19 January 2023

Outthink. Outperform.

AFFIN HWANG INVESTMENT BANK

Company Update | **RM1.96 @ 18 January 2023**

"Expecting a slight earnings dip in FY23E followed by a better FY24E"

Share price performance

	1M	3M	12M
Absolute (%)	-3.9	1.6	-20.3
Rel KLCI (%)	-4.9	-4.8	-17.7

	BUY	HOLD	SELL
Consensus	12	1	2

Stock Data

Sector	Consumer
Issued shares (m)	9,431.5
Mkt cap (RMm)/(US$m)	18,485.6/4,264
Avg daily vol - 6mth (m)	4.3
52-wk range (RM)	1.84-2.55
Est free float	23.8%
Stock Beta	0.59
Net cash/(debt) (RMm)	(1,385.09)
ROE (CY23E)	7.7%
Derivatives	Nil
Shariah Compliant	Yes
FTSE4Good Constituent	Yes
FBM EMAS (Top 200)	
ESG Rank	Top 25%
ESG Risk Rating*	31.4 (NA yoy)

Key Shareholders

BEE FAMILY LIMITED	50.9%
HYPTIS	6.6%
PLATINUM ALPHABET	6.1%

Source: Bloomberg, Affin Hwang, Bursa Malaysia, ESG Risk Rating Powered by Sustainalytics
** Full ESG commentary inside*

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MR D.I.Y. (MRDIY MK)

SELL (maintain)
Up/Downside: -5.0%

Price Target: RM1.87
Previous Target (Rating): RM1.87 (Sell)

Pushing forward on existing expansion strategies

- **Mr DIY is pushing ahead on its store network expansion strategy with a 2023 new store target of c.180 to drive top line growth, having met its 2022 target**
- **We are cautious on the near-term outlook due to softer consumer sentiment and intense competition preventing the passing on of increasing cost pressure**
- **Maintain Sell rating and EPS forecasts with an unchanged TP of RM1.87 on DCF valuation (WACC: 6.6%, g: 3.0%) on likely earnings contraction with growth coming mainly from smaller and rural areas where disposable income is lower**

Mr DIY continues disciplined store additions with 2023 target

Having achieved its 2022 target of 1,080 stores (+20% yoy growth), Mr DIY has now set its 2023 new store target of c.180 (+17% yoy) across all retail formats, 70% of which are to be met by the Mr DIY format, 20% by the Express format and the rest by the Mr. Dollar, Toy and Plus formats. We see a steady decline in SSSG from +6.5% in FY17 to -6.9% in FY20 and +11.2% in FY21 (off a low base), while qoq the SSSG seemed somewhat flat on a net basis with 3Q22's +5.5% vs 3Q21's -10.6% and 2Q22's +19.9% vs 2Q21's -16.7% (Fig 5). While Mr DIY has been able to defend its quarterly revenue per store, we think this is unsustainable in the long run with growth becoming increasingly driven by expansion to smaller and rural areas where consumer disposable income is lower than in urban areas.

Automated warehouse in progress to support growth of outlets

Mr DIY is investing c.RM100m in an automated warehouse on a 9-acre plot to be completed by end-2023 that is expected to support 1,260 stores. We expect the warehouse to help deliver labour and cost efficiencies, enabling it to better manage inventory with real time data flow and lower the required headcount to 5 per 10 stores vs 12 per 10 stores at a manual warehouse.

Maintain Sell with an unchanged TP of RM1.87

We maintain our Sell rating with an unchanged 12-month TP of RM1.87 based on DCF valuation (g: 3.0%, WACC: 6.6%). We are cautious on the company's near-term outlook with the tightening of spending in a high inflation environment as home improvement projects are prioritized and focus moves away from the home post-pandemic and as competition intensifies with consumers moving towards more value-for-money options. Given a pricey 42x FY23PER and on likely earnings contraction in the long term, we maintain our Sell rating.

Earnings & Valuation Summary

FYE 31 Dec	2020	2021	2022E	2023E	2024E
Revenue (RMm)	2,559.3	3,373.4	3,853.8	4,144.6	4,769.3
EBITDA (RMm)	702.9	869.0	1,001.2	1,023.7	1,130.3
Pretax profit (RMm)	457.7	586.4	651.3	599.7	636.9
Net profit (RMm)	337.2	431.8	462.5	443.8	464.9
EPS (sen)	3.6	4.6	4.9	4.7	4.9
PER (x)	55.1	43.0	40.2	41.8	39.9
Core net profit (RMm)	345.8	429.1	462.5	443.8	464.9
Core EPS (sen)	3.7	4.6	4.9	4.7	4.9
Core EPS growth (%)	9.0	24.1	7.8	(4.0)	4.8
Core PER (x)	53.7	43.3	40.2	41.8	39.9
Net DPS (sen)	1.0	1.8	2.0	1.9	2.0
Dividend Yield (%)	0.5	0.9	1.0	1.0	1.0
Chg in Core EPS (%)			-	-	-
Affin/Consensus (x)			0.9	0.7	0.7

