

Wednesday, November 06, 2019 | Monthly Market Outlook, an excerpt

VRG buy (no change)

Piotr Bogusz +48 22 438 24 08 piotr.bogusz@mbank.pl

VRG generated strong earnings in Q2 2019 slightly ahead of market expectations. The gross margin expanded by 1.4 pp y/y to 53.5% after the implementation of a new pricing policy. In September, VRG registered declining like-for-like sales growth across all of its fashion lines, and the contraction continued into October, led mainly by Bytom menswear stores - a sign that the 2019 autumn/winter collection might not have been received as well as hoped. Other reasons behind the slower like-for-like growth, aside from the new pricing policy, might have been VRG's scaled-back marketing activity in the period; on the upside, these measures drove the monthly gross margin up by 2pp y/y in October. With that said, on weaker like-for-like trading figures achieved by the fashion segment, VRG will most likely report slower EBITDA growth for Q3 2019 at an estimated 20% (ex. IFRS 16 effects). As far as the jewelry segment is concerned, its earnings performance this year will be determined by the high sales season of the fourth quarter. We believe VRG can maintain double-digit earnings momentum in 2020, supported by improving organic expansion combined with synergy benefits.

| | | |
|------------------------|----------|---------------|
| Current Price | 4.11 PLN | Upside |
| 9M Target Price | 5.20 PLN | +26.7% |

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

| Key Metrics | | | VRG PW | vs. WIG |
|------------------|--------------|-------------------|--------|----------|
| Ticker | VRG PW | 1M Price Chng | -1.1% | -7.4% |
| ISIN | PLVSTLA00011 | YTD Price Chng | +1.6% | -1.6% |
| Outst. Stock (m) | 234.5 | ADTV 1M | | PLN 0.3m |
| MC (PLN m) | 962.4 | ADTV 6M | | PLN 0.8m |
| EV (PLN m) | 1,013.8 | EV/EBITDA 12M fwd | 7.1 | -19.1% |
| 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 | 16.5 | 18.0 | 13.0 | 11.3 | 10.2 |
| P/B | 1.3 | 1.2 | 1.1 | 1.0 | 0.9 |
| EV/EBITDA | 10.4 | 11.5 | 8.2 | 6.9 | 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 | 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

Recommendations of Dom Maklerski mBanku:

A recommendation is valid for a period of 9 months, unless a subsequent recommendation is issued within this period. Expected returns from individual recommendations are as follows:

BUY – we expect that the rate of return from an investment will be at least 15%
ACCUMULATE – we expect that the rate of return from an investment will range from 5% to 15%
HOLD – we expect that the rate of return from an investment will range from -5% to +5%
REDUCE – we expect that the rate of return from an investment will range from -5% to -15%
SELL – we expect that an investment will bear a loss greater than 15%
 Recommendations are updated at least once every nine months.

mBank S.A. with its registered office in Warsaw at Senatorska 18 renders brokerage services in the form of derived organisational unit – Brokerage Office which uses name Dom Maklerski mBanku.

mBank S.A. as part of the Exchange's Analytical Coverage Support Programme ("Programme", <https://www.gpw.pl/eacsp>) prepares analytical reports for the following companies: Cognor Holding, Comarch, VRG. These documents are prepared at the request of Giełda Papierów Wartościowych w Warszawie S.A. ("WSE"), which is entitled to copyrights to these materials. mBank S.A. receives remuneration from the WSE for the preparation of the reports. All documents prepared for the Programme are available at:
https://www.mdm.pl/ui-pub/site/market_and_analysis/analysis_and_recommendations/analytical_coverage_support_programme

This document has been created and published by Dom Maklerski mBanku. The present report expresses the knowledge as well as opinions of the authors on day the report was prepared. The opinions and estimates contained herein constitute our best judgment at this date and time, and are subject to change without notice. The present report was prepared with due care and attention, observing principles of methodological correctness and objectivity, on the basis of sources available to the public, which Dom Maklerski mBanku considers reliable, including information published by issuers, shares of which are subject to recommendations. However, Dom Maklerski mBanku, in no case, guarantees the accuracy and completeness of the report, in particular should sources on the basis of which the report was prepared prove to be inaccurate, incomplete or not fully consistent with the facts. mBank S.A. bears no responsibility for investment decisions taken on the basis of the present report or for any damages incurred as a result of investment decisions taken on the basis of the present report.

This document does not constitute an offer or invitation to subscribe for or purchase any financial instruments and neither this document nor anything contained herein shall form the basis of any contract or commitment whatsoever. It is being furnished to you solely for your information and may not be reproduced or redistributed to any other person. This document does not constitute investment, legal, accounting or other advice, and mBank is not liable for damages resulting from or related to the use of data provided in the documents. This document may not be copied, duplicated and/or be directly or indirectly distributed in the United States, Canada, Australia or Japan, nor transferred to citizens or residents of a state where its distribution may be legally restricted, which does not limit the possibility of publishing materials prepared for the Programme on Cognor Holding, Comarch, VRG, mBank or WSE websites. Persons who disseminate this document should be aware of the need to comply with such restrictions.

