South Africa

Lesaka Technologies: A Fintech Turnaround Case

Aug. 02, 2023 11:05 AM ET | **Lesaka Technologies, Inc. (LSAK)** | NWITY, NWKLF, PAGS...

Yiannis Zourmpanos

Investing Group Leader

About this article

Ticker	Analyst rating	Price at publication	Last price	Change since publication	S&P 500
LSAK	HOLD	-	$3.55	-	

Summary

- Lesaka Technologies' turnaround from a mismanaged holding company to a promising African fintech company is almost finished.
- Lesaka's focus on synergies, growth potential, and customer acquisition cost advantages contribute to its potential for sustained growth.
- Management expects revenues to grow by ~130% to roughly $510 million in FY2023 following the transformative acquisition of the Connect Group.
- Lesaka's B2B merchant payments business has accelerated revenue growth and continues to innovate, and Easypay's B2C business may boost its sales growth due to PostBank's issues.
- Key risks, such as potential operational challenges, geopolitical risk, exposure to economic downturns, and regulatory and political uncertainties, lead to a hold rating for LSAK for the foreseeable future.

- I do much more than just articles at Yiazou Capital Research: Members get access to model portfolios, regular updates, a chat room, and more. Learn More »

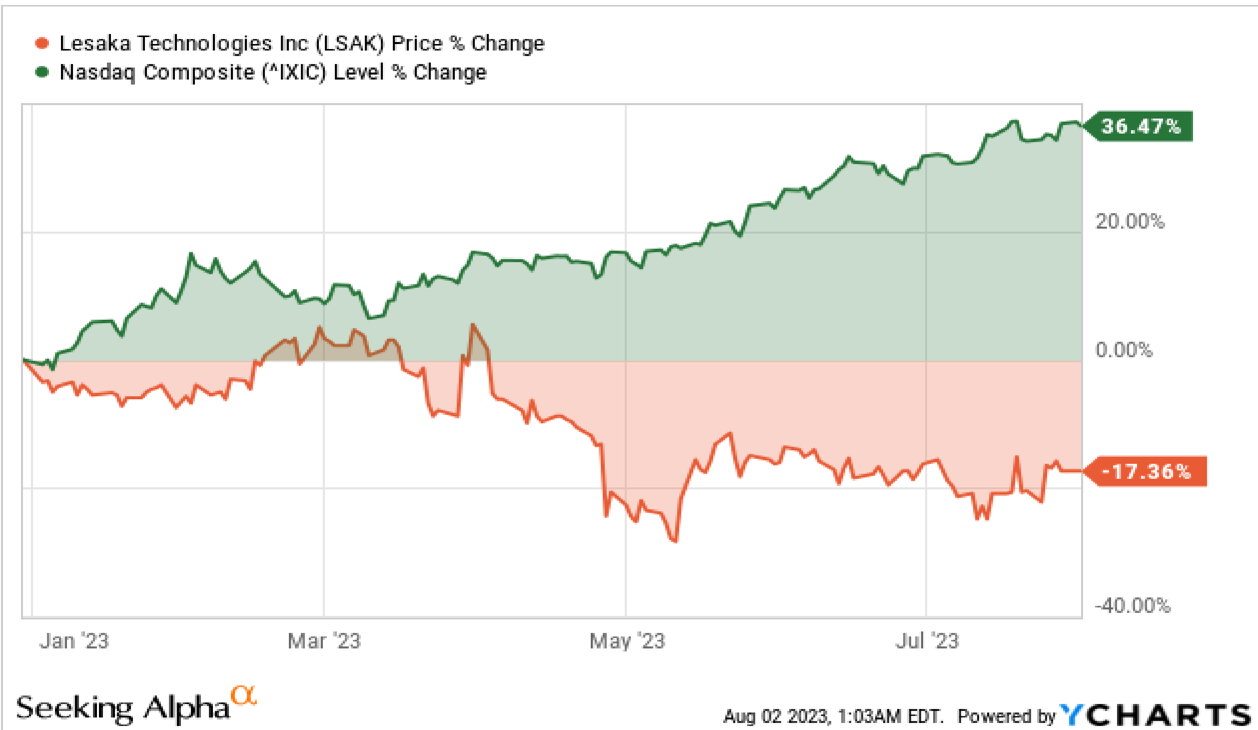
FG Trade/E+ via Getty Images

Investment Thesis

Lesaka Technologies, Inc. (NASDAQ:LSAK), a South African-based fintech, provides a compelling turnaround case for the special situation and growth investors with upside potential in the next 2-3 years. Even though LSAK has underperformed the market year-to-date, and its historical financials are uninspiring, its recent positive developments and turnaround progress have not been adequately priced into the current stock price.

Key risks, such as potential operational challenges, geopolitical risk, exposure to economic downturns, and regulatory and political uncertainties, lead to a hold rating for LSAK for the foreseeable future. However, there is a potential for rerating in the second half of the year depending on certain key outcomes, including the developments of the turnaround plan.

The success of Lesaka will be based on its capacity to successfully carry out its turnaround plan, seize market opportunities, and control the risks associated with operating in the South African fintech sector.



Data by YCharts

Turnaround Story: From Unloved Holding Company To Fintech Powerhouse

Lesaka is transitioning from an unloved, mismanaged holding company into a fast-growing fintech focused on financial inclusion and serving micro, small, and medium enterprises (MSMEs) and underbanked consumers in South Africa. The company completed a transformational acquisition of the Connect Group in April 2022, now representing most of its value.

