

Padini (PAD MK)

Positive outlook but cost pressures persists

Maintain BUY with lower TP of MYR4.10

We expect PAD to benefit from improved consumer spending in sequential quarters with consumers gradually returning to pre-pandemic routines and given the unlikely recurrence of national lockdowns in view of high vaccination rates. However, margin contraction may materialise if PAD is unable to offset rising cost of production with better product mix going forward. We reduce our FY22-FY23E earnings estimates by 7%-9% and derive a lower TP of MYR4.10 (20x CY23 PER, +0.5SD to mean).

Emerging signs of consumer down-trading

PAD posted stronger FY21 operating profit of +27% YoY (EBIT margin: +3.8ppts YoY) despite weaker revenue (-9% YoY) mainly due to lower salary expense and depreciation of right-of-use assets given the slowdown in new store openings. However, we expect sales trends to turn positive in FY22. We understand that overall store transaction volumes have sustained despite recent spikes in new COVID-19 cases. Its "Brands Outlet" stores which have a lower average product price point versus its "Padini Concept Stores" have also experienced a faster pace of recovery post-lockdown.

Balancing cost pressures with better product mix

Management shared that cost pressures (material, freight cost) are likely to have a larger impact on earnings in FY22 as they has risen by c.5-10% YoY. To mitigate this, certain new product launches could see an upward revision in pricing to offset higher cost of production. Separately, PAD is also facing store labour shortages (stores are currently c.10% understaffed) which could partially hinder its sales recovery potential.

Revising FY22-FY23E earnings estimates

Topline growth is expected to improve in 2HFY22 led by normalised store operations and improved store traffic. That said, we prudently lower our FY22/FY23E earnings estimates by 9%/7% after adjusting for gross profit margin contraction of c.1% p.a. to impute for rising raw material costs. FY24 estimates are unchanged. A mitigating factor will arise from PAD's ability to up-sell higher margin items during the festive seasons in 3Q and 4QFY22. We also lift our DPS estimates to pre-pandemic levels of 10sen p.a. (from 7.5sen p.a.) in FY22-FY24E.

FYE Jun (MYR m)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	1,355	1,029	1,258	1,290	1,328
EBITDA	171	128	173	205	251
Core net profit	73	56	97	120	150
Core EPS (sen)	11.1	8.5	14.7	18.3	22.8
Core EPS growth (%)	(54.3)	(23.1)	72.3	24.5	24.9
Net DPS (sen)	7.5	2.5	10.0	10.0	10.0
Core P/E (x)	22.5	32.6	22.7	18.2	14.6
P/BV (x)	2.1	2.3	2.6	2.5	2.3
Net dividend yield (%)	3.0	0.9	3.0	3.0	3.0
ROAE (%)	10.0	6.9	11.8	14.0	16.1
ROAA (%)	6.2	4.2	7.4	8.9	10.6
EV/EBITDA (x)	10.0	13.1	11.1	8.7	6.4
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	103	128	149
MKE vs. Consensus (%)	-	-	(6.3)	(6.1)	1.0

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BUY

Share Price MYR 3.33
12m Price Target MYR 4.10 (+26%)
Previous Price Target MYR 4.25

Company Description

Padini is the owner and operator of fashion retail outlets such as Padini, Brands Outlet, Seed and Vincci.

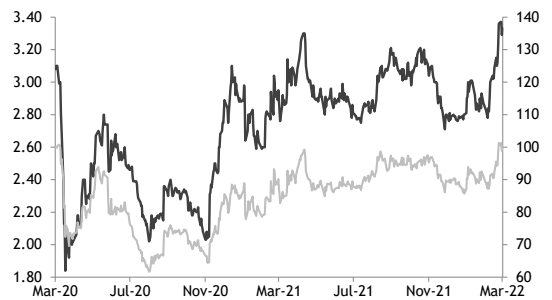
Statistics

52w high/low (MYR)	3.37/2.71
3m avg turnover (USDm)	0.3
Free float (%)	44.3
Issued shares (m)	658
Market capitalisation	MYR2.2B USD522M