Source: Company, Affin Hwang forecasts

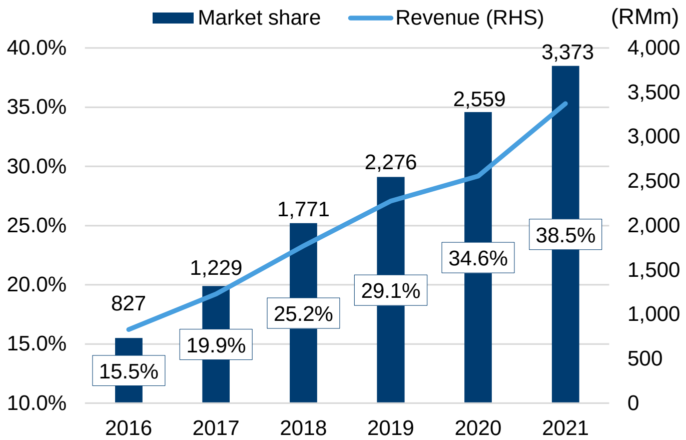
Sales driven by new store openings

Store network additions for 9M22 at 77% of full-year target; introduced 2023 new store target of c.180

The largest home improvement retailer in Malaysia

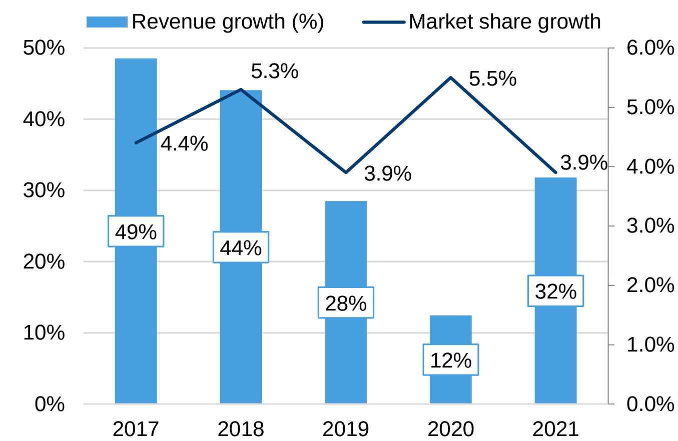
To recap, Mr DIY's 9M22 top line and bottom line increased to RM2.9bn (+21.8% yoy) and RM339.9m (+14.9% yoy), respectively, on the back of higher transaction volume growth to 35.8m (+40%) as well as positive contribution from new stores (+197 stores vs 3Q21). In terms of market share as of end-2021, Mr DIY held 38.5% of the home improvement retail market in Malaysia (Fig 1). This also seemed to have been slightly boosted by the tough operating environment and strict Covid-related movement controls possibly impacting smaller players in 2020 where Mr DIY saw a higher spike in market share despite smaller revenue growth compared to other years (Fig 2).

