Lewis Group

Strong GP margins deliver a FY24 surprise

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Price (07/06/2026):	R50.80
Market cap	R2662mn
Shares in issue	52.4mn

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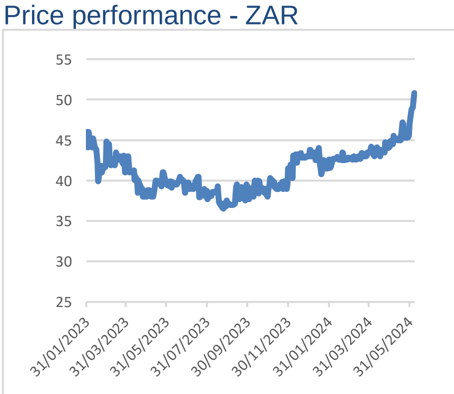
- Lewis announced FY24 HEPS of 925c, up 7% on FY23 and well ahead of our 622c. The beat in earnings emanates from a sharp widening in GP margins in 2H24 – 45.2% vs 40.7% in 1H. Revenue growth was 1% ahead of expectations. A full year dividend of 500c was declared, up 21%. Combined with the R170m of share buy backs in the year, the total return to shareholders was in line with the attributable profit of R436m.
- Affordability remains constrained in the retail environment, weighing heavily on cash sales, down 11.8%. Credit has been a large facilitator of sales with group credit sales rising 15.8% and now comprising 66% of sales, in line with expectations. Sales of 4.7% was supported by a net new 29 stores, with like for like sales up 1.9%, reflecting a challenging operating environment.
- The traditional brands delivered 6.9% sales growth. Store expansion continues as management takes advantage of favourable sites becoming available. BEST saw the bulk of expansion followed by Bedzone which is coming off a low base but performing well given decades of experience in mattresses and bed sets. A further 4 stores were added outside of SA, which is now 16% of stores.
- UFO continues to disappoint with sales down 12.6%, in line with the decline in cash sales across the group. A net 4 stores closed, and further stores are likely to close in FY25E given the short three year lease durations. Management remains committed to UFO which unfortunately has faced various headwinds since Covid. Focus is on the product range and channels to market.
- GP margins benefited in 2H with the renewal of the furniture range which was priced for higher shipping charges that didn't realise. Current shipping rates have spiked again with GP margins guided lower. We forecast a GP margin of 40.5% in FY25E, in line with FY23 and at the lower end of managements guidance range of 40-42%. There is high forecast risk in GP margins.
- Higher credit sales results in a larger debtors book (+16%) that requires funding (debt up 111% off a low base) and additional credit provisioning (up 21%). Customer credit quality has not deteriorated (satisfactory paying customers rose to a new high of 81.3%), suggesting a prudent approach to credit sales, highlighted further by a rise in the credit application decline rate from 34.7% to 35.1%. New loans are provided for at 25% on origination resulting in high upfront provisioning with higher economic overlay provisions ((+105%) that should decline as the operating environment improves – we forecast the debtors charge to decline from 17.6% to 15.8% of debtors.
- The ongoing investment in the debtors book is benefiting finance income and will continue to do so in the short term. New business is being written at a 25.25% interest rate compared to the average yield of 23.4% (21.6% in FY23), We forecast total other revenue to grow 11.4% in FY25E (+17.2% in FY24).
- We forecast operating margins to rise from 14.8% to 16% in FY25E, benefiting from strong other revenue growth and no growth in the debtors charge. Higher debt will see the interest charge rise circa 18% (+R30m) resulting in headline earnings declining from R500m to R489m. FY24 benefited from the higher GP margin in 2H as well as a R27.3m insurance payout. We revise our FY25E HEPS from 945c to 968c (+5%), benefiting from further buy backs. Our revised FY26E HEPS forecast of 1239c is 2% lower than our prior forecast.
- The mid-point of our DFCF valuation rises from R54 to R58.30 per share given improved free cash flow post high debtors investment. We still envisage a fairly consistent dividend payout ratio (fwd 10.5% dividend yield) and ongoing share buy backs in FY25E. The stock trades on an attractive 12m fwd P/E of 5.3x.

