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VRG – Fashion Group Posts In-Line 2019 Q3 Results

Rating: buy | current price: PLN 4.08 | target price: PLN 5.20

VST PW; VSTP.WA | Retail, Poland

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- VRG reported 2019 Q3 **EBITDA in line with market expectations**, but it **exceeded our estimate** owing to a higher-than-forecast gross profit.
- The total quarterly sales revenue was up 39.5% year over year at PLN 251.2m. **Revenue per square meter declined for most of VRG's fashion brands** except Wólczanka (+7.9%) and Deni Cler (+14.1%), but it **grew 7.4%** at the W.Kruk **jewelry stores**.
- **Gross margin expanded by 1.0pp to 51%** in Q3, driven by improvement in the fashion segment (+0.5pp y/y) as well as the jewelry segment (+1.7pp).
- Total quarterly SG&A expenses showed a 43% y/y surge at PLN 115.6m, however **SG&A per square meter were down 8% on the year**, owing to the consolidation of the more cost-efficient menswear unit, Bytom.
- **EBIT** before IFRS 16 effects **increased 23%** to PLN 12.4m, driven by a **4% rise to PLN 2.8m in the fashion segment** and a 31% rebound to PLN 9.6m in the jewelry segment.
- **Operating cash flow** ex. IFRS 16 turned **negative at PLN -33m in Q3 2019** vs. positive OCF of PLN 19.7m posted in the same year-ago period, led by higher accounts receivable and higher inventory per square meter (up 1% y/y to PLN 10,474).
- **Summing up, on an ex-IFRS 16 basis, VRG delivered 2019 Q3 results consistent with analysts' expectations.** The synergy-driven improvement in sales margins observed in the period is likely to continue boosting profits in the quarters ahead, but on the other hand VRG's key labels, Vistula and Bytom, are experiencing slower like-for-like growth of late, as evidenced by weak sales figures for October. With that said, earnings results in the fourth quarter hinge largely on the performance of the jewelry business during the peak holiday shopping season in December.

2019 Q3 results vs. expectations

(PLN m)	3Q'19 (ex IFRS16)	3Q'18	change	3Q'19 (IFRS16)	3Q'19E	differ.	consensus (median)	differ.	2019E	2018	change
Revenue	251.2	180.1	39.5%	251.2	249.6	0.6%	249.5	0.7%	1,035.3	805.7	28.5%
EBITDA	18.4	14.0	31.2%	40.9	16.8*	9.5%	18.5	-0.5%	123.7	89.3	38.6%
margin	7.3%	7.8%	-0.46p.p.	16.3%	14.9%	-7.6p.p.	7.4%	-0.1p.p.	11.9%	11.1%	0.87p.p.
EBIT	12.4	10.0	23.4%	12.6	11.4*	8.9%	12.8		101.4	71.9	41.0%
Pre-tax profit	9.1	8.8	3.0%	0.2	3.7		-	-	90.2	65.7	37.2%
Net profit	7.1	6.9	2.6%	-1.8	2.1		5.8	22.4%	73.9	53.6	37.9%

Source: VRG, E – estimates by Dom Maklerski mBanku, consensus estimates provided by PAP
*ex IFRS16 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

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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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.

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