

Friday, April 23, 2021 | update

VRG: accumulate (downgraded)

VRG PW; VRGP.WA | Retail, Poland

Taking Back Momentum

VRG used 2020 as an opportunity to improve working capital, bring down costs, close loss-making stores, and maximize e-commerce sales. As a result, despite a 79% fall in EBITDA, the Company was able to end the year with a safe level of net debt-to-EBITDA by significantly reducing financial obligations. With better working capital management, VRG unlocked PLN 44m in cash in 2020, mostly working capital tied up in inventories. With these efforts, VRG positioned itself to enter the new fiscal year of 2021 with a leaner cost base and ready to restart sales. From a low 2020 base, VRG is expected to deliver increasing sales and margins this year, as evidenced by March figures which showed revenue as rebounding 40% year on year alongside a 5.7pp bounce in gross margin. VRG's jewelry business is demonstrating resilience in the face of challenging market conditions, while its clothing stores, in particular those carrying mostly formalwear, are experiencing pressure.

After adjustments to reflect a slower-than-expected recovery in fashion revenues, and after accounting for reined-in SG&A expenses, we revise our 2021 and 2022 EBITDA forecasts for VRG upwards by 6.8% and 3.6%, respectively. Even after rallying 29% since our last recommendation, we still see upside potential in VRG, which on our updated estimates is currently trading at 26.2x 2021E P/E and 14.4x 2022E multiple, showing a 2% premium and a discount of 8%, respectively, to comparable retailers. We downgrade VRG one notch to accumulate with a raised price target of PLN 3.65.

It's Tailwinds from Q2 2021

VRG is heading into 2021 with a leaner sales network and a slimmed-down cost base. The Company is constantly working on making its fashion and jewelry lines more attractive to consumers, including by introducing more casual styles to the Vistula menswear range, expanding the Wólczanka line of shirts, and by listing Vistula and Deni Cler apparel on third-party e-commerce platforms. At the same time VRG is also investing in maximizing its own e-commerce capabilities. With intensified sales efforts, supported by positive base effects, VRG in our view is poised for sustained growth in 2021 and 2022.

Lockdown Weighed on 2021 Q1 Results

With non-essential retail establishments in Poland on lockdown for about a half of the first quarter, this is bound to affect the period's revenues and sales margins of VRG. On a positive note, the earlier efforts to curb SG&A expenses (through cutbacks in payroll and rent) can be expected to mitigate the negative impact on EBITDA to make a projected year-over-year loss of 38%. On the upside, the first-quarter slowdown seems to be fully priced in, with investors now focusing on VRG's strong prospects for the future.

(PLN m)	2019	2020	2021E	2022E	2023E
Revenue	1,068.3	853.7	1,021.2	1,135.9	1,196.0
EBITDA (adj.)*	111.1	11.1	71.9	97.0	109.5
EBITDA margin (adj.)*	10.4%	1.3%	7.0%	8.5%	9.2%
EBIT (adj.)*	87.6	0.5	50.9	76.5	89.2
Net profit (adj.)*	65.9	-5.3	29.8	54.1	66.5
P/E (adj.)*	11.8	-	26.2	14.4	11.7
P/CE (adj.)*	8.7	44.0	15.5	10.5	9.0
P/B	0.9	1.0	0.9	0.9	0.8
EV/EBITDA (adj.)*	7.6	72.4	11.0	8.0	6.8
DPS	0.0	0.0	0.0	0.0	0.0
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%

*ex. IFRS16 effects

Current Price	PLN 3.33
Target Price	PLN 3.65
Market Cap	PLN 780m
Free Float	PLN 254m
ADTV (3M)	PLN 0.8m

Ownership

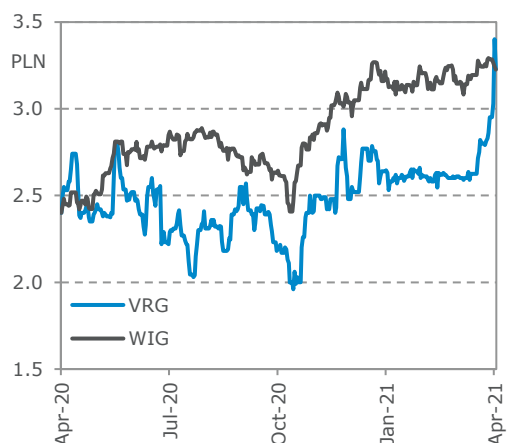
Ipopema TFI	20.07%
OFE PZU	15.33%
OFE NN	15.00%
Jerzy Mazgaj	9.46%
TFI Forum	7.54%

Others 32.61%

About

VRG designs and sells high-quality men's and women's apparel and jewelry. The Company runs the fashion labels Bytom, Vistula, Wólczanka, and Deni Cler, and the chain jewelry brand W. Kruk. Vistula owes its fast-paced expansion to a strategy of organic growth complemented by mergers and acquisitions. Vistula is aiming to become a "house of brands" with a presence across the CEE region able to deliver consistent growth in profits.

VRG vs. WIG



Company	Target Price		Rating
	new	old	
VRG	3.65	3.14	accumulate

Company	Current Price	9MTP	Upside

Forecast Update	2021E	2022E	2023E
EBITDA	+6.8%	+3.6%	+4.1%
Net Profit	+2.4%	+1.6%	+0.7%
Sales/sqm	-4.2%	-3.0%	-0.4%
SG&A/sqm	-6.4%	-4.3%	-0.9%
Sales Area	-0.6%	-1.8%	-2.3%

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Key Risks

Lockdown Restrictions

VRG faces more store closures in the future if the spread of the coronavirus is not contained. However as we write this the lockdown risk is decreasing thanks to ongoing vaccination efforts and rising population immunity. Consumers at this point have become used to shopping under sanitary and social distancing restrictions.

Economic Slowdown

VRG faces a slowdown in sales any time there is a decline in consumer confidence.

Exchange Rate Risk

VRG reports an increasing share of foreign currency payments to international suppliers. At the end of 2020, orders in USD, EUR, and CHF accounted for 33%, 17%, and 13%, respectively, of total purchases. This means that any depreciation in the zloty vis-à-vis the other currencies could raise merchandise costs for the Company, causing a squeeze on sales margins. The same is true for SG&A expenses, with euro-denominated SG&A accounting for approx. 23% of total annual SG&A in 2020.

Price Wars

VRG operates in the challenging and fiercely competitive fashion market where local retailers sometimes are forced to engage in price wars against global players. Such heated price competition can be potentially destructive to sales profits. However over the past year the competitive landscape has adjusted to pandemic conditions, and most retailers by now have adapted their inventory management in such a way as to be able to navigate a challenging market. As a result clothing stores and they do not have to put items on sale as frequently.