Price performance - ZAR



Source: FactSet

Figure 1 Financial summary

Year Ending	FY2021A	FY2022A	FY2023A	FY2024A	FY2025F	FY2026F	FY2027F
Income Statement							
Merchandise Sales	3,931	4,383	4,443	4,653	4,948	5,312	5,689
Sales growth (%)	*6.7%*	*11.5%*	*1.4%*	*4.7%*	*6.3%*	*7.4%*	*7.1%*
Gross profit	1,642	1,775	1,806	2,006	2,004	2,167	2,361
growth %	*8.6%*	*8.1%*	*1.8%*	*11.1%*	*-0.1%*	*8.2%*	*8.9%*
Finance income	1,271	1,280	1,334	1,655	1,873	2,011	2,074
growth %	*-3.1%*	*0.7%*	*4.2%*	*24.0%*	*13.2%*	*7.4%*	*3.1%*
Insurance income	707	776	854	986	1,083	1,122	1,147
growth %	*6.2%*	*9.7%*	*10.1%*	*15.4%*	*9.9%*	*3.6%*	*2.2%*
Ancillary income	817	818	825	891	976	1,052	1,219
growth %	*3.4%*	*0.2%*	*0.9%*	*8.0%*	*9.6%*	*7.8%*	*15.8%*
Total revenue	4,437	4,649	4,819	5,537	5,936	6,353	6,800
growth %	*3.7%*	*4.8%*	*3.7%*	*14.9%*	*7.2%*	*7.0%*	*7.0%*
EBITDA	1,039	996	960	1,058	1,185	1,300	1,417
EBITDA Margin (%)	*26.4%*	*22.7%*	*21.6%*	*22.7%*	*23.9%*	*24.5%*	*24.9%*
EBIT	696	668	609	690	793	895	994
EBIT Margin (%)	*17.7%*	*15.2%*	*13.7%*	*14.8%*	*16.0%*	*16.8%*	*17.5%*
Recurring EBIT	726	767	703	754	793	895	994
Recurring EBIT Margin (%)	*18.5%*	*17.5%*	*15.8%*	*16.2%*	*16.0%*	*16.8%*	*17.5%*
Profit before tax	604	674	567	590	662	782	809
Net profit	433	483	411	436	489	574	591
Net profit post minorities	433	483	411	436	489	574	591
Headline Earnings	463	561	510	500	489	574	591
% growth	*126.4%*	*21.2%*	*-9.1%*	*-1.9%*	*-2.2%*	*17.4%*	*2.8%*
Basic EPS (ZAc)	576	731	695	807	968	1,239	1,376
Headline EPS (ZAc)	617	849	863	925	968	1,239	1,376
% growth	*137.0%*	*37.7%*	*1.7%*	*7.1%*	*4.6%*	*28.1%*	*11.0%*
DPS (ZAc)	328	413	413	500	532	682	784
Payout ratio (%)	*56.9%*	*56.5%*	*59.4%*	*62.0%*	*55.0%*	*55.0%*	*57.0%*
Balance Sheet							
Cash and Cash equivalents	447	308	183	224	268	258	175
Current asset (ex – cash)	4,588	4,739	5,175	5,547	6,176	6,714	6,928
Net Fixed assets	1,021	396	426	442	478	520	569
Intangible assets	297	258	175	110	118	126	135
Investments	254	266	257	243	304	348	392
Other assets	218	940	916	967	1,020	1,082	1,137
Total assets	**6,823**	**6,907**	**7,133**	**7,533**	**8,363**	**9,048**	**9,336**
Debt	0	81	368	426	500	600	500
Current liabilities	1,295	1,305	1,252	1,217	1,281	1,358	1,432
Other liabilities	656	805	820	1,188	1,560	1,839	1,885
Total liabilities	**1,951**	**2,190**	**2,440**	**2,831**	**3,341**	**3,797**	**3,818**
Shareholders' equity	4,873	4,717	4,693	4,703	4,709	4,913	5,176
Minorities	0	0	0	0	0	0	0
Total shareholders' equity	**4,873**	**4,717**	**4,693**	**4,703**	**4,709**	**4,913**	**5,176**
BVPS (ZAR)	*6,812*	*7,523*	*8,218*	*8,890*	*9,761*	*11,049*	*12,500*
ROE (%)	*9.7%*	*11.7%*	*10.8%*	*10.7%*	*10.4%*	*11.9%*	*11.7%*