With its recent transformational acquisition, Lesaka has expanded its product offerings to a dual-sided fintech platform and is well-positioned to capture a substantial portion of the market. Additionally, the Connect Group acquisition has brought together assets like Kazang and CashConnect, enabling merchants to offer mobile top-ups, accept credit cards, bill payments, merchant acquiring, and value-added services. Since the acquisition, Lesaka has been actively right-sizing its operations, refining its offerings, and striving to achieve cash flow breakeven, ultimately reducing its debt.

With its turnaround strategy and acquisition of the Connect Group, management expects revenues to grow by ~130% in FY2023 to $510 million. Since the acquisition, Lesaka has been actively right-sizing its operations, refining its offerings, and getting closer to achieving cash flow breakeven.

A critical upcoming catalyst will be in September when they release earnings for the quarter ended 6/30/23 (the company's fourth quarter). Management is also expected to release financial guidance for 2024 at that time. If these numbers show continued sales growth and improvements in profitability, investors may become increasingly interested in this undiscovered stock.

Driving Growth With Kazang & Expanding Consumer Business

Lesaka sells digital financial services, primarily in South Africa, through two divisions: Merchant and Consumer. Like Block Inc (SQ) in the US, LSAK has a dual-sided product ecosystem targeting both consumers and merchants, enabling cross-selling and resulting in a lower customer acquisition cost (CAC) than competitors.

Most of Lesaka's revenues (90% in FYQ3 2023) come from its Business-to-Business (B2B) merchant fintech offering targeting MSMEs. The leading product in this segment is Kazang, a handheld mobile point of sale (POS) device, which, paired with its app, enables merchants to accept credit cards, borrow money and offer consumers a plethora of digital financial products.

Kazang helps merchants make more money, save time, and quickly and easily leap into the digital age. This business is similar to other US publicly traded fintechs like StoneCo Ltd. (STNE) and PagSeguro Digital Ltd. (PAGS). Kazang operates in the "informal economy" (smaller independent businesses, i.e., a corner store) and offers compelling unit economics with CAC compared to the lifetime value (LTV) of a customer. In the quarter ending on March 30, the number of mobile POS devices distributed to merchants was 72,000, up 52% year over year, which is accelerating.

