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VRG - 2019 Q4 Earnings Conference Highlights

Rating: buy | current price: PLN 1.83 | target price: PLN 4.50

VRG PW; VRGP.WA | Retail, Poland

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- **The four critical takeaways from VRG's earnings call earlier today is that the Company is bracing for 20% sales contraction this year, alongside tightening sales margins, but expects EBITDA to be in the positive territory, and does not see net debt as growing beyond what it was at the end of 2019.**
- The **closure of shopping centers** as part of a coronavirus lockdown means that 97% of VRG's brick stores are currently closed. Consequently, brick-and-mortar sales have dropped noticeably (i.e. by an estimated 80%) since the lockdown went into effect in mid-March, but at the same time online sales for the last two weeks are up 90% compared to this time last year.
- **e-Commerce:** VRG eyes online sales of about PLN 200m in 2020, an equivalent of 20% of the total expected sales for the year. Since there are no plans to cut back on digital marketing campaigns, on higher e-commerce revenue the 2020 sales margin will most likely tighten relative to the previous year.
- **Curbed expansion:** VRG's updated plan for this year is to reduce the total trading area by 2% to 53,400 square meters versus an original plan to grow floor space by 6%. At the same time, the size of an average fashion store will decrease by 3%, while jewelry stores will be upsized by 3%.
- **CAPEX** has been cut from PLN 25m to PLN 15m.
- **Rent:** VRG expects to be able to negotiate rent-free periods for its stores for the duration of the current lockdown. Afterwards, the Company will be negotiating with property managers to transition more locations to turnover leases. Locations where such negotiations fail might be closed.
- **Payroll cuts:** VRG has frozen performance and sales bonuses, which account for about 20% of its total payroll expenses. Moreover, the Company will be adjusting staff numbers depending on store size, and changing employee contracts.
- **Total marketing costs** will most likely be cut in half to PLN 10m in 2020.
- **Working capital:** The payables-to-inventory ratio is low. VRG will trim orders for the 2020 spring/summer season by 20%, and reduce autumn/winter collection purchases by 20-30%. By the end of the year, the Company hopes to reduce the clothing inventory by 15%, and bring the jewelry stock down by 5%. There is a focus on extending payment terms and increasing the use of reverse factoring.
- **Loan covenants** for 2020 will probably be reformulated. There are no plans for an equity issue.
- **In the worst-case scenario,** VRG has cash reserves to meet obligations until June assuming that is when shopping centers are allowed to reopen, and assuming online sales continue to go well.
- **VRG ended FY2020 on relatively solid financial footing. Thanks to a low payables/inventory ratio, and the planned optimization of working capital, the Company should not be squeezed for liquidity for the next few months. We are working on an updated valuation and earnings outlook for VRG to reflect the changed market conditions in retail, and the planned cost savings.**

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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