Software delays the earnings recovery

- Capital Appreciation (CTA) announced 1H25 HEPS of 6c, down on an adjusted 7.3c in 1H24. The result is disappointing relative to expectations requiring us to lower our FY25E HEPS. This equates to three challenging years for CTA with a 3-year CAGR of 5% in HEPS. Over this period the two divisions have had contrasting performances, with Payment disappointing in FY23 (and a sub optimal performance in FY24) and Software in FY24 and FY25E. We retain our view that the fundamentals for these businesses remain strong and an improvement in the underlying operating environment would see them both recover sharply, resulting in a substantial increase in earnings. Forecast risk remains high, particularly around the timing of fulfillment of multi-year contracts.
- The Payment business has seen consistent growth in its terminal estate with a 3yr CAGR of 14.3% to 1H25. This has not translated to EBITDA growth (2.3% CAGR over the period) due to a shift to rentals (although more profitable over the rental period), cheaper Android devices at lower margins and prolonged replacement cycles due to capex constraints by banks. However, the larger estate provides a greater base off which to earn annuity revenue (now 56% of its revenue) and a larger estate that at some point will be replaced with new technology, prompting a surge in sales and rentals. The phase out of 2G and 3G networks provides a catalyst as circa 50% of the estate run on these networks, requiring replacement by 2027 should governments timeline materialise.
- The past couple of years have seen a sharp decline in the replacement of maturing terminals with banks opting to keep them in the field, extending their lives. We demonstrate this with numbers. Terminal sales was R139m in 1H25. Assuming an average device price of R4 300, equates to 32 000 devices sold. The estate increased by 30 000, we estimate 5 000 are for rentals. This implies 25 000 new devices were sold. This means only 7 000 of sales relate to the replacement of maturing devices, yet the estate was 118 000 six years ago. This rate of replacement is expected to increase materially going forward, positively impacting sales and rentals.
- The industry wide delays in IT spend by key players in retail, telcos and financial services has had its toll on the Software division. Revenue has still consistently grown over the past three years, however not to the extent that the business had anticipated and in areas that are less staff intensive with low margins. A team of highly skilled IT experts has been built in anticipation of a pipeline that has seen deferrals, scaling back and cancellations, an industry wide problem. Despite this market share has been gained. A rise in SA business confidence combined with the inevitable move with technological trends by these industries will prompt the fulfilment of this pipeline and its subsequent growth. Early green shoots are being seen with momentum improving considerably since the general election in May. We remain positive on trends in Cloud, digital and data.
- There is ongoing traction in other operations as measured by the growing client base. This includes Halo Dot, Lay-up and Asset Pool, none of which we account for in our estimates.
- In line with guidance, we see a stronger 2H25E as the bank contracts begin to roll out in Payments and excess capacity issues ease in Software. FY26E will see a greater impact of these developments. We revise FY25E down from 18.9c to 15.1c (+3%) and FY26E from 24.8c to 22.4c (+48%). In our DFCF we calculate a fair value range of 260-300c/share. The balance sheet remains ungeared, and cash and treasury stock represent 41c/share. The stock trades on an attractive 18m fwd. P/E of 7.5x, an EV/EBITDA of 4.1x. Lesaka Technologies recently acquired two SA payment business on a 6 and 9x EV/EBITDA.

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Price (2024/12/09):	R1.68
Market cap	R2200m
Shares in issue	1310mn

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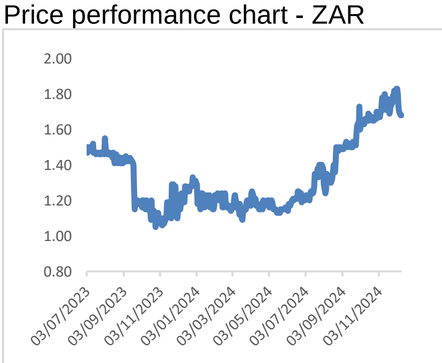
Price performance chart - ZAR



