

Thursday, November 05, 2020 | Monthly Market Outlook, an excerpt

VRG buy (no change)

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Shares in VRG took a downward turn in October in response to rising COVID-19 infections and increasing fears over a second lockdown, which came true on November 4th with the announcement of non-essential store closures in Poland from November 7th to 29th. Lockdown aside, VRG has its 2020 third-quarter release scheduled for November 10th, and based on the period's monthly sales we see a 1% decline in quarterly revenue to an estimated PLN 249.3m, and we expect EBIT to rise 6% y/y to PLN 13.4m, thanks mainly to jewelry stores, which have low sensitivity to market shifts. Unfortunately, sales in October seem to have plunged by approximately 30.6% from the same month a year earlier, led largely by the fashion business (-42.3% y/y), with the jewelry business registering much slower contraction at an annual rate of 4.9%. Based on the fact that the pace of the October falls in VRG clothing stores far outpaced the general rate of decline in shopping center footfall for the month, we have to assume that this is the fault of VRG's new 2020 autumn/winter designs. If we are correct, this would put into question our FY2020 earnings expectations for VRG, newly undercut also by the November lockdown. On a positive note, VRG has healthy cash reserves that can be used to cushion the November brick-and-mortar store closures. Furthermore, with initiatives to optimize working capital by, among others, scaling back orders and negotiating longer payment terms, and looking at the deleveraging achieved in the first half of 2020, we believe VRG can keep its net debt from increasing too much this year.

Financial Highlights (adjusted for IFRS 16)

(PLN m)	2018	2019	2020P	2021P	2022P
Fashion Sales	483	692	544	648	746
Fashion EBIT	33	43	-17	12	36
Jewelry Sales	323	376	360	418	439
Jewelry EBIT	39.4	44.5	35.7	42.6	45.0
Gross profit margin	51.2%	52.1%	49.6%	50.7%	51.0%
Operating cash flow	54	109	110	156	151
D&A	17	24	21	19	20
D&A (IFRS 16)	0	87	96	99	104
Working capital	-21	-75	7	9	-25
Investing cash flow	-19	-17	-15	-20	-22
Financing cash flow	-18	-100	-73	-141	-132
Credit/loans	8	-5	27	-42	-28
FCF	37	-6	35	48	33
FCF/EBITDA	41%	-6%	88%	71%	35%
OCF/EBITDA	60%	19%	35%	84%	51%

DCF Analysis (adj. for IFRS 16)

(PLN m)	20P	21P	22P	23P	24P	25P	26P	27P	28P	29P	+
Sales/sqm (PLN)	1,408	1,675	1,808	1,804	1,818	1,824	1,829	1,834	1,840	1,845	1,845
SG&A/sqm (PLN)	652	772	808	805	811	814	820	826	832	839	839
Sales area (ksqm)	53	53	56	57	59	59	60	61	62	62	62
Revenue	904	1,066	1,185	1,227	1,266	1,290	1,309	1,329	1,350	1,371	1,399
EBITDA	39	67	94	105	108	110	109	107	106	104	106
EBITDA margin	4.4%	6.3%	7.9%	8.6%	8.5%	8.5%	8.3%	8.1%	7.9%	7.6%	7.6%
EBIT	19	48	74	85	87	89	88	86	85	83	85
Tax	-3	9	14	16	17	17	17	16	16	16	16
CAPEX	15	20	22	22	22	21	21	20	20	20	21
Working capital	7	9	-25	-22	-8	-8	-8	-9	-9	-6	-6
FCF	35	48	33	45	62	64	63	62	60	61	62
PV FCF	34	43	27	34	43	41	38	34	31	29	
WACC	8.6%	8.7%	8.8%	8.5%	8.5%	8.4%	8.0%	8.0%	8.0%	8.0%	8.0%
Risk-free rate	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%

Current Price 1.99 PLN
9M Target Price 3.14 PLN **Upside +57.8%**

	rating	target price	issued
unchanged	buy	3.14 PLN	2020-09-23

Key Metrics			VRG PW	vs. WIG
Ticker	VRG PW	1M Price Chng	-17.9%	-14.4%
ISIN	PLVSTLA00011	YTD Price Chng	-50.7%	-32.5%
Outst. Stock (m)	234.5	ADTV 1M		PLN 0.6m
MC (PLN m)	466.6	ADTV 6M		PLN 0.7m
EV (PLN m)	536.3	EV/EBITDA 12M fwd	5.1	-39.5%
Free Float	36.7%	EV/EBITDA 5Y avg	8.4	discount