Lesaka's Consumer business, EasyPay Everywhere (EPE), contributes 12% of revenues and sells digital financial products to less well-off consumers. Specifically, they target South Africa's "grant beneficiaries" i.e., consumers receiving the equivalent of US welfare payments from the government. The company provides these customers with a digital wall solution, including a payment card and an EasyPay app. Lastly, Lesaka sells life insurance and small unsecured loans to these customers.

EasyPay grew customers by 16% YoY to 1.3m active accounts in the latest quarter, and consumer average revenue per user (ARPU) is constantly increasing QoQ. EasyPay has been turned around through sales force revitalization, operational revamping, and cost-cutting measures and is expected to show improved profitability in the fourth quarter.

Q3 FY23 (Lesaka)

Non-core Assets For Sale: Pave The Path To Debt Reduction

Apart from the growing core business, Lesaka also owns four equity investments in other companies which equal a substantial portion of the current market cap. Management has stated these investments will be sold off opportunistically. These positions have been valued at an estimated total of $40 million to $76 million by analysts and the company. The most significant of these positions is a 10% equity stake in MobiKwik, a large fintech company in India. Therefore, the proceeds could be used to pay down debt or for growth marketing.

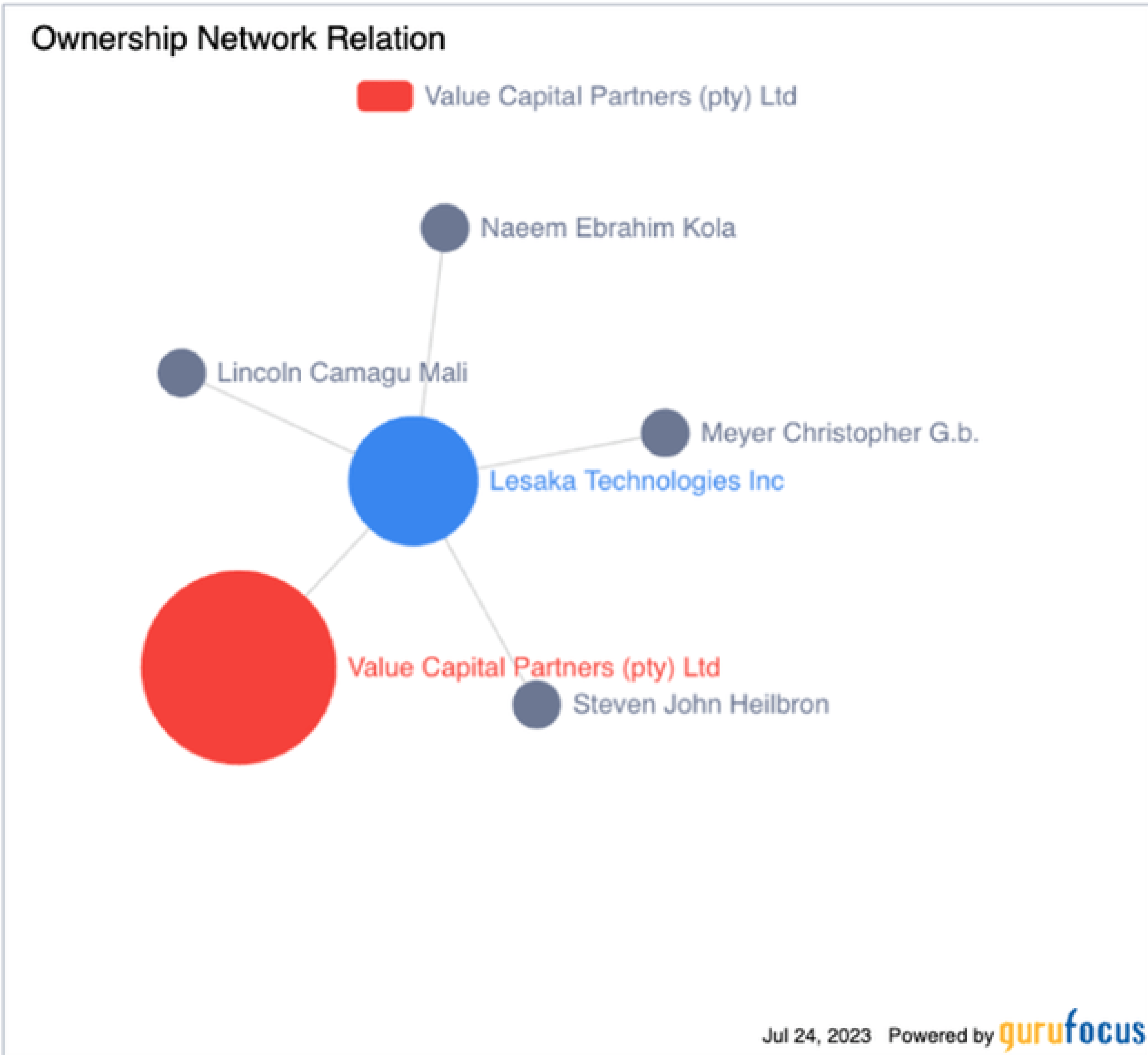
New Leadership, Strategic Acquisitions, And Aligned Interests