Fig 1: Mr DIY market share and revenue trend



Source: Company, Affin Hwang

Fig 2: Mr DIY market share and revenue growth trend

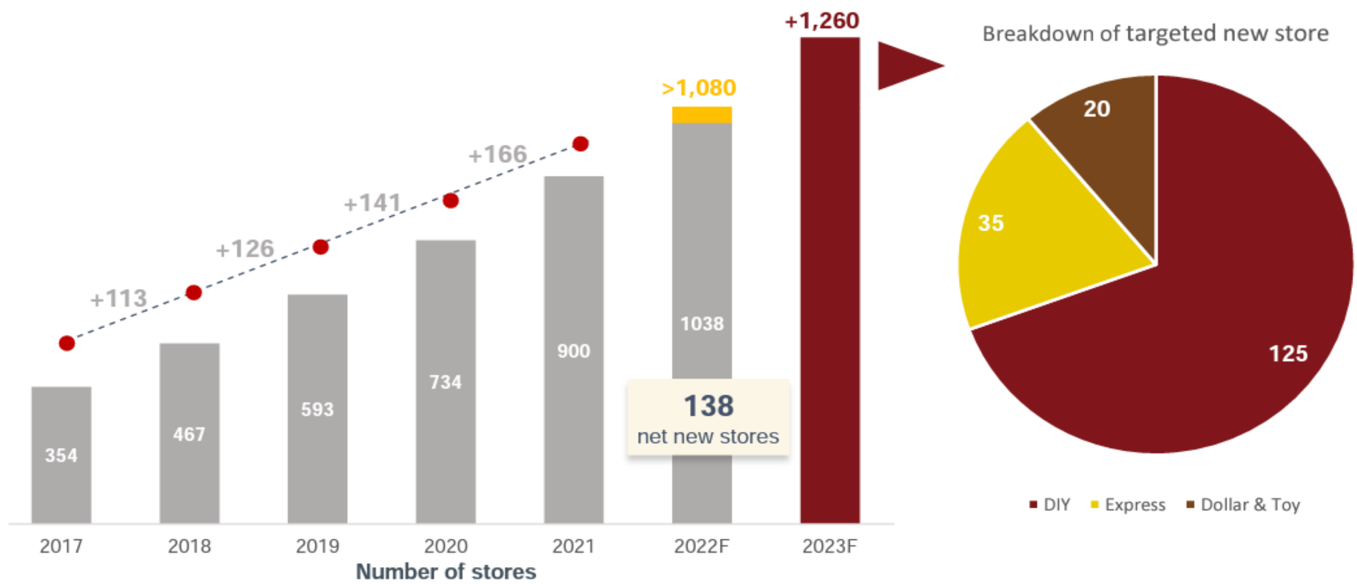


Source: Company, Affin Hwang

New store target for 2023 set at c.180 across all retail formats

As of end-2022, Mr DIY had achieved its 2022 new store target of 180 and is committed to furthering its expansion strategy with a new store target of c.180 for 2023. Mr DIY guided that about 70% of the additions will be met by Mr DIY format stores, 20% by Mr DIY Express format stores and the rest by Mr Dollar, Mr Toy and Mr DIY Plus stores, to reach a total store network of 1,260 by end-2023 (Fig 3).

Fig 3: New store target for 2023



Source: Company (2022F depicted as of 3Q22 results briefing)

Overall, defending quarterly revenue per store and lowering yoy average capex per store, but we see disciplined expansion as unsustainable in supporting marginal growth

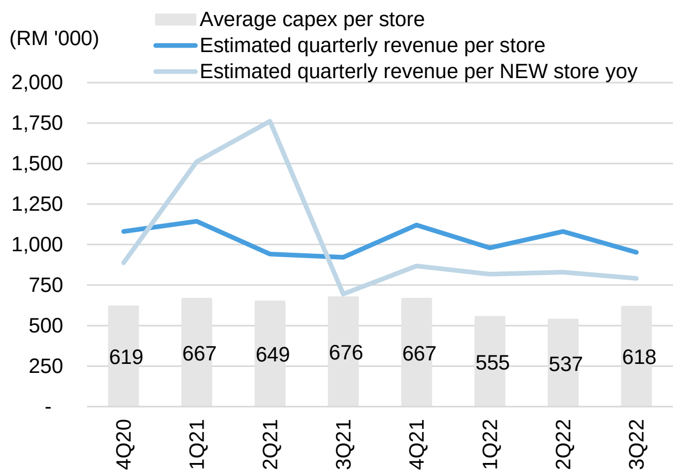
Strategic focus on Mr DIY and Mr DIY Express formats

The lower average capex per store across 9M22 vs 9M21 was contributed by the opening of stores in more suburban areas in second-tier townships rather than in urban areas in major cities (Fig 4). Mr DIY also specifically highlighted the Mr DIY Express format as part of its growth opportunities for 2023. This format is typically <4,000 sq ft, targeted to grow market share across smaller towns and offers Mr DIY merchandise but with the assortment catered to maximise sales productivity. On the other end, Mr DIY had also launched the Mr DIY Plus format (c.30k sq ft with all three brands under one roof) in May 2022. While it has not committed to any addition of this new large size store format for 2023, the group in its 2Q22 briefing had guided that it expects to open c.10 Plus stores over the next 2-3 years in major cities across Malaysia, subject to availability of sites.

Unsustainable marginal revenue growth

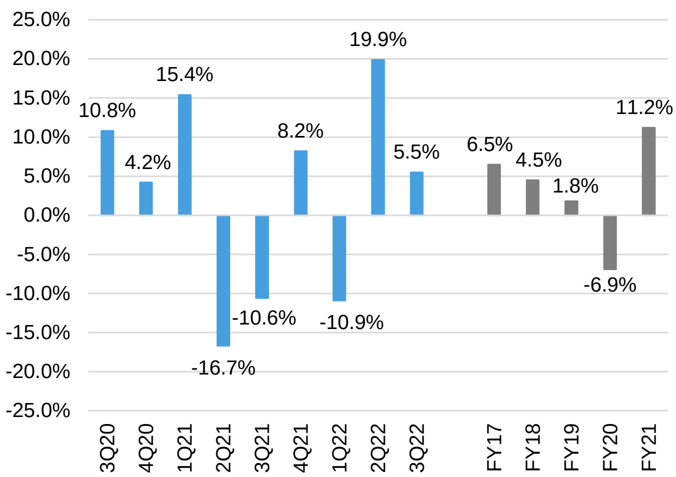
Based on our estimates, Mr DIY has been able to defend its quarterly revenue per store, which includes the sales added by new stores opened in the comparison period from 4Q20 to 3Q22, but also saw its estimated quarterly revenue per new store drop from the peak in 2Q21 over the same period (Fig 4). On its SSSG trend, we saw a decline from FY17-20 with FY21 coming up off a low base (Fig 5). Further, on a qoq basis, we observe an almost flat trend on a net basis as changes in 1Q-3Q22 seem to have cancelled out the corresponding quarter's growth or decline. While these indicators suggest that Mr DIY's growth was dependent on and will be driven by the expansion in the number of outlets, it may have a harder time sustaining its marginal revenue growth moving forward as growth becomes increasingly driven by expansion to smaller and rural areas where consumer disposable income is lower.

