

1H25 - Investing in the book is paying off

- Lewis announced 1H25E HEPS of 555c (+49%), well ahead of expectations. At a merchandise sales level the result met expectations, however, the other revenue category outperformed (+20%) driven largely by finance and insurance income; debtors costs increased less than expected and the tax rate declined from 26.5% to 21.1%. An interim dividend of 300c was declared.
- There is a change in capital allocation with buy backs suspended and a greater investment in the debtors book from internally generated cash and greater leverage. Buy backs at current price levels makes less sense given lower levels of liquidity and a narrower discount of 12% to NAV (circa 50% 12m ago), but this has not been compensated with a higher payout ratio, instead credit sales has accelerated further, now 69.4% (64.4% in 1H24) of total sales, resulting in the debtors book growing 17% to R7.6bn. In FY23 the guidance range was 52-56%. Borrowings (excl leases) have consequently risen from R862m to R1485m.
- We believe this approach has been driven by the quality of the debtors book with satisfactory accounts at an all time high and therefore a higher net yield on the book. We do not fault the approach but caution against the higher financial risk, particularly interest rate risk given a fixed interest rate received vs floating funding costs. In the current environment of declining interest rates, it raises no concern but a sudden change in macro economics poses a risk.
- A greater credit sales ratio, and higher debtors book, positively impact operating margins given that the financials services revenues, now 52% of total revenue, is growing (+24%) well ahead of cost growth with insurance benefiting further from lower lapse rates given better quality customers. Net of debtors the growth is 29%. As a consequence, operating margins have risen from 14.2% in 1H24 to 20.2%, well ahead of the guidance of 12-16% provided at the beginning of the year.
- The medium term gearing ratio (excl leases) was forecast at <15% in the FY23 results presentation, its now revised to <25%, demonstrating the willingness to invest further into credit sales and the debtors book. This ratio is currently 26.5% and should drop below 25% for FY25E as excess inventory is sold. Despite the rise in gearing the interest cover ratio has remained stable at 8.5x.
- Credit quality remains well managed, benefiting from circa 55% (52% in 1H24) of the book collected via debit order (this is unlikely to exceed 60% in part because debit orders are not used outside of SA) and a better quality customer (decline rates have risen further to 37.4%). The book remains well provided for at 37.1% (37.5% in FY24). The debtors charge rose 15%, below the 17% debtors book growth and is now 13.5% of gross debtors.
- The sharp rise in operating margins, higher finance costs and the suspension of share buy backs require a revision of our estimates. We anticipate the debtors book to be circa R1bn greater in FY26E due to ongoing high levels of credit sales facilitated by a greater debt appetite. We anticipate margins to rise to 20.4% in FY25E and peaking at 21.3% in FY26E, benefiting from double digit growth in other revenue. We have it declining gradually thereafter as the yield on the debtors book declines and credit sales growth slows off an elevated base.
- We revise FY25E & FY26E HEPS from 968c and 1239c to 1202c and 1390c. Our DFCF valuation range is R72-96/share benefiting from a lower risk free rate, higher gearing and earnings. Our FY27E ROE is 14.5%, short of the targeted 15%. We retain our view that retirement withdrawals and interest rate cuts will have little impact on sales given the robust credit sales over the past three years. At the mid-point of our valuation (R83), the stock trades on a fwd. 6.9x P/E, below its 10 year average of 7.3x, implying upside. Similarly, the stock is on a fwd. P/B of 0.88x compared to a 0.64x average. Its fwd. ROE is broadly in line with its WACC, suggesting parity to NAV is achievable.

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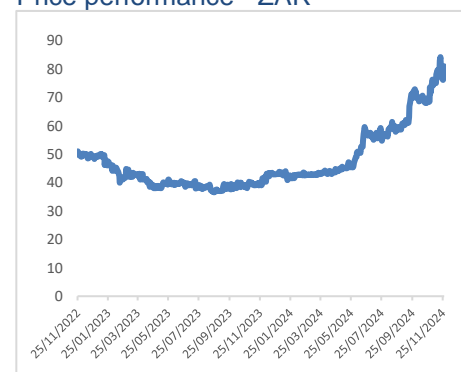
Price (27/11/2024) **R80.88**

