

Tuesday, August 04, 2020 | Monthly Market Outlook, an excerpt

VRG accumulate (no change)

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VRG stock took a downward turn at the end of July, most likely on reports of an increase in Poland's daily coronavirus infections. In June, the Company reported a huge improvement in sales, which declined only 8.3% from the same year-ago month as compared to falls of 42% in March, 65% in April, and 35% in May. Of this, the contraction in clothing sales amounted to 13.7% while sales of jewelry fell much less at -4% y/y, thanks in part to positive base effects. The sales margin tightened by 1.8pp in June relative to the year-ago figure, much less than the margin declines suffered in previous months. We expect that the positive trends continued in July. Our 2020 Q2 estimates for VRG assume an IAS 17 EBITDA loss of PLN 5.6m vs. an operating profit of PLN 35m posted in Q2 2019. We predict that year-over-year declines in sales and margins in the period were mitigated by tight cost management and financial crisis relief (resulting in a reduction in per-sqm SG&A by an estimated 17.5% y/y). VRG held a Management Board reshuffle in early July, with Andrzej Jaworski taking over as CEO.

Current Price	2.24 PLN	Upside
9M Target Price	2.43 PLN	+8.5%

	rating	target price	issued
unchanged	accumulate	2.43 PLN	2020-07-02

Key Metrics			VRG PW	vs. WIG
Ticker	VRG PW	1M Price Chng	-12.2%	-13.3%
ISIN	PLVSTLA00011	YTD Price Chng	-44.6%	-33.7%
Outst. Stock (m)	234.5	ADTV 1M		PLN 0.9m
MC (PLN m)	525.2	ADTV 6M		PLN 0.9m
EV (PLN m)	593.3	EV/EBITDA 12M fwd	6.3	-25.3%
Free Float	40.1%	EV/EBITDA 5Y avg	8.5	discount

Earnings Projections (adjusted for IFRS 16)

(PLN m)	2018	2019	2020P	2021P	2022P
Revenue	806	1,068	824	1,032	1,155
EBITDA adj.	89	111	6	51	89
EBITDA margin	11.1%	10.4%	0.7%	4.9%	7.7%
EBIT	72	87	-16	30	68
Net income	54	66	-36	11	46
P/E	9.8	8.0	-	48.3	11.4
P/B	0.7	0.6	0.6	0.6	0.6
EV/EBITDA adj.	6.6	5.3	100.0	10.9	6.5
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%

Financial Highlights (adjusted for IFRS 16)

(PLN m)	2018	2019	2020P	2021P	2022P
Fashion Sales	483	692	525	656	761
Fashion EBIT	33	43	-22	2	28
Jewelry Sales	323	376	298	376	394
Jewelry EBIT	39.4	44.5	5.9	28.5	37.6
Gross profit margin	51.2%	52.1%	47.9%	48.8%	49.0%
Operating cash flow	54	109	98	145	90
D&A	17	24	22	21	22
D&A (IFRS 16)	0	87	85	86	90
Working capital	-21	-75	33	30	-64
Investing cash flow	-19	-17	-16	-21	-23
Financing cash flow	-18	-100	10	-128	-117
Credit/loans	8	-5	95	-42	-28
FCF	37	-6	23	54	-11
FCF/EBITDA	41%	-6%	380%	106%	-12%
OCF/EBITDA	60%	19%	230%	116%	1%

Key Ratios (adj. for IFRS 16)

(PLN)	2018	2019	2020P	2021P	2022P
Sales/sqm, Fashion	1,318	1,049	660	870	981
Sales/sqm, Jewelry	2,540	2,689	2,046	2,577	2,638
SG&A/sqm, Fashion	420	598	549	629	641
SG&A/sqm, Jewelry	1,118	1,216	1,106	1,240	1,239
Cash (PLN m)	34	25	118	114	63
Net debt (PLN m)	63	66	68	30	53
Net debt/EBITDA (x)	0.7	0.6	11.5	0.6	0.6

Relative Valuation Summary

	P/E			EV/EBITDA		
	20P	21P	22P	20P	21P	22P
Minimum	6.0	5.3	5.2	4.6	5.2	4.6
Maximum	121.5	67.8	34.4	26.1	26.8	20.0
Median	16.6	14.4	11.1	8.7	6.6	6.3
Weight	17%	17%	17%	17%	17%	17%

DCF Analysis (adj. for IFRS 16)

(PLN m)	20P	21P	22P	23P	24P	25P	26P	27P	28P	29P	+
Sales/sqm (PLN)	1,301	1,669	1,814	1,818	1,835	1,846	1,864	1,881	1,900	1,919	1,919
SG&A/sqm (PLN)	647	765	781	780	787	792	800	807	814	821	821
Sales area (ksqm)	51	52	54	56	57	57	58	59	59	60	60
Revenue	824	1,032	1,155	1,198	1,236	1,262	1,290	1,318	1,347	1,377	1,405
EBITDA	6	51	89	93	96	98	99	101	103	105	107
EBITDA margin	0.7%	4.9%	7.7%	7.8%	7.8%	7.7%	7.7%	7.7%	7.6%	7.6%	7.6%
EBIT	-16	30	68	71	73	75	76	78	80	82	84
Tax	1	6	13	13	14	14	14	15	15	16	16
CAPEX	16	21	23	24	24	23	23	23	23	22	23
Working capital	33	30	-64	-17	-3	-3	-3	-3	-4	-4	-4
FCF	23	54	-11	39	55	57	59	61	61	63	64
PV FCF	21	46	-9	28	37	35	33	31	29	28	
WACC	9.6%	9.2%	8.8%	8.8%	9.0%	8.9%	8.5%	8.5%	8.5%	8.5%	8.5%
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%

DCF Summary

(PLN m)	
Beta	1.1
FCF perp. growth rate	2.0%
PV FCF	712
Net debt	66
Other adjustments	0
Value per share (PLN)	2.75

Valuation Summary

(PLN)	Weight	Price
Relative Val.	40%	1.60
DCF Val.	60%	2.75
Implied Price		2.29
Cost of equity (9M)		6.4%
9M Target Price		2.43

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%
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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 the Company in the 12 months prior to this publication
VRG

Rating	accumulate	hold	hold	buy	accumulate
Rating date	2020-07-02	2020-06-03	2020-04-06	2020-02-05	2019-12-02
Target price (PLN)	2.43	2.43	2.00	4.50	4.50
Price on rating day	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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