Is DIY on the mend?

Created: 1 February 2011 Written by: **John Hughman**

One of the benefits of the downturn has been that Laurence Llewellen-Bowen and Sarah Beeny are not quite as omnipresent on our television screens as they once were. Home makeover shows might not have been killed off altogether, but the national obsession with MDF and magnolia is showing signs of waning as the housing market ebbs. Consumer confidence hit a new 20 month low in December - the largest drop in the GfK/NOP survey's 20 year history, and that's before the VAT rise - which means households are less likely to splash out on revamping tired decor. Property is no longer perceived to be the sure-fire route to riches that it was back in the boom years, when values were climbing at a stratospheric rate and becoming a buy-to-let landlord was as easy as signing your name on a mortgage application.

Self Help for Do It Yourself

For any retailers focused on home improvement, the health of the housing market is important. **Carpetright**, for one, is quite open in its acceptance that its sales are closely correlated to mortgage approvals, which fell to a 23-month low in December and by 10 per cent overall in 2010 as a result of consumers paying down loans and banks' new-found reluctance to lend to the less creditworthy. Official retail statistics, meanwhile, regularly point to big-ticket durable goods as most prone to consumer cutbacks.

Even so, retailers in the sub-sector appear more confident about trading prospects, even if consumers are not. Having seen business collapse during 2008, **Topps Tiles**, for example, has recovered strongly, and with like-for-like sales inching up has once again started to open new stores. The same is true of kitchen supplier **Howden Joinery**, which has rekindled plans to open 30 depots a year.

There are several reasons for this surprising resilience, not least that for many, they are recovering from a very low base. Sales and profit peaks are well below the peaks reached during the boom years of 2007, and with earnings generally still well short of those glory days, the market is pricing in the potential for a cyclical recovery.

Secondly, companies have invested in self-help initiatives to reduce debt, lower costs and improve merchandising, as DIY chain **Kingfisher** has demonstrated. As well as shedding less profitable stores, it is increasing the proportion of stock sourced directly from factories and packaged under its own-label brands, which is lifting gross margins. That's particularly important at the moment, because it makes it easier to pass on rising cost inflation.

There are also indications that the housing market may be playing less of role in dictating the fortunes of home improvement companies. "You go through a certain phase where housing transactions are important, but then the replacement phase kicks in", says analyst Sanjay Vidyarthi at broker Espirito Santo points out. "It's the move rather than improve scenario."

Housing hangover

But housing market weakness could still prove problematic. Although house prices have bounced back after the slump in 2008, the year-on-year growth rate has once again begun to slow. According to the Land Registry’s December House Price Index, house prices were up 1.5 per cent over the year, but that's well below the near 8 per cent rate of increase it hit last summer and the most recent monthly data has been of price falls.

Similar surveys from Nationwide and Halifax confirm the trend. Many think that despite house prices remaining 11 per cent below their peak, according to the Land Registry, there could be further falls to come. Economist Howard Archer at HIS Global Insight believes house prices could fall 10 per cent over 2011. However, he considers an outright collapse unlikely, which is some comfort to DIY companies, although, Carpetright's post-Christmas profit warning suggests the worst is far from over.

Some fundamentals certainly look weak, though. For example, while first time buyer earnings to house price ratio is down from its 2007 peak of 5.4, at 4.4 it is well above the long-term average. And despite recent terrible GDP figures, runaway inflation increases the risk that interest rates will rise this year, heaping more pressure on households.

And unlike some successful clothing retailers, overseas expansion is unlikely to prove much of buffer to domestic weakness for DIY retailers. Howden's expansion into France is moving at a snail's pace, while Topps and Carpetright have both closed overseas operations, in Benelux and Poland respectively. While Kingfisher has been more successful in foreign markets, it's nevertheless been forced to radically restructure a loss-making Chinese business. "Overseas markets are difficult,. It takes time to understand customer needs", says Mr Vidyarthi at Espirito Santo. And, as Mr Vidyarthi points out, the UK still presents challenges and opportunity in equal measure and is where huge investment has already been sunk, so management cannot afford to devote too much time to foreign forays.