

Monday, December 02, 2019 | research report

VRG: accumulate (downgraded)

VRG PW; VRGP.WA | Retail, Poland

Menswear Sales Underperform in 2019

VRG's 2019 third-quarter results came in line with market expectations, but they showed a sales slowdown at key fashion stores which continued into October, as reflected in further declines in the like-for-like sales generated by the menswear label Bytom. On top of a changed pricing policy, it would seem that Bytom's autumn/winter collections failed to appeal to shoppers. Bytom's more casual sister brand, Vistula, improved per-square-meter sales in October, with the new pricing strategy this case helping to curb the pace of year-over-year contraction. VRG's jewelry stores have been doing very well this year, and they will most likely continue to grow sales at double-digit rates in Q4 2019 and further into 2020, when like-for-like sales are projected to grow by 3% despite negative base effects. Rising labor costs present a major challenge for VRG going forward, but we expect expanding sales margins and improved sales at Bytom and Vistula stores to mitigate the impact. We have adjusted our 2019 and 2020 EBITDA estimates lower to reflect the better-than-expected results of the jewelry business on the one hand, and the weaker performance of the fashion business on the other hand (though the temporary clothing slump in our view has been excessively discounted by the market). On the updated outlook, we downgrade VRG from buy to accumulate.

Fashion sales fall short

VRG's Vistula stores posted a 3% decline in per-square-meter sales in the nine months to 30 September 2019 relative to the same period last year, and at the same time the Bytom stores suffered lfl shrinkage at the rate of 8%. We blame the slump on the new pricing policy, which cuts down on deals. At the same time, per-square-meter costs this year have decreased at a much slower rate than sales. We expect sales and profits to improve next year as VRG tailors its 2020 collections to better fit the tastes of its customers.

Jewelry sales exceed expectations

The W.Kruk jewelry stores have delivered strong like-for-like sales this year, supported by a strong economy, thanks mainly to an attractive selection of watches which we expect to be expanded further in 2020, most likely resulting in continued growth in sales. VRG wants to build on the strong sales streak and expand its jewelry sales area by a further 10% in 2020.

Synergy boosts sales margins

VRG has realized synergies on sales margins this year by modifying the pricing and deals policies. In 2020, through centralized purchasing and economies of scale, sales margins are expected to grow by a further 0.8pp, offsetting the impending hikes in labor costs.

(PLN m)	2017	2018	2019E	2020E	2021E
Revenue	688.5	805.7	1 055.3	1 154.6	1 241.0
EBITDA (adj.)*	78.4	89.2	108.9	121.1	130.3
EBITDA margin (adj.)*	11.4%	11.1%	10.3%	10.5%	10.5%
EBIT (adj.)*	62.8	71.9	85.8	97.1	106.0
Net profit (adj.)*	43.2	53.5	64.2	70.2	78.1
P/E (adj.)*	15.9	17.3	14.4	13.1	11.8
P/CE (adj.)*	11.7	13.0	10.6	9.9	9.1
P/B	1.3	1.1	1.1	1.0	0.9
EV/EBITDA (adj.)*	10.0	11.1	9.1	8.2	7.3
DPS	0.0	0.0	0.0	0.0	0.0
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%

*adjusted for IFRS16 effects

Current Price	PLN 3.94
Target Price	PLN 4.50
Market Cap	PLN 924m
Free Float	PLN 374m
ADTV (3M)	PLN 1.3m

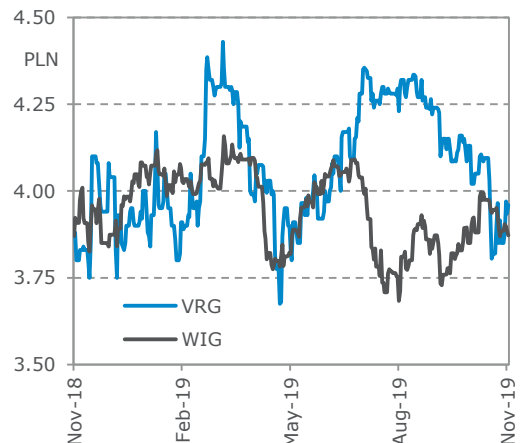
Ownership

Ipopema 2 FIZAN	14.96%
OFE PZU	14.60%
OFE NN	13.99%
Jerzy Mazgaj	9.33%
TFI Forum	6.65%
Others	40.47%

Business Profile

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. VRG owes its fast-paced expansion to a strategy of organic growth complemented by mergers and acquisitions. VRG 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	new	old
VRG	4.50	5.20	accumulate	buy

Company	Current Price	9MTP	Upside
VRG	3.94	4.50	+14.2%

Forecast Update	2019E	2020E	2021E
EBITDA	-12.0%	-12.4%	-12.5%
Net profit	-13.1%	-17.3%	-16.9%
Sales/sqm	-0.3%	-1.7%	-2.0%
SG&A/sqm	-0.5%	0.3%	0.4%
Total sales area	-0.4%	-2.3%	-4.5%

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Investment Risk

Economic Slowdown

VRG faces a slowdown in sales any time there is a decline in consumer demand. At the moment, consumer confidence in Poland is strong, supported by low unemployment rising and wages, and boosted further by various new government-sponsored benefits programs.

Exchange Rate Risk

Increasingly, VRG makes payments to its international suppliers in foreign currencies. As of 30 September 2019, orders in USD, EUR, and CHF accounted for 32%, 20%, and 6%, 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. 25% of 9M 2019 SG&A.

