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Lewis Group

ANCHOR STOCKBROKERS

GP margins surprise again

- Lewis announced FY25 HEPS of 1483c, up 60% and well ahead of expectations of 1202c. The beat was so prolific it was ahead of our FY26E estimate of 1390c, having a positive impact on our valuation. Revenue of R9287m was only slightly ahead of our R9264m estimate, the HEPS outperformance coming from margin expansion, with the GP margin rising further off a FY24 elevated base. A full year dividend of 800c was declared, up 55%.
- Lewis seems to have entered a new paradigm, higher GP margins, greater appetite for credit sales, improved operating margins and a debtors book in its best state of health. This has resulted in it achieving a ROE of 15.7%, a level which once seemed out of reach given a balance sheet that was unleveraged. The 40% growth in its debtors book since FY21 has resulted in net debt rising from R359m to R1857m and the cessation of its share buyback programme.
- Affordability remains constrained in the retail environment, weighing on cash sales, up 3.4%. Credit remains the facilitator of sales with group credit sales rising 12.1% and now comprising 68% (66% in FY24) of sales, in line with expectations. Like for like sales were up 5.9% with circa 3% of product inflation, suggesting growth in its market. This is further supported by customers numbers up 10% and the store footprint growing 5.6% (3.8% excl acquisitions) with scope to add a further 40 stores (+4.4%) in FY26E.
- Merchandise sales grew 9.2%, 8.5% from Traditional stores and 15.1% from Speciality Stores that benefited from new stores and the acquisition of Real Beds. UFO achieved like for like sales growth of 4% after a few poor years of trading resulting in 6 store closures. We forecast 11.1% growth in group merchandise sales given 4-5% growth in stores, ongoing volume growth and inflation – we anticipate credit sales to be 68.5% of total sales in FY26E.
- The GP margin rose to 45.6% in 2H25 given favourable shipping and FX rates and an exclusive furniture range, with a strong Black Friday performance. Whilst guidance is 40-42% in FY26E, we believe improved procurement management and a competitive market offering will see a GP margin of 43.1% in FY26E, slightly down on FY25 (forecast risk is high). The proposed acquisition by Pepkor of OK Furniture and House & Home could impact 2H26E margins, although these are not new entrants into the market and their credit appetite is significantly lower.
- The investment in the debtors book is benefiting finance income, although the yield of 24.1% is close to peaking. New business is written at 24.25%. Insurance income is benefiting from robust credit sales. Other revenue is 66% of total revenue, a seven year high, impacting favourably on operating margins. We forecast total other revenue to grow 13.1% in FY26E (+19.1% in FY25).
- Credit quality continues to improve (satisfactory paying customers at a new high), suggesting a prudent approach to credit sales, supported by a rise in the credit decline rate from 35.1% to 38.5%. We believe the debtors book is conservatively provided for but provisions are likely to remain elevated as new loans are provided for at 25% on origination and economic overlay provisions will remain elevated. We forecast the debtors charge to decline from 15% to 13.8% of debtors.
- We forecast operating margins to rise from 22.9% to 24% in FY26E (25.2% in 2H25) benefiting from strong other revenue growth and 4.2% growth in the debtors charge. Higher debt will see the net interest charge rise circa 10%. We revise our FY26E HEPS from 1390c to 1677c (+13%). The mid-point of our DFCF valuation rises from R84 to R98 per share. This is in line with its FY25 NAV/share - coincidentally Pepkor intends acquiring the Shoprite assets at NAV. The stock trades on an attractive 12m fwd. P/E of 5x.

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Price (09/06/2025):	R83.39
Market cap	R4295mn
Shares in issue	51.5mn