Recommendations are based on essential data from the entire history of a company being the subject of a recommendation, with particular emphasis on the period since the previous recommendation. Investing in shares is connected with a number of risks including, but not limited to, the macroeconomic situation of the country, changes in legal regulations as well as changes on commodity markets. Full elimination of these risks is virtually impossible.

Recommendations are based on essential data from the entire history of a company being the subject of a recommendation, with particular emphasis on the period since the previous recommendation.

Investing in shares is connected with a number of risks including, but not limited to, the macroeconomic situation of the country, changes in legal regulations as well as changes on commodity markets. Full elimination of these risks is virtually impossible.

mBank S.A. bears no responsibility for investment decisions taken on the basis of the present report or for any damages incurred as a result of investment decisions taken on the basis of the present report.

It is possible that mBank S.A. in its brokerage activity renders, will render or in the past has rendered services for companies and other entities mentioned in the present report.

mBank S.A. does not rule out offering brokerage services to an issuer of securities being the subject of a recommendation. Information about any conflicts of interest that may arise in connection with the issuance of recommendations (should such a conflict exist) is provided below, and it is valid as of the date of the most recent Monthly Report published by Dom Maklerski mBanku or as of the date of the most recent recommendation issued for an Issuer, as applicable.

This document was not transferred to the issuers prior to its publication.

mBank S.A. may have received compensation from the following companies in the last 12 months: ABC Data, Alchemia, Alior Bank, Ambra, Amica, Bank Handlowy, Bank Millennium, Bank Pekao, BGŻ BNP Paribas, BoomBIT, Boryszew, Capital Park, CD Projekt, Centrum Nowoczesnych Technologii, Ceramika Nowa Gala, CI Games, Echo Investment, Elemental Holding, Elzab, Enea, Emergoaparatura, Erbud, Ergis, Erste Bank, Famur, Ferrum, GetBack, Getin Holding, Getin Noble Bank, Globalworth Poland, Groclin, Helio SA, Impexmeta, INDATA, ING BSK, Kopec, Kruk, LW Bogdanka, Mangata, MCI Capital, Mennica Polska, Mostostal Warszawa, Netia, Neuca, NVAI Dom Maklerski, Oponeo.pl, Orbis, OTP Bank, PA Nova, PBKM, PEKABEX, Pfeiderer Group, PGNG, PKO BP, Polenergia, Polimex-Mostostal, Polnord, Polwax, Prime Car Management, Primetech, Prochem, Projprzem, PZU, Raiffeisen Bank International, Rawplug, Santander Bank Polska, Seco/Warwick, Skarbiec Holding, Solar Company, Sygnity, Tarczyński, Trakcja, Unibep, Vistal Gdynia, Wittchen, Work Service, YOLO, Zastal, ZUE.

In the last 12 months mBank S.A. has acted as dealer-manager for tender or exchange offers for the shares of: ABC Data, BoomBIT, Centrum Nowoczesnych Technologii, Ceramika Nowa Gala, CI Games, Globalworth Poland, Helio SA, MCI Capital, Mostostal Warszawa, NVAI Dom Maklerski, Orbis, Pfeiderer Group, Polenergia, Prime Car Management, Primetech.

Assec Poland provides IT services to mBank S.A.

mBank S.A. has a cash service agreement in place with Pekao and a phone subscription agreement in place with Orange Polska S.A.

mBank S.A., its shareholders and employees may hold long or short positions in the issuers' shares or other financial instruments related to the issuers' shares. mBank, its affiliates and/or clients may conduct or may have conducted transactions for their own account or for account of another with respect to the financial instruments mentioned in this report or related investments before the recipient has received this report.

Copying or publishing the present report, in full or in part, or disseminating in any way information contained in the present report requires the prior written agreement of mBank S.A. Recommendations are addressed to all Clients of Dom Maklerski mBanku.

Recommendations are addressed to all Clients of Dom Maklerski mBanku.

All investment recommendations and strategies issued by mBank S.A. over the last 12 months are available at:
http://www.mdm.pl/ui-pub/site/market_and_analysis/analysis_and_recommendations/fundamental_analysis/recommendations?recent_filter_active=true&lang=en

The activity of mBank S.A. is subject to the supervision of the Polish Financial Supervision Commission.

Individuals who did not participate in the preparation of recommendations, but had or could have had access to recommendations prior to their publication, are employees of Dom Maklerski mBanku authorised to access the premises in which recommendations are prepared and/or individuals having to access to recommendations based on their corporate roles, other than the analysts mentioned as the authors of the present recommendations.