Fig 4: Average capex and quarterly revenue per # store



Source: Company, Affin Hwang

Fig 5: Mr DIY SSSG trend



Source: Company, Affin Hwang

Automated warehouse to support store network expansion growth expected to be completed by end-2023

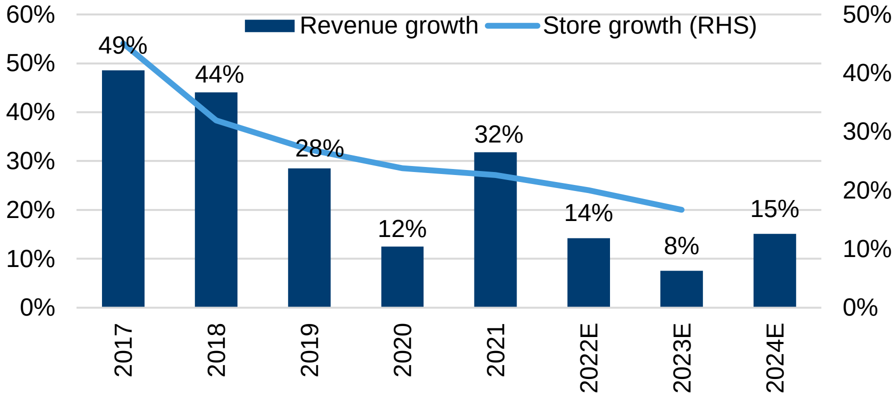
Focus on automation to optimise operational efficiencies

Mr DIY is also focused on automation and technology to optimise operational efficiencies that will help it reduce manual labour, improve employee safety and upskill its talent pool. It is building an automated warehouse on a 9-acre plot to be completed by end-2023. The warehouse will feature an Automated Storage & Retrieval System, Autonomous Mobile Robot Pick to Light System and Warehouse Management System for better inventory management and real time data flow (link to time lapse video). Its expected investment is c.RM100m with a payback period of c.5 years, of which ~RM6m had been spent as of November 2022. Management guided that the warehouse will be able to cater to 1,260 stores with a lower headcount of 5 for 10 stores vs a manual warehouse, which requires 12 headcount for 10 stores). We expect the automated warehouse, when operational, to support business growth and drive labour and cost efficiencies.

Earnings outlook, valuation and recommendation

Anticipate steady topline growth on store network expansion for FY23-24E
We expect Mr DIY's revenue growth to slow to 7.5% for FY23E and improve to 15.1% for FY24E, on the back of contribution from new stores and better footfall with the resumption of economic activities and tourist arrivals (Fig 6).

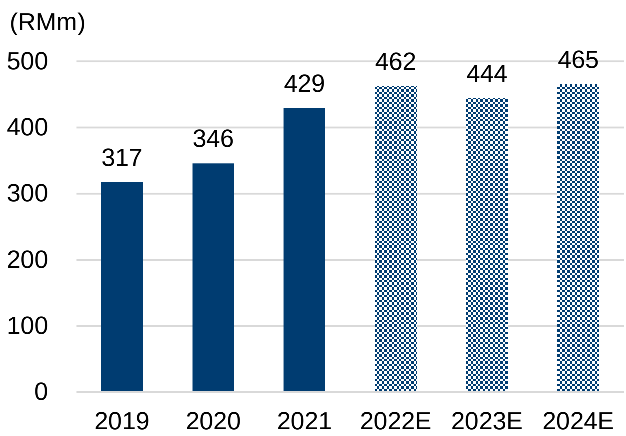
Fig 6: Mr DIY yoy revenue and store growth



Source: Company, Affin Hwang forecasts

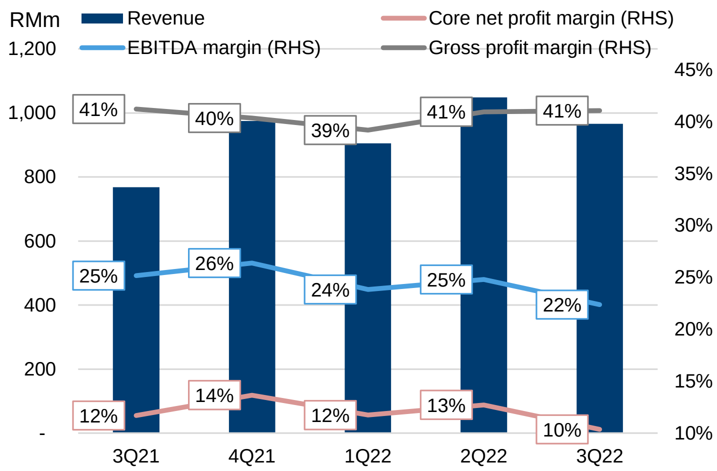
We forecast core net profit to dip in FY23E but rise in FY24E
We forecast Mr DIY's core net profit to decline by 4.0% to RM443.8m for FY23E and increase by 4.8% to RM464.9m for FY24E (Fig 7). We expect a dip in FY23E due to higher input costs amidst the inflationary environment. Margins trended downwards in 3Q22 with gross profit and EBITDA margins reaching 41.1% and 22.4% respectively (Fig 8). This was slightly offset by price increases across selected range of products in 2Q and 3Q22. 9M22 was also affected by higher operating expenses, including higher input, freight costs and employee wages with given the minimum wage increase (Fig 9, 10 and 11). This was slightly offset by favourable rental rates due to stronger bargaining power by Mr DIY. With management also seeing a tightening of consumer spending in 3Q22, we expect it to be harder in FY23 for Mr DIY to pass on cost pressures to customers, especially with cost leadership competition.