Year Ending	FY2021A	FY2022A	FY2023A	FY2024A	FY2025F	FY2026F	FY2027F
Cash Flow							
Reported net profit	**433**	**483**	**411**	**436**	**489**	**574**	**591**
Change in net working capital	-139	-156	-239	-1,021	-578	-473	-153
Dividends paid	-147	-254	-241	-224	-282	-282	-328
Other adjustments	661	618	482	1,268	953	783	892
Cash flow from operations	**808**	**691**	**412**	**459**	**583**	**603**	**1,001**
Net Capex	-119	-67	-125	-118	-134	-143	-154
Capex/sales (%)	*3.0%*	*1.5%*	*2.8%*	*2.5%*	*2.7%*	*2.7%*	*2.7%*
Other investing cash flows	23	102	51	41	-2	-2	-3
Cash flow from investing	**-96**	**34**	**-74**	**-77**	**-136**	**-146**	**-156**
Equity raised/(bought back)	-136	-408	-310	-222	-209	-189	-168
Net inc/(dec) in borrowings	0	0	0	350	399	325	-100
Other financing cash flows	-1,323	-551	-547	-529	-597	-607	-664
Cash flow from financing	**-1,459**	**-959**	**-856**	**-399**	**-404**	**-467**	**-927**
Net cash flow	**-747**	**-234**	**-517**	**-17**	**44**	**-10**	**-82**
Free cash flow	**610**	**582**	**441**	**-235**	**301**	**1,093**	**1,198**
Repayment of lease liabilities	**-254**	**-297**	**-305**	**-303**	**-312**	**-321**	**-331**
Net free cash flow	**355**	**285**	**136**	**-538**	**-11**	**772**	**867**
Valuation Summary							
Valuation Metrics							
Share Price (ZAc)	3,050	4,696	4,100	5,080	5,080	5,080	5,080
P/E (Underlying) (x)	4.9	5.5	4.7	5.5	5.3	4.1	3.7
P/BV (x)	0.4	0.6	0.5	0.6	0.5	0.5	0.4
EV/Sales (x)	1.0	0.9	0.9	0.8	0.8	0.7	0.7
EV/EBITDA (x)	3.8	4.0	4.1	3.7	3.3	3.0	2.8
EV/EBIT (x)	5.7	5.9	6.5	5.7	5.0	4.4	4.0
FCF Yield (%)	13.2	10.6	5.1	-20.0	-0.4	28.7	32.3
Dividend Yield (%)	10.8	8.8	10.1	9.8	10.5	13.4	15.4
Net debt	359	723	1130	1492	1895	2279	2313
Gearing ratio	7%	15%	24%	32%	40%	46%	45%
Net debt (excluding lease liabilities)	-447	-227	185	551	907	1242	1225
Gearing ratio (excluding lease liabilities)	-9%	-5%	4%	12%	19%	25%	24%

Source: Company data, FactSet, ASB estimates

Debtors Book

The debtors book has maintained its quality despite no signs of improvement in the operating environment. Debit order use has remained fairly stable in 2H at circa 52% of the book, with 80-90% on new SA applications from formally employed customers. Better quality customers is positive for future debtors management - repeat business is around 45% of new sales. Provisions as a % of gross debtors rose from 36% to 37.5% as economic overlay provisions are raised considerably (+105%) due to ongoing elevated macro risks. Collection rates are modestly lower at 79.7% compared to 80.8% in FY23. Satisfactory paid accounts by value increased from 73.8% to 76.7%, the highest in recent history.