After appointing Chris Meyer as the new CEO in 2021, Lesaka underwent significant changes. New management implemented aggressive cost-cutting measures and introduced a new strategic direction for the company.

The new executive team is believed to be a significant upgrade, with extensive experience in large companies reflecting Lesaka's ambitious goals. Notably, management's interests and compensation align with shareholders, encouraging top executives and board members to purchase the company's stock on the open market at prices higher than current levels.

Value Capital Partners (VCP), a prominent and well-respected activist fund in South Africa, owns a sizable portion of LSAK and is pulling the strings. The involvement of VCP and other experienced fintech insiders on the board has led to positive market sentiment and the potential for the stock to be rerated as an attractive investment opportunity.

Overall, the swift and effective execution of changes by the new management team, coupled with strategic acquisitions and alignment of interests with shareholders, indicates Lesaka's potential for seizing opportunities and creating value for investors.



GuruFocus

Market Opportunity For Lesaka Technologies

South Africa's fintech market offers significant growth and financial inclusion potential due to its tech-savvy population, increasing mobile and internet penetration, unbanked population, low card penetration, and demand for digital payment services. The country's favorable business environment, strong rule of law, property rights, and urbanization make it an attractive market for fintech firms.

The table below illustrates the **untapped fintech** market opportunity in South Africa supported by:

1. **UnBanked Population:** The percentage of people with financial institution accounts in South Africa is 67%, significantly lower than 93% in the U.S. The percentage of the unbanked is even higher among those less fortunate. This indicates a sizable unbanked or underbanked population in South Africa, creating a substantial market opportunity for fintech companies to offer innovative and accessible financial solutions.
2. **Card Penetration:** Only 25% of people in South Africa made purchases using debit or credit cards in the past year, in contrast to 86% in the U.S. This highlights a gap in digital payment adoption and card usage in South Africa, presenting fintech companies with opportunities to introduce secure and convenient digital payment options.
3. **Digital Payments:** While 60% of people in South Africa sent or received digital payments in the past year, the percentage is lower than 91% in the U.S. This indicates a growing demand for digital payment services in South Africa, offering fintech companies the chance to tap into this potential market and provide efficient payment solutions.
4. **Internet Usage:** South Africa has a significantly higher percentage of individuals using the internet, 94% compared to 87% in the U.S. This high internet penetration provides a strong foundation for fintech companies to offer digital services and reach a large customer base.
5. **Mobile Usage**: South Africa boasts mobile subscriptions exceeding 100 per 100 people, indicating widespread mobile phone access. This presents a tremendous opportunity for fintech companies to leverage mobile platforms for financial services and expand their reach to a broad audience.

