levels, which will likely lead to an increase in depreciation expense in future quarters as in-progress assets are placed into service. On top of these concerns, we note that executives have increased the pace of divestures to record levels over the last two quarters. Finally, shares of YOOX trade at a premium to both historical company levels and peer comparisons based on a number of valuation multiples.

Risk to Thesis

Revenue growth at YOOX has been consistently high, and forward estimates indicate that this high growth is expected to continue. Should growth trends accelerate relative to expectations, issues regarding inventory and other accruals may be overshadowed.

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