Price War

VRG operates in a challenging and fiercely competitive casual-fashion market where rivals sometimes engage in price wars which can be potentially destructive to sales profits.

Risk of Failed Fashion Collections

VRG has to stay on top of the changing tastes of consumers, and by and large it has been successful in keeping up with trends, resulting in increasing like-for-like sales. The Company also works on drawing more traffic to its stores through celebrity marketing campaigns. However, if a collection should fail to appeal to shoppers, this can potentially hurt sales.

Pricing Policy

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 with extremely price-conscious customers. VRG is aware of the risks, and its pricing policies to date have been successful in driving sales.

Risk Of Failed Acquisitions

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 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 4.44, and the Relative Valuation method, yielding a value of PLN 4.00 per share.

(PLN)	weight	price
Relative Valuation	50%	4.00
DCF Analysis	50%	4.44
	price	4.22
	9M target price	4.50

Relative Valuation

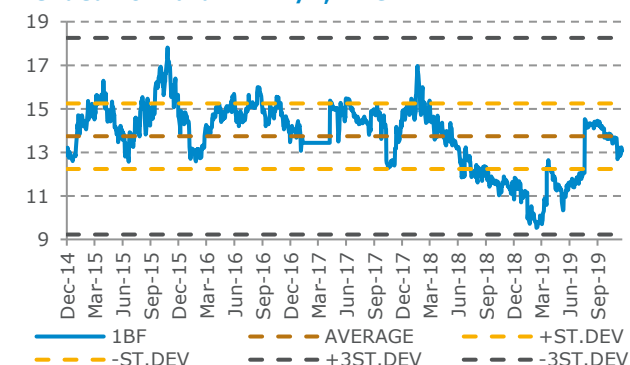
We compared the forward P/E and EV/EBITDA multiples of VRG with the multiples of two peer groups as projected for fiscal 2019 through 2021. Each multiple is assigned an equal weight. The two peer groups analyzed consist of comparable

fashion retailers and jewelry retailers, respectively. Note that the growth potential of VRG measured using the PEG ratio is greater when compared to most peers, implying premium valuation.

Relative Valuation

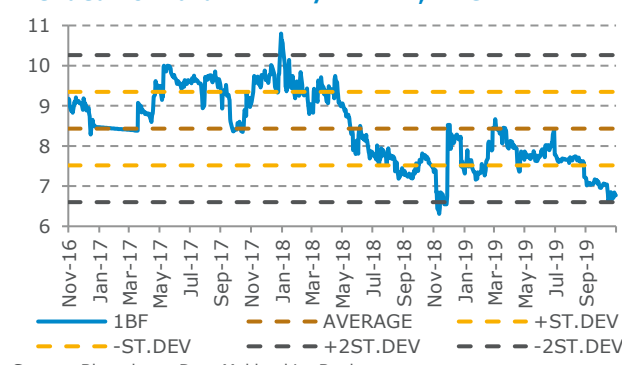
	Price	PEG			P/E			EV/EBITDA		
		2019E	2020E	2021E	2019E	2020E	2021PE	2019E	2020E	2021PE
Clothing Retailers										
HENNES & MAURI-B	184.84	3.7	3.4	3.2	23.4	21.6	20.1	11.2	10.4	9.9
INDITEX	28.26	3.9	3.6	3.4	25.3	23.1	21.7	15.9	11.8	11.3
KAPPAHL AB	20.02	-0.7	-0.7	-0.8	10.6	10.4	10.8	6.3	5.8	6.0
MARKS & SPENCER	194.35	0.1	0.1	0.1	8.1	10.4	10.6	6.9	6.4	6.7
NEXT PLC	6758	3.2	3.0	2.9	15.6	14.7	14.1	13.0	12.2	12.1
HUGO BOSS -ORD	42.75	3.1	2.7	2.5	13.2	11.9	11.0	7.7	7.4	7.0
CCC SA	112.4	0.6	0.3	0.2	44.1	21.2	15.2	8.5	7.2	6.2
LPP	8700	1.3	1.1	1.0	24.5	20.6	18.5	12.8	11.4	10.0
Jewelry Retailers										
TIFFANY & CO	133.6	1.4	1.4	1.3	28.5	27.6	25.8	17.2	16.9	15.9
PANDORA A/S	273.0	-2.5	-2.4	-2.2	7.1	6.9	6.3	6.0	5.9	5.4
LAO FENG XIANG-A	47.9	1.1	1.0	0.9	17.6	15.3	13.5	8.5	7.4	6.5
CHOW SANG SANG	9.0	1.4	1.3	1.2	6.1	5.8	5.3	4.8	4.4	4.1
LUK FOOK HLDGS I	21.8	6.1	7.4	6.4	8.6	10.4	9.0	6.8	7.5	6.5
CHOW TAI FOOK JE	7.4	1.9	1.8	1.6	16.5	16.0	13.9	12.5	11.7	10.4
LAO FEN XIANG-B	3.2	0.5	0.5	0.4	8.2	7.1	6.3	8.5	7.4	6.5
Minimum		-2.5	-2.4	-2.2	6.1	5.8	5.3	4.8	4.4	4.1
Maximum		6.1	7.4	6.4	44.1	27.6	25.8	17.2	16.9	15.9
Median (fashion)		2.2	1.9	1.7	19.5	17.7	14.6	9.8	8.9	8.4
Median (jewelers)		1.4	1.3	1.2	8.6	10.4	9.0	8.5	7.4	6.5
Median		1.4	1.3	1.2	15.6	14.7	13.5	8.5	7.4	6.7
VRG		1.4	1.1	1.0	16.7	13.7	12.3	9.1	8.2	7.3
premium / discount		-	-	-	7%	-7%	-9%	7%	10%	9%
Implied Valuation										
Median		1.4	1.3	1.2	15.6	14.7	13.5	8.5	7.4	6.7
Multiple weight						50%			50%	
Year weight					17%	17%	17%	17%	17%	17%
Equity value per share (PLN)	4.00									