	Egypt	Kenya	Nigeria	South Africa	U.S.	EU	China	India	Brazil
Internet Usage % of individuals using the Internet [1]	49%	84%	56%	94%	87%	90%	50%	35%	58%
Mobile Usage mobile subscriptions - per 100 people [1]	93	91	75	>100	106	124	109	87	102
% smartphone user base [2]	34%	60%	27%	64%	74%	76%	52%	30%	38%
Banked Population % of people with financial institution account [3]	32%	56%	39%	67%	93%	95%	80%	80%	68%
Card Penetration % of people that made purchases using debit or credit cards in past year [3]	4%	13%	10%	25%	86%	82%	42%	12%	39%
Digital Payments % of people that sent or received digital payments in past year [3]	23%	79%	30%	60%	91%	92%	68%	29%	58%

FT Partners

A recent Boston Consulting Group study on the international fintech market said, "Africa can leapfrog its way to a new financial ecosystem, unencumbered by legacy infrastructure", and says the African fintech market could grow by 13x faster than any other continent due to its sizeable unbanked population and fast population growth.

Unlocking Lesaka's Expansive Market Opportunity

Specifically, Lesaka's total addressable market (TAM) comprises several segments, including MSMEs and underbanked consumers, in the informal market, which accounts for 30% of South Africa's GDP.

This sector is enormous, with an estimated GDP of well over R300 billion, or ~$16.7 billion, and is made up of businesses and individuals who are underserved by traditional banks and have little access to conventional financial services. Only 10% of payments in the informal market are made via digital payments; 90% of transactions take place in cash.

Merchant in South Africa (Lesaka)

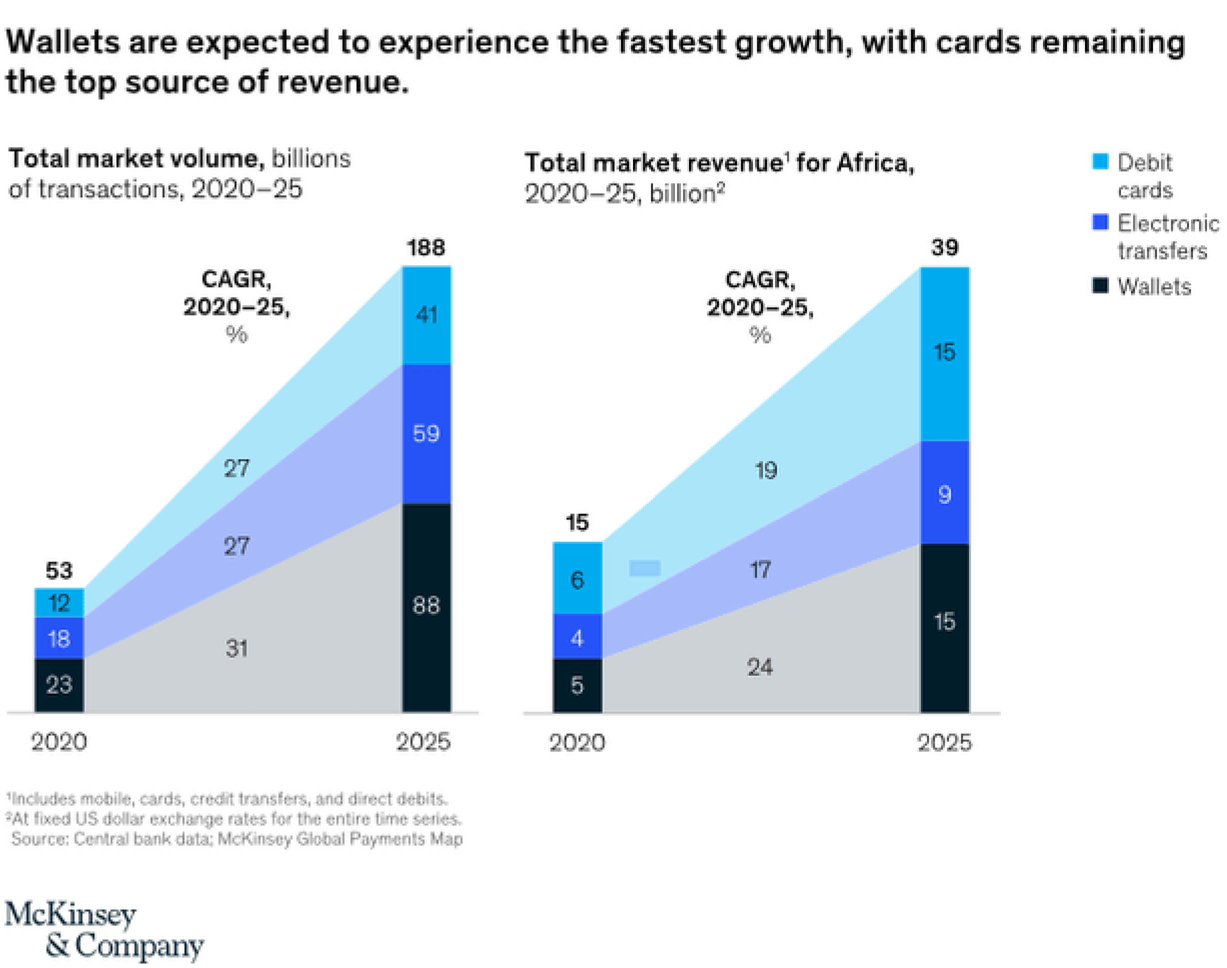
The company's market share in the merchant division is currently low, with less than 1% in the formal market and less than 4% in the informal sector, so if the company can execute, and they have yet to show they can do so, they can grow at a fairly fast clip for some time.