Total arrears have declined from 27.8% in FY23 to 24.5% - this was as high as 42% in FY18. NPA's (non-performing accounts) have declined from 11.4% of total gross debtors in FY23 to 8.4% (FY23 has been restated due to Insurance accounting changes). Credit application decline rates rose from 34.7% to 35.1%.

A further test for adequacy of provisions is to look at coverage levels across the arrears in the three categories (satisfactory paid, slow payers, non-performing) of the book. We assume that NPAs should be fully provided for as well as >3-month arrears in the other two categories (we define this as the problematic book). Total provisions provide 215% coverage (173% in FY23) of the problematic book. We have excess provisions of R1393m which represents a general provision of 20% (15% in FY23) of the gross debtors book. The significant increase in economic overlay provisions has been a key driver of this trend. In the absence of IFRS 9 we would see a material decline in provisions and therefore a considerably lower debtors cost in the income statement.

In FY24 provisions of R2606m are adequate to cover:

- All the NPAs totalling R585m.
- All the arrears in Slow Payers – totalling R612m
- All the arrears in Satisfactory Paid – R695m

We therefore believe the book is adequately provided for.

Figure 2 Provision coverage of the "problematic book"

Stress test provision levels	F17	F18	F19	F20	F21	F22	F23	F24
Non performing accounts	1484	1452	1285	1261	1238	971	688	585
Slow payers > 3m in arrears	483	460	412	383	382	364	350	395
Satisfactory paid >3m in arrears	233	211	196	196	216	222	214	234
Problematic book	2200	2123	1894	1839	1836	1557	1252	1214
Total group provisions	1561	1620	2323	2534	2424	2300	2163	2606
% coverage	71%	76%	123%	138%	132%	148%	173%	215%
Excess provisions/general provision	-639	-503	429	695	588	744	911	1393
% of gross debtors	-11%	-9%	8%	12%	10%	13%	15%	20%

Source: Company data, ASB estimates

Despite the high levels of provisions, provision coverage levels of circa 37% is likely to persist given the ongoing (at a slower rate though) growth in the debtors book and the raising of provisions on origination of new credit. We should see some relief in the overlay provisions in FY25E. As a consequence, the debtors costs should be flat in FY25E, equating to 15.8% of debtors. Management is guiding 13-17% - FY24 was 17.6%. We forecast 14.5% in FY26E – management guides 12-15%.

Other revenue

The other revenue categories are accelerating in growth on the back of rising credit sales. Growth was 1% in FY21, 2.8% in FY22, 4.9% in FY23 and 17.2% in FY24. Accelerating credit sales is positive for ancillary income, although there is a delay as extended warranty products only kick in after the manufacturers 12-month warranty lapses. We therefore anticipate an acceleration in growth in FY25E to 10% from 8%, Insurance income growth will follow that of credit sales as no new products have been launched. Finance income saw very strong growth in FY24, up 24% as the yield from the debtors book continues to rise – a 23.4% yield in FY24 compared to 21.6% in FY23. We anticipate further yield expansion in FY25E given new business is still done at a higher rate than the average yield (new business is currently done at 25.25%) We don't however see the yield expansion being as great as in FY24 and therefore forecast 13% growth in finance income. Overall, we have other revenue growing at 11.4% in FY25E.

Competition

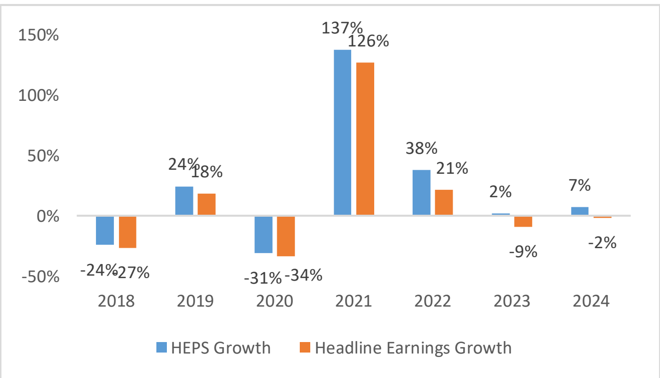
Recent results from competitors reflect the challenging trading conditions. Lewis is expanding its store footprint at a greater rate than competitors.