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Price performance - ZAR

Source: FactSet

Figure 1 Financial summary

Year Ending	FY2022A	FY2023A	FY2024A	FY2025A	FY2026F	FY2027F	FY2028F
Income Statement							
Merchandise Sales	4,383	4,443	4,653	5,081	5,645	6,180	6,733
Sales growth (%)	*11.5%*	*1.4%*	*4.7%*	*9.2%*	*11.1%*	*9.5%*	*9.0%*
Gross profit	1,775	1,806	2,006	2,207	2,433	2,645	2,882
growth %	*8.1%*	*1.8%*	*11.1%*	*10.0%*	*10.2%*	*8.7%*	*9.0%*
GP margin %	*40.5%*	*40.6%*	*43.1%*	*43.4%*	*43.1%*	*42.8%*	*42.8%*
Finance income	1,280	1,334	1,655	2,047	2,341	2,587	2,783
growth %	*0.7%*	*4.2%*	*24.0%*	*23.7%*	*14.3%*	*10.5%*	*7.6%*
Insurance income	776	854	986	1,181	1,326	1,463	1,593
growth %	*9.7%*	*10.1%*	*15.4%*	*19.8%*	*12.3%*	*10.3%*	*8.9%*
Ancillary income	818	825	891	979	1,090	1,197	1,300
growth %	*0.2%*	*0.9%*	*8.0%*	*9.9%*	*11.4%*	*9.8%*	*8.6%*
Total other revenue	2,874	3,013	3,531	4,207	4,758	5,246	5,677
growth %	*2.8%*	*4.9%*	*17.2%*	*19.1%*	*13.1%*	*10.3%*	*8.2%*
Debtors costs	702	720	1,225	1,193	1,243	1,324	1,408
growth %	*-13.6%*	*2.4%*	*70.3%*	*-2.6%*	*4.2%*	*6.5%*	*6.4%*
% of gross debtors	*12.0%*	*11.8%*	*17.6%*	*15.0%*	*13.8%*	*13.5%*	*13.4%*
EBITDA	996	960	1,124	1,548	1,774	1,927	2,070
EBITDA Margin (%)	*22.7%*	*21.6%*	*24.2%*	*30.5%*	*31.4%*	*31.2%*	*30.7%*
EBIT	668	609	690	1,152	1,353	1,493	1,620
EBIT Margin (%)	*15.2%*	*13.7%*	*14.8%*	*22.7%*	*24.0%*	*24.2%*	*24.1%*
Recurring EBIT	767	703	754	1,166	1,353	1,493	1,620
Recurring EBIT Margin (%)	*17.5%*	*15.8%*	*16.2%*	*22.9%*	*24.0%*	*24.2%*	*24.1%*
Profit before tax	674	567	591	984	1,167	1,335	1,477
Net profit	483	411	437	755	864	988	1,078
Net profit post minorities	483	411	437	755	864	988	1,078
Headline Earnings	561	510	501	768	864	988	1,078
% growth	*21.2%*	*-9.1%*	*-1.8%*	*53.3%*	*12.4%*	*14.4%*	*9.1%*
Basic EPS (ZAc)	731	695	808	1,457	1,677	1,909	2,073
Headline EPS (ZAc)	849	863	926	1,483	1,677	1,909	2,073
% growth	*37.7%*	*1.7%*	*7.3%*	*60.1%*	*13.1%*	*13.8%*	*8.6%*
DPS (ZAc)	413	413	500	800	973	1,107	1,244
Payout ratio (%)	*56.5%*	*59.4%*	*61.9%*	*54.9%*	*58.0%*	*58.0%*	*60.0%*
Balance Sheet							
Cash and Cash equivalents	308	183	224	175	324	342	316
Current asset (ex – cash)	4,739	5,175	5,547	6,459	7,127	7,846	8,438
Net Fixed assets	396	426	442	467	475	486	507
Intangible assets	258	175	110	127	129	132	134
Investments	266	257	243	160	203	248	297
Other assets	940	916	967	1,052	1,112	1,161	1,232
Total assets	**6,907**	**7,133**	**7,533**	**8,440**	**9,369**	**10,214**	**10,923**
Debt	81	368	426	1,055	1,100	1,100	900
Current liabilities	1,305	1,252	1,217	1,452	1,581	1,708	1,833
Other liabilities	805	820	1,188	854	1,352	1,210	1,173
Total liabilities	**2,190**	**2,440**	**2,831**	**3,362**	**4,033**	**4,017**	**3,906**
Shareholders' equity	4,717	4,693	4,703	5,078	5,602	6,062	6,514
Minorities	0	0	0	0	0	0	0
Total shareholders' equity	**4,717**	**4,693**	**4,703**	**5,078**	**5,602**	**6,062**	**6,514**
BVPS (ZAR)	*7,523*	*8,218*	*8,890*	*9,861*	*10,877*	*11,657*	*12,526*
ROE (%)	*11.7%*	*10.8%*	*10.7%*	*15.7%*	*16.2%*	*16.9%*	*17.1%*