Overall, Lesaka Technologies has a sizable market opportunity in South Africa, and its focus on financial inclusion and serving MSMEs and underbanked consumers position it well for growth in the coming years. As it continues to execute its turnaround plan and capture more market share, the company's TAM is expected to grow further, presenting attractive opportunities for investors looking to capitalize on the potential of a fast-growing fintech/payments company in the South African market.

Visa's $1 Billion Investment In Africa

One recent piece of news that shows the promise of fintech in Africa is that Visa Inc. (V) recently announced plans to invest $1 billion in Africa over the next five years to take advantage of the continent's emerging economy and rapid growth in digital payments.

The investment will enable Visa to seize emerging opportunities, drive financial inclusion, and contribute to the continued digital transformation of the African economy. According to a McKinsey report, Africa's e-payments market is expected to grow annual revenue by nearly 20%, reaching around $40 billion by 2025.



McKinsey

PostBank's Issues Is An Opportunity For Lesaka's Consumer Business

PostBank (the government-owned South African post office) distributes about six million of the roughly 12 million active consumer "grant distributions" in South Africa. Due to PostBank's well-publicized problems and poor handling of distributing these payments to consumers, these six million grant beneficiary accounts will be up for grabs by the end of 2023.

Lesaka's experience as a prior payment distributor for the government enhances its potential to capture a significant share of these newly available accounts. If the company were to get one million of those six million accounts, and we assume each account generates the current ARPU of roughly $4.50 per month, that would translate into roughly $50 million in revenue per year.

Competitive Edge: Solid Offerings & Regional Presence

Despite facing numerous competitors, the company stands out due to its significant size, scale, and reach. With over 68,000 touchpoints in South Africa, including merchant MPOS devices, cash vaults, kiosks, and ATMs, Lesaka has a unique advantage, being the only company capable of reaching all citizens within a three-mile radius in South Africa in addition to its digital products.

In the merchant segment, Lesaka's Connect Group is a leading player in the informal market, competing with Flash, which targets the same sector but needs an in-house card-acquiring device. Lesaka's broader set of products and free MPOS device (opposed to sold) set it apart from competitors like Yoco in the informal market, even though Yoco has seen great success targeting the formal market.