Negative Response to Clothing or Jewelry Lines

VRG has to stay on top of the changing tastes of consumers, and its fashions over the years have mostly kept pace with current trends, as evidenced by increasing like-for-like sales. The Company also works on drawing more traffic to its stores with celebrity marketing campaigns. However if a collection should fail to appeal to shoppers, this can potentially hurt sales. The pandemic has forced VRG to adjust its clothing designs, but if consumers do not like the changes this might impact the sales and profits on a fashion or jewelry range.

Defective Pricing

A pricing policy that seeks to maximize margins at the expense of revenues is not the best strategy in case of a fashion retailer operating in an intensely competitive market characterized by extremely price-conscious customers. VRG is aware of the risks, and its current pricing strategy to date has been successful, as demonstrated by improved sales profits on both clothing and jewelry.

M&A Risk

VRG aims to become a house of brands by acquiring companies based in Poland and across the CEE region. The Company's M&A track record has been good so far, however there is always a chance that a future acquisition will fail to deliver the desired synergies, or take longer than hoped to produce them.

Valuation

We used two valuation methods to determine the value of VRG: the Discounted Cash Flow method, indicating a per-share valuation of PLN 3.43, and the Relative Valuation method, yielding a value of PLN 3.45 per share. Based on this, we set our 9-month target price at PLN 3.65 per share.

(PLN)	weight	price
Relative Valuation	50%	3.45
DCF Analysis	50%	3.43
	price	3.44
9M target price		3.65

Relative Valuation Summary

We compared the forward P/E and EV/EBITDA multiples of VRG with the multiples of two peer groups as projected for fiscal 2021 through 2023. Each multiple is assigned an equal weight. The two peer groups analyzed consist of comparable fashion retailers and jewelry retailers, respectively. The median ratios used to calculate the final outcome are assigned weights of 75% jewelry and 25% clothing to reflect the current contributions of these segments to VRG's earnings.

Relative Valuation Summary

	Price	PEG			P/E			EV/EBITDA		
		2021E	2022E	2023E	2021E	2022E	2023E	2021E	2022E	2023E
Clothing Retailers										
HENNES & MAURI-B	204.1	0.2	0.2	0.1	32.5	22.4	20.2	9.9	9.0	8.4
INDITEX	28.53	76.7	32.6	28.1	65.1	27.7	23.8	18.4	12.9	11.6
MARKS & SPENCER	154.45	0.5	0.1	0.1	67.2	12.9	10.2	8.5	6.6	6.2
NEXT PLC	7910	15.0	7.4	6.5	35.8	17.7	15.6	16.7	11.9	11.1
HUGO BOSS -ORD	37.83	-	-	-	40.4	19.6	15.5	8.2	6.7	6.1
CCC SA	98.8	-	-	-	88.1	27.3	19.9	10.2	8.6	7.2
LPP	8665	-	-	-	-	29.4	19.7	18.6	12.0	12.6
Jewelry Retailers										
PANDORA A/S	690.0	0.5	0.4	0.4	18.0	15.3	13.7	10.1	9.3	8.7
LAO FENG XIANG-A	56.9	-	-	-	16.6	14.6	14.7	8.3	7.3	-
CHOW SANG SANG	13.0	0.2	0.2	0.2	8.9	7.5	6.2	5.4	4.7	4.2
LUK FOOK HLDGS I	20.7	-	-	-	14.4	11.0	9.0	6.5	5.4	4.6
CHOW TAI FOOK JE	12.4	0.7	0.6	0.6	24.4	20.8	18.3	15.5	13.9	12.5
LAO FEN XIANG-B	3.0	-	-	-	5.6	4.9	5.0	8.3	7.3	-
Minimum		0.2	0.1	0.1	5.6	4.9	5.0	5.4	4.7	4.2
Maximum		76.7	32.6	28.1	88.1	29.4	23.8	18.6	13.9	12.6
Median (fashion)		7.8	3.8	3.3	52.8	22.4	19.7	10.2	9.0	8.4
Median (jewelers)		0.5	0.4	0.4	15.5	12.8	11.4	8.3	7.3	6.7
Median (25%/75%)		0.5	0.4	0.4	24.8	15.2	13.5	8.7	7.7	7.1
VRG	3.23	-	-	-	28.9	15.0	12.0	10.7	7.8	6.6
premium / discount		-	-	-	17%	-1%	-11%	22%	0%	-7%
Implied Valuation										
Median		0.5	0.4	0.4	24.8	15.2	13.5	8.7	7.7	7.1
Multiple weight						50%			50%	
Year weight					33%	33%	33%	33%	33%	33%
Equity value per share (PLN)	3.45									

Additional Assumptions

Sales Efficiency Metrics

	2016	2017	2018*	2019	2020	2021E	2022E	2023E
Sales area (1,000 sqm)								
VRG	30.5	33.3	51.6	54.4	53.0	53.1	54.8	56.1
YoY change	9%	9%	55%	5%	-3%	0%	3%	2%
Fashion Stores	22.2	24.6	42.1	43.7	42.0	41.4	42.5	43.3
YoY change	8.2%	10.7%	70.9%	3.9%	-3.9%	-1.5%	2.7%	2.0%
Jewelry Stores	8	9	10	11	11	12	12	13
YoY change	11.2%	5.0%	10.0%	11.4%	3.1%	6.6%	5.5%	3.7%

Sales per Square Meter (PLN)

VRG	1,705	1,798	1,581	1,679	1,325	1,605	1,754	1,796
YoY change	7.8%	5.5%	-12.1%	6.2%	-21.1%	21.1%	9.3%	2.4%
Fashion Stores	1,164	1,780	1,318	1,048	622	808	934	937
YoY change	-11.0%	52.9%	-26.0%	-20.5%	-40.6%	29.9%	15.5%	0.3%
Jewelry Stores	2,185	2,358	2,540	2,689	2,312	2,771	2,805	2,871
YoY change	-4.3%	7.9%	7.7%	5.9%	-14.0%	19.8%	1.2%	2.4%

SG&A per sqm (PLN)

VRG	744	766	668	738	647	723	773	797
YoY change	6.6%	2.9%	-12.9%	10.5%	-12.3%	11.8%	6.9%	3.2%
Fashion Stores	618	618	420	598	520	573	605	634
YoY change	8.3%	0.0%	-32.1%	42.4%	-13.0%	10.1%	5.6%	4.8%
Jewelry Stores	970	1,062	1,118	1,217	1,068	1,252	1,297	1,311
YoY change	0.5%	9.5%	5.3%	8.9%	-12.2%	17.2%	3.6%	1.1%
Cash conversion cycle (days)	220	240	259	252	262	236	239	250
Days inventory outstanding	362	350	427	382	423	382	385	396
Days receivables outstanding	13	11	11	7	6	6	6	6
Days payables outstanding	154	121	179	137	167	152	152	152

