Furniture retailers solidly built

By Stafford Thomas

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Business models are as good as their ability to stand up in tough conditions. In furniture retail none has proved more resilient than Lewis's unique model, honed over more than 70 years.

Tests of durable goods credit retailers don't come much tougher than the conditions of 2008 and 2009. Lewis came through with flying colours, its headline EPS dipping by 7.4% in its year to March 2009, staying flat in 2009/2010 and rising 21.6% to a new high of 772,4c in 2010/2011.

CEO Johan Enslin attributes Lewis's resilience in part to its decentralised model, which rests heavily on a close relationship between stores and their customers. "Managers are fully responsible for their stores, except for credit granting," says Enslin. "They are close to the ground and can react quickly."

Also standing Lewis in good stead was its focus on lower-income consumers, many of whom are state or unionised workers who received good wage increases during the recession. Customer loyalty is high, with 55% of sales to repeat customers.

Lewis's sales of R2,6bn rank it as SA's third-largest furniture retailer. Leading the pack is JD Group (JDG), with furniture contributing just over half of its total retail sales of about R12bn. African Bank's (Abil) Ellerines unit ranks second, with retail sales of about R5bn, and is Lewis's biggest competitor in the low-income segment.

JDG has been tested and found badly wanting. Restructuring was an added burden and the group's EPS fell for three consecutive years, from 823,5c in its year to August 2006 to 251c in 2008/2009, excluding a tax settlement that left EPS at 44c. Now recovering, JDG's rolling 12-month EPS were lifted to 361c by a 44% rise at its February 2011 interim stage.

Operating margin on JDG's furniture retail operations came in at 9%, compared with Lewis' 16%, while JDG's financial services unit's 16% margin was half that of Lewis.

Ellerines has also had a rough time. Abil's bold plan when it acquired Ellerines in late 2007 for R9,85bn was to double sales to around R10bn over the medium term. Instead, Abil found itself downsizing Ellerines in a bid to coax a profit from its retail operations, which ran up a R223m loss in Abil's year to August 2008.

Some success has been achieved; Abil reported that Ellerines had reached an 8% retail operating margin on sales of R2,5bn in the six months to March 2011. Since the Ellerines debtor book has been absorbed into Abil's balance sheet, a full comparison with Lewis or JD Group is not possible.

Though Lewis stands out on all metrics compared with its larger rivals, it can be argued that Ellerines and JDG offer recovery potential Lewis does not. However, that an investor wanting furniture retail exposure would do it through a bank seems unlikely. And JDG is also far from being a pure furniture business, having cash-only operations Incredible Connection and Hi-Fi Corporation, and soon to add Steinhoff's motor retail and building supplies units.

Lewis itself is not sitting back and has a programme aimed at growing store numbers by about 120 to almost 700 in three years. Enslin says new stores are about 250m², roughly half the size of traditional Lewis stores, but the 26 already opened are producing rand sales on a par with their larger counterparts.

Focusing on a single brand, Lewis also seems to be gaining market share. Between 2004 and 2009 Lewis grew sales by 9.1%/year while, according to research firm Datamonitor, total furniture sales in SA grew at 7.7%/year.

On a price:earnings ratio of only 10 and offering an attractive 4.7% dividend yield, Lewis represents solid value.

Source: Financial Mail