Earnings Projections (adjusted for IFRS 16)

(PLN m)	2018	2019	2020P	2021P	2022P
Revenue	806	1,068	904	1,066	1,185
EBITDA adj.	89	111	39	67	94
EBITDA margin	11.1%	10.4%	4.4%	6.3%	7.9%
EBIT	72	87	19	48	74
Net income	54	66	8	29	53
P/E	8.7	7.1	58.5	16.1	8.8
P/B	0.6	0.5	0.5	0.5	0.5
EV/EBITDA adj.	5.9	4.8	13.6	7.4	5.1
DPS	0.00	0.00	0.00	0.00	0.00
DYield	0.0%	0.0%	0.0%	0.0%	0.0%
Forecast Update (% change)			2020P	2021P	2022P
EBITDA			0.0%	0.0%	0.0%
Net income			0.0%	0.0%	0.0%
B&M sales/sqm			0.0%	0.0%	0.0%
SG&A/sqm			0.0%	0.0%	0.0%
Floorspace			0.0%	0.0%	0.0%

Key Ratios (adj. for IFRS 16)

(PLN)	2018	2019	2020P	2021P	2022P
Sales/sqm, Fashion	1,318	1,048	719	927	1,049
Sales/sqm, Jewelry	2,540	2,689	2,314	2,693	2,759
SG&A/sqm, Fashion	420	598	538	626	643
SG&A/sqm, Jewelry	1,118	1,216	1,140	1,304	1,368
Cash (PLN m)	34	25	47	42	40
Net debt (PLN m)	63	66	70	33	7
Net debt/EBITDA (x)	0.7	0.6	1.8	0.5	0.1

Relative Valuation Summary

	P/E			EV/EBITDA		
	20P	21P	22P	20P	21P	22P
Minimum	6.1	5.9	5.2	4.7	3.7	3.5
Maximum	174.6	53.4	28.2	22.0	23.9	15.2
Median	18.3	19.9	13.5	8.2	7.2	5.7
Weight	0%	25%	25%	0%	25%	25%

DCF Summary

(PLN m)	
Beta	1.0
FCF perp. growth rate	2.0%
PV FCF	845
Net debt	66
Other adjustments	0
Value per share (PLN)	3.32

Valuation Summary

(PLN)	Weight	Price
Relative Val.	50%	2.60
DCF Val.	50%	3.32
Implied Price		2.96
Cost of equity (9M)		6.4%
9M Target Price		3.14

List of abbreviations and ratios contained in the report:

EV – net debt + market value (EV – economic value)
EBIT – Earnings Before Interest and Taxes
EBITDA – EBIT + Depreciation and Amortisation
PBA – Profit on Banking Activity
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

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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%
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Relative – based on a comparison of valuation multipliers of companies from a given sector; simple in construction, reflects the current state of the market better than DCF; weak points include substantial variability (fluctuations together with market indices) as well as difficulty in the selection of the group of comparable companies.

Economic profits – discounting of future economic profits; the weak point is high sensitivity to changes in the assumptions made in the valuation model.

Discounted Dividends (DDM) – discounting of future dividends; the weak point is high sensitivity to changes in the assumptions as to future dividends made in the valuation model.

NAV – valuation based on equity value, one of the most frequently used method in case of developing companies; the weak point of the method is that it does not factor in future changes in revenue/profits of a company.

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Rating	buy	accumulate	hold	hold	buy	accumulate
Rating date	2020-09-23	2020-07-02	2020-06-03	2020-04-06	2020-02-05	2019-12-02
Target price (PLN)	3.14	2.43	2.43	2.00	4.50	4.50
Price on rating day	2.51	2.33	2.40	1.94	3.93	3.94

Comparable Companies Used In Relative Valuation Models

VRG H&M, Inditex, Kappahl, Marks & Spencer, Next, Hugo Boss, CCC, LPP, Tiffany, Pandora, Lao Feng, Chow Sang, Luk Fook, Chow Tai Fook, Lao Fen Xiang

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