*The comparability of 2018 numbers is affected by the acquisition of Bytom in December

Sales & Profit Forecast by Operating Segment

	2016	2017	2018	2019	2020	2021E	2022E	2023E
Fashion								
Revenue	363	420	483	692	501	580	663	695
Gross profit	189	214	245	358	237	293	339	355
SG&A expenses	165	183	212	314	262	284	308	330
Other operating gains/losses	0	0	2	-1	-14	-1	-1	-1
EBIT	24	29	33	43	-40	7	30	25
Gross margin	52.0%	50.9%	50.7%	51.7%	47.2%	50.4%	51.1%	51.1%
YoY change (pp)	-1.4	-1.1	-0.2	1.0	-4.5	3.3	0.7	0.0
EBIT margin	6.6%	6.9%	6.7%	6.2%	-7.9%	1.3%	4.5%	3.6%
YoY change (pp)	-1.0	0.2	-0.1	-0.5	-14.1	9.2	3.2	-0.9
SG&A/Sales	45.5%	43.5%	43.9%	45.3%	52.3%	49.0%	46.5%	47.4%
YoY change (pp)	0.1	-2.0	0.4	1.5	7.0	-3.3	-2.5	0.9
Jewelry								
Revenue	236	271	323	376	352	441	472	501
Gross profit	123	145	167	198	181	231	251	266
SG&A expenses	96	111	128	155	141	176	192	201
Other operating gains/losses	0	-1	1	2	1	0	0	0
EBIT	27	34	39	44	41	55	59	65
Gross margin	52.3%	53.6%	51.9%	52.7%	51.3%	52.4%	53.1%	53.1%
YoY change (pp)	-0.3	1.3	-1.7	0.8	-1.4	1.1	0.7	0.0
EBIT margin	11.4%	12.5%	12.2%	11.8%	11.8%	12.6%	12.5%	12.9%
YoY change (pp)	1.7	1.1	-0.3	-0.4	-0.1	0.8	-0.1	0.4
SG&A/Sales	40.8%	40.8%	39.7%	41.3%	39.9%	39.9%	40.6%	40.2%
YoY change (pp)	-1.4	0.0	-1.1	1.6	-1.4	-0.1	0.8	-0.4

DCF Valuation

Assumptions:

- Cash flow is discounted as of the end of March 2021. Equity value calculations factor in net debt as of 31 December 2020.
- We assume a decrease in gross margin by 1.9pp to 50.7% in 2021, and by 2023 we anticipate a rebound to 51.4%.
- Average annual CAPEX in 2021-30E is PLN 18.2m.
- The DCF model does not account for the impact of exchange-rate differences on profits.
- Figures are presented ex-IFRS 16 effects.
- We assume an annual tax rate of 19% in 2021-30E.
- The risk-free rate is 3.5%.
- We assume that FCF after FY2030 will grow at an annual rate of 2.0%.
- Unleveraged beta=1.0, leveraged beta=1.08.

DCF Model

(PLN m)	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E	2030+
Sales revenues	1,021	1,136	1,196	1,227	1,251	1,270	1,290	1,310	1,330	1,351	
change	19.6%	11.2%	5.3%	2.6%	1.9%	1.5%	1.6%	1.6%	1.6%	1.6%	
EBITDA	72	97	110	113	113	116	118	118	121	125	
EBITDA margin	7.0%	8.5%	9.2%	9.2%	9.0%	9.1%	9.2%	9.0%	9.1%	9.2%	
D&A expenses	20.7	20.1	20.0	19.9	19.9	20.3	20.6	21.0	21.4	21.9	
EBIT	51	77	90	93	93	95	98	97	99	103	
EBIT margin	5.0%	6.8%	7.5%	7.6%	7.4%	7.5%	7.6%	7.4%	7.5%	7.6%	
Tax on EBIT	12.9	14.6	17.0	17.7	17.7	18.1	18.5	18.5	18.9	19.5	
NOPLAT	38	62	73	76	75	77	79	79	81	83	
CAPEX	-17.7	-19.3	-19.6	-19.4	-20.9	-21.3	-21.7	-22.1	-22.5	-21.9	
Working capital	-17.3	-36.9	-29.0	-7.4	-6.9	-7.8	-8.0	-8.7	-7.4	-7.8	
FCF	24.1	26.2	43.9	68.7	67.5	68.5	70.0	69.0	72.0	75.4	76.9
WACC	9.1%	9.2%	9.0%	8.9%	8.9%	8.6%	8.6%	8.6%	8.6%	8.6%	
discount factor	93.7%	85.8%	78.7%	72.2%	66.3%	61.1%	56.2%	51.8%	47.7%	43.9%	
PV FCF	22.6	22.4	34.6	49.6	44.7	41.8	39.3	35.7	34.3	33.1	
WACC	9.1%	9.2%	9.0%	8.9%	8.9%	8.6%	8.6%	8.6%	8.6%	8.6%	
Cost of debt	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	
Risk-free rate	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	
Risk premium	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	
Effective tax rate	25.1%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	
Net debt / EV	1.4%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	
Cost of equity	9.1%	9.2%	9.0%	8.9%	8.9%	8.6%	8.6%	8.6%	8.6%	8.6%	
Risk premium	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	
Beta	1.1	1.1	1.1	1.1	1.1	1.0	1.0	1.0	1.0	1.0	

FCF growth after the forecast period	2.00%
Terminal value	1,164
Present value of terminal value	510
Present value of FCF in the forecast period	360
Enterprise value	870
Net debt	66
Minority interests	0.0
Equity value	804
Shares outstanding (millions)	234.46
Equity value per share (PLN)	3.43
9M cost of equity	6.2%
Target price (PLN)	3.64
EV/EBITDA ('22) at target price	8.3
P/E('22) at target price	16.0
TV / EV	58.63%

Sensitivity Analysis

	FCF growth in perpetuity				
	1.0%	1.5%	2.0%	2.5%	3.0%
WACC +1.0 p.p.	3.74	3.91	4.11	4.34	4.61
WACC +0.5 p.p.	3.45	3.61	3.79	4.00	4.25
WACC	3.32	3.47	3.64	3.84	4.08
WACC -0.5 p.p.	3.19	3.33	3.50	3.69	3.92
WACC -1.0 p.p.	2.95	3.08	3.24	3.41	3.62

2020 Q4 Results

VRG fulfilled our expectations with its 2020 fourth-quarter results, with revenue and gross margin results confirming figures reported in monthly sales updates. SG&A expenses were in line with our forecast, and per-square-meter SG&A are estimated to have decreased 5.4% from Q4 2019, to PLN 770.