Fig 7: Mr DIY core net profit



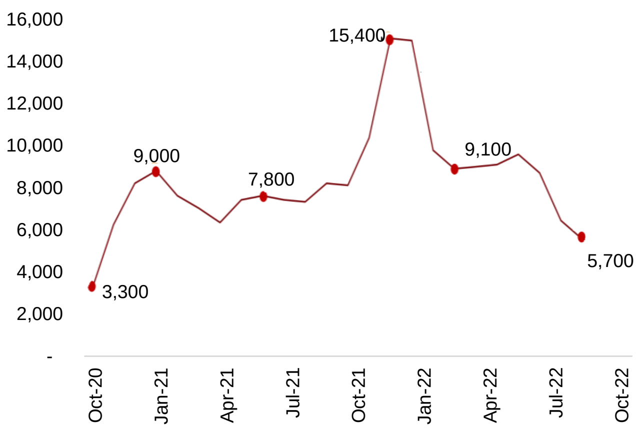
Source: Company, Affin Hwang

Fig 8: Mr DIY revenue, EBITDA margin and core net profit margin



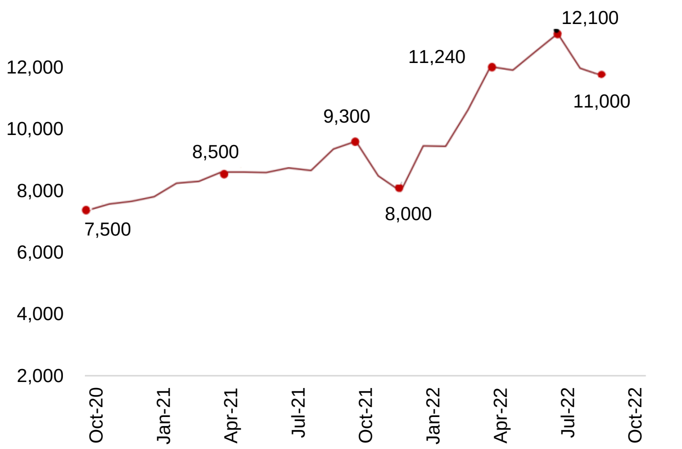
Source: Affin Hwang

Fig 9: Ex-China freight costs (RM per container)



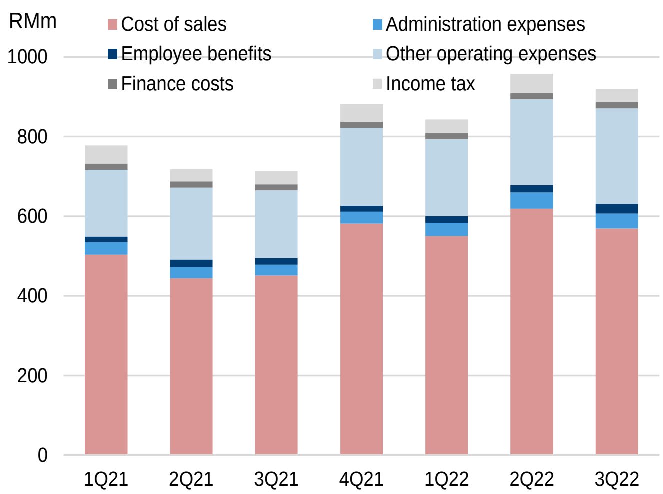
Source: Company, Affin Hwang

Fig 10: EM freight costs - West Malaysia to East Malaysia (RM per container)