Major shareholders:

YONG PANG CHAUN HOLDINGS SDN BHD	43.7%
Employees Provident Fund Board	8.3%
Kumpulan Wang Persaraan Diperbadankan	7.1%

Price Performance



	-1M	-3M	-12M
Absolute (%)	17	19	16
Relative to index (%)	12	12	15

Source: FactSet

Risk Rating & Score ¹	16.2 (Low)
Score Momentum ²	0.0
Last Updated	31 Mar 2021
Controversy Score ³ (Updated: 14 Feb 2014)	0 - No reported incidents

Business Model & Industry Issues

- Globally, the textile industry is one of the largest producers of landfill waste, with the concept of fast fashion being the key driver to industry growth.
- Fashion retailers like PAD have an inherent responsibility to incorporate more ethically produced clothing items in its stores and work towards decreasing its overall contribution to landfills.
- Another concern lies with the common usage of forced and child labour in textile manufacturing. To avoid this, PAD has a strict evaluation process in onboarding supplier partnerships, with each supplier thoroughly vetted to ensure that its labour and working conditions are up to par.
- While PAD is cognisant of selected points of concerns to be addressed, we believe its ESG compliance will benefit from the inclusion of concrete sustainability targets, particularly with regards landfill waste, to showcase its resolve in reducing the groups' environmental footprint.

Material E issues

- Group sustainability plans have been aligned to the United Nations Global Sustainable Development Agenda.
- As 99% of in-store waste comes from product packaging, PAD uses biodegradable plastic bags and recycle paper bags at all its stores to minimise its waste contribution to landfills. A 'No Plastic Bag' campaign is also conducted at stores to raise awareness for plastic pollution.
- While logistics are fully outsourced to third parties, PAD aims to better plan its distribution routes to reduce its contribution to carbon emissions.
- Installed solar systems at head offices and warehouses have resulted in 45% reduction in electricity consumption since 2018.

Material S issues

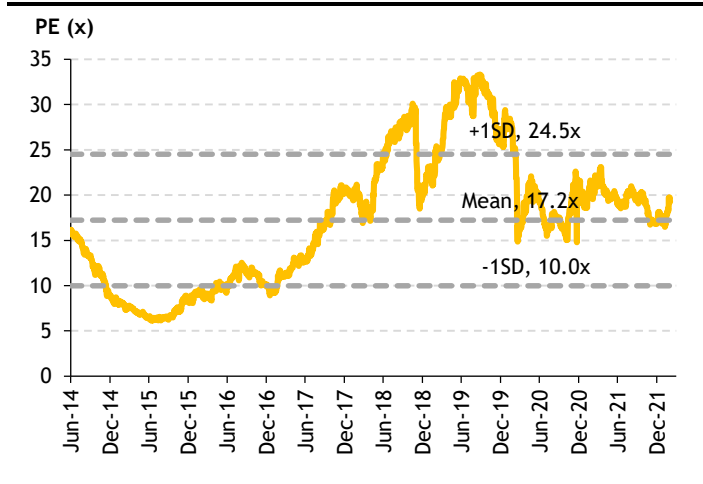
- PAD has c.2,900 employees across its businesses in Malaysia, Cambodia and Thailand. Female employees account for 60% of its workforce.
- Teams up with partner factories to develop guidelines for responsible procurement throughout its supply chain. PAD's sourcing team vets and monitors suppliers to ensure no forced or child labour is employed. Periodic visits to suppliers' factories are also conducted to verify proper working conditions are met.
- In efforts to train and develop domestic talent, PAD has committed to hiring 100% domestic employees for all its business operations.
- Annual internal training programmes are organised for all levels of staff. Staff sponsorships for work-related study and external training programs are also offered.
- Donated MYR0.6m cash under its CSR arm to various vulnerable groups in FY21. 1,600 cartons of Padini merchandise, IT equipment and hostel equipment were also donated to 6 NGO's during the year.

