



United States

Company
Gymboree Corp

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HY Corporate Credit
Retailing

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Still Waiting For The Turnaround

Friday the 13thth came a day early with fiscal 3Q13 results yesterday. We were surprised and disappointed by the dismal results from Gymboree as the company took a step backwards on its turnaround effort. With new management installed in January 2013, admittedly there was little that could be done by them to refine committed designs for the fall and holiday seasons but the quarter was also beset by increased promotional activity and a fulfillment issue on the e-commerce platform. Modest silver linings on strong inventory control and a \$25 million bond repurchase were encouraging but not nearly enough to turn investor sentiment on the credit.

We recognize that the competitive environment in children's apparel is very challenging but feel that management is on the right path with its inventory control and a revised design aesthetic slated for the Spring 2014 season. With positive free cash flow and potential for additional bond repurchases, full access to the revolver as of the earnings call, no meaningful maturities until 2018 and attractive yield, we maintain our long-term positive view on the term loan and our BUY recommendation on the bonds.

Getting design right

We've heard a lot this year from the new management about needing to have clearer points of view on design, providing fresh takes on classic looks and continuing to stream new flow through the stores while still reducing the SKU proliferation but the major disappointment is that very little of these critical action items were actually actionable for the fall and holiday seasons. With nine month lead times in design the fall season was already done when management came on board and holiday was nearly complete as well.

Crazy 8 pause

The *Janie & Jack* and *Gymboree* banners outperformed the company's value oriented growth concept *Crazy 8* for the quarter, which we believe is a good reason to take a pause in the hereto rapid growth of the brand. With 383 stores at quarter end, the *Crazy 8* banner should be the outperforming concept in our opinion given the cautious consumer. Our sense from the earnings call is that management may scale back its *Crazy 8* openings, roughly 85 this year, further in 2014, along with cap ex, as it works to get the assortment of basics and key items aligned with its target demographic.

E-commerce platform fix underway

The transition to a new 3rd party DC for web fulfillment in the quarter did not go smoothly as management was forced to scale back promotions so as to not overwhelm the system. In addition to missed top-line opportunities, the company paid \$1 million in additional expenses to remedy customer orders. Management noted that it's on-line "Black Friday" promotions were handled correctly by the system and that while not yet 100%, they are continuing to make progress on this important part of the go to market strategy.

Risks

We remain cautious on competitive pressure, promotional environment, gross margin, inventory, input costs, e-commerce platform, capital expenditures, store openings, management changes and execution on design.

Outstanding Issues

Issue	Ticker	Maturity Date	Coupon Rate	Price	YTW	STW	Ratings
9.125% Sr Nts	GYMB	12/1/18	9.125	91.00	11.6%	1002	Caa2/CCC
Term Loan	GYMB	2/23/18	L+350, 150 flr	95.00	6.4%		B2/B-

Source: Deutsche Bank

Deutsche Bank Securities Inc.

DISCLOSURES AND ANALYST CERTIFICATIONS ARE LOCATED IN APPENDIX 1. MICA(P) 054/04/2013.