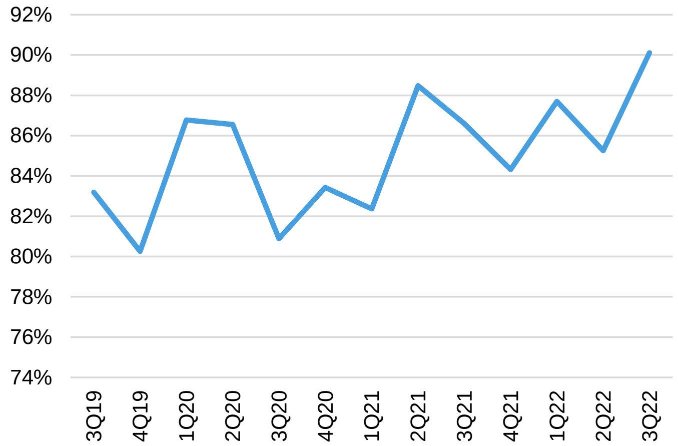
Source: Company, Affin Hwang

Fig 11: Mr DIY's key cost items



Source: Company, Affin Hwang

Fig 12: Key costs (ex. finance costs and income tax) as a % of revenue

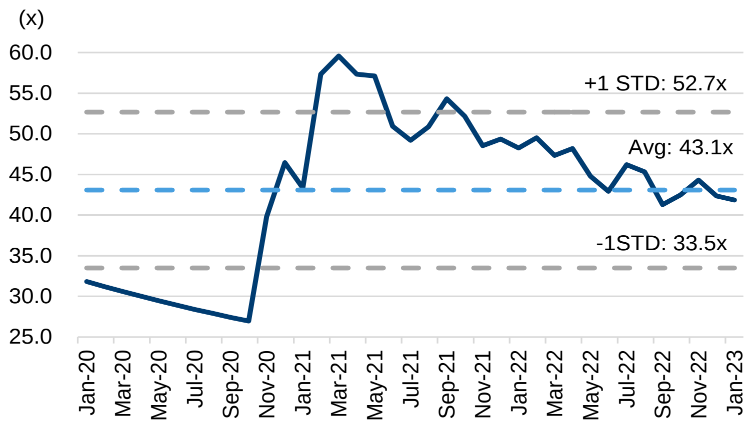


Source: Affin Hwang

Maintain Sell rating and TP of RM1.87

We maintain our Sell rating and TP of RM1.87 based a on DCF valuation (WACC: 6.6%, g: 3.0%). While the share price has corrected by 17% in FY22 and is currently trading in line with its 2-year forward mean, we still find the stock pricey at a forward PE of 42x.

Fig 13: Mr DIY's historical forward P/E band



Source: Bloomberg. Affin Hwang

Key risks

Upside/downside risks include: 1) better- or worse-than-expected consumer sentiment, 2) better- or worse-than-expected cost management and efficiencies, and 3) supply chain conditions or disruptions impacting cost pressures.

Financial Summary – Mr DIY

Profit & Loss Statement

FYE Dec (RMm)	2020	2021	2022E	2023E	2024E
Total revenue	2,559.3	3,373.4	3,853.8	4,144.6	4,769.3
Operating expenses	(1,856.5)	(2,504.4)	(2,852.6)	(3,120.9)	(3,639.0)
EBITDA	**702.9**	**869.0**	**1,001.2**	**1,023.7**	**1,130.3**
Depreciation and amortisation	(172.6)	(228.4)	(272.8)	(333.6)	(394.1)
EBIT	**530.2**	**640.6**	**728.5**	**690.1**	**736.2**
Net interest income/(expense)	(65.8)	(59.0)	(79.8)	(93.3)	(102.6)
Associates' contribution	1.9	2.1	2.7	2.9	3.3
Pretax profit	**457.7**	**586.4**	**651.3**	**599.7**	**636.9**
Tax	(120.5)	(154.6)	(188.9)	(155.9)	(172.0)
Minority interest	0.0	0.0	0.0	0.0	0.0
Net profit	**337.2**	**431.8**	**462.5**	**443.8**	**464.9**
EI	(8.7)	2.7	0.0	0.0	0.0
Core net profit	**345.8**	**429.1**	**462.5**	**443.8**	**464.9**

Balance Sheet Statement

FYE Dec (RMm)	2020	2021	2022E	2023E	2024E
Fixed assets	441.4	537.4	436.7	476.6	501.5
Other long term assets	902.9	1078.8	1357.5	1562.0	1767.0
Total non-current assets	**1344.3**	**1616.2**	**1794.2**	**2038.6**	**2268.5**
Cash and equivalents	90.9	192.7	343.2	762.4	1181.2
Stocks	690.0	748.9	879.5	945.9	1096.2
Debtors	127.8	139.1	184.3	191.6	215.1
Other current assets	0.0	0.0	0.0	0.0	0.0
Total current assets	**908.7**	**1080.7**	**1407.0**	**1899.9**	**2492.5**
Total asset	**2253.0**	**2696.9**	**3201.2**	**3938.5**	**4761.0**
Creditors	119.9	148.7	66.6	81.5	103.9
Short term borrowings	242.8	192.2	142.2	92.2	43.2
Other current liabilities	160.9	194.0	208.7	224.9	242.7
Total current liabilities	**523.6**	**534.8**	**417.5**	**398.6**	**389.8**
Total liabilties	**1376.3**	**1547.7**	**1762.7**	**2106.9**	**2539.4**
Long term borrowings	20.8	16.2	66.9	117.5	168.2
Other long term liabilities	831.9	996.7	1278.3	1590.8	1981.4
Total long term liabilities	**852.7**	**1012.9**	**1345.2**	**1708.3**	**2149.6**
Shareholders' funds & liabilities	**2253.0**	**2696.9**	**3201.3**	**3938.5**	**4761.0**

