chief financial officer's

report

"With increases of:

- **16% in merchandise sales**
- **23% in normalised operating profit**
- **67% increase in dividend**

Lewis once again delivered strong growth for all its shareholders."

Les Davies (Chief Financial Officer)

Introduction

The group's financial performance for the year has been shaped by real top line growth, improved gross margin and containment of costs resulting in a significant increase in operating margin.

Normalised operating profit increased by 22.8% to R728.6 million (2005: R593.5 million). Attributable profit and headline earnings per share on a normalised basis increased by 24.9% and 30.9% respectively. Operating profit per employee and per square metre have been steadily increasing over the last five years.

The company continues to generate strong cash flows despite the R160.5 million additional working capital requirement this year. A share repurchase programme commenced in September 2005 and 3.36% of the company's share capital (R151.9 million) has been repurchased. The dividend for the full year increased by 67% to 225 cents per share compared to 135 cents per share last year.

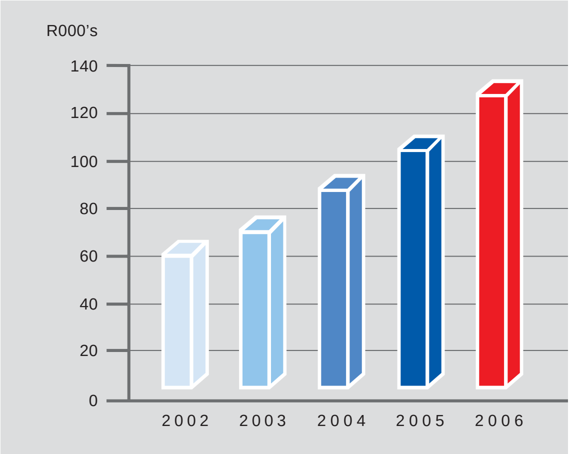
Income statement analysis

Revenue comprising merchandise sales, finance charges, services and insurance income, grew by 14.5% to R2 874.5 million (2005: R2 511.2 million).

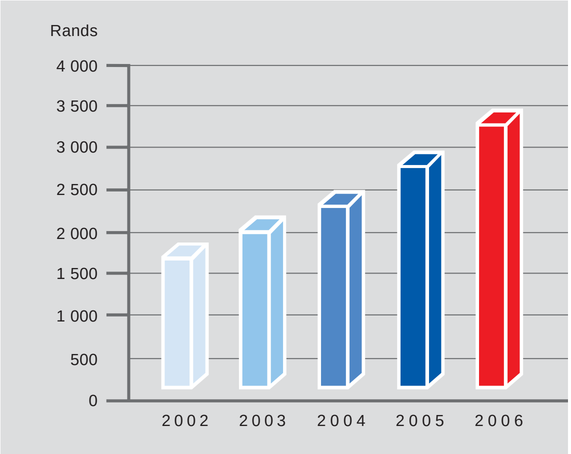
Merchandise sales increased by 16.0% this year mainly as a result of the group's merchandise initiatives. Sales growth was particularly good in the second half of the year reflecting a growth rate of 17.3%.

Insurance revenue earned grew by 12.0% to R400.4 million with a larger charge for the unearned premium reserve due to the higher levels of current trade. Finance charges increased by 11.5% to R674.4 million with lower arrear interest income as a result of the improving debtors book.

normalised operating profit per employee



normalised operating profit per sqm



Merchandise margin increased to 34.9% from 34.5%. This has been the result of merchandise sourcing and supply chain initiatives.

Significant strides have been made in the past few years to improve the quality of the debtors book through the regular upgrades to scoring systems and the focus on collection drives.

The increase in bad debts was 6.1% over last year against a debtors book increase of 9.1%. The impairment provision reflects a release of R17.4 million in the current year as compared to R23.7 million last year, which is attributable to the increase in the debtors book of R244.3 million. The impairment provision has decreased from 14.4% to 12.6% of gross debtors. The overall bad debt and impairment charge amounts to 4% of gross debtors (2005: 3.8%).

Operating expenses, excluding bad debts, the impairment provision and share-based payments, increased by 8.4% to R1 009.5 million, well below the levels of sales growth of 16%. Expense management and the drive for efficiency remains a priority in the business. The main trends in the expenditure are as follows:

- Employment costs at 8.3% higher than last year reflects higher commission earnings as a consequence of the sales growth and improved gross margins.
- Administration and IT increase of 13.2% is distorted by some exceptional recoveries in the prior year and adjusting for this, the increase is 8%.
- Marketing increased by 11.9% to support the sales momentum.
- The rise in occupancy costs is mainly due to the cost of additional storage to cater for the higher stock holding and additional maintenance to existing stores.
- The increase in transport and travel is a consequence of rising fuel costs, a large proportion of which was recovered through service charges.

Investment income consists mainly of interest and dividends on listed investments held by Monarch Insurance Company. The investments are held for the long term and traded when there is a need to rebalance the portfolio. Investment income has declined as a result of the impairment of an available-for-sale asset.