Shoprite's furniture segment (OK Furniture and House & Home) achieved 1.7% growth in sales (0.7% like for like) for the 26 weeks ended 31 December 2023. Credit sales remain at considerably lower levels than Lewis, at 15.3% (up from 14.9%). It opened no new stores in the period. Trading profit declined 3.7% on the comparable period with 3.1% trading margins.

JD Group (part of Pepkor Holdings) reported sales growth of 4.3%, like for like sales up 3.9%, for the 6 months ended 31 March 2024. A net 1 new store was opened. Credit sales rose slightly to 12% of total sales – 20% within JD Home.

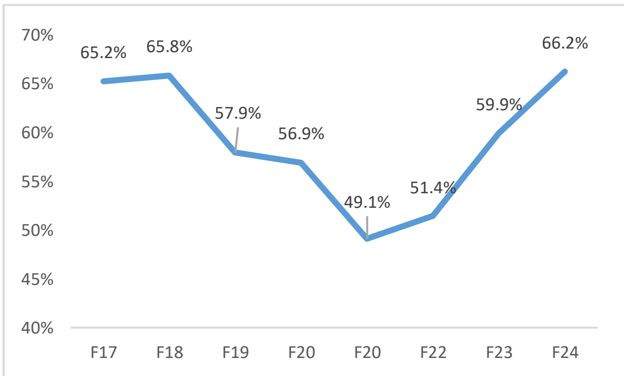
Financials

Figure 3 HEPS benefitting from buy backs



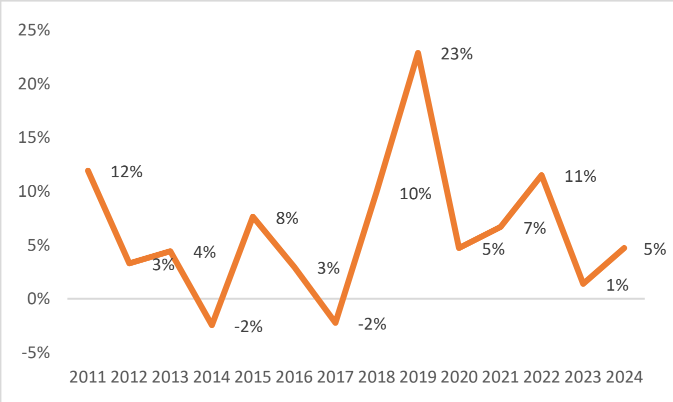
Source: Company data, ASB Research

Figure 4 Credit sales as % of total sales



