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VRG - Fashion Group Posts In-Line 2019 Q4 Results

Rating: buy | current price: PLN 1.74 | target price: PLN 4.50

VRG PW; VRGP.WA | Retail, Poland

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- The 2019 fourth-quarter **EBITDA** of VRG **fulfilled market expectations and topped our own estimate** on higher-than-expected sales.
- The total quarterly sales **revenue** was up 22% year over year at PLN 332.5m. In terms of revenues **per square meter**, they were reported to **contract for the Vistula and Bytom** menswear stores, but grew for Wólczanka shirts (+3%) and Deni Cler women's apparel (+9.4%). The W.Kruk **jewelry stores improved unit sales as well** at an annual rate of 2.1%.
- **Gross margin expanded by 0.8pp to 53.7%** in Q4'19, driven by improvement (+1.6pp y/y) in the fashion segment, accompanied by a narrow decline (-0.3pp) in the jewelry segment due to a higher share of watches in the quarterly sales mix.
- Total quarterly SG&A expenses showed a 28% y/y increase at PLN 132.2m, however **SG&A per square meter were down 5% on the year,** owing mainly to the consolidation of the more cost-efficient Bytom menswear stores.
- **EBIT** before IFRS 16 effects increased 17% to PLN 47.5m, driven by a **32% rebound to PLN 26.5m in the fashion segment** and a 2% increase to PLN 21m in the jewelry segment.
- **Operating cash flow** ex. IFRS 16 effects increased to PLN 93.6m in Q4 2019 from PLN 75.3m posted in the same year-ago period, thanks to cash released from inventories and receivables. Inventory as of 31 December 2019 was 10% higher per square meter than in December 2018 at PLN 9,848. Net debt ended FY2019 at PLN 91.3m vs. PLN 89.4m the year before, with the net debt/EBITDA ratio at 0.8x.
- **Summing up, on an ex-IFRS 16 basis, VRG delivered 2019 fourth-quarter results consistent with analysts' expectations. Highlights included further reductions in per-sqm SG&A and synergy-driven improvement in sales margins, provided by Bytom. On the other hand, the jewelry business experienced slower like-for-like growth after sales in December declined off a high year-ago base.**

When it comes to the FY2020 earnings prospects, they hinge entirely on the duration of the coronavirus pandemic and the related lockdown, and on the sufficiency of state aid. As far as processes that can be controlled, VRG wants to cut this year's CAPEX from PLN 25m to PLN 15m, and it is preparing to negotiate rental rates with retail property managers, as well as identifying loss-making stores for eventual closure. Furthermore, VRG is aiming to have its Web stores account for well upwards of 20% the year's revenue. Last but not least, the Company is working on adjusting orders for H2 2020 to the changing retail conditions.

2019 Q4 actuals vs. expectations

(PLN m)	4Q'19 (ex. IFRS16)	4Q'18	change	4Q'19 (IFRS16)	4Q'19E*	differ.	consensus (median)	differ.	2019	2018	change
Revenue	332.5	272.1	22.2%	332.5	315.1	5.5%	329.4	0.9%	1,068.3	805.7	32.6%
EBITDA	54.3	45.6	19.1%	76.1	49.5	9.7%	53.9	0.7%	198.5	89.3	122.4%
EBITDA margin	16.3%	16.8%	-0.42p.p.	22.9%	15.7%	0.6p.p.	16.4%	0p.p.	18.6%	11.1%	7.5p.p.
EBIT	47.5	40.8	16.5%	47.6	44.0	8.0%	49.0	-3.1%	87.5	71.9	21.7%
Pre-tax profit	47.6	38.9	22.5%	53.9	51.4	-7.4%		-	79.4	65.7	20.7%
Net profit	38.0	32.4	17.2%	44.3	43.2	-12.0%	40.3	-5.7%	64.0	53.6	19.4%

Source: VRG, E - estimates by mBank, consensus estimates provided by PAP; *EBIT/EBITDA are stated ex. IFRS effects

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

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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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