Year Ending	FY2022A	FY2023A	FY2024A	FY2025A	FY2026F	FY2027F	FY2028F
Cash Flow							
Reported net profit	**483**	**411**	**437**	**755**	**864**	**988**	**1,078**
Change in net working capital	-156	-239	-1,021	-1,055	-1,101	-607	-481
Dividends paid	-254	-241	-224	-310	-478	-528	-626
Other adjustments	618	482	1,267	1,170	1,353	1,338	1,424
Cash flow from operations	**691**	**412**	**459**	**560**	**637**	**1,191**	**1,396**
Net Capex	-67	-125	-118	-123	-147	-154	-168
Capex/sales (%)	*1.5%*	*2.8%*	*2.5%*	*2.4%*	*2.6%*	*2.5%*	*2.5%*
Other investing cash flows	102	51	41	-39	-3	-3	-3
Cash flow from investing	**34**	**-74**	**-77**	**-162**	**-149**	**-157**	**-171**
Equity raised/(bought back)	-408	-310	-222	-120	0	28	0
Net inc/(dec) in borrowings	0	0	350	-350	445	-200	-300
Other financing cash flows	-551	-547	-529	-610	-788	-848	-956
Cash flow from financing	**-959**	**-856**	**-399**	**-1,077**	**-339**	**-1,015**	**-1,250**
Net cash flow	**-234**	**-517**	**-17**	**-679**	**149**	**18**	**-26**
Free cash flow	**582**	**441**	**-169**	**142**	**222**	**818**	**1,022**
Repayment of lease liabilities	**-297**	**-305**	**-303**	**-297**	**-306**	**-315**	**-324**
Net free cash flow	**285**	**136**	**-472**	**-155**	**-83**	**503**	**698**
Valuation Summary							
Valuation Metrics							
Share Price (ZAc)	4,696	4,100	4,350	8,339	8,339	8,339	8,339
P/E (Underlying) (x)	5.5	4.7	4.7	5.6	5.0	4.4	4.0
P/BV (x)	0.6	0.5	0.5	0.8	0.8	0.7	0.7
EV/Sales (x)	1.4	1.3	1.3	1.2	1.1	1.0	0.9
EV/EBITDA (x)	6.0	6.2	5.3	3.9	3.4	3.1	2.9
EV/EBIT (x)	9.0	9.8	8.7	5.2	4.4	4.0	3.7
FCF Yield (%)	6.6	3.2	-11.0	-3.6	-1.9	11.7	16.3
Dividend Yield (%)	8.8	10.1	11.5	9.6	11.7	13.3	14.9

Net debt	723	1130	1492	1857	2201	2035	1815
Gearing ratio	0.15	0.24	0.32	0.37	0.39	0.34	0.28
Net debt (excluding lease liabilities)	-227	185	551	880	1176	958	684
Gearing ratio (excluding lease liabilities)	- 0.05	0.04	0.12	0.17	0.21	0.16	0.10

Source: Company data, FactSet, ASB estimates

Margins

Recurring operating margins have risen from 16.2% to 22.9%, driven by the following:

- Gross margin – this has risen from 43.1% to 43.4%, a new high. Its averaged 41.9% over the past five years. The correlation between operating and GP margins is evident in Figure 7 below.
- Revenue mix – a growing component of other revenue results in higher operating margins. This is evident in Figure 8 below. Currently other revenue is 66% of total revenue up from 62% in FY22. In FY17 it represented 73% of revenue when the operating margin was 25.3%.
- Cost containment – Lewis has a history of tight cost management, but we believe there is limited scope to cut costs going forward particularly while store roll outs are taking place and strong credit sales leads to higher variable incentives. Operating costs (excluding depreciation) as a % of total revenue increased from 39% to 39.6% in FY25. Some margin enhancement resulted from the depreciation charge that only increased 2%.
- Debtors charge – this declined 3% in FY25, supporting margins. It represents 23% of total costs (operating costs plus depreciation plus debtors charge), thereby having a meaningful impact on margins. Given the high levels of provisions, we anticipate the charge to grow slower than sales growth (+4.2% in FY26E) for the next few years. See more in the Debtors Book section below.