Source: FactSet

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Figure 1 Financial summary

Year Ending	FY2021A	FY2022A	FY2023A	FY2024A	FY2025F	FY2026F	FY2027F
Income Statement							
Total Revenue	620	831	996	1,183	1,359	1,632	1,938
Revenue growth (%)	*-11.7%*	*34.2%*	*19.8%*	*18.8%*	*15.0%*	*20.1%*	*18.7%*
Payments revenue	397	534	524	563	735	897	1,093
Growth (%)	*-21.5%*	*34.3%*	*-1.9%*	*7.5%*	*30.7%*	*21.9%*	*21.9%*
Software revenue	223	297	472	620	624	735	845
Growth (%)	*14.4%*	*33.2%*	*58.6%*	*31.5%*	*0.7%*	*17.9%*	*14.9%*
EBITDA	173	252	236	269	295	430	577
EBITDA Margin (%)	*28.0%*	*30.3%*	*23.7%*	*22.7%*	*21.7%*	*26.4%*	*29.8%*
Payments EBITDA	147	218	206	248	327	400	490
Margin (%)	*36.9%*	*40.9%*	*39.4%*	*44.1%*	*44.4%*	*44.6%*	*44.8%*
Software EBITDA	61	67	83	69	24	91	154
Margin (%)	*27.4%*	*22.4%*	*17.5%*	*11.2%*	*3.8%*	*12.4%*	*18.3%*
Corporate/head office	-35	-33	-53	-48	-56	-61	-67
% Change	*21.3%*	*-4.9%*	*60.4%*	*-8.9%*	*15.0%*	*10.0%*	*9.0%*
EBIT	138	211	193	215	237	365	503
EBIT Margin (%)	*22.3%*	*25.3%*	*19.4%*	*18.2%*	*17.4%*	*22.4%*	*26.0%*
Profit before tax	157	232	156	246	263	398	523
Net profit	126	162	91	171	187	283	372
Headline earnings	127	163	162	184	188	283	372
% Change	*-11%*	*28%*	*0%*	*13%*	*3%*	*50%*	*31%*
Diluted EPS (ZAc)	10.2	12.6	6.9	13.0	14.3	21.5	28.2
Headline EPS (ZAc)	10.3	13.3	13.2	14.6	15.1	22.4	29.3
% Change	*-3%*	*29%*	*-1%*	*11%*	*3%*	*48%*	*31%*
DPS (ZAc)	5.5	7.5	8.3	10.0	9.8	14.6	20.5
Payout ratio (%)	*53%*	*56%*	*63%*	*68%*	*65%*	*65%*	*70%*
Balance Sheet							
Cash and Cash equivalents	538	533	495	467	403	472	543
Current asset (ex – cash)	67	146	262	224	305	362	427
Net Fixed assets	26	24	43	72	89	137	204
Intangible assets	61	55	68	106	108	115	129
Investments	42	68	32	60	104	96	87
Other assets	747	773	764	846	846	848	851
Total assets	**1,481**	**1,600**	**1,664**	**1,776**	**1,855**	**2,031**	**2,241**
Debt	9	9	4	6	17	18	19
Current liabilities	71	86	136	116	137	160	187
Other liabilities	25	22	28	71	59	69	79
Total liabilities	**105**	**116**	**169**	**194**	**213**	**247**	**284**
Shareholders' equity	1,376	1,483	1,495	1,582	1,631	1,757	1,906
Minorities							
Total shareholders' equity	**1,376**	**1,483**	**1,495**	**1,582**	**1,631**	**1,757**	**1,906**