Blended Forward 12M P/E, VRG



Source: Bloomberg, Dom Maklerski mBanku

Blended Forward 12M EV/EBITDA, VRG



Source: Bloomberg, Dom Maklerski mBanku

Additional Assumptions

Sales Efficiency Metrics

	2015	2016	2017	2018*	2019P	2020P	2021P	2022P
Sales area (1,000 sqm)								
Total VRG	28.0	30.5	33.3	51.6	55.2	57.6	59.7	61.8
y/y change	7%	9%	9%	55%	7%	4%	4%	4%
Fashion Stores	20.6	22.2	24.6	42.1	44.6	45.9	47.3	48.7
y/y change	8.2%	8.2%	10.7%	70.9%	6.0%	3.0%	3.0%	3.0%
Jewelry Stores	7	8	9	10	11	12	12	13
y/y change	3.4%	11.2%	5.0%	10.0%	11.0%	10.0%	6.0%	6.0%
Sales per square meter (PLN)								
Total VRG	1 581	1 705	1 798	1 581	1 646	1 706	1 764	1 808
y/y change	9.6%	7.8%	5.5%	-12.1%	4.1%	3.6%	3.4%	2.5%
Fashion Stores	1 308	1 413	1 495	1 207	1 303	1 340	1 380	1 414
y/y change	7.9%	8.1%	5.8%	-19.3%	7.9%	2.9%	3.0%	2.5%
Jewelry Stores	2 283	2 374	2 602	2 814	2 970	3 049	3 161	3 198
y/y change	13.1%	4.0%	9.6%	8.2%	5.5%	2.7%	3.6%	1.2%
SG&A/sqm (PLN)								
Total VRG	698	744	766	668	725	758	784	800
y/y change	6.4%	6.6%	2.9%	-12.9%	8.6%	4.6%	3.4%	2.1%
Fashion Stores	571	618	618	420	579	615	634	646
y/y change	2.1%	8.3%	0.0%	-32.1%	37.9%	6.2%	3.0%	2.0%
Jewelry Stores	964	970	1 062	1 118	1 214	1 242	1 292	1 305
y/y change	12.6%	0.5%	9.5%	5.3%	8.7%	2.3%	4.0%	1.0%
Cash conversion cycle (days)	364	362	350	427	395	408	409	410
Days inventory outstanding	11	13	11	11	5	4	4	4
Days receivables outstanding	174	154	121	179	149	134	134	134
Days payables outstanding	201	220	240	259	251	279	279	280

*Comparability of 2018 numbers is affected by the acquisition of Bytom

Sales & Profit Forecast by Operating Segment

	2015	2016	2017	2018	2019P	2020P	2021P	2022P
Fashion								
Revenue	310	363	420	483	677	728	772	815
Gross profit	166	189	214	245	349	383	408	430
SG&A expenses	141	165	183	212	310	339	360	378
Other operating gains/losses	-1	0	0	2	-1	-1	-1	-1
EBIT	24	24	29	33	39	43	47	51
Gross profit margin	53.4%	52.0%	50.9%	50.7%	51.6%	52.6%	52.8%	52.8%
YoY change (pp)	0.2	-1.4	-1.1	-0.2	0.9	1.0	0.2	0.0
EBIT margin	7.6%	6.6%	6.9%	6.7%	5.7%	5.8%	6.1%	6.3%
YoY change (pp)	1.5	-1.0	0.2	-0.1	-1.0	0.1	0.2	0.2
SG&A/Sales	45.4%	45.5%	43.5%	43.9%	45.8%	46.6%	46.6%	46.4%
YoY change (pp)	-2.0	0.1	-2.0	0.4	1.9	0.8	0.0	-0.2
Jewelry								
Revenue	204	236	271	323	378	427	469	503
Gross profit	107	123	145	167	202	229	251	270
SG&A expenses	86	96	111	128	155	174	192	205
Other operating gains/losses	-1	0	-1	1	0	0	0	0
EBIT	20	27	34	39	47	55	60	64
Gross profit margin	52.6%	52.3%	53.6%	51.9%	53.3%	53.6%	53.6%	53.6%
YoY change (pp)	-1.8	-0.3	1.3	-1.7	1.4	0.3	0.0	0.0
EBIT margin	9.7%	11.4%	12.5%	12.2%	12.4%	12.9%	12.7%	12.8%
YoY change (pp)	-2.0	1.7	1.1	-0.3	0.2	0.5	-0.2	0.1
SG&A/Sales	42.2%	40.8%	40.8%	39.7%	40.9%	40.7%	40.9%	40.8%
YoY change (pp)	-0.2	-1.4	0.0	-1.1	1.2	-0.2	0.1	-0.1

DCF Valuation

Assumptions

- Cash flows are discounted to their present value as of 29 November 2019. Equity value calculations factor in net debt as of 31 December 2018.
- We assume gross margin expansion by 1pp to 52.2% in 2019 and further growth to 53% in 2020.
- Average CAPEX in 2019-28E is PLN 25.3m.
- The DCF model does not account for the impact of exchange-rate differences on profits.
- Figures are presented ex-IFRS 16.
- We assume an annual tax rate of 19% in 2019-28E.
- The risk-free rate is 3.5%.
- We assume that FCF after FY2028 will grow at an annual rate of 2.0%.
- Unleveraged beta=1.0, avg. leveraged beta=1.1.