With brick-and-mortar stores at times having to close under coronavirus regulation, VRG's jewelry business did better than the clothing business in Q4 2020, generating a positive EBIT for the period.

As consumers shifted to digital shopping during periods of physical store closures, VRG's online sales increased their share in total sales by 9.8pp y/y to 24.3% in Q4 2020.

Operating cash flow in the quarter was weaker, consistently with weaker profits, however it is worth noting the positive effects of optimized working capital that drove improvement across the board. VRG reduced total inventories by 5.6% y/y in Q4 2020, including a 16.5% decrease in the clothing stock, and it increased the use of supplier financing (PLN 28.3m). As a result, net debt as of 31 December 2020 showed a decrease to PLN 53.7m from PLN 91.3m the year before, with the net debt/EBITDA ratio at 2.3x vs. 0.8x at the end of 2019.

Overview of 2020 Q4 Results

(PLN m)	Q4'19	Q4'20	change
Revenue	332	232	-30.2%
Fashion	207	118	-43.1%
Jewelry	126	114	-9.1%
Gross margin	53.7%	51.2%	-2.4p.p.
Fashion	53.6%	49.3%	-4.3p.p.
Jewelry	53.8%	53.2%	-0.6p.p.
EBIT	47.6	-2.9	-106.1%
Fashion	26.6	-8.6	-132.3%
Jewelry	21	19	-7.6%
margin	14.3%	-1.2%	-15.6p.p.
Fashion	12.8%	-7.3%	-20.1p.p.
Jewelry	16.7%	17.0%	0.3p.p.
Pre-tax profit	53.9	-16.7	-
Net profit	44.3	-18.9	-

Source: VRG, mBank

At the conference to discuss 2020 Q4 results, VRG said it wanted to maintain its physical store areas unchanged in 2021, adding that the CAPEX budget for the year was PLN 18m. VRG is also guiding for significantly higher profit and strong e-commerce sales in 2021, supported by deals with digital third-party marketplaces to sell the Deni Cler women's lines (Zalando) and Vistula suits (Modivo). By establishing a presence on these platforms, VRG can reach potential customers in new geographic markets. If successful, the Company will consider listing more of its labels on digital marketplaces.

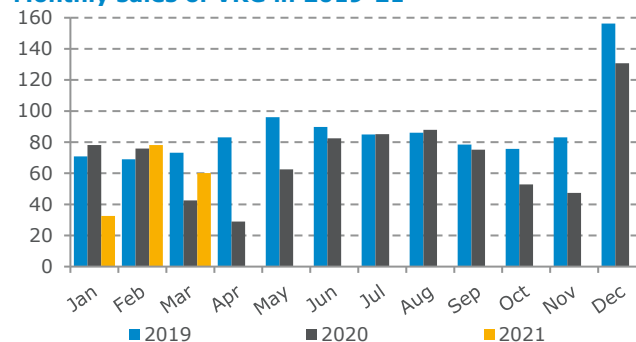
Ready to Weather Lockdown

VRG had to again contend with closing its brick-and-mortar stores under lockdown regulations in the first quarter of 2021, and as a result in January its sales fell significantly compared to the same month in 2020, only to rebound in February, with revenue beating the results from February 2020 and February 2019.

In March, Poland again imposed restrictions on nonessential shopping but with lockdown also in place in March 2020 VRG was able to report higher sales for the month.

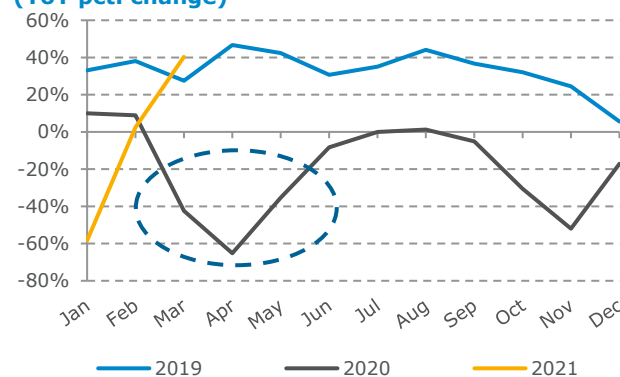
Sales growth in subsequent months from April through June will again be supported by positive base effects, but even relative to 2019 levels we are expecting VRG to grow future monthly sales past their pre-pandemic levels.

Monthly sales of VRG in 2019-21



Source: VRG, mBank

Growth in monthly sales of VRG in 2019-21 (YoY pct. change)

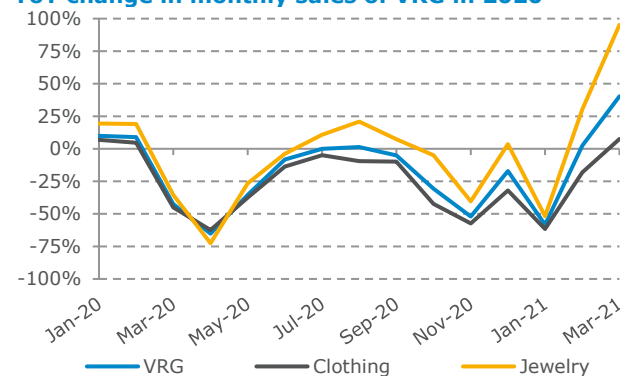


Source: VRG, mBank

Jewelry Sales Soar

VRG increased sales of jewelry pieces and watches significantly in 2020, and the upward momentum has continued into 2021, with monthly sales this year beating the pre-pandemic levels registered in 2019. As we see it, part of the growth is owed to the increasing trading area of W.Kruk stores, and mostly it is driven by the improving sales effectiveness of existing stores.

YoY change in monthly sales of VRG in 2020

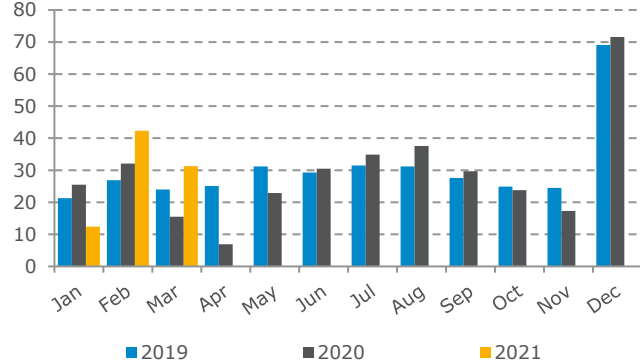


Source: VRG, mBank

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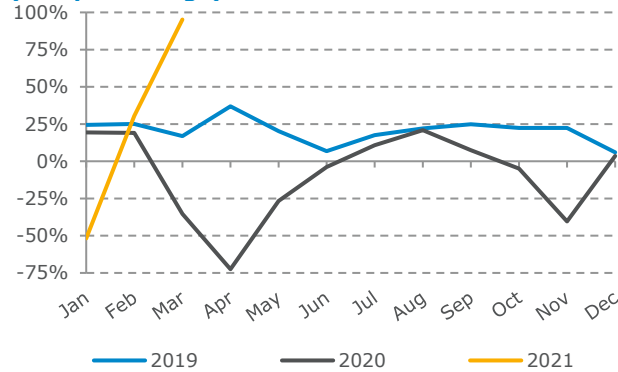
In March 2021, the volume of jewelry sold by VRG increased both relative to March 2020 and March 2019, and we are expecting continued growth in April and May, and probably the months after.

