

Monday, October 07, 2019 | Monthly Market Outlook, an excerpt

VRG buy (no change)

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VRG generated strong earnings in Q2 2019 slightly ahead of market expectations. The quarterly gross margin expanded by 1.4pp to 53.5%, driven by improved pricing at fashion stores and higher sales of silver pieces at jewelry stores. In H2 2019, margin improvement will be additionally supported by sourcing synergies, favorable USDPLN movements, which are relevant to costs of fashion collections, and rising prices of gold and silver, which influence the profits of the jewelry business. In September, VRG registered declining like-for-like sales growth across all of its fashion lines, possibly indicating cool reception of the 2019 autumn/winter collections among shoppers. The sales margin for the month retreated as well, down by 0.1pp on the year, and with the pace of ytd margin expansion at ca. 0.9pp the FY2019 growth target is not likely to be raised any more this year. Much depends on the sales results for October. On the whole, however, we believe VRG is on track to generating record earnings in 2019, fueled by organic expansion and merger synergies. The strong momentum will probably continue into 2020 with sustained EBITDA growth in the double digits.

Current Price	4.15 PLN	Upside
9M Target Price	5.20 PLN	+25.3%

	rating	target price	issued
unchanged	buy	5.20 PLN	2019-07-26

Key Metrics			VRG PW	vs. WIG
Ticker	VRG PW	1M Price Chng	-3.9%	-2.9%
ISIN	PLVSTLA00011	YTD Price Chng	+2.7%	+5.7%
Outst. Stock (m)	234.5	ADTV 1M		PLN 0.9m
MC (PLN m)	973.0	ADTV 6M		PLN 0.9m
EV (PLN m)	1,024.4	EV/EBITDA 12M fwd	6.9	-21.2%
Free Float	46.5%	EV/EBITDA 5Y avg	8.7	discount

Earnings Projections (adjusted for IFRS 16)

(PLN m)	2017	2018	2019P	2020P	2021P
Revenue	689	806	1,035	1,133	1,239
EBITDA adj.	78	89	124	138	149
EBITDA margin	11.4%	11.1%	11.9%	12.2%	12.0%
EBIT	63	72	101	116	126
Net income	43	54	74	85	94
P/E	16.7	18.2	13.2	11.5	10.3
P/B	1.3	1.2	1.1	1.0	0.9
EV/EBITDA	10.5	11.6	8.3	7.0	6.1
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	660	720	784
Fashion EBIT	32	35	53	64	72
Jewelry Sales	271	323	369	413	455
Jewelry EBIT	34.0	39.8	45.9	51.6	54.4
Gross profit margin	52.2%	51.2%	51.9%	52.2%	52.0%
Operating cash flow	21	54	119	167	169
D&A	16	17	22	23	23
D&A (IFRS 16)	0	0	82	87	92
Working capital	-27	-21	-51	-28	-41
Investing cash flow	-15	-19	-25	-24	-24
Financing cash flow	-5	-18	-29	-99	-104
Credit/loans	-8	8	54	-12	-12
FCF	19	37	29	65	60
FCF/EBITDA	25%	41%	24%	47%	40%
OCF/EBITDA	26%	60%	30%	58%	51%

Key Ratios (adj. for IFRS 16)

(PLN)	2017	2018	2019P	2020P	2021P
Sales/sqm, Fashion	1,495	1,207	1,264	1,294	1,329
Sales/sqm, Jewelry	2,602	2,814	2,951	3,061	3,178
SG&A/sqm, Fashion	618	420	530	541	553
SG&A/sqm, Jewelry	1,062	1,118	1,175	1,219	1,266
Cash (PLN m)	16	34	99	143	183
Net debt (PLN m)	99	63	51	-5	-57
Net debt/EBITDA (x)	1.3	0.7	0.4	0.0	-0.4

Relative Valuation Summary

	P/E			EV/EBITDA		
	19P	20P	21P	19P	20P	21P
Minimum	6.4	6.4	5.9	4.8	4.5	4.2
Maximum	25.4	22.6	21.2	15.4	12.3	11.4
Median	15.4	13.8	12.6	9.0	8.0	7.0
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)	1,612	1,651	1,699	1,719	1,720	1,725	1,740	1,756	1,771	1,787	
SG&A/sqm (PLN)	677	691	709	716	725	732	734	741	748	755	
Sales area (ksqm)	55	59	63	66	69	72	75	79	82	86	
Revenue	1,035	1,133	1,239	1,328	1,397	1,463	1,540	1,623	1,709	1,800	1,836
EBITDA	124	138	149	159	161	163	175	183	192	201	205
EBITDA margin	11.9%	12.2%	12.0%	12.0%	11.5%	11.2%	11.4%	11.3%	11.2%	11.1%	11.1%
EBIT	101	116	126	136	136	139	150	158	166	174	178
Tax	18	22	24	26	26	26	28	30	31	33	34
CAPEX	25	24	24	25	26	26	27	27	28	26	27
Working capital	-51	-28	-41	-34	-28	-27	-32	-34	-36	-39	-39
FCF	29	65	60	74	80	83	88	92	96	102	104
PV FCF	28	57	49	55	55	52	50	49	47	46	
WACC	8.8%	9.1%	9.0%	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	1,189
Net debt	63
Other adjustments	0
Value per share (PLN)	4.80

Valuation Summary

(PLN)	Weight	Price
Relative Val.	50%	5.00
DCF Val.	50%	4.80
Implied Price		4.90
Cost of equity (9M)		6.4%
9M Target Price		5.20

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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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 Company in the 12 months prior to this publication

VRG	buy	overweight	overweight	overweight	overweight
Rating date	2019-07-26	2019-05-29	2019-03-28	2018-12-05	2018-11-08
Rating date (PLN)	5.20	-	-	-	-
Price on rating day	4.20	3.90	4.29	3.83	4.06

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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