DCF Model

(PLN m)	2019P	2020P	2021P	2022P	2023P	2024P	2025P	2026P	2027P	2028P	+
Revenue	1,055	1,155	1,241	1,318	1,367	1,410	1,453	1,509	1,569	1,632	
change	31.0%	9.4%	7.5%	6.2%	3.7%	3.2%	3.0%	3.8%	4.0%	4.0%	
EBITDA	109	121	130	140	139	139	143	147	152	157	
EBITDA margin	10.3%	10.5%	10.5%	10.6%	10.2%	9.8%	9.8%	9.8%	9.7%	9.6%	
D&A expenses	23.1	23.5	23.9	24.3	24.7	25.0	25.2	25.4	25.5	24.7	
EBIT	86	98	106	116	114	114	117	122	127	132	
EBIT margin	8.1%	8.5%	8.6%	8.8%	8.4%	8.1%	8.1%	8.1%	8.1%	8.1%	
Tax on EBIT	16.0	18.5	20.2	22.0	21.7	21.6	22.3	23.2	24.1	25.1	
NOPLAT	70	79	86	94	93	92	95	99	103	107	
CAPEX	-25.7	-24.8	-24.7	-25.4	-25.6	-25.5	-25.4	-25.5	-25.6	-24.7	
Working capital	-59.8	-66.1	-31.8	-29.4	-16.1	-14.6	-15.4	-17.3	-17.5	-6.9	
FCF	7	12	54	63	76	77	79	81	85	100	102
WACC	8.7%	9.1%	8.9%	9.0%	8.9%	8.9%	8.8%	8.8%	8.7%	8.7%	
discount factor	99.3%	91.0%	83.6%	76.7%	70.4%	64.7%	59.5%	54.7%	50.3%	46.3%	
PV FCF	7.4	10.6	44.8	48.5	53.3	49.9	47.2	44.4	42.8	46.2	

WACC	8.7%	9.1%	8.9%	9.0%	8.9%	8.9%	8.8%	8.8%	8.7%	8.7%
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	18.6%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%
Net debt / EV	7.2%	0.0%	2.6%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Cost of equity	9.1%	9.1%	9.0%	9.0%	8.9%	8.9%	8.8%	8.8%	8.7%	8.7%
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	1.1	1.1	1.1	1.0	1.0

FCF growth after the forecast period	2.00%
Terminal value	1,531
Present value of terminal value	709
Present value of FCF in the forecast period	395
Enterprise value	1,104
Net debt	63
Minority interests	0.0
Equity value	1,041
Shares outstanding (millions)	234.46
Equity value per share (PLN)	4.44
9M cost of equity	6.3%
Target Price (PLN)	4.72
	9.6
EV/EBITDA ('19) at target price	20.1
EV/EBITDA ('19) at target price	64.2%
TV / EV	2.00%

Sensitivity Analysis

	FCF growth in perpetuity				
	0.0%	1.0%	2.0%	3.0%	5.0%
WACC +1.0 p,p	4.8	5.0	5.3	5.6	6.0
WACC +0.5 p,p	4.5	4.7	4.9	5.2	5.6
WACC	4.3	4.5	4.7	5.0	5.3
WACC -0.5 p,p	4.1	4.3	4.6	4.8	5.1
WACC -1.0 p,p	3.8	4.0	4.2	4.5	4.8

2019 Q3 Results

VRG reported 2019 Q3 results in line with market expectations. The **Jewelry** business increased EBIT in the period relative to the year-ago figure thanks to continuing like-for-like sales growth accompanied by gross margin expansion of 1.7pp. On the other hand, the **Fashion** segment suffered **contraction in operating profit** in Q3 led by **falling like-for-like sales at the Vistula and Bytom menswear stores** (the women's fashion brand Deni Cler, and Wólczanka shirts, both improved on the year-ago sales). It seems that weak lfl growth at Bytom is the biggest challenge faced by VRG going forward.

2019 Q3 results by operating segment

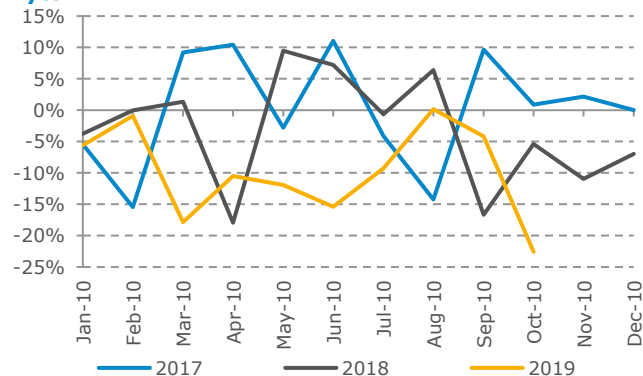
	3Q'18	3Q'19	change
Revenue	180	251	39.5%
Fashion	103	160	55.1%
Jewelry	77	91	18.4%
Gross margin	50.0%	51.0%	0.9p.p.
Fashion	49.9%	50.4%	0.5p.p.
Jewelry	50.2%	51.9%	1.7p.p.
EBIT	10.0	12.6	25.5%
Fashion	2.7	3.0	8.5%
Jewelry	7	9	26.7%
EBIT margin	5.6%	5.0%	-0.6p.p.
Fashion	2.6%	1.8%	-0.8p.p.
Jewelry	9.5%	10.2%	0.7p.p.
Pre-tax profit	8.8	0.2	-98.0%
Net profit	6.9	-1.8	-