Key G metrics and issues

- PAD's BOD comprises of 10 members - 4 independent non-executive directors and 6 executive directors (including the managing director).
- At 40%, PAD falls short of MCCG's recommended independent representation of at least 50% on company BOD's. PAD aims to increase its number of independent directors within 2 years.
- In 2021, the male:female ratio on the BOD was 60:40. This is in compliance with MCCG's recommended industry practise of >33% female BOD representation.
- A member of the BOD has served as an independent director for >9 cumulative years in 2021. PAD has chosen to retain him upon assessing his independence based on the requirements under the main market listing requirements. This decision was not put forth for shareholder's approval.
- The chairman and managing director positions are held by separate individuals.
- The managing director's total remuneration amounted to MYR1m in FY21 (c.1.3% of FY21 pre-tax profit).
- PAD has not disclosed details of its senior management's remuneration packages due to confidentiality reasons.
- The group has been audited by BDO PLT since 2013.
- Significant recurring related party transactions surrounding the day-to-day operations of the business amounted to c.MYR6m in FY21 (c.7.4% of FY21's group PBT).

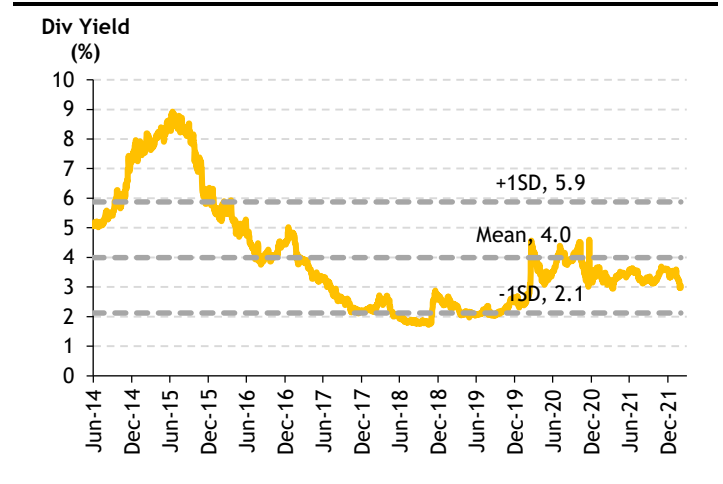
¹**Risk Rating & Score** - derived by Sustainalytics and assesses the company's exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company's enterprise value, respectively, from ESG-driven financial impacts. ²**Score Momentum** - indicates changes to the company's score since the last update - a **negative** integer indicates a company's improving risk score; a **positive** integer indicates a deterioration. ³**Controversy Score** - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

Fig 1: Forward PER



Source: Bloomberg, Maybank IBG Research

Fig 2: Forward dividend yield



Source: Bloomberg, Maybank IBG Research

Risk statement

There are several risk factors for our earnings estimates, target price and rating for Padini. Changes in sales volume, selling prices and operating expenses may lead to lower earnings for Padini. Increasing competition (including from online retailing) and weak consumer sentiment are additional earnings risk factors.

FYE 30 Jun	FY20A	FY21A	FY22E	FY23E	FY24E
Key Metrics					
P/E (reported) (x)	27.5	32.1	22.7	18.2	14.6
Core P/E (x)	22.5	32.6	22.7	18.2	14.6
P/BV (x)	2.1	2.3	2.6	2.5	2.3
P/NTA (x)	2.2	2.3	2.6	2.5	2.3
Net dividend yield (%)	3.0	0.9	3.0	3.0	3.0
FCF yield (%)	8.1	9.9	5.5	7.1	8.3
EV/EBITDA (x)	10.0	13.1	11.1	8.7	6.4
EV/EBIT (x)	12.8	17.6	13.0	9.8	7.3

INCOME STATEMENT (MYR m)