The GP margin has now surprised for two years running, with a particularly strong 2H performance in each year. We believe this is partly driven by Black Friday. The FY25 GP margin has benefitted from favourable shipping and FX rates with credit due to management for taking advantage of changing market conditions. Management guided to 40-42% in FY25 with 43.4% achieved. We believe the 45.6% margin achieved in 2H25 is not sustainable but still forecast the GP margin ahead of the 40-42% guidance at 43.1% in FY26E. Forecast risk for the GP margin is high and any surprise can have a meaningful impact – a 1% change equates to a 5.4% move in HEPS.

The outcome of Pepkor Holdings 'proposed acquisition of Shoprite's furniture businesses, OK Furniture and House & Home, which is currently with the Competition Tribunal, may have an impact on market conditions going forward, impacting GP margins. We note that the two business are mature and have been competitors for many years but synergies from the merger could make them more competitive on pricing. This combined with an increase in credit risk appetite (Pepkor is only at 12% credit sales) are potential future risks for Lewis.

Other revenue

The other revenue categories are accelerating in growth on the back of robust credit sales – 15.3% CAGR over three years. Growth was 1% in FY21, 2.8% in FY22, 4.9% in FY23, 17.2% in FY24 and 19.1% in FY25. 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 11.4% from 9.9%, Insurance income growth will follow that of credit sales as no new products have been launched. Finance income saw very strong growth in FY25, up 23.7%, in line with FY24, as the yield from the debtors book continues to rise – a 24.1% yield in FY25 compared to 23.4% in FY24 (see Figure 13). We anticipate modest yield expansion in FY26E given new business is still done at a higher rate than the average yield (new business is currently done at 24.25%). We don't anticipate the yield expansion being as great as in FY25 and therefore forecast 14.3% growth in finance income. Overall, we have other revenue growing at 13.1% in FY25E.

Debtors Book

The gross debtors book increased 14.4% to R8bn, marginally ahead of the 12.1% growth in credit sales. Provisions grew at 13.5% resulting in a lower provision coverage ratio. However, this is justified given the quality of the book has improved if measured by NPAs (non-performing accounts) that were down from 8.4% to 7% of the book and satisfactory paid accounts that by value increased from 76.7% to 77.9%, the highest in recent history. Total arrears have declined from 24.5% in FY24 to 23.4%, a new low. Debit order use has risen from circa 52% of the book to 57%, a 60% level being a target as debit orders are not used for self-employed customers and those outside of SA.

Credit quality has been retained despite growing customers by 10% to 705k. Decline rates have risen from 35.1% to 38.5% indicating that new customers remain of a high standard. Better quality customers is positive for future debtors management - repeat business is around 45% of new sales. Provisions as a % of gross debtors dropped slightly from 37.5% to 37.2% given the improved customer profile. Collection rates improved from 76% to 78%, a level it was at back in FY22 and FY23.

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 228% coverage (215% in FY24) of the problematic book. We have excess provisions of R1663m which represents a general provision of 21% (20% in FY23) of the gross debtors book. An increase in economic overlay provisions has contributed to this. 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 FY25 provisions of R2959m are adequate to cover:

- All the NPAs totalling R561m.
- All the arrears in Slow Payers – totalling R696m
- All the arrears in Satisfactory Paid – R818m

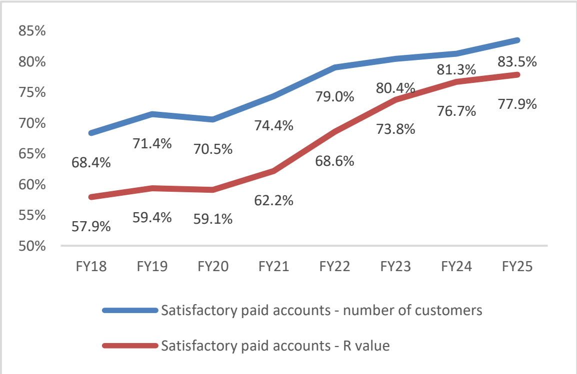
We therefore believe the book is adequately provided for.