Source: VRG, Dom Maklerski mBanku

LFL Deterioration at Bytom

Monthly revenues per square meter generated by Bytom stores have been on a **persistent decline** since the beginning of the year, and with **continuing shrinkage** reported in the latest **data for October**, this might be a **sign that the autumn/winter menswear collection has not been received as well as hoped**. If this is right, VRG can easily remedy the problem by delivering better designs for the 2020 spring/summer collection.

YoY change in monthly sales per square meter of Bytom



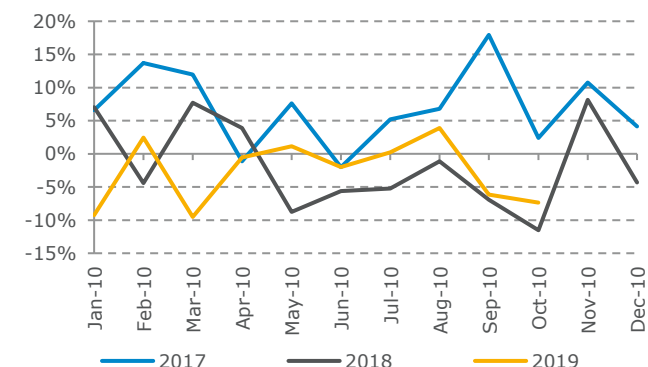
Source: VRG, Dom Maklerski mBanku

Weaker LFL Sales at Vistula

VRG's other fashion brands registered accelerated falls in like-for-like sales in September and October, and the downturn was most likely driven by the Vistula label. Like at Bytom, aside from a changed pricing policy and restrictions

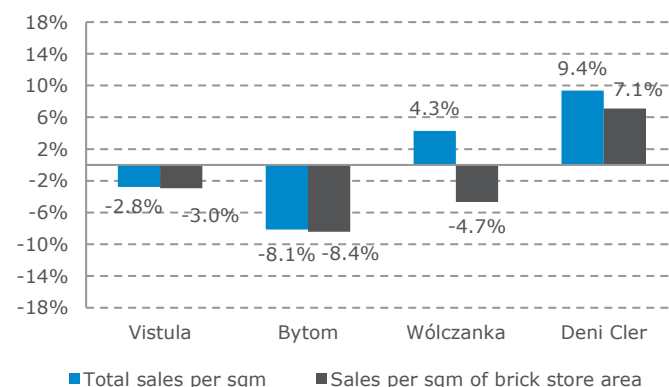
on Sunday trading, the slowdown in Vistula's case might also be due to an underwhelming autumn/winter collection. If this hypothesis proves correct, this could generate downside risk to our 2020 earnings forecasts for the Fashion business.

YoY change in monthly sales per square meter of Vistula



Source: VRG, Dom Maklerski mBanku

YoY change in per-sqm sales of VRG fashion stores in 9M'19

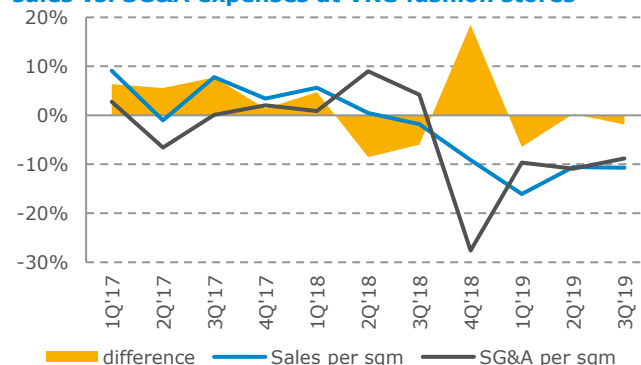


Source: VRG, Dom Maklerski mBanku

SG&A Expenses Fall Slower Than Sales

With the acquisition of Bytom in November 2018, VRG has seen a decline in monthly sales per square meter, but at the same time it has been able to reduce average SG&A expenses per store. This year, however, the ytd pace of SG&A decline has been slower than the rate of sales contraction **and slower than we had initially expected to see**.

Difference in annual growth rate of monthly per-sqm sales vs. SG&A expenses at VRG fashion stores

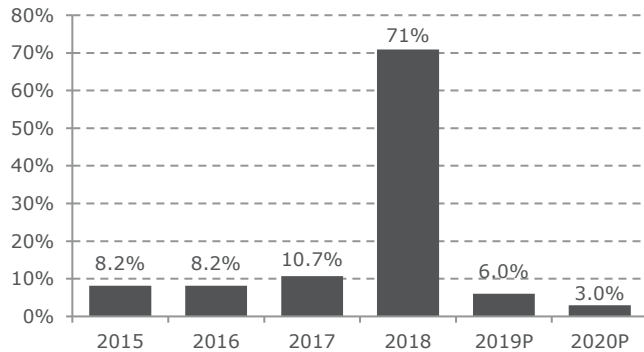


Source: VRG, Dom Maklerski mBanku

Dialed-Back Expansion Plans

VRG decided to **scale back its expansion plans for brick fashion stores**, based probably on the **weaker-than-expected performance of Bytom and Vistula**, and as **online sales increase their share in total revenues**. In 2020, we expect to the Company to place focus on improving the sales effectiveness of the existing stores, and on generating further sales margin synergies. VRG might go eventually back to the original expansion plans once the profitability of the two core fashion brands stabilizes.