Monthly sales of jewelry by VRG in 2019-21



Source: VRG, mBank

Growth in monthly jewelry sales in 2019-21 (YoY pct. change)

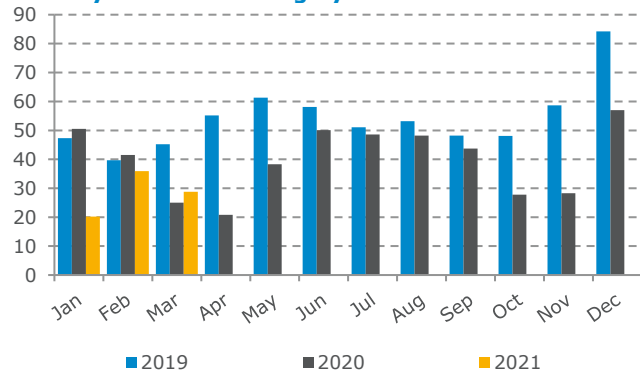


Source: VRG, mBank

Clothing Sales Slow

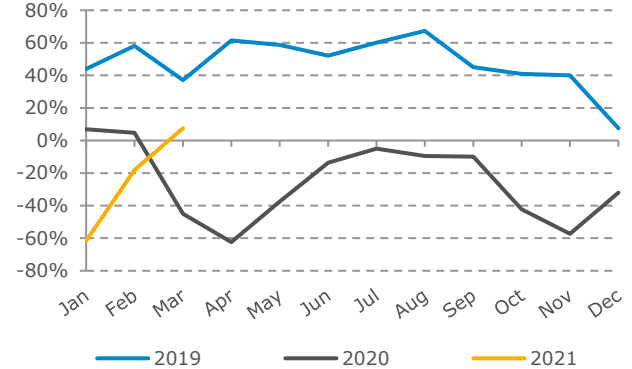
Due in part to negative base effects, VRG's clothing business has not managed to deliver growth so far this year amid persistent downward pressures that include weaker demand for formalwear under pandemic conditions, accompanied by stronger sales of casual clothing at lower price tags. With a portion of the working population likely to remain on remote working set-ups beyond the end of the pandemic, this is a factor that might continue to affect sales in the long term.

Monthly sales of clothing by VRG in 2019-21



Source: VRG, mBank

Growth in monthly clothing sales in 2019-21 (YoY pct. change)

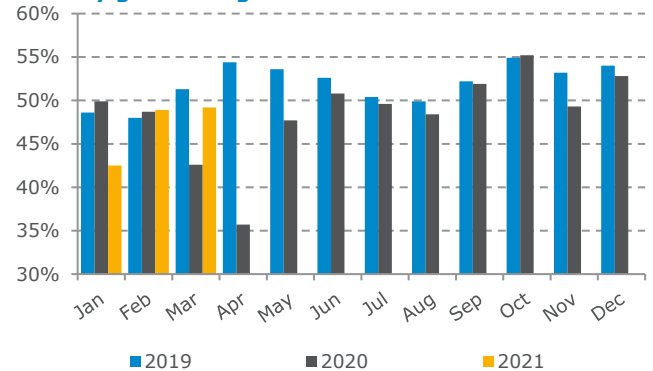


Source: VRG, mBank

Favorable Base Effects

VRG is able to better manage sales margins now that it has adapted its business model and working-capital levels to pandemic conditions. The benefits are experienced particularly intensely when the Company's stores are allowed to stay open for business, and the hope for the coming months is that sales margins can materialize fully as the pandemic is brought under control.

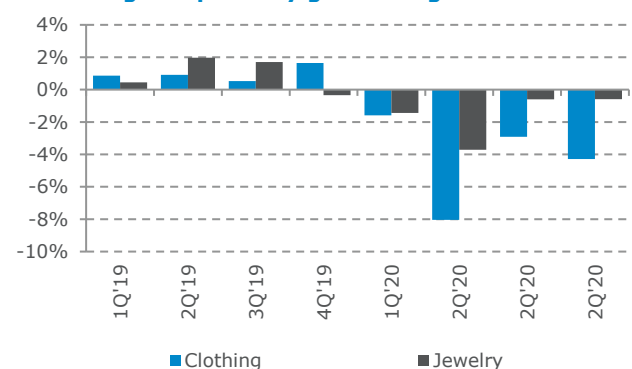
Monthly gross margins of VRG



Source: VRG, mBank

Margins on jewelry sales have contracted at a much slower rate this year than the clothing margins. Since June 2020, this trend has been supported by rising prices of gold and silver (VRG has a policy of keeping markup constant over costs). We see even more room for margin expansion in the coming months assuming fewer clearance sales, with inventory as of December 2020 said to have been at an optimal level, supported by positive base effects.

YoY change in quarterly gross margins of VRG

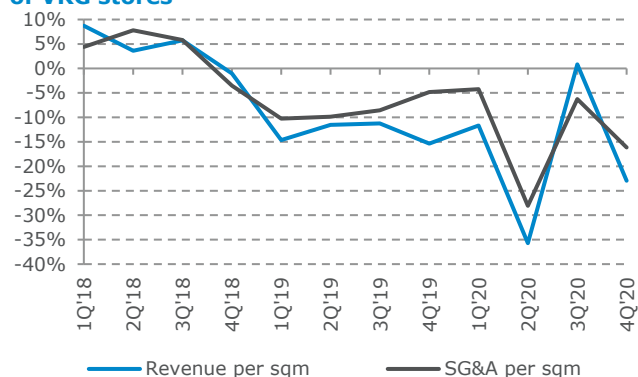


Source: VRG, mBank

Reversal of Cost Trends

VRG set out to reduce operating costs during 2020 as a way of shielding against sales falls during periods of store closures. Among others, the Company opted for savings on payroll and rent. Nevertheless, on average, the amount of revenue generated by physical stores fell in three quarters of 2020 except for the third quarter, when there were not lockdown periods. This year, we believe the per-sqm revenue ratio will improve from the second quarter.