This publication constitutes investment research within the meaning of Art. 36.1 of Commission Delegated Regulation (EU) 2017/565.

The compensation of the research analysts responsible for preparing investment research is determined independently of and without regard to the compensation of or revenue generated by any other employee of the Bank, including but not limited to any employee whose business interests may reasonably be considered to conflict with the interests of the persons to whom the investment research prepared by the Research Department of Dom Maklerski mBanku is disseminated. With that being said, since one of the factors taken into consideration when determining the compensation of research analysts is the degree of fulfillment of annual financial targets by customer service functions, there is a risk that the adequacy of compensation offered to persons preparing investment research will be questioned by a competent oversight body.

For U.S. persons only: This research report is a product of mBank SA which is the employer of the research analyst(s) who has prepared the research report. The research analyst(s) preparing the research report is/are resident outside the United States (U.S.) and are not associated persons of any U.S. regulated broker-dealer and therefore the analyst(s) is/are not subject to supervision by a U.S. broker-dealer, and is/are not required to satisfy the regulatory licensing requirements of FINRA or required to otherwise comply with U.S. rules or regulations regarding, among other things, communications with a subject company, public appearances and trading securities held by a research analyst account. This report is intended for distribution by mBank SA only to "Major Institutional Investors" as defined by Rule 15a-6(b)(4) of the U.S. Securities and Exchange Act, 1934 (the Exchange Act) and interpretations thereof by U.S. Securities and Exchange Commission (SEC) in reliance on Rule 15a-6(a)(2). If the recipient of this report is not a Major Institutional Investor as specified above, then it should not act upon this report and return the same to the sender. Further, this report may not be copied, duplicated and/or transmitted onward to any U.S. person, which is not the Major Institutional Investor.

In reliance on the exemption from registration provided by Rule 15a-6 of the Exchange Act and interpretations thereof by the SEC in order to conduct certain business with Major Institutional Investors, mBank SA has entered into an agreement with a U.S. registered broker-dealer, Cabrera Capital Markets. ("Cabrera"). Transactions in securities discussed in this research report should be effected through Cabrera or another U.S. registered broker dealer.

Strong and weak points of valuation methods used in recommendations:

DCF – acknowledged as the most methodologically correct method of valuation; it consists in discounting financial flows generated by a company; its weak point is the significant susceptibility to a change of forecast assumptions in the model.

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.

VRG

| Rating | buy | overweight | overweight | overweight | overweight |
|---------------------|------------|------------|------------|------------|------------|
| Rating date | 2019-07-26 | 2019-05-29 | 2019-03-28 | 2018-12-05 | 2018-11-08 |
| Target price (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

Dom Maklerski mBanku

Senatorska 18
00-082 Warszawa
<http://www.mbank.pl/>

Research Department

Kamil Kliszczyk
director
+48 22 438 24 02
kamil.kliscz@mbank.pl
energy, power generation

Jakub Szkopek
+48 22 438 24 03
jakub.szkopek@mbank.pl
industrials, chemicals, metals

Aleksandra Szklarczyk
+48 22 438 24 04
aleksandra.szklarczyk@mbank.pl
construction, real-estate development

Michał Marczak
+48 22 438 24 01
michal.marczak@mbank.pl
strategy

Paweł Szpigiel
+48 22 438 24 06
pawel.szpigiel@mbank.pl
media, IT, telco

Piotr Poniatowski
+48 22 438 24 09
piotr.poniatowski@mbank.pl
industrials

Michał Konarski
+48 22 438 24 05
michal.konarski@mbank.pl
banks, financials

Piotr Bogusz
+48 22 438 24 08
piotr.bogusz@mbank.pl
retail, gaming

Mikołaj Lemańczyk
+48 22 438 24 07
mikolaj.lemanczyk@mbank.pl
financials

Sales and Trading

Traders

Piotr Gawron
director
+48 22 697 48 95
piotr.gawron@mbank.pl

Adam Prokop
+48 22 697 47 90
adam.prokop@mbank.pl

Sales, Foreign Markets

Bartosz Orzechowski
+48 22 697 48 47
bartosz.orzechowski@mbank.pl

Krzysztof Bodek
+48 22 697 48 89
krzysztof.bodek@mbank.pl

Magdalena Bernacik
+48 22 697 47 35
magdalena.bernacik@mbank.pl

Jędrzej Łukomski
+48 22 697 49 85
jedrzej.lukomski@mbank.pl

Tomasz Jakubiec
+48 22 697 47 31
tomasz.jakubiec@mbank.pl

Andrzej Sychowski
+48 22 697 48 46
andrzej.sychowski@mbank.pl

Private Client Sales

Kamil Szymański
director
+48 22 697 47 06
kamil.szymanski@mbank.pl

Jarosław Banasiak
deputy director
+48 22 697 48 70
jaroslaw.banasiak@mbank.pl