

Wednesday, February 05, 2020 Monthly Market Outlook, an excerpt

VRG buy (upgraded)

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VRG generated weak sales in December, due mainly to a decline in revenues generated by jewelry stores relative to a high year-ago comparable base. Nevertheless we expect the Company do deliver 9% y/y EBITDA growth in the fourth quarter of 2019. VRG's main challenge in the months ahead is to improve sales effectiveness in the fashion segment, and to maintain positive like-for-like sales growth in the jewelry segment despite unfavorable base effects. The Company has recently parted ways with former CFO Mateusz Żmijewski, giving rise to concerns over further reshuffling within its top executive ranks once the current Management Board's term ends on 31 March 2020. These concerns, combined with the fact that first-quarter sales account for a minor portion of VRG's full-year earnings outlook, might prompt investors to hold off investment decisions until the doubts are cleared. We believe VRG can maintain double-digit earnings momentum in 2020, supported by improving organic expansion combined with synergy benefits. We upgrade VRG from accumulate to buy to reflect the recent share price decline.

Current Price	3.93 PLN	Upside
9M Target Price	4.50 PLN	+14.6%

	rating	target price	issued
new	buy	4.50 PLN	2020-02-05
old	accumulate	4.50 PLN	2019-12-02
Key Metrics			
			VRG PW vs. WIG
Ticker	VRG PW	1M Price Chng	+0.6% +2.3%
ISIN	PLVSTLA00011	YTD Price Chng	-2.8% -2.5%
Outst. Stock (m)	234.5	ADTV 1M	PLN 0.7m
MC (PLN m)	920.2	ADTV 6M	PLN 0.6m
EV (PLN m)	979.0	EV/EBITDA 12M fwd	5.6 -35.0%
Free Float	40.5%	EV/EBITDA 5Y avg	8.5 discount

Earnings Projections (adjusted for IFRS 16)

(PLN m)	2017	2018	2019P	2020P	2021P
Revenue	689	806	1,068	1,168	1,255
EBITDA adj.	78	89	204	223	237
EBITDA margin	11.4%	11.1%	19.1%	19.1%	18.9%
EBIT	63	72	92	105	114
Net income	43	54	61	73	81
P/E	15.8	17.2	15.1	12.6	11.3
P/B	1.3	1.1	1.1	1.0	0.9
EV/EBITDA adj.	10.0	11.0	9.0	8.0	7.1
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)			2019P	2020P	2021P
EBITDA			0.0%	0.0%	0.0%
Net income			0.0%	0.0%	0.0%
Gross profit margin			0.0 p.p.	0.0 p.p.	0.0 p.p.
B&M sales/sqm			0.0%	0.0%	0.0%
SG&A/sqm			0.0%	0.0%	0.0%

Financial Highlights (adjusted for IFRS 16)

(PLN m)	2017	2018	2019P	2020P	2021P
Fashion Sales	420	483	677	728	772
Fashion EBIT	29	33	39	43	47
Jewelry Sales	271	323	378	427	469
Jewelry EBIT	34.0	39.4	46.9	55.1	59.7
Gross profit margin	52.2%	51.2%	52.2%	53.0%	53.1%
Operating cash flow	21	54	103	120	166
D&A	16	17	23	23	24
D&A (IFRS 16)	0	0	88	95	99
Working capital	-27	-21	-60	-66	-32
Investing cash flow	-15	-19	-18	-25	-25
Financing cash flow	-5	-18	-41	-107	-111
Credit/loans	-8	8	113	-12	-12
FCF	19	37	7	12	54
FCF/EBITDA	25%	41%	7%	10%	41%
OCF/EBITDA	26%	60%	14%	20%	52%

Key Ratios (adj. for IFRS 16)

(PLN)	2017	2018	2019P	2020P	2021P
Sales/sqm, Fashion	1,495	1,207	1,303	1,340	1,380
Sales/sqm, Jewelry	2,602	2,814	2,970	3,049	3,161
SG&A/sqm, Fashion	618	420	579	615	634
SG&A/sqm, Jewelry	1,062	1,118	1,214	1,242	1,292
Cash (PLN m)	16	34	78	66	96
Net debt (PLN m)	99	63	66	66	24
Net debt/EBITDA (x)	1.3	0.7	0.6	0.5	0.2

Relative Valuation Summary

	P/E			EV/EBITDA		
	19P	20P	21P	19P	20P	21P
Minimum	6.1	5.8	5.3	4.8	4.4	4.1
Maximum	44.1	27.6	25.8	17.2	16.9	15.9
Median	15.6	14.7	13.5	8.5	7.4	6.5
Weight	17%	17%	17%	17%	17%	17%

DCF Analysis (adj. for IFRS 16)

(PLN m)	19P	20P	21P	22P	23P	24P	25P	26P	27P	28P	+
Sales/sqm (PLN)	1,646	1,706	1,764	1,808	1,813	1,814	1,814	1,827	1,842	1,856	
SG&A/sqm (PLN)	725	758	784	800	810	816	816	821	828	834	
Sales area (ksqm)	55	58	60	62	64	66	68	70	72	74	
Revenue	1,055	1,155	1,241	1,318	1,367	1,410	1,453	1,509	1,569	1,632	1,665
EBITDA	109	121	130	140	139	139	143	147	152	157	160
EBITDA margin	10.3%	10.5%	10.5%	10.6%	10.2%	9.8%	9.8%	9.8%	9.7%	9.6%	9.6%
EBIT	86	98	106	116	114	114	117	122	127	132	135
Tax	16	19	20	22	22	22	22	23	24	25	26
CAPEX	26	25	25	25	26	26	25	25	26	25	25
Working capital	-60	-66	-32	-29	-16	-15	-15	-17	-17	-7	-7
FCF	7	12	54	63	76	77	79	81	85	100	102
PV FCF	7	11	45	48	53	50	47	44	43	46	
WACC	8.7%	9.1%	8.9%	9.0%	8.9%	8.9%	8.8%	8.8%	8.7%	8.7%	8.7%
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	1,104
Net debt	63
Other adjustments	0
Value per share (PLN)	4.44

Valuation Summary

(PLN)	Weight	Price
Relative Val.	50%	4.00
DCF Val.	50%	4.44
Implied Price		4.22
Cost of equity (9M)		6.4%
9M Target Price		4.50

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
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VRG					
Rating	buy	accumulate	buy	overweight	overweight
Rating date	2020-02-05	2019-12-02	2019-07-26	2019-05-29	2019-03-28
Target price (PLN)	4.50	4.50	5.20	-	-
Price on rating day	3.93	3.94	4.20	3.90	4.29

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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