YoY change in per-sqm revenues and SG&A expenses of VRG stores



Source: VRG, mBank

Slower Store Expansion

The outbreak of the coronavirus pandemic pushed VRG to pare down plans as regards expansion of clothing stores to assume a 2% decrease in 2021, but at the same time the Company intends to grow the trading area of jewelry stores. VRG is also expected to keep a fast pace of growth in franchise locations in the coming periods – a strategy that allows to mitigate operating risks.

Change in floor area of VRG stores by operating segment

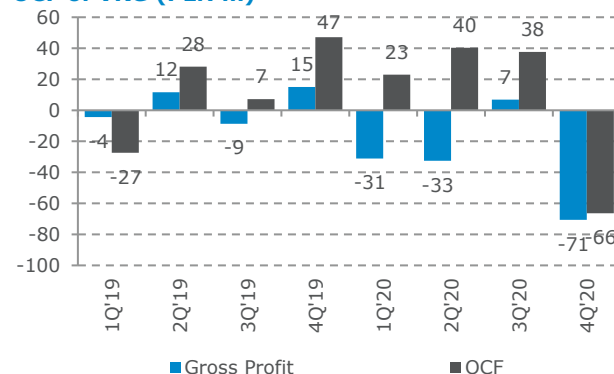
	2016	2017	2018	2019	2020	2021E
Total store area (1,000 sqm)						
VRG	30.5	33.3	51.6	54.4	53.0	53.1
Fashion	22.2	24.6	42.1	43.7	42.0	41.4
Jewelry	8.3	8.7	9.6	10.6	11.0	11.7
YoY change						
VRG	9%	9%	15%	5%	-3%	0%
Fashion	8%	11%	17%	4%	-4%	-2%
Jewelry	11%	5%	10%	11%	3%	7%

Source: VRG, mBank

Optimization of Working Capital

VRG's efforts to stay afloat in 2020 also involved a successful attempt at improving management of working capital. Amid falling sales profits, in 1Q'20, 2Q'20 and 4Q'20 the Company was able to report higher OCF than in the corresponding year-ago periods by releasing cash from inventories. In 4Q'20, OCF was influenced by increased stocking of jewelry.

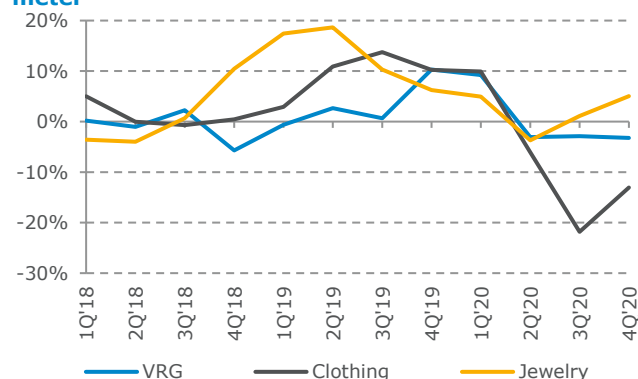
YoY nominal change in quarterly gross profit and OCF of VRG (PLN m)



Source: VRG, mBank

Initiatives aimed at reducing inventories brought measurable results in Q2 2020, with the clothing stock in particular brought to more manageable levels while the jewelry stock has been kept slightly higher to fulfill stronger demand. As of 31 December 2020 VRG's inventory totaled PLN 505.6m – PLN 30m less than in December 2019. Of this, an estimated PLN 255m was clothing, down PLN 50m or 16.5% year over year, and PLN 249m was jewelry (+PLN 19m or +8.3% y/y).

YoY change in avg. quarterly inventory per square meter



Source: VRG, mBank

FY2020 ending net debt stood at PLN 54m after a 41.2% y/y reduction. In FY2021, we are expecting a small rebound in working capital after the big cuts of 2020.

Forecast of 2020 Q1 Results

VRG's stores had to stay closed for an equivalent of nearly 1.5 months in Q1 2021, and based on monthly sales reports from that period we expect the quarterly SG&A expenses reduced by 8.3% y/y after cuts in payroll and rental costs. EBITDA is likely to post a 38% drop from Q1 2020. We are not expecting any losses on FX adjustments.

Forecast of 2021 Q1 Results

(PLN m)	Q1'21E	Q1'20	Y/Y
Revenue	171.5	197.5	-13%
Gross profit	81.8	94.0	-13%
margin	47.7%	47.6%	0.1p.p.
EBITDA	10.7	17.4	-38%
EBITDA margin	6.3%	8.8%	
EBIT	-15.0	-11.9	
Pre-tax profit	-21.4	-35.1	
Net profit	-19.5	-32.0	

Source: mBank

Outlook for FY2021

As we write this, VRG's brick-and-mortar stores remain closed since mid-March under the latest round of coronavirus restrictions. Nevertheless, in March, the Company managed to improve sales relative to the same year-ago month, supported by positive base effects.

Once stores reopen, we are anticipating a strong rebound in sales and margins in 2021, underpinned by the cost optimization of 2020. Challenges still ahead include losses on the clothing business, which might need more time to recoup with profits likely to remain in the negative territory through the whole of this year. On the other hand, the jewelry business with its remarkable resilience can be expected to deliver robust growth in 2021.

Key efficiency metrics of VRG stores

	2018	2019	2020	2021E	2022E
Revenue per sqm (PLN)	1,581.1	1,679.3	1,324.9	1,604.5	1,754.2
Gross margin	51.2%	52.1%	48.9%	50.2%	50.9%
SG&A/Sales	42.2%	43.9%	48.8%	45.1%	44.1%
SG&A per sqm (PLN)	667.5	737.5	646.9	722.9	773.0
EBIT margin	8.9%	8.2%	-1.4%	5.0%	6.8%
Total store area (1,000 sqm)	51.6	54.4	53.0	53.1	54.8

YoY change

Revenue per sqm	-12.1%	6.2%	-21.1%	21.1%	9.3%
Gross margin	-1p.p.	0.9p.p.	-3.2p.p.	1.3p.p.	0.7p.p.
SG&A/Sales	-0.4p.p.	1.7p.p.	4.9p.p.	-3.8p.p.	-1p.p.
SG&A per sqm	-12.9%	10.5%	-12.3%	11.8%	6.9%
EBIT margin	-0.2p.p.	-0.7p.p.	-9.6p.p.	6.4p.p.	1.7p.p.
Total store area (1,000 sqm)	55.0%	5.4%	-2.6%	0.2%	3.3%

Source: VRG, mBank

Forecast Revision

We have revised downward our sales forecasts for VRG to reflect worse-than-expected revenues from the clothing business. At the same time we adjusted for stronger-than-initially-thought reductions in SG&A expenses, and their positive effects on EBITDA. Based on FY2020 figures, we have also raised slightly our expectations as to future financing costs.