Cash Flow Statement

FYE Dec (RMm)	2020	2021	2022E	2023E	2024E
PBT	457.7	586.4	651.3	599.7	636.9
Depreciation & amortisation	172.6	228.4	272.8	333.6	394.1
Working capital changes	(202.4)	(105.1)	(257.8)	(58.8)	(151.4)
Cash tax paid	(120.8)	(138.8)	(188.9)	(155.9)	(172.0)
Others	78.0	76.8	88.7	109.0	140.4
Cashflow from operations	**385.2**	**647.7**	**566.1**	**827.5**	**848.1**
Capex	(119.9)	(141.2)	(126.0)	(126.0)	(119.0)
Disposal/(purchases)	0.9	1.8	0.0	0.0	0.0
Others	1.5	(0.9)	(3.0)	(3.0)	(3.0)
Cash flow from investing	**(117.5)**	**(140.2)**	**(129.0)**	**(129.0)**	**(122.0)**
Debt raised/(repaid)	(379.4)	(47.2)	(50.0)	(50.0)	(49.0)
Equity raised/(repaid)	301.5	0.0	0.0	0.0	0.0
Net interest income/(expense)	(67.9)	(59.5)	(73.2)	(87.6)	(101.2)
Dividends paid	(95.8)	(172.6)	(184.9)	(177.4)	(185.9)
Others	(86.6)	(117.0)	38.3	35.7	28.7
Cash flow from financing	**(328.2)**	**(396.4)**	**(269.8)**	**(279.3)**	**(307.4)**
Free Cash Flow	**265.2**	**506.4**	**440.1**	**701.5**	**729.1**

Key Financial Ratios and Margins

FYE Dec (RMm)	2020	2021	2022E	2023E	2024E
Growth					
Revenue (%)	12.5	31.8	14.2	7.5	15.1
EBITDA (%)	10.5	23.6	15.2	2.2	10.4
Core net profit (%)	9.0	24.1	7.8	(4.0)	4.8
Profitability					
EBITDA margin (%)	27.5	25.8	26.0	24.7	23.7
PBT margin (%)	17.9	17.4	16.9	14.5	13.4
Core net profit margin	13.5	12.7	12.0	10.7	9.7
Effective tax rate (%)	26.3	26.4	29.0	26.0	27.0
ROA (%)	15.0	16.0	14.4	11.3	9.8
Core ROE (%)	15.4	15.9	14.4	11.3	9.8
ROCE (%)	19.5	20.0	16.6	12.5	10.6
Dividend payout ratio ('	28.4	40.0	40.0	40.0	40.0
Liquidity					
Current ratio (x)	1.7	2.0	3.4	4.8	6.4
Op. cash flow (RMm)	385.2	647.7	566.1	827.5	848.1
Free cashflow (RMm)	265.2	506.4	440.1	701.5	729.1
FCF/share (sen)	2.8	5.4	4.7	7.4	7.7
Asset management					
Debtors turnover (days	0.5	0.3	0.3	0.3	0.3
Stock turnover (days)	147.5	132.5	129.6	135.1	131.3
Creditors turnover (day	7.6	16.9	16.6	10.5	11.4
Capital structure					
Core ROA (%)	0.2	0.2	0.1	0.1	0.1
ROCE (%)	19.5	20.0	16.6	12.5	10.6

Quarterly Profit

FYE Dec (RMm)	3Q21	4Q21	1Q22	2Q22	3Q22
Revenue	768.0	975.4	905.2	1,048.7	966.2
Op costs	(574.7)	(718.0)	(689.4)	(788.6)	(750.0)
EBITDA	193.3	257.4	215.8	260.1	216.2
Depn & amort	(55.6)	(65.3)	(61.0)	(65.0)	(67.9)
EBIT	137.7	192.2	154.7	195.2	148.3
Int expense	(14.9)	(15.0)	(15.1)	(15.4)	(15.8)
Int and other inc	0.3	0.6	0.5	0.6	(0.5)
Associates	0.6	0.2	0.2	1.2	1.6
EI	0.4	1.2	(5.8)	1.7	1.0
Pretax Profit	124.0	179.1	134.5	183.3	134.6
Tax	(33.7)	(44.6)	(34.0)	(48.1)	(33.4)
Tax rate (%)	27.2	24.9	25.3	26.2	24.8
MI	0.0	0.0	0.0	0.0	0.0
Net Profit	90.4	134.6	100.5	135.2	101.2
EPS (sen)	1.0	1.4	1.1	1.4	1.1
Core net profit	90.0	133.3	106.3	133.5	100.1
Margin (%)					
EBITDA	23.96	25.17	26.39	23.84	24.81
PBT	14.81	16.15	18.37	14.86	17.48
Core net profit	10.75	11.71	13.67	11.74	12.73