Figure 2 Provision coverage of the "problematic book"

	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25
Total arrears % of gross book	42%	39%	37%	36%	33%	28%	25%	23%
Provisions as a % of book	29.6%	42.0%	44.1%	42.6%	40.4%	36.0%	37.5%	37.2%
Provisions as a % of arrears	71%	109%	120%	118%	122%	129%	153%	159%
Charges as a % of average debtors	17%	13%	18%	14%	12%	12%	19%	16%
Satisfactory paid accounts - number of customers	68.4%	71.4%	70.5%	74.4%	79.0%	80.4%	81.3%	83.5%
Satisfactory paid accounts - R value	57.9%	59.4%	59.1%	62.2%	68.6%	73.8%	76.7%	77.9%

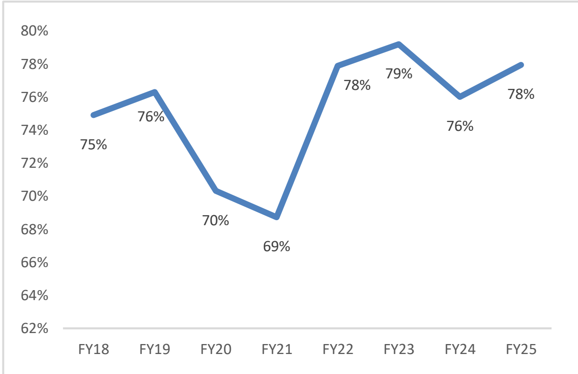
Source: Company data, ASB estimates

Figure 3 Satisfactory accounts at record highs



Source: Company data, ASB Research

Figure 4 Collection rates remain elevated



Source: Company data, ASB Research

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. As a consequence, we forecast debtors costs at 13.8% (15% in FY25), resulting in the debtors charge rising 4.2% . Management is guiding 13-16% in FY26E. Should the economic outlook in SA improve beyond CY2025 we could see the reversal of overlay provisions that would result in a lower debtors costs % of gross debtors.

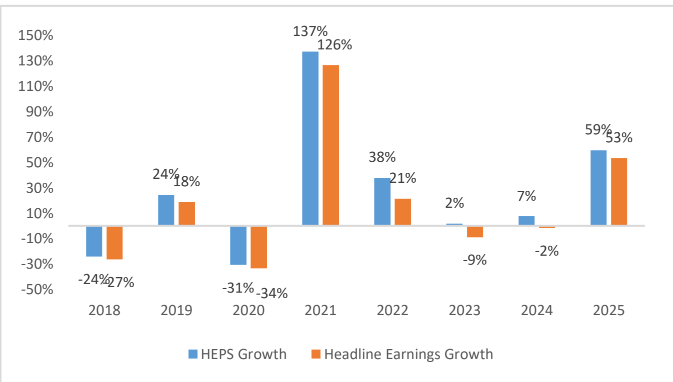
Competition

Shoprite's furniture segment (OK Furniture and House & Home), now discontinued operations given a pending sale to Pepkor Holdings, achieved 6.2% growth in sales for the 26 weeks ended 29 December 2024. A net 3 stores were closed resulting in 407 stores.

JD Group (part of Pepkor Holdings) reported sales growth of 9.2%, like for like sales up 6.3%, for the 6 months ended 31 March 2025. 26 new stores were opened resulting in 922 stores. Credit sales (+15.3%) remains at 12% of total sales. It has a significantly greater sales composition from non-home products than Lewis at 53%.

