Travel Book – Prague – December 2017

We just spent a week in Prague attending an Eastern European conference organised by Czech broker Wood. The event gathered 167 companies and 240 investors. We met over 20 companies from Poland, Russia, Greece, Turkey and Austria. Financials Erste Bank (Czech, Austria and Romania), Kruk (NPL specialist in Poland, Romania, Spain & Italy) and Warsaw Stock Exchange (Poland) shared their macro views across the region. We discussed about Turkey prospects with management teams from KOC and Sabanci, the two major Turkish conglomerates. CCC (shoe maker), LPP (apparel retailer), DP Eurasia (Dominos Pizza licensee in Turkey and Russia) and Ulker (confectionary specialist in Turkey & MENA) shared their views on consumer discretionary universe. While Eurocash, Dino, Lenta and X5 did the same on the groceries side. In conclusion, strong economic growth should be maintained in Eastern Europe. Russian GDP growth will stabilize around 2% while Turkey economy remains complicated (12% inflation, negative real rates) and unpredictable given the country uncertain geopolitics.

**Macro focus on Eastern Europe**

Eastern European region continues to enjoy solid economic growth (cf chart below), fuelled by favourable fiscal and monetary policies. Wage inflation is strong: 8% on average. Several companies highlighted encountered difficulties to hire, especially sales people among retailers. This environment is favourable for discretionary consumption however comes as additional burden on operating expenses.

**GDP growth across the region**

We also came back with an impression that the cycle peak is close. Events such as Brexit in March 2019 could create uncertainty and be a trigger for market correction. However macro fundamentals remain solid and favourable.

In terms of investments, Poland remains the most sizeable and liquid market. Taking a closer look at stocks with Average Daily Volume above $1M, the following result comes up:

- 34 stocks in Poland;
- 5 stocks in Czech Republic;
- 4 stocks in Hungary;
- 3 stocks in Romania.

The largest part of the above is in traditional sectors such as financials, utilities, petrochemicals and telecom. One can however find interesting companies in the consumer space. Here 2 companies stand out: CCC and LPP.

**Stock focus: CCC – Poland – Sales of $1.2bn – Market capitalization of $3.1bn**

In 2017, CCC or Cena Czyni Cuda (Price Makes Miracles in Polish) sell 40M pairs of shoes through 900 stores, Eobuwie.pl website across 17 European countries. In other words, it is the largest affordable shoe retailer in Poland (25% market share) with ambition to become a leader on the whole of Central Europe. The company was set up as a shoe trader back in 1996 by Darius Milek. Today the 49-year old businessman holds 27% of capital and 35% of voting rights of CCC. He is ranked among the richest persons in Poland with estimated wealth of $1.4bn (Forbes).

**CCC sales detail per category and geography**

Women contribute up to 60% of its sales, followed by men at 20% and children at 12%. The majority of revenue is generated in Poland (57%), followed by the rest of Central Europe (24%) and Western Europe (13%). In Western Europe (mostly Austria and Germany), CCC started in 2013 but has been losing money ever since. As per the management, 2017 is likely to be the peak year.
in terms of negative impact on EBIT (-20% on consolidated basis). Austria should breakeven in 2018 and in Germany the assortment was adjusted to local tastes (lower heels, less fashion).

While Russia generates only 2% of sales in 2017 from 11 stores, it has been identified as a key growth market. CCC plans to double the number of stores every year to reach 80 stores by 2019. The profitability is good, in line with Poland.

YTD growth has been strong: +37% in sales over 9M17 with Ebitda margin of 10%. Sales space growth was 24% in 2016, 17% in 2017 and is expected to accelerate to 20% in 2018. The e-commerce contributes already 14% to sales and 17% to earnings.

ROE reaches 27%, ND/EBITDA is at healthy 1x and dividend pay-out stands at 30% of earnings. Earnings CAGR over the next 3 years is estimated at 25%. Given those strong fundamentals, valuation (25x PE18) seems reasonable, in line with Latam and Asian peers.

**Sales evolution and mix per brand**

<table>
<thead>
<tr>
<th>Year</th>
<th>Reserved</th>
<th>Cropp</th>
<th>House</th>
<th>MOHITO</th>
<th>SINSAY</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>4,116</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2014</td>
<td>4,769</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2015</td>
<td>5,130</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2016</td>
<td>6,019</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: LPP

The company operates across 20 countries and continues to expand: Kazakhstan and Israel planned for 2018. Poland generates 55% of sales while the remaining 45% are well spread across the region (cf chart below).

**LPP : a strong regional player**

<table>
<thead>
<tr>
<th>Country</th>
<th>% of Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poland</td>
<td>55%</td>
</tr>
<tr>
<td>Russia</td>
<td>2%</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>2%</td>
</tr>
<tr>
<td>Israel</td>
<td>2%</td>
</tr>
<tr>
<td>Other</td>
<td>40%</td>
</tr>
</tbody>
</table>

Source: LPP

For 2018 the company foresees 15-20% top line growth driven by 10% space expansion. It is said to be sustainable for 2019. Gross profit margin should expand to 53-54%, up from 51% seen over 9M17. But the level is still below 2014 (58%). The balance sheet is healthy and the management is focused on improving working capital terms through factoring. The stock is trading at PE18 of 30x, which seems rich vs 25x PE18 for Inditex, the sector reference. We put the name on our watchlist and be interested at lower level.

**Stock focus : LPP – Poland – Sales of $2bn – Market capitalization of $4.4bn**

**LPP**

LPP is the largest apparel retailer in Poland with 16% market share. The company was set up by 2 friends that still own 20% of the capital. They present the company as something in-between H&M and Zara. First in terms of prices, second in terms of business model (fast fashion, short collections, portfolio of various brands). The portfolio comprises of 5 brands:

- **Reserved** (45% of sales): historic brand launched in 1998. Designed for women, men and kids the store format is large – 1,200 sqm for existing store, 2,400 sqm for new openings.

- **Cropp, House, Sinsay et Mohito** (47% of sales): brands launched in later and target young adults aged from 18 to 30. It is operated through smaller store formats (450sqm for new openings).