YoY change in VRG fashion store area

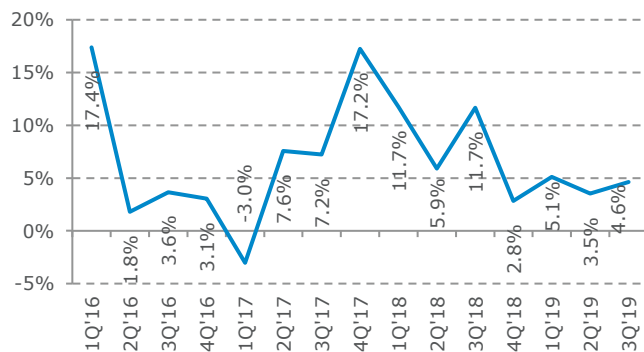


Source: VRG, P – projection by Dom Maklerski mBanku

Gentler Trajectory In Jewelry in 2020

VRG's jewelry business has enjoyed strong sales growth this year compared to an already high year-ago base. According to our estimates, nearly half of the revenue improvement achieved in 9M 2019 was fueled by watches. The sales momentum in 2020 relative to this year's strong numbers might decelerate, however as the watch range expands, and jewelry continues to sell well, the **positive sales momentum is expected to continue next year at an annual rate of 3%**.

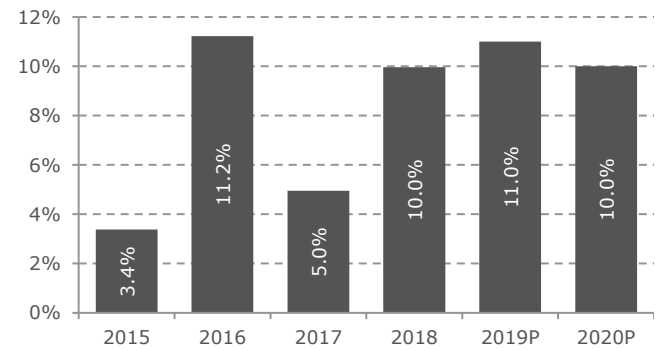
YoY change in monthly revenues per square meter at jewelry stores



Source: VRG, Dom Maklerski mBanku

VRG plans to grow the W.Kruk jewelry store area by **another 10% in 2020 to build on the strong sales performance so far, after a successful franchise pilot**. Further, VRG is currently mulling the acquisition of the Czech watch retailer Klenoty Aurum, a move which in our view would additionally boost the sales growth potential of the jewelry business. When it comes to global expansion plans outside of the potential Czech acquisition, however, we do not feel VRG will ever want to take the W.Kruk business international.

YoY change in VRG jewelry store area



Source: VRG, P – projection by Dom Maklerski mBanku

Outlook for 2020

VRG's main priority for Fashion in 2020 is to improve the sales effectiveness of Vistula and Bytom, continue to grow sales margins, and keep growing online sales, so that it can mitigate the negative impact of higher labor costs. Sales of jewelry next year will most likely increase at strong double-digit rates, fueled by an expanding trading area and improving sales effectiveness.

Key efficiency metrics FY2019-2021 projection

	'17	'18	'19P	'20P	'21P
Sales per sqm (PLN)	1,798.4	1,581.1	1,646.4	1,706.0	1,763.7
Gross margin	52.2%	51.2%	52.2%	53.0%	53.1%
SG&A/Sales	42.6%	42.2%	44.0%	44.4%	44.4%
SG&A/sqm	766.1	667.5	724.7	757.9	783.7
EBIT margin	9.1%	8.9%	8.1%	8.5%	8.6%
Total store area (1,000 sqm)	33.3	51.6	55.2	57.6	59.7

YoY change

Sales per square meter (PLN)	5.5%	-12.1%	4.1%	3.6%	3.4%
Gross margin	0.1p.p.	-1p.p.	1p.p.	0.8p.p.	0.1p.p.
SG&A/Sales	-1p.p.	-0.4p.p.	1.8p.p.	0.4p.p.	0p.p.
SG&A/sqm	2.9%	-12.9%	8.6%	4.6%	3.4%
EBIT margin	0.6p.p.	-0.2p.p.	-0.8p.p.	0.3p.p.	0.1p.p.
Total store area (1,000 sqm)	9.2%	55.0%	6.9%	4.3%	3.6%

Source: VRG, Dom Maklerski mBanku

2019-2020 Forecast Update

We have revised our earnings expectations for 2019 and 2020 to reflect weaker-than-expected like-for-like growth in Fashion and stronger-than-expected growth in Jewelry. We raised our original estimate for average SG&A expenses per square meter to account for rising costs of labor and franchise expenses, and as a consequence we had to cut our projections for EBIT and EBITDA.