Market cap **R4206mn**

Shares in issue **52mn**

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Price performance - ZAR



Source: FactSet

Figure 1 Financial summary

Year Ending	FY2021 A	FY2022 A	FY2023 A	FY2024 A	FY2025 F	FY2026 F	FY2027 F
Income Statement							
Merchandise Sales	3,931	4,383	4,443	4,653	5,053	5,489	5,939
<i>Sales growth (%)</i>	6.7%	11.5%	1.4%	4.7%	8.6%	8.6%	8.2%
Gross profit	1,642	1,775	1,806	2,006	2,072	2,251	2,494
<i>growth %</i>	8.6%	8.1%	1.8%	11.1%	3.3%	8.6%	10.8%
<i>GP margin %</i>	41.8%	40.5%	40.6%	43.1%	41.0%	41.0%	42.0%
Finance income	1,271	1,280	1,334	1,655	2,024	2,323	2,490
<i>growth %</i>	-3.1%	0.7%	4.2%	24.0%	22.3%	14.8%	7.2%
Insurance income	707	776	854	986	1,192	1,288	1,360
<i>growth %</i>	6.2%	9.7%	10.1%	15.4%	21.0%	8.0%	5.6%
Ancillary income	817	818	825	891	994	1,083	1,156
<i>growth %</i>	3.4%	0.2%	0.9%	8.0%	11.6%	8.9%	6.8%
Total revenue	4,437	4,649	4,819	5,537	6,282	6,944	7,501
<i>growth %</i>	3.7%	4.8%	3.7%	14.9%	13.5%	10.5%	8.0%
Debtors costs	813	702	720	1,225	1,126	1,231	1,269
<i>growth %</i>	-19.5%	-13.6%	2.4%	70.3%	-8.1%	9.3%	3.1%
<i>% of gross debtors</i>	-14.0%	-12.0%	-11.8%	-17.6%	-13.8%	-13.5%	-13.4%
EBITDA	1,039	996	960	1,124	1,420	1,567	1,670
<i>EBITDA Margin (%)</i>	26.4%	22.7%	21.6%	24.2%	28.1%	28.5%	28.1%
EBIT	696	668	609	690	1,029	1,171	1,266
<i>EBIT Margin (%)</i>	17.7%	15.2%	13.7%	14.8%	20.4%	21.3%	21.3%
Recurring EBIT	726	767	703	754	1,029	1,171	1,266
<i>Recurring EBIT Margin (%)</i>	18.5%	17.5%	15.8%	16.2%	20.4%	21.3%	21.3%
Profit before tax	604	674	567	590	813	951	1,083
Net profit	433	483	411	436	630	723	801
Net profit post minorities	433	483	411	436	630	723	801
Headline Earnings	463	561	510	500	630	723	801
<i>% growth</i>	126.4%	21.2%	-9.1%	-1.9%	26.0%	14.7%	10.9%
Basic EPS (ZAc)	576	731	695	807	1,202	1,390	1,541
Headline EPS (ZAc)	617	849	863	925	1,202	1,390	1,541
<i>% growth</i>	137.0%	37.7%	1.7%	7.1%	29.9%	15.7%	10.9%
DPS (ZAc)	328	413	413	500	699	806	894
<i>Payout ratio (%)</i>	56.9%	56.5%	59.4%	62.0%	58.2%	58.0%	58.0%
Balance Sheet							
Cash and Cash equivalents	447	308	183	224	242	279	271
Current asset (ex – cash)	4,588	4,739	5,175	5,547	6,566	7,339	7,660
Net Fixed assets	1,021	396	426	442	438	440	443
Intangible assets	297	258	175	110	118	120	123
Investments	254	266	257	243	180	214	243
Other assets	218	940	916	967	1,001	1,050	1,103
Total assets	6,823	6,907	7,133	7,533	8,545	9,442	9,843
Debt	0	81	368	426	1,250	1,500	850
Current liabilities	1,295	1,305	1,252	1,217	1,305	1,398	1,479
Other liabilities	656	805	820	1,188	1,218	1,425	1,888
Total liabilities	1,951	2,190	2,440	2,831	3,773	4,323	4,217
Shareholders' equity	4,873	4,717	4,693	4,703	4,897	5,357	5,720
Minorities	0	0	0	0	0	0	0
Total shareholders' equity	4,873	4,717	4,693	4,703	4,897	5,357	5,720
<i>BVPS (ZAR)</i>	6,812	7,523	8,218	8,890	9,418	10,302	10,999
<i>ROE (%)</i>	9.7%	11.7%	10.8%	10.7%	13.1%	14.1%	14.5%

Year Ending	FY2021 A	FY2022 A	FY2023 A	FY2024 A	FY2025 F	FY2026 F	FY2027 F
Cash Flow							
Reported net profit	433	483	411	436	630	723	801
Change in net working capital	-139	-156	-239	-1,021	-1,446	-996	-252
Dividends paid	-147	-254	-241	-224	-311	-394	-439
Other adjustments	661	618	482	1,268	1,186	1,158	1,046
Cash flow from operations	808	691	412	459	59	491	1,156
Net Capex	-119	-67	-125	-118	-132	-143	-148
<i>Capex/sales (%)</i>	<i>3.0%</i>	<i>1.5%</i>	<i>2.8%</i>	<i>2.5%</i>	<i>2.6%</i>	<i>2.6%</i>	<i>2.5%</i>
Other investing cash flows	23	102	51	41	-3	-2	-3
Cash flow from investing	-96	34	-74	-77	-135	-145	-151
Equity raised/(bought back)	-136	-408	-310	-222	-113	0	0
Net inc/(dec) in borrowings	0	0	0	350	824	400	-250
Other financing cash flows	-1,323	-551	-547	-529	-620	-713	-768
Cash flow from financing	-1,459	-959	-856	-399	95	-309	-1,013
Net cash flow	-747	-234	-517	-17	18	37	-8
Free cash flow	610	582	441	-169	-342	200	988
Repayment of lease liabilities	-254	-297	-305	-303	-306	-315	-324
Net free cash flow	355	285	136	-472	-648	-115	663
Valuation Summary							
Valuation Metrics							
Share Price (ZAc)	3,050	4,696	4,100	8,088	8,088	8,088	8,088
P/E (Underlying) (x)	4.9	5.5	4.7	8.7	6.7	5.8	5.2
P/BV (x)	0.4	0.6	0.5	0.9	0.9	0.8	0.7
EV/Sales (x)	1.4	1.3	1.2	1.2	1.1	1.0	0.9
EV/EBITDA (x)	5.3	5.6	5.8	4.9	3.9	3.5	3.3
EV/EBIT (x)	7.9	8.3	9.1	8.0	5.4	4.7	4.4
FCF Yield (%)	8.3	6.7	3.2	-11.0	-15.1	-2.7	15.5
Dividend Yield (%)	10.8	8.8	10.1	6.2	8.6	10.0	11.1
Net debt	359	723	1130	1492	2314	2725	2534
Gearing ratio	7%	15%	24%	32%	47%	51%	44%
Net debt (excluding lease liabilities)	-447	-227	185	551	1358	1721	1479
Gearing ratio (excluding lease liabilities)	-9%	-5%	4%	12%	28%	32%	26%

Source: Company data, FactSet, ASB estimates

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