ESG Analysis

Analyst summary

With a total unmanaged ESG risk rating of 31.4, Mr DIY is placed in the 3rd quartile of Sustainalytics' ESG Risk Rating global universe ranking. The high unmanaged ESG risk score could be partly attributable to the Sustainalytics review being done based on Mr DIY's FY20 9-pager inaugural sustainability statement as compared to its improved disclosures in its FY21 standalone 40-pager sustainability report. As Mr DIY continues to integrate sustainability into its business strategy, we expect gradual improvements in its ESG performance as well as Risk Rating.

Mr D.I.Y ESG Risk Rating

31.4	(out of 100)	Rating Date	Momentum (yoy)							
		6-Sep-21	**0.0**		(RISK) EXPOSURE		**36.0**	out of	100	
Negl.	Low	Med.	High	Severe	Low		Med.		High	
0-10	10-20	20-30	30-40	40+	0-35		35-55		55+	
INDUSTRY		**Traders & Distributors**			(RISK) MANAGEMENT		**13.8**	out of	100	
UNIVERSE RANKING (1st = least risky)		**10,929**	out of	15,634	Strong		Average		Weak	
					100-50		50-25		25-0	

Source: Affin Hwang, Powered by Sustainalytics

Sustainalytics ESG Risk Rating summary

MRDIY has a Sustainalytics ESG risk rating of 31.4, a medium exposure score of 36.0 and a low management score of 13.8.

ESG opportunities

Pillar	Opportunities	Analyst comments
G	Digitalisation and data privacy - In FY2021, Mr DIY recorded zero substantiated complaints concerning breaches of customer privacy and recorded zero identified leaks, thefts or loss of customer data with its IT department continuing to safeguard the integrity of its IT infrastructure and system.	We believe this is important, especially in its omnichannel strategy as it grows its e-commerce business. Management of this issue could support data discipline, management, analysis and integrity for its own online storefront and potentially in its expansion of partnerships with e-wallets and e-marketplaces.
G	Quality management - Mr DIY has a focus on automation and technology to increase operational efficiencies, improve inventory management, reduce manual labour and enable the upskilling of warehouse workforce into more management and supervisory positions.	We see its automation initiatives as positive in increasing efficiencies and facilitating process and quality controls as well as risk management. Trends in automation include those covering warehouse productivity, route and logistics performance, and price optimisation systems.

ESG risks

Pillar	Risks	Analyst comments
S	Human capital and employee health and safety - Employee health and safety and Talent attraction, development and retention are two material ESG issues under Mr DIY's materiality framework. Its employee turnover was c. 61% in FY21. While it has set a Lost Time Injury Frequency Rate (LTIFR) target of 0 by 2025 (FY21: 0.70), it is noted that its health and safety performance has greatly deteriorated from FY18 to FY21 with the increase in number of staff.	Exposure to human capital issues may affect its reputation and increase administrative and employee benefits expenses in replacing, retraining or retaining employees, e.g. those vital and qualified with negotiation and project management skills, especially to engage in the opening of new stores.
E & S	Environmental and social supply chain - Responsible sourcing and supply chain practices are part of Mr DIY's material ESG issues. It has decreased its proportion of imported products procurement spending from 73.2% in FY19 to 70.6% in FY21. It has also introduced its Vendor Code of Conduct that provides its team with a set of environmental and social criteria that its suppliers are expected to comply with. The Group also adopts a zero-tolerance policy towards child and forced labour across its entire value chain.	The risks relating to environmental and social supply chains remain with majority of its trading products coming from overseas. This posed heightened challenges in 2022 amid high shipping container costs, city-wide lockdowns, backlogged ports and tough labour conditions. With more exploration of local supplier sourcing and emphasis on supply chain tracing and auditing of ESG standards, the risks relating to this criterion could be managed further.
E & S	Responsible consumption - To promote responsible consumption, Mr DIY has incorporated eco-products in its sales mix since inception and has set a target to increase the proportion of eco-products in its sales mix to 10% by 2030. Mr DIY defines eco-products as those that are (i) capable of reducing energy and water consumption, (ii) made of recycled material or biodegradable material, or (iii) that are reusable.	On one hand, Mr DIY enables affordability and a wider access to higher home quality as it targets to cater to even smaller and rural towns, especially beneficial during the pandemic where focus on the home increased. Nevertheless, its number of transactions also raise concerns on responsible consumption. One mitigation strategy is still work in progress, i.e. on its eco-products.

Important Disclosures and Disclaimer

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +10% over a 12-month period
HOLD	Total return is expected to be between -5% and +10% over a 12-month period
SELL	Total return is expected to be below -5% over a 12-month period
NOT RATED	Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation

The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.

OVERWEIGHT	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
NEUTRAL	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
UNDERWEIGHT	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

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