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VRG: 2020 Q3 Results Beat Expectations

Rating: buy | target price: PLN 3.14 | current price: PLN 2.20

VRG PW; VRGP.WA | Retail, Poland

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- **The 2020 third-quarter results of VRG exceeded market expectations.**
- Relative to **our forecasts** EBIT was in line at PLN 13.3m, as was net profit before IFRS16 financing costs in the amount of PLN 4.4m.
- Compared to the same period a year earlier, total **revenue** in Q3 2020 showed a small 1% decline at PLN 249.4m. This after contraction in per-square-meter sales across all fashion stores and a rebound at the jewelry stores by 8.6% year over year.
- **Gross margin** was down by 1.9pp y/y to 49.1% after a 2.9pp decrease in the margin on fashion sales and the margin on jewelry sales edging 0.6pp lower; the factors that affected sales profits in Q3 included a growing share of e-commerce in total orders, combined with price discounts.
- Total quarterly **SG&A** expenses showed an 8% y/y fall at PLN 106.8m, and **SG&A per square meter** were down 6% on the year, owing mainly to a 4% reduction in the costs of store maintenance and a 12% cut in HQ expenses – a result of ongoing **savings** initiatives.
- **EBIT** increased to PLN 13.3m in Q3 2020 from PLN 12.6m in the comparable year-ago period after an operating loss of PLN 2.9m incurred by the fashion segment (vs. positive EBIT of PLN 2.8m in 3Q'19) offset by a PLN 16.1m operating profit generated by the jewelry segment, representing a 68% rebound on the previous year.
- VRG generated **cash flow** of PLN 14.2m in Q3 2020 vs. PLN -12.5m in Q3 2019, an improvement driven by higher profits, lower inventory, and longer payment terms. Inventory per square meter was 3% lower as of 30 September 2020 than in September 2019.
- **Net debt** ex. IFRS 16 effects stood at PLN 87.9m at the time vs. PLN 172m the year prior, resulting in a net debt/ EBITDA ratio of 1.5x.
- VRG has revised its guidance on the likely rate of revenue decline in 2020 upwards to 25% from an original 15%.
- **The reason why VRG had to adjust its 2020 revenue guidance was the lockdown on clothing stores imposed in Poland from 7 November, although the sales figures for October were also less than stellar, suggesting the new collections may have failed to wow consumers. On lower revenue, VRG might not fulfill our current FY2020 full-year forecasts.**

2020 Q3 actuals vs. expectations

(PLN m)	3Q'20	3Q'19	change	3Q'20E	differ.	Consensus (median)	differ.	2020E*	2019*	change
Revenue	249.4	251.2	-0.7%	249.3	0.0%	249.4	0.0%	904.3	1 068.3	-15.4%
EBITDA	39.8	41.0	-2.9%	42.6	-6.5%	32.3	23.2%	39.4	111.1	-64.6%
margin	16.0%	16.3%	-0.4p.p.	17.1%	-1.1p.p.	46.9%		4.4%	10.4%	-6p.p.
EBIT	13.3	12.6	5.2%	13.4	-0.9%	11.1	19.4%	44.8	31.7	41.0%
Pre-tax income	7.0	0.2		9.4				-5.4	79.4	-106.8%
Net income	5.0	-1.8		9.4		6.3	-20.7%	8.0	65.9	-87.9%

Source: VRG, E - mBank estimates, consensus estimates provided by PAP; *EBITDA ex. IFRS16 effects

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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HOLD – we expect that the rate of return from an investment will range from -5% to +5%
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