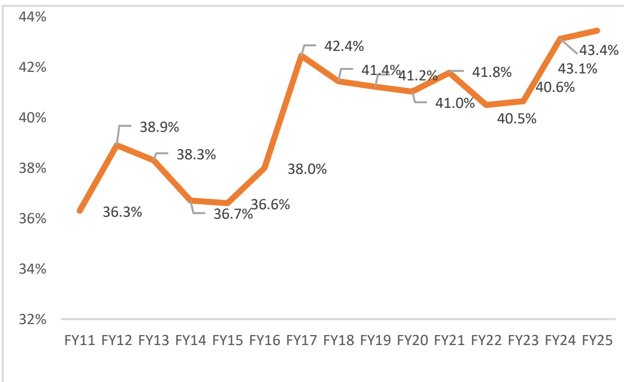
Financials

Figure 5 HEPS benefitting from buy backs



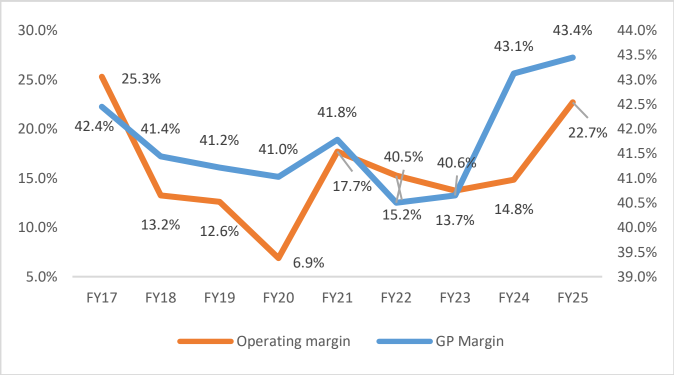
Source: Company data, ASB Research

Figure 6 GP margin – new highs



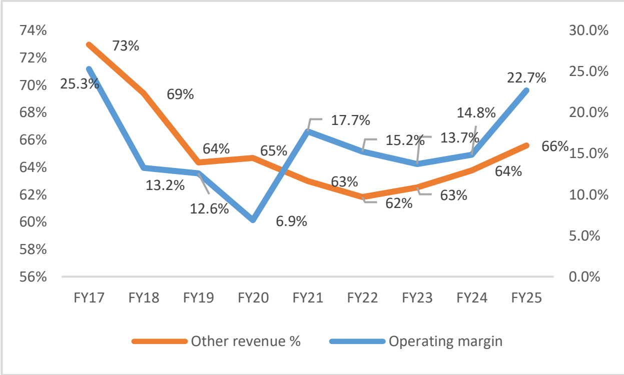
Source: Company data, ASB Research

Figure 7 Operating vs GP margin



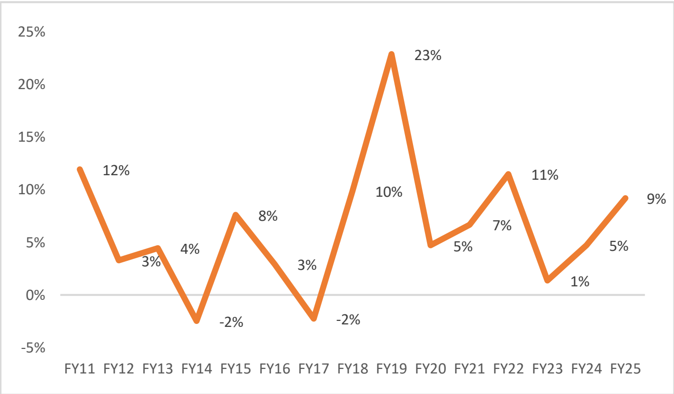
Source: Company data, ASB Research

Figure 8 Other revenue benefitting margins



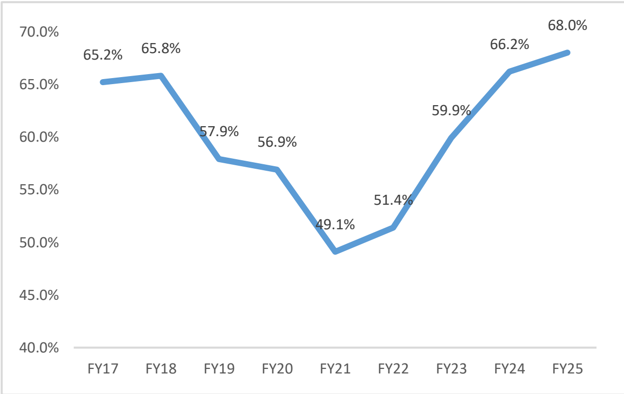
Source: Company data, ASB Research

Figure 9 Merchandise sales growth



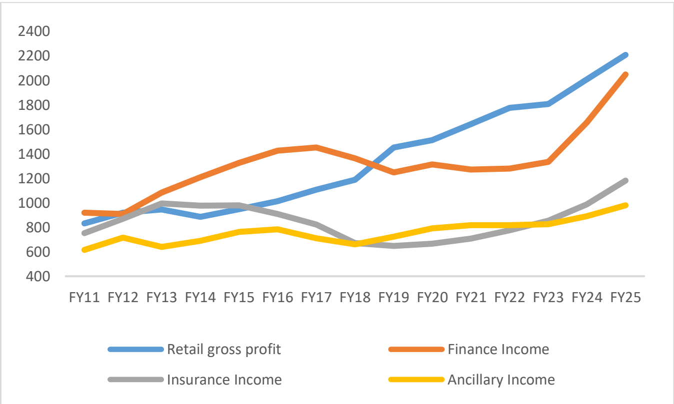
Source: Company data, ASB Research