Revenue	1,354.7	1,029.4	1,258.2	1,289.7	1,328.5
EBITDA	171.3	127.9	173.3	204.5	250.7
Depreciation	(36.1)	(30.9)	(23.8)	(22.7)	(27.9)
Amortisation	(1.7)	(1.7)	(1.7)	(1.7)	(1.7)
EBIT	133.4	95.2	147.7	180.1	221.1
Net interest income / (exp)	(26.1)	(21.1)	(15.3)	(15.3)	(15.3)
Associates & JV	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	107.3	74.1	132.4	164.8	205.9
Income tax	(32.1)	(20.1)	(35.9)	(44.7)	(55.8)
Minorities	0.0	0.0	0.0	0.0	0.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	75.2	54.1	96.6	120.2	150.1
Core net profit	72.8	56.0	96.6	120.2	150.1

BALANCE SHEET (MYR m)

Cash & Short Term Investments	441.5	523.8	578.7	668.8	786.1
Accounts receivable	49.2	47.6	58.2	59.7	61.5
Inventory	273.9	218.6	272.0	275.8	276.3
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	103.0	79.5	75.6	93.0	105.1
Intangible assets	4.6	3.8	2.1	0.3	(1.4)
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	525.4	401.3	333.9	278.8	233.5
Total assets	1,397.5	1,274.5	1,320.6	1,376.3	1,461.0
ST interest bearing debt	1.6	0.0	0.0	0.0	0.0
Accounts payable	88.5	61.7	76.7	77.8	78.0
Insurance contract liabilities	0.0	0.0	0.0	0.0	0.0
LT interest bearing debt	0.0	0.0	0.0	0.0	0.0
Other liabilities	542.0	411.0	411.0	411.0	411.0
Total Liabilities	631.8	472.7	487.8	488.8	489.0
Shareholders Equity	765.8	801.8	832.8	887.5	972.0
Minority Interest	0.0	0.0	0.0	0.0	0.0
Total shareholder equity	765.8	801.8	832.8	887.5	972.0
Total liabilities and equity	1,397.5	1,274.5	1,320.6	1,376.3	1,461.0

CASH FLOW (MYR m)

Pretax profit	107.3	74.1	132.4	164.8	205.9
Depreciation & amortisation	37.8	32.6	25.6	24.4	29.6
Adj net interest (income)/exp	(14.8)	(13.2)	(15.3)	(15.3)	(15.3)
Change in working capital	(79.3)	25.8	(49.0)	(4.1)	(2.2)
Cash taxes paid	(44.6)	(34.0)	(35.9)	(44.7)	(55.8)
Other operating cash flow	(7.4)	(27.3)	0.0	0.0	0.0
Cash flow from operations	143.9	186.0	140.5	195.7	222.7
Capex	(11.3)	(5.0)	(20.0)	(40.0)	(40.0)
Free cash flow	132.5	181.0	120.5	155.7	182.7
Dividends paid	(49.3)	(16.4)	(65.8)	(65.8)	(65.8)
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.0
Change in Debt	(21.2)	(1.6)	0.0	0.0	0.0
Other invest/financing cash flow	10.6	7.2	0.0	0.0	0.0
Effect of exch rate changes	0.7	0.3	0.3	0.3	0.3
Net cash flow	73.2	170.4	54.9	90.1	117.2