In the consumer division, Lesaka's EPE Moneyline loan business faces competition from "loan sharks", i.e., unregulated lenders charging high-interest rates. EasyPay faces competition from players like Shoprite's Money Market product and Capitec, a large and entrepreneurial South African bank.

Nevertheless, despite the competitive landscape, Lesaka's broad product offerings, extensive reach, and unique positioning in both the consumer and acquiring sides of the market contribute to its potential for sustained growth and customer acquisition cost advantages in the long run.

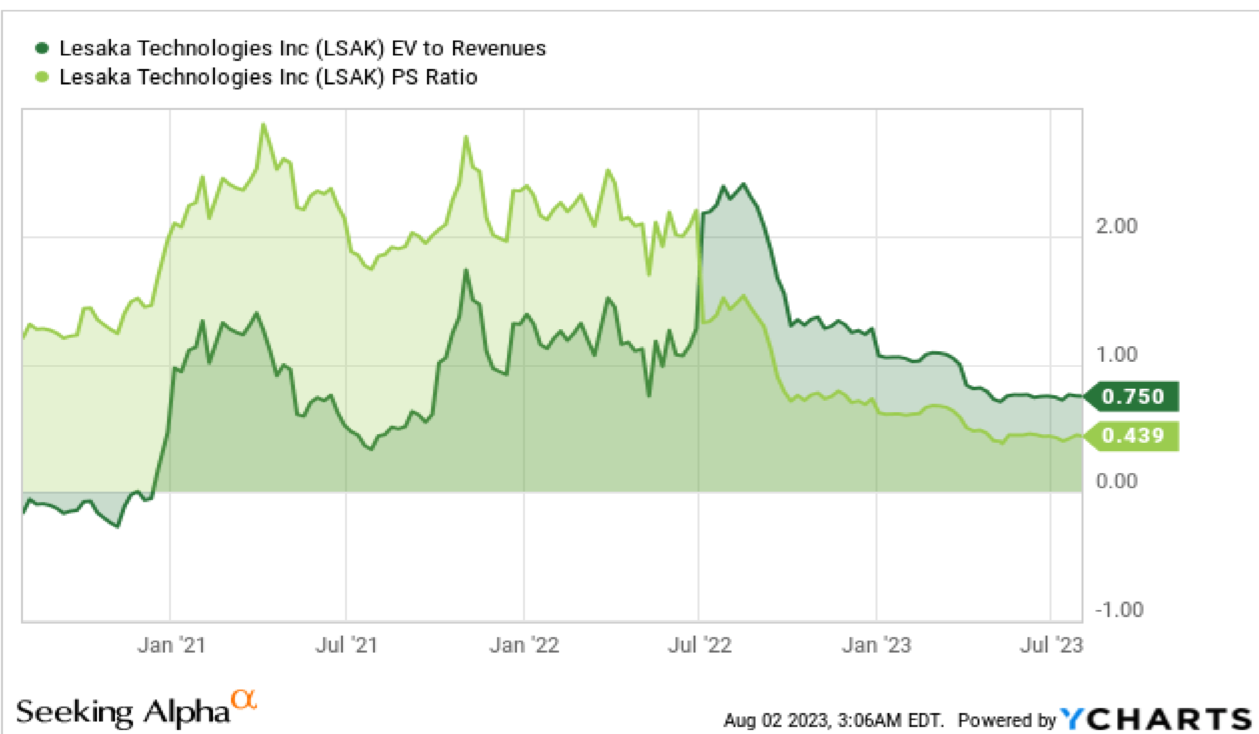
Lesaka's Risk & Reward

While its future is potentially promising, LSAK has yet to prove it can grow revenues and reach profitability. And it currently faces several risks that could impact its market positioning and valuation. Firstly, operating in a continent unfamiliar to many US-based investors may result in limited sell-side coverage and fewer analysts following the company. This lack of visibility might lead to a mispricing of the stock.