Finance costs declined by R29.9 million due to the cessation of interest payments to the former holding company.

The effective tax rate is currently 31.9% adjusted for the permanent difference created by the share-based payment. We expect next year's tax rate to be slightly higher due to increased STC payments as a consequence of the higher dividend.

Balance sheet review

The increase in insurance investments has largely been driven by improved equity and bond markets.

Inventory levels increased as a consequence of 23 new stores and our strategy to carry higher levels of stock to support sales initiatives. This is evidenced by the second half sales performance of 17.3%.

Gross debtors increased by 9.1% to R2 921.4 million well below revenue growth, reflecting the quality of our debt collection process. The average age of the debtors book has improved to 14.3 months from 14.8 months. Total debtors provisions increased from 35.6% at March 2005 to 36.3% as a result of increased accounting provisions for unearned finance charges, insurance income and maintenance contract revenue.

Deferred tax reflects as a non-current asset and the increase is attributable to lower debtor tax allowances resulting from a change in the mix of credit granted.

Cash flow

We continued to generate strong cash flow, despite the need to fund the larger debtors book and higher inventory levels as a result of buoyant trade.

Strong cash flow is underpinned by:

- growth in debtors book of 9.1% compared to revenue growth of 14.5%, reflecting the quality of our debtor collections;
- reduction in arrears; and
- containment of costs.

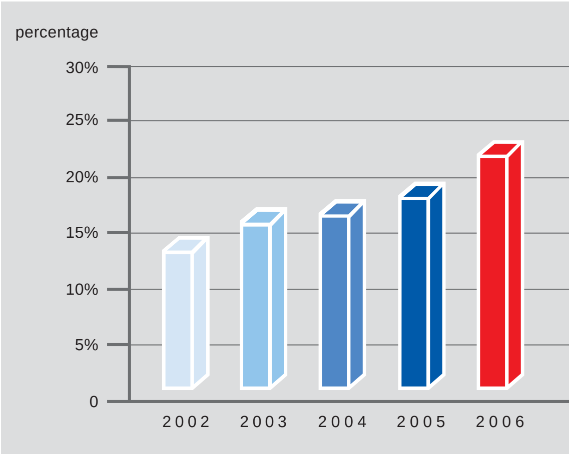
These strong cash flows positioned the company to:

- pay dividends of R156.9 million; and
- repurchase shares of R151.9 million.

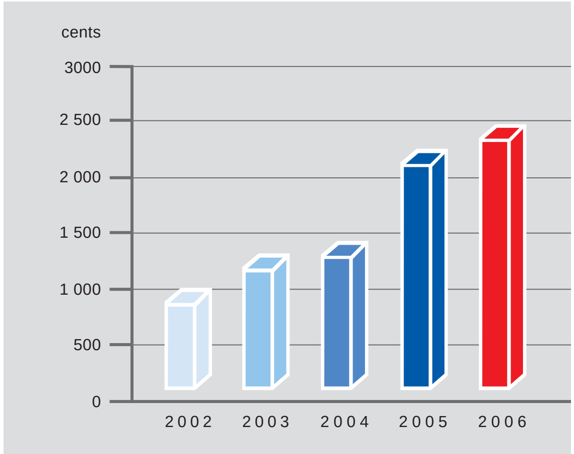
Changes in equity

The increase in other reserves is the result of the rising market values of equities and bonds held by Monarch Insurance Company as prescribed investments.

return on capital employed



net asset value per share



The group repurchased 3.36% of its own shares at an average market price of R44.86. The shares have not been cancelled, but held by the subsidiary, Lewis Stores (Pty) Ltd. This has enhanced earnings per share and improved return on equity.

Segmental reporting

Lewis is the largest single furniture brand in Southern Africa and is the core business of the group. Sales growth for this chain was 12.1%. Best Electric has made a significant contribution to group sales with growth for the year of 31.4%. There has been a turnaround in the Lifestyle Living chain as a result of merchandise initiatives reflecting sales growth of 68.1%.

On a geographic basis, 89.6% (2005: 88.8%) of revenue is generated within South Africa. The balance is attributable to Botswana, Lesotho, Namibia and Swaziland (BLNS). Store expansion has mainly been in South Africa and two stores have been closed in Botswana due to poor trading conditions.

International Financial Reporting Standards

The financial statements have been presented in terms of International Financial Reporting Standards ("IFRS") for the first time this year. We recognise that IFRS is evolving with new statements being issued and revisions or clarifications made to existing standards.

The following changes in accounting policies and interpretations were implemented:

- Use of transitional arrangements in terms of IFRS 1 for property, employee benefits, translation differences and the designation of financial instruments.
- A number of income statement reclassifications were made in order to comply with IFRS interpretation.
- The application of IFRS 2 in respect of share-based payments.
- Property leases with fixed escalations have been recognised on a straight-line basis over the period of the lease in terms of SAICA Circular 7/2005 and IAS 17.
- Compliance with IAS 16 with regard to depreciation and residual values.

Closing

My thanks to the finance team for their effort throughout the financial year.

Les Davies
Chief Financial Officer