Figure 10 Credit sales as % of total sales



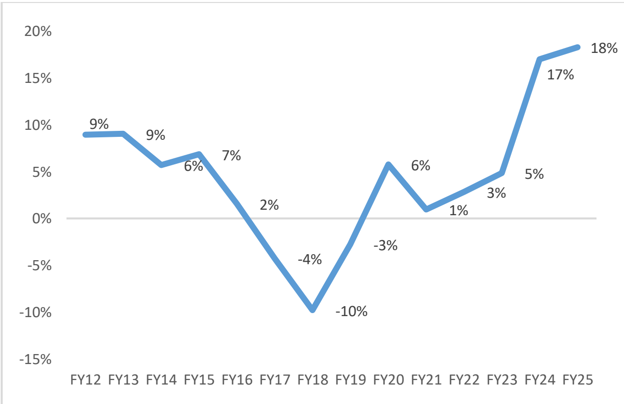
Source: Company data, ASB Research

Fig 11 Revenue trends – benefitting from credit sales



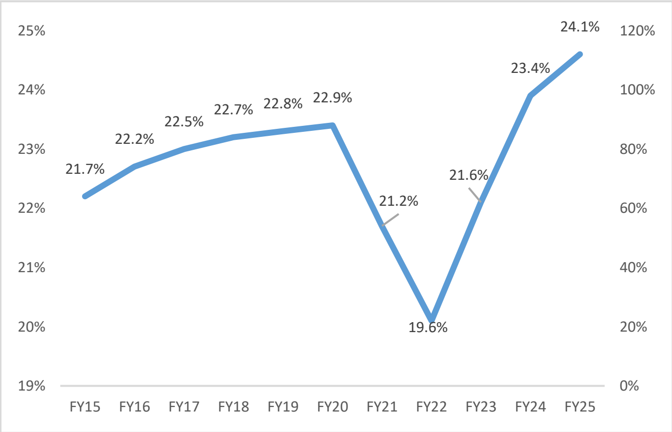
Source: Company data, ASB Research

Figure 12 Other revenue growth rates



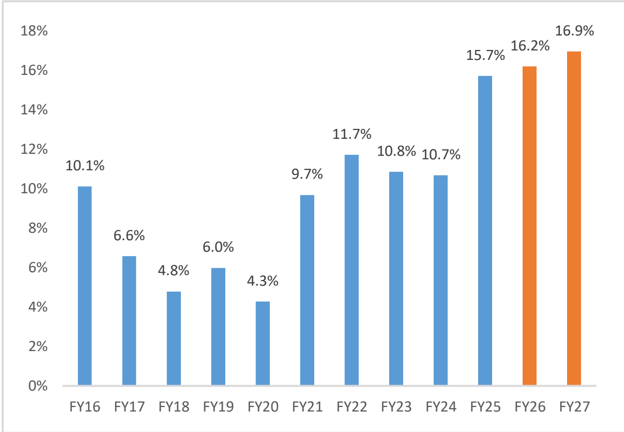
Source: Company data, ASB Research

Figure 13 Ave yield on debtors book – lagged effect from rising Repo rate



Source: Company data, ASB Research

Figure 14 ROE- Management targets 17%



Source: Company data, ASB Research

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