FYE 30 Jun	FY20A	FY21A	FY22E	FY23E	FY24E
Key Ratios					
Growth ratios (%)					
Revenue growth	(24.0)	(24.0)	22.2	2.5	3.0
EBITDA growth	(35.2)	(25.3)	35.5	18.0	22.6
EBIT growth	(39.7)	(28.6)	55.1	21.9	22.8
Pretax growth	(51.1)	(30.9)	78.6	24.5	24.9
Reported net profit growth	(53.1)	(28.1)	78.6	24.5	24.9
Core net profit growth	(54.3)	(23.1)	72.3	24.5	24.9
Profitability ratios (%)					
EBITDA margin	12.6	12.4	13.8	15.9	18.9
EBIT margin	9.8	9.3	11.7	14.0	16.6
Pretax profit margin	7.9	7.2	10.5	12.8	15.5
Payout ratio	65.6	30.4	68.1	54.7	43.8
DuPont analysis					
Net profit margin (%)	5.5	5.3	7.7	9.3	11.3
Revenue/Assets (x)	1.0	0.8	1.0	0.9	0.9
Assets/Equity (x)	1.8	1.6	1.6	1.6	1.5
ROAE (%)	10.0	6.9	11.8	14.0	16.1
ROAA (%)	6.2	4.2	7.4	8.9	10.6
Liquidity & Efficiency					
Cash conversion cycle	79.1	113.2	94.7	104.1	104.6
Days receivable outstanding	13.9	16.9	15.1	16.5	16.4
Days inventory outstanding	121.4	138.5	110.9	122.1	122.8
Days payables outstanding	56.2	42.2	31.3	34.5	34.7
Dividend cover (x)	1.5	3.3	1.5	1.8	2.3
Current ratio (x)	4.0	5.4	5.6	6.2	6.9
Leverage & Expense Analysis					
Asset/Liability (x)	2.2	2.7	2.7	2.8	3.0
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Net gearing (%) (excl. perps)	net cash	net cash	net cash	net cash	net cash
Net interest cover (x)	5.1	4.5	9.7	11.8	14.5
Debt/EBITDA (x)	0.0	0.0	0.0	0.0	0.0
Capex/revenue (%)	0.8	0.5	1.6	3.1	3.0
Net debt/ (net cash)	(439.9)	(523.8)	(578.7)	(668.8)	(786.1)

Source: Company; Maybank

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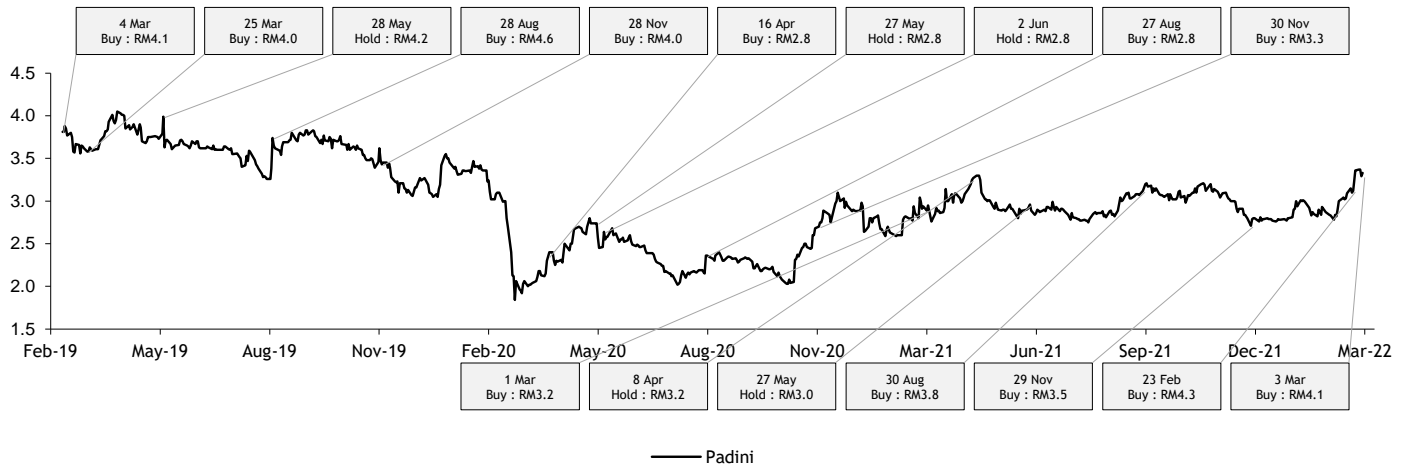
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Historical recommendations and target price: Padini (PAD MK)



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