Changes to 2021-2022 earnings forecasts

(PLN m)	2021E			2022E		
	old	new	change	old	new	change
Revenue	1,065.9	1,021.2	-4.2%	1,185.3	1,135.9	-4.2%
Gross margin	50.7%	50.2%	-0.5p.p.	51.0%	50.9%	-0.08p.p.
EBITDA*	67.3	71.9	6.8%	93.6	97.0	3.6%
Margin	6.3%	7.0%	0.7p.p.	7.9%	8.5%	0.6p.p.
EBIT	48.2	51.3	6.4%	73.9	76.9	3.9%
Pre-tax profit	34.8	35.0	0.4%	65.3	62.2	-4.8%
Net income*	29.1	29.8	2.4%	53.3	54.1	1.6%

Source: mBank; *IAS 17 figures

Income statement

(PLN m)	2015	2016	2017	2018	2019	2020	2021E	2022E	2023E
Revenue	514.2	598.5	688.5	805.7	1,068.3	853.7	1,021.2	1,135.9	1,196.0
change	16.0%	16.4%	15.0%	17.0%	32.6%	-20.1%	19.6%	11.2%	5.3%
COGS	241.4	286.7	329.1	393.4	512.2	436.4	508.8	557.5	574.5
Gross profit	272.7	311.8	359.4	412.3	556.1	417.3	512.4	578.4	621.5
Gross margin	53.0%	52.1%	52.2%	51.2%	52.1%	48.9%	50.2%	50.9%	52.0%
Selling expenses	174.1	205.1	230.5	272.8	383.1	339.8	344.1	377.1	398.4
General and administrative expenses	52.8	56.1	62.8	67.3	86.1	77.0	116.0	123.4	132.6
Other operating activity (net)	-2.5	0.4	-3.2	-0.2	0.6	-12.4	-1.0	-1.0	-1.0
EBIT	43.3	50.9	62.8	71.9	87.5	-11.9	51.3	76.9	89.5
change	17.8%	17.6%	23.3%	14.4%	21.7%	-113.6%	-529.9%	49.9%	16.5%
EBIT margin	8.4%	8.5%	9.1%	8.9%	8.2%	-1.4%	5.0%	6.8%	7.5%
Net financing gains/losses	-11.2	-6.6	-7.8	-6.2	-8.1	-36.2	-16.3	-14.7	-11.6
Pre-tax profit	32.1	44.3	55.0	65.7	79.4	-48.1	35.0	62.2	77.9
Tax	-6.8	-9.3	-11.8	-12.2	-15.4	-0.1	-8.8	-11.8	-14.8
Net profit	25.4	35.0	43.2	53.5	64.0	-48.2	26.2	50.4	63.1
change	25.0%	38.2%	23.3%	23.9%	19.5%	-175.3%	-154.3%	92.5%	25.3%
margin	4.9%	5.9%	6.3%	6.6%	6.0%	-5.6%	2.6%	4.4%	5.3%
D&A expenses	12.5	14.2	15.5	17.3	23.6	23.0	20.7	20.1	20.0
EBITDA	55.9	65.2	78.4	89.2	198.5	98.4	154.7	182.4	197.0
EBITDA (ex. IFRS 16)	55.9	65.2	78.4	89.2	111.1	11.1	71.9	97.0	109.5
change	16.0%	16.7%	20.2%	13.8%	24.5%	-90.0%	549.3%	34.8%	12.9%
EBITDA margin (adj.)	10.9%	10.9%	11.4%	11.1%	10.4%	1.3%	7.0%	8.5%	9.2%
EBIT (ex. IFRS 16)	43.3	50.9	62.8	71.9	87.6	0.5	50.9	76.5	89.2
Net profit (ex. IFRS 16)	25.4	35.0	43.2	53.5	65.9	-5.3	29.8	54.1	66.5
Shares outstanding at eop (millions)	173.9	173.9	173.9	234.5	234.5	234.5	234.5	234.5	234.5
EPS	0.1	0.2	0.2	0.2	0.3	-0.2	0.1	0.2	0.3
ROA	3.8%	4.8%	5.6%	5.7%	5.0%	-3.3%	1.8%	3.2%	3.9%
ROE	5.7%	7.4%	8.3%	7.9%	7.7%	-5.7%	3.2%	5.8%	6.8%

Balance Sheet

(PLN m)	2015	2016	2017	2018	2019	2020	2021E	2022E	2023E
ASSETS	697.3	751.5	778.8	1,113.4	1,431.3	1,458.0	1,509.1	1,594.0	1,627.4
Fixed assets	424.6	428.5	425.5	593.2	847.0	889.8	841.6	847.9	852.7
Property, plant and equipment	57.0	61.3	59.4	78.0	71.6	60.6	57.6	56.8	56.4
Intangible assets	357.7	357.6	358.8	507.3	499.7	499.0	499.0	499.0	499.0
Deferred tax assets	7.9	8.2	5.8	6.4	7.7	16.3	16.3	16.3	16.3
Other	2.0	1.3	1.5	1.5	268.0	313.9	268.7	275.8	281.0
Current assets	272.7	323.0	353.4	520.1	584.3	568.2	667.5	746.1	774.7
Inventory	240.6	284.0	315.3	460.8	535.5	505.6	532.4	587.8	622.9
Accounts receivable	15.2	21.0	20.2	23.9	19.9	13.3	15.9	17.7	18.7
Cash and cash equivalents	15.6	16.8	16.4	33.5	25.3	48.8	118.7	140.2	132.7
Other	1.4	1.3	1.4	1.9	3.6	0.5	0.5	0.5	0.5