Summary of 2019-2020 forecast revisions

(PLN m)	2019P			2020P		
	old	new	change	old	new	change
Revenue	1,035.3	1,055.3	1.94%	1,132.9	1,154.6	1.92%
Gross margin	51.9%	52.2%	0.3p.p.	52.2%	53.0%	0.8p.p.
EBITDA	123.7	108.9	-11.99%	138.2	121.1	-12.41%
margin	11.9%	10.3%	-1.6p.p.	12.2%	10.5%	-1.7p.p.
EBIT	101.4	85.8	-15.41%	115.5	97.1	-15.91%
Pre-tax profit	90.2	76.9	-14.76%	104.9	86.7	-17.32%
Net profit	73.9	64.2	-13.12%	85.0	70.2	-17.32%

Source: VRG, P – projection by Dom Maklerski mBanku

Earnings History and Future Projections

(PLN m)	2014	2015	2016	2017	2018	2019P	2020P	2021P	2022P
Revenue	443.4	514.2	598.5	688.5	805.7	1,055.3	1,154.6	1,241.0	1,318.2
change	11.5%	16.0%	16.4%	15.0%	17.0%	31.0%	9.4%	7.5%	6.2%
COGS	205.7	241.4	286.7	329.1	393.4	504.5	543.0	582.1	618.3
Gross profit	237.7	272.7	311.8	359.4	412.3	550.8	611.6	658.9	699.9
Gross margin	53.6%	53.0%	52.1%	52.2%	51.2%	52.2%	53.0%	53.1%	53.1%
Selling expenses	158.5	174.1	205.1	230.5	272.8	402.5	513.0	551.5	583.2
Administrative expenses	43.0	52.8	56.1	62.8	67.3	62.0	0.0	0.0	0.0
Other operating activity (net)	0.6	-2.5	0.4	-3.2	-0.2	-0.5	-1.0	-1.0	-1.0
EBIT	36.8	43.3	50.9	62.8	71.9	85.8	97.6	106.5	115.7
change	9.4%	17.8%	17.6%	23.3%	14.4%	19.4%	13.7%	9.1%	8.7%
EBIT margin	8.3%	8.4%	8.5%	9.1%	8.9%	8.1%	8.5%	8.6%	8.8%
Net financing gains/losses	-11.3	-11.2	-6.6	-7.8	-6.2	-18.0	-14.5	-13.8	-13.1
Pre-tax profit	25.5	32.1	44.3	55.0	65.7	67.8	83.1	92.7	102.7
Tax	-5.2	-6.8	-9.3	-11.8	-12.2	-12.6	-15.8	-17.6	-19.5
Net profit	20.3	25.4	35.0	43.2	53.5	55.2	67.3	75.1	83.2
change	-55.0%	25.0%	38.2%	23.3%	23.9%	3.1%	22.0%	11.5%	10.8%
margin	4.6%	4.9%	5.9%	6.3%	6.6%	5.2%	5.8%	6.0%	6.3%
D&A expenses	11.3	12.5	14.2	15.5	17.3	23.1	23.5	23.9	24.3
EBITDA	48.1	55.9	65.2	78.4	89.2	196.8	215.9	228.9	242.1
EBITDA (ex. IFRS 16)	48.1	55.9	65.2	78.4	89.2	108.9	121.1	130.3	140.0
change	7.1%	16.0%	16.7%	20.2%	13.8%	22.0%	11.2%	7.6%	7.4%
EBITDA margin	10.9%	10.9%	10.9%	11.4%	11.1%	10.3%	10.5%	10.5%	10.6%
EBUT (ex. IFRS16)	36.8	43.3	50.9	62.8	71.9	85.8	97.1	106.0	115.2
Net profit (ex. IFRS 16)	20.3	25.4	35.0	43.2	53.5	64.2	70.2	78.1	86.3
Shares outstanding at eop (millions)	173.9	173.9	173.9	173.9	234.5	234.5	234.5	234.5	234.5
EPS	0.1	0.1	0.2	0.2	0.2	0.2	0.3	0.3	0.4
ROA	3.2%	3.8%	4.8%	5.6%	5.7%	4.2%	4.3%	4.6%	4.8%
ROE	4.8%	5.7%	7.4%	8.3%	7.9%	6.6%	7.6%	7.8%	8.0%

Balance Sheet

(PLN m)	2014	2015	2016	2017	2018	2019P	2020P	2021P	2022P
ASSETS	645.3	697.3	751.5	778.8	1,113.4	1,524.4	1,582.7	1,668.5	1,761.6
Fixed assets	420.2	424.6	428.5	425.5	593.2	881.5	892.5	901.7	911.5
Property, plant and equipment	52.0	57.0	61.3	59.4	78.0	74.8	76.2	77.0	78.1
Intangible assets	359.2	357.7	357.6	358.8	507.3	499.7	499.7	499.7	499.7
Deferred tax assets	7.4	7.9	8.2	5.8	6.4	8.2	8.2	8.2	8.2
Other	1.6	2.0	1.3	1.5	1.5	298.8	308.5	316.8	325.5
Current assets	225.1	272.7	323.0	353.4	520.1	642.8	690.2	766.8	850.1
Inventory	196.1	240.6	284.0	315.3	460.8	545.8	607.0	652.0	693.8
Accounts receivable	14.5	15.2	21.0	20.2	23.9	15.7	14.0	15.0	16.0
Cash and cash equivalents	13.2	15.6	16.8	16.4	33.5	77.6	65.6	96.0	136.6
Other	1.4	1.4	1.3	1.4	1.9	3.7	3.7	3.7	3.7
(PLN m)	2014	2015	2016	2017	2018	2019P	2020P	2021P	2022P
EQUITY & LIABILITIES	645.3	697.3	751.5	778.8	1,113.4	1,524.4	1,582.7	1,668.5	1,761.6
Equity	430.6	458.5	494.4	542.5	805.1	854.9	922.2	997.3	1,080.5
Non-current liabilities	109.6	101.1	95.1	85.3	76.8	287.5	297.1	305.5	314.1
Loans and borrowings	0.0	98.1	91.9	82.1	70.8	64.2	64.2	64.2	64.2
Other	109.6	3.0	3.2	3.2	6.0	223.3	233.0	241.3	250.0
Current liabilities	105.1	137.7	162.0	151.0	231.5	382.0	363.4	365.7	367.0
Loans and borrowings	6.0	5.9	17.7	20.4	14.6	79.6	67.6	55.6	43.6
Trade creditors	83.7	114.9	121.2	108.8	192.8	205.8	199.2	213.5	226.8
Finance leases	0.0	0.0	0.0	0.0	0.0	88.2	88.2	88.2	88.2
Other	15.4	16.9	23.2	21.8	24.0	8.5	8.5	8.5	8.5
Debt	6.0	103.9	109.6	102.6	85.4	143.7	131.7	119.7	107.7
Net Debt	-7.2	88.4	92.8	86.2	51.9	66.1	66.2	23.7	-28.9
Net debt / Equity	-1.7%	19.3%	18.8%	15.9%	6.4%	7.7%	7.2%	2.4%	-2.7%
Net debt/ EBITDA	-0.1	1.6	1.4	1.1	0.6	0.3	0.3	0.1	-0.1
BVPS	2.5	2.6	2.8	3.1	3.4	3.6	3.9	4.3	4.6