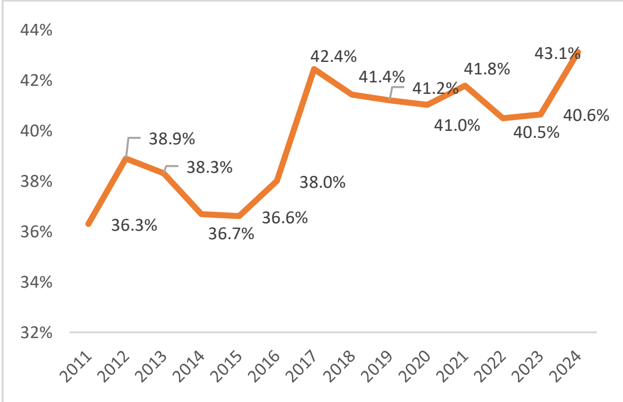
Source: Company data, ASB Research

Figure 5 Merchandise sales growth



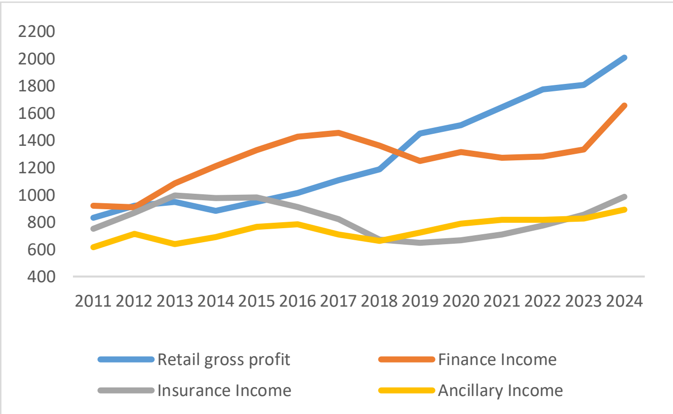
Source: Company data, ASB Research

Figure 6 GP Margin – FY24 not sustainable



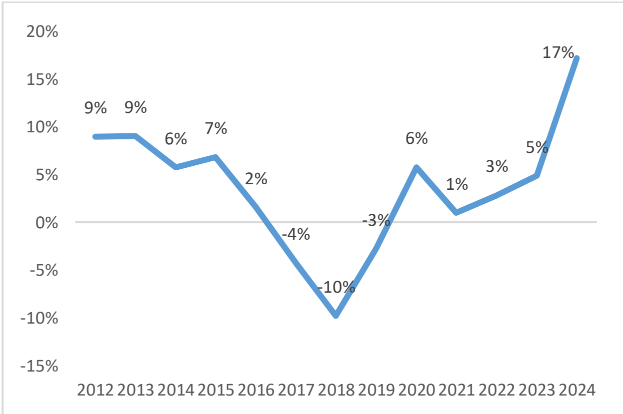
Source: Company data, ASB Research

Fig 7 Revenue trends – benefitting from credit sales



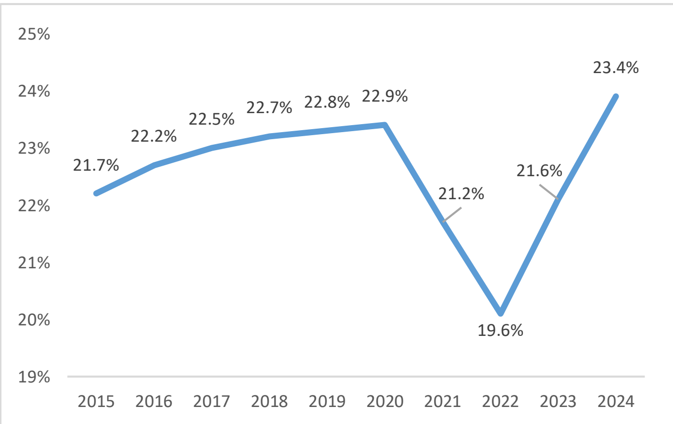
Source: Company data, ASB Research

Fig 8 Other revenue growth rates



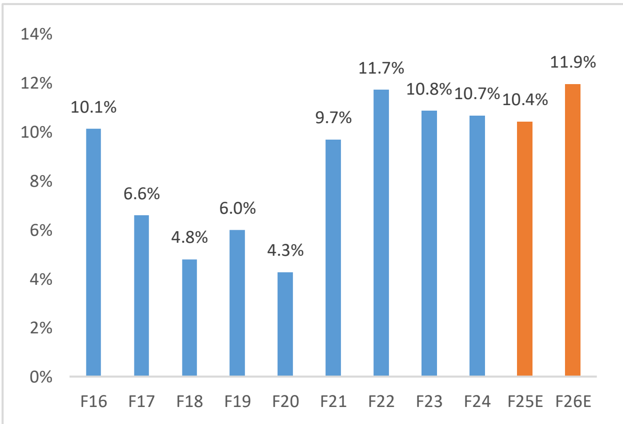
Source: Company data, ASB Research

Figure 9 Ave yield on debtors book – lagged effect from rising Repo rate



Source: Company data, ASB Research

Figure 10 ROE- Management targets 15%



Source: Company data, ASB Research

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