(PLN m)	2015	2016	2017	2018	2019	2020	2021E	2022E	2023E
EQUITY & LIABILITIES	697.3	751.5	778.8	1,113.4	1,431.3	1,458.0	1,509.1	1,594.0	1,627.4
Equity	458.5	494.4	542.5	805.1	863.3	815.1	841.3	891.7	954.8
Non-current liabilities	101.1	95.1	85.3	76.8	243.4	307.2	242.0	213.3	218.5
Loans and borrowings	98.1	91.9	82.1	70.8	55.9	47.2	27.2	-8.7	-8.7
Other	3.0	3.2	3.2	6.0	187.5	260.0	214.8	221.9	227.2
Current liabilities	137.7	162.0	151.0	231.5	324.7	335.7	425.8	489.1	454.1
Loans and borrowings	5.9	17.7	20.4	14.6	21.3	11.3	102.4	145.4	103.4
Trade creditors	114.9	121.2	108.8	192.8	191.7	199.2	211.4	231.6	238.7
Finance leases	0.0	0.0	0.0	0.0	86.3	98.8	98.8	98.8	98.8
Other	16.9	23.2	21.8	24.0	25.3	26.3	13.2	13.2	13.2
Debt	103.9	109.6	102.6	85.4	77.2	58.5	129.6	136.7	94.7
Net debt	98.2	106.5	98.6	63.1	66.1	22.7	10.9	-3.4	-38.0
Net debt / Equity	21.4%	21.5%	18.2%	7.8%	7.7%	2.8%	1.3%	-0.4%	-4.0%
Net debt/ EBITDA	1.8	1.6	1.3	0.7	0.6	2.1	0.2	0.0	-0.3
BVPS	2.6	2.8	3.1	3.4	3.7	3.5	3.6	3.8	4.1

Cash Flow

(PLN m)	2015	2016	2017	2018	2019	2020	2021E	2022E	2023E
Cash flow from operating activities	25.7	6.0	20.5	53.5	108.6	143.2	112.3	119.1	141.6
Pre-tax income	28.2	35.2	43.2	65.7	79.4	-48.1	26.2	50.4	63.1
D&A expenses	12.5	14.2	15.5	17.3	23.6	23.0	20.7	20.1	20.0
Amortization of assets held u. finance leases	0.0	0.0	0.0	0.0	87.4	87.3	82.7	85.5	87.4
Change in provisions	1.8	2.3	0.5	-2.9	0.3	-1.1	0.0	0.0	0.0
Working capital	-12.3	-33.0	-27.0	-21.1	-75.3	88.4	-17.3	-36.9	-29.0
Other	-4.6	-12.7	-11.8	-5.6	-6.7	-6.4	0.0	0.0	0.0
Cash flow from investing activities	-12.6	-18.0	-15.3	-18.6	-16.8	-16.1	-17.7	-19.3	-19.6
CAPEX	-14.4	-19.2	-18.7	-18.2	-25.0	-16.9	-17.7	-19.3	-19.6
Other	1.8	1.2	3.4	-0.4	8.2	0.8	0.0	0.0	0.0
Cash flow from financing activities	-10.7	13.2	-5.0	-17.8	-100.1	-103.5	-24.7	-78.3	-129.4
Loans and borrowings	108.1	9.4	-8.4	8.0	-4.7	-18.6	58.0	7.2	-42.0
Debt securities	-119.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Dividends	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.2	3.9	3.4	-25.8	-95.4	-84.9	-82.7	-85.5	-87.4
Change in cash	2.4	1.3	0.3	17.1	-8.2	23.6	69.9	21.5	-7.5
FX effects	0.0	0.0	0.7	0.0	0.0	0.0	0.0	0.0	0.0
Cash at eop	15.6	16.8	16.4	33.5	25.3	48.8	118.7	140.2	132.7
DPS (PLN)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FCF	20.0	2.3	19.2	36.6	-6.1	82.5	24.1	26.2	43.9
CAPEX/Sales	2.8%	3.2%	2.7%	2.3%	2.3%	2.0%	1.7%	1.7%	1.6%

Trading Multiples*

	2015	2016	2017	2018	2019	2020	2021E	2022E	2023E
P/E*	22.8	16.5	13.4	14.6	11.8	-147.1	26.2	14.4	11.7
P/CE*	15.3	11.7	9.8	11.0	8.7	44.0	15.5	10.5	9.0
P/B	1.3	1.2	1.1	1.0	0.9	1.0	0.9	0.9	0.8
P/S	1.1	1.0	0.8	1.0	0.7	0.9	0.8	0.7	0.7
FCF/EV*	3.0%	0.3%	2.8%	4.3%	-0.7%	10.3%	3.0%	3.4%	5.9%
EV/EBITDA	12.1	10.5	8.6	9.4	7.6	72.4	11.0	8.0	6.8
EV/EBIT*	15.6	13.4	10.8	11.7	9.7	1,604.6	15.5	10.1	8.3
EV/S*	1.3	1.1	1.0	1.0	0.8	0.9	0.8	0.7	0.6
OCF/EBITDA	46%	9%	26%	60%	19%	504%	41%	35%	49%
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Price (PLN)	3.325	3.325	3.325	3.325	3.325	3.325	3.325	3.325	3.325
Shares outstanding at eop (millions)	173.9	173.9	173.9	234.5	234.5	234.5	234.5	234.5	234.5
MC (PLN m)	578	578	578	780	780	780	780	780	780
Minority interest (PLN m)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
EV (PLN m)*	676	685	677	843	846	802	790	776	742

*ex. IFRS 16

List of abbreviations and ratios contained in the report:

EV – net debt + market value
EBIT – Earnings Before Interest and Taxes
EBITDA – EBIT + Depreciation and Amortisation
P/CE – price to earnings with amortisation
MC/S – market capitalisation to sales
EBIT/EV – operating profit to economic value
P/E – (Price/Earnings) – price divided by annual net profit per share
ROE – (Return on Equity) – annual net profit divided by average equity
P/BV – (Price/Book Value) – price divided by book value per share
Net debt – credits + debt papers + interest bearing loans – cash and cash equivalents
EBITDA margin – EBITDA/Sales

OVERWEIGHT (OW) – a rating which indicates that we expect a stock to outperform the broad market
NEUTRAL (N) – a rating which indicates that we expect the stock to perform in line with the broad market
UNDERWEIGHT (UW) – a rating which indicates that we expect the stock to underperform the broad market

Recommendations of Biuro maklerskie mBanku:

A recommendation is valid for a period of 9 months, unless a subsequent recommendation is issued within this period. Expected returns from individual recommendations are as follows:

BUY – we expect that the rate of return from an investment will be at least 15%
ACCUMULATE – we expect that the rate of return from an investment will range from 5% to 15%
HOLD – we expect that the rate of return from an investment will range from -5% to +5%
REDUCE – we expect that the rate of return from an investment will range from -5% to -15%
SELL – we expect that an investment will bear a loss greater than 15%
Recommendations are updated at least once every nine months.

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The production of this recommendation was completed on April 23, 2021, 8:16 AM.
This recommendation was first disseminated on April 23, 2021, 8:25 AM.

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mBank issued the following recommendations for VRG in the 12 months prior to this publication:**VRG**

recommendation	buy	accumulate	hold	hold
date issued	2020-09-23	2020-07-02	2020-06-03	2020-04-06
target price (PLN)	3.14	2.43	2.43	2.00
price on rating day	2.51	2.33	2.40	1.94

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