BVPS (ZAc)	*105*	*113*	*114*	*121*	*124*	*134*	*146*
ROE (%)	*9.4%*	*11.3%*	*6.1%*	*11.1%*	*11.6%*	*16.7%*	*20.3%*

Year Ending	**FY2021 A**	**FY2022 A**	**FY2023 A**	**FY2024 A**	**FY2025 F**	**FY2026 F**	**FY2027 F**
Cash Flow							
Reported net profit before tax & interest	**138**	**211**	**193**	**215**	**237**	**365**	**503**
Change in net working capital	19	-60	-66	35	-59	-24	-29
Interest (paid)/received	-45	-61	-66	-68	-103	-127	-207
Tax paid	-53	-57	-67	-78	-76	-115	-151
Depreciation	35	41	45	53	58	65	74
Other adjustments	9	13	11	16	3	3	4
Cash flow from operations	**102**	**86**	**50**	**174**	**60**	**167**	**195**
Net Capex	-7	-17	-33	-45	-41	-73	-97
Capex/sales (%)	*1.1%*	*2.0%*	*3.3%*	*3.8%*	*3.0%*	*4.5%*	*5.0%*
Other investing cash flows	-51	-51	-52	-98	-65	-18	-21
Cash flow from investing	**-58**	**-68**	**-86**	**-143**	**-106**	**-92**	**-118**
Equity raised/(bought back)	-1	-14	6	-53	-13	0	0
Net inc/(dec) in borrowings	0	0	0	0	0	0	0
Other financing cash flows	-8	-9	-10	-6	-6	-6	-6
Cash flow from financing	**-9**	**-23**	**-4**	**-59**	**-19**	**-6**	**-6**
Net cash flow	**35**	**-5**	**-39**	**-28**	**-65**	**69**	**71**
Free cash flow	**154**	**106**	**72**	**184**	**119**	**217**	**300**
Repayment of lease liabilities	**-8**	**-9**	**-10**	**-6**	**-6**	**-6**	**-6**
Net Free cash flow	**147**	**97**	**62**	**179**	**113**	**211**	**294**
Valuation Summary							
Valuation Metrics							
Share Price (ZAc)	99	185	157	168	168	168	168
P/E (Underlying) (x)	9.6	13.9	11.9	11.5	11.1	7.5	5.7
P/BV (x)	0.9	1.6	1.4	1.4	1.3	1.3	1.2
EV/Sales (x)	2.8	2.1	1.8	1.5	1.3	1.1	0.9
EV/EBITDA (x)	10.1	7.0	7.4	6.5	6.0	4.1	3.0
EV/EBIT (x)	12.7	8.3	9.1	8.1	7.4	4.8	3.5
FCF Yield (%)	6.7%	4.4%	2.8%	8.1%	5.1%	9.6%	13.4%
Dividend Yield (%)	5.6%	4.1%	5.3%	6.0%	5.8%	8.7%	12.2%
Net debt	-502	-506	-457	-414	-352	-330	-454
Net debt/Ebitda	-2.9	-2.0	-1.9	-1.5	-1.2	-0.8	-0.8

Source: Company data, FactSet, ASB Research

Financials

Comments on financial forecasts:

- We assume the terminal estate grows from 357k to 419k in FY25E and 465k in FY26E. Its currently 387k. This has been revised upwards given the two bank contracts awarded in 1H25. We estimate a net 100k new devices awarded to CTA over three years from these contracts with circa 50% being rentals.
- We assume that 25% of new devices issued are on rental contracts. These range from 3-5 years. We assume a cost of R3200 per rental device in FY24, escalating by 4% in FY25E. We estimate a monthly rental of R260 per device. None of these details are disclosed as management is wary of providing competitive information.
- On our estimates there was circa 18k rental devices in FY24. We forecast this to rise to 37k in FY25E.
- Maintenance revenue is not growing in line with terminal estate growth as certain banks are opting not to go with a monthly maintenance contract, instead incurring the repair expense when required. New devices would require less maintenance further impacting the growth profile. This is not the case with rental devices as a monthly maintenance charge is part of the contract. Forecast risk is therefore high and its growth profile more irregular.
- Transaction related income is difficult to forecast as new products are rolled out, for example software installed on third party devices, a trend which is emerging. It is also a reflection of the amount of data passed through the Sim cards in its devices. An immaterial amount of Transaction related revenue relates to devices directly with retailers as the bulk of the estate is sold/rented to banks. We grow it in line with the terminal estate growth.
- We anticipate a modest increase in activity in Software in 2H25 (revenue up 10% on 1H25), however, revenue will be broadly in line with FY24. FY26E should see a greater improvement, we forecast 16% growth. Our forecasts do not account for any contribution from Halo Dot which is currently enjoying good traction with new contracts being awarded.
- Software EBITDA margins have consistently declined since FY18 when 39% was achieved. We don't see these margins ever being achieved again as software reseller margins have declined and a greater component of Software's revenue is from security hardware that attracts considerably lower margins. We believe 20% margins are achievable in the medium term and we conservatively glide our margin expansion towards 20% in FY28E.
- The company has repurchased R63m shares at 1H25 at an average cost of 124c. This represents 4.8% of shares in issue. The shares are not cancelled, rather treated as treasury stock and utilised for acquisitions and share incentive awards.
- There is no fixed dividend policy. We estimate a 65% payout in FY25E.

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