BIZCOMMUNITY

Moving the furniture

By Sasha Planting

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Lewis does not “upfront” its furniture revenues and therefore has no intention of changing its accounting policies as other major retailers have done, CEO Alan Smart was at pains to explain at the results presentation last week.

The context for his defensiveness was the fuss made when African Bank wrote down R1,4bn in future instalment income that retailer Ellerines claimed to have already earned (African Bank acquired Ellerines last year). JD Group has also changed its accounting treatment of insurance income and initiation fees.

Lewis recognises 55% of insurance revenue in the course of the first year of a two-year contract. “We need this to cover the expenses that you incur in a sale,” says financial director Les Davies But he draws attention to specific reserves which appear in the group's financial statements and which, he says, are a clear indication of a deferment of insurance revenue: together the unearned insurance reserve, the reinsurance premium reserve, the incurred but not reported reserve and the contingency reserve add up to R463m.

“All those reserves reflect deferred revenue that will be earned in year two of the contract,” says Davies. “This would not exist if we upfronted the insurance revenue.”

Lewis's revenue increased by a satisfactory 8% to R3,6bn from R3,3bn last year. Net profit was up 7,4% to R642m, and earnings per share increased 10% to 717c.

Lewis's bigger competitor, JD Group, has had a torrid time. In its six months to February, turnover declined 4% to R6,6bn, but attributable profit declined 47% to R385m. “It's simple,” says CEO designate Grattan Kirk “Turnover and bad debts.”

Turnover figures are declining at chains like Bradlows, Morkels and Russells, which target shoppers in the middle income brackets — those most affected by rising interest rates. At Barnetts and Price 'n Pride, turnover has been flat. “The number of credit applications has declined by 20%,” says Kirk. “On top of that we are declining more applications because of arrears on other accounts.”

JD's bad debt write-offs and impairment provisions for receivables have increased by 38% — roughly the same increase as was reported in the same period last year. Provision for doubtful debts increased by 27%, which has had a significant effect on the margins. The operating margin in the traditional retail business (furniture) has dropped from 16,2% to 10,2%, while the cash retail (Hi-Fi Corp and Incredible Connection) margins declined from 7,8% to 6,3%.

It was only at the solidly performing Polish operation, Abra, that margins were up, from 5% to 6,6%.

While Lewis's bad debt write-offs increased 24,6% from R138m to R172m, margins were preserved at a healthy 26%.

To boost sales Lewis has introduced Re Serve, a scheme in which the company targets its best customers to offer them extended terms over 36 months rather than 24 months. This, says Smart, has boosted productivity at the store level.

JD, meanwhile, is internally focused and is midway through a painful process of separating its furniture business from the credit business.

“The biggest issue is change management,” says Kirk. “IT platforms have to change, revenue collection is being centralised, job descriptions and reporting lines are changing. It's not easy.”

At Lewis, management remains convinced that furniture sales and credit granting are intertwined. “You don't get the first transaction without the second transaction,” says Smart. “Our core strength is the management of our debtors' book — we do not think we need to split that relationship.”

Source: Financial Mail

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