Cash Flow

(PLN m)	2014	2015	2016	2017	2018	2019P	2020P	2021P	2022P
Cash flow from operating activities	18.8	25.7	6.0	20.5	53.5	102.9	119.6	165.7	180.1
Pre-tax profit	20.3	28.2	35.2	43.2	65.7	61.0	67.3	75.1	83.2
D&A expenses	11.3	12.5	14.2	15.5	17.3	23.1	23.5	23.9	24.3
Amortization of assets held u. finance leases	0.0	0.0	0.0	0.0	0.0	88.0	94.8	98.5	102.1
Change in provisions	0.6	1.8	2.3	0.5	-2.9	-3.7	0.0	0.0	0.0
Working capital	-12.5	-12.3	-33.0	-27.0	-21.1	-59.8	-66.1	-31.8	-29.4
Other	-0.9	-4.6	-12.7	-11.8	-5.6	-5.7	0.0	0.0	0.0
Cash flow from investing activities	-12.3	-12.6	-18.0	-15.3	-18.6	-17.9	-24.8	-24.7	-25.4
CAPEX	-12.5	-14.4	-19.2	-18.7	-18.2	-25.7	-24.8	-24.7	-25.4
Other	0.2	1.8	1.2	3.4	-0.4	7.8	0.0	0.0	0.0
Cash flow from financing activities	-11.6	-10.7	13.2	-5.0	-17.8	-40.9	-106.8	-110.5	-114.1
Loans and borrowings	-0.8	108.1	9.4	-8.4	8.0	112.7	-12.0	-12.0	-12.0
Debt securities	-10.5	-119.0	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	-0.3	0.2	3.9	3.4	-25.8	-153.6	-94.8	-98.5	-102.1
Change in cash	-5.0	2.4	1.3	0.3	17.1	44.1	-12.1	30.5	40.6
FX effects	0.0	0.0	0.0	0.7	0.0	0.0	0.0	0.0	0.0
Cash at eop	13.2	15.6	16.8	16.4	33.5	77.6	65.5	96.0	136.6
DPS (PLN)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FCF	15.7	20.0	2.3	19.2	36.6	7.4	11.7	53.6	63.2
CAPEX/Sales	2.8%	2.8%	3.2%	2.7%	2.3%	2.4%	2.1%	2.0%	1.9%

Trading Multiples*

	2014	2015	2016	2017	2018	2019P	2020P	2021P	2022P
P/E*	33.8	27.0	19.5	15.9	17.3	14.4	13.1	11.8	10.7
P/CE*	21.7	18.1	13.9	11.7	13.0	10.6	9.9	9.1	8.4
P/B	1.6	1.5	1.4	1.3	1.1	1.1	1.0	0.9	0.9
P/S	1.5	1.3	1.1	1.0	1.1	0.9	0.8	0.7	0.7
FCF/EV*	2.0%	2.6%	0.3%	2.5%	3.7%	0.8%	1.2%	5.7%	7.1%
EV/EBITDA	16.3	14.0	12.1	10.0	11.1	9.1	8.2	7.3	6.4
EV/EBIT*	21.3	18.1	15.5	12.5	13.7	11.5	10.2	8.9	7.8
EV/S*	1.8	1.5	1.3	1.1	1.2	0.9	0.9	0.8	0.7
OCF/EBITDA	39%	46%	9%	26%	60%	14%	20%	52%	56%
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Price (PLN)	3.94	3.94	3.94	3.94	3.94	3.94	3.94	3.94	3.94
Shares outstanding at eop (millions)	173.9	173.9	173.9	173.9	234.5	234.5	234.5	234.5	234.5
MC (PLN m)	685	685	685	685	924	924	924	924	924
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)*	786	783	792	784	987	990	990	947	895

*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

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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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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.

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

recommendation	buy	overweight	overweight	overweight	overweight
date issued	2019-07-26	2019-05-29	2019-03-28	2018-12-05	2018-11-08
target price (PLN)	5.20	-	-	-	-
price at issue date	4.20	3.90	4.29	3.83	4.06

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