Unraveling LSAK's Valuation

Depending on which metric you use, the stock is cheap, but to be fair, it has been cheap for a long time. If comparing the company to its publicly traded rivals, LSAK's Price/Sales multiple is significantly lower than its sector median (0.44x vs. 6.28x) and hovers around its all-time low levels of 0.41x.

For LSAK's valuation, EV/Sales is preferred as opposed to EV/EBITDA, since while LSAK's EV/EBITDA multiple of 43x looks very high compared to its sector's median of 12x, this is because Lesaka is amid a turnaround and EBITDA has been suppressed. If management can execute as promised, EBITDA could grow, and the EV/EBITDA multiple could look similar to its public peers.



Data by YCharts

If we look at recent M&A deals in international fintech, Lesaka also looks cheap. A publicly traded payments company in MENA called Network International Holdings plc (OTCPK:NWITY) was recently acquired by a US PE firm for EV/Sales of 6.3x and 21.8x EV/EBITDA.

Its current valuation might not entirely reflect the recent transformation from a money-losing Holdco to a growing operating company. Investors may still perceive it as a Holdco, potentially undervaluing the company based on its future growth prospects. Moreover, the market might underestimate LSAK's growth potential in the South African fintech industry, hindering its ability to attract investors and achieving a higher valuation.

Navigating Challenges And Uncertainties

LSAK faces several risks that could impact its performance and financial results. The company operates in a highly competitive environment, catering to the informal merchant base in South Africa. To maintain its relevance, LSAK must continuously evolve its business mix in response to the increasing digitization of the economy while fending off competition attracted to the same target addressable market. Although experts believe that LSAK has the potential to succeed and emerge as a market winner, executing this transformation successfully is critical for its long-term success.

Another risk relates to financial leverage, particularly after the Connect Group acquisition. As of June 30, the company has net debt of roughly $150 million. This could be problematic if the company does not start generating higher EBITDA. However, the sales of the company's roughly $50-$70 million of non-core assets could give the company more breathing room. Pro forma projections indicate a gradual decline in leverage, but a higher debt burden could restrict financial flexibility and increase interest rate risk.

Additionally, as LSAK generates most of its revenue in the South African market, it is exposed to currency risk. Fluctuations in the rand's value against major currencies, even with a 4% annual devaluation assumption, could impact the company's reported operating results and financial stability.

Apart from internal risks, external factors pose significant challenges. Economic downturns, the credit risk associated with the micro-lending loan book, and changes in public market valuations of invested companies could all negatively affect LSAK's operations and financial performance.

Operating in emerging markets with varying regulatory environments and political instability exposes the company to additional uncertainties. Moreover, potential terrorist attacks, natural disasters, and a global health crisis, like a pandemic, could disrupt LSAK's operations and lead to a deterioration in financial results. Addressing these risks effectively will be essential for LSAK to successfully navigate the financial technology sector and achieve its investment objectives.

The perception of South Africa's economic and political situation may also deter some investors, leading to a discounted valuation despite the company's growth prospects and strong management team. Regulatory changes and political instability in South Africa could threaten the company's operations and profitability.

Therefore, market perception and recognition of LSAK's potential may take time, affecting the stock's pricing. Overall, LSAK's success will depend on its ability to navigate these risks and capitalize on the market opportunities in the fintech industry.

Takeaway

In conclusion, Lesaka presents a compelling turnaround case with significant upside potential for particular situations and growth investors. The company's recent transformational acquisition of the Connect Group has doubled its revenues and positioned it for substantial growth in the coming years.

Lesaka's success will depend on its ability to effectively execute its turnaround plan, capitalize on market opportunities, and manage the risks inherent in operating in the South African fintech industry. Even though LSAK's risk/reward profile appears balanced, investors should carefully monitor the company's progress and market developments before considering any investment in the stock.

Editor's Note: This article discusses one or more securities that do not trade on a major U.S. exchange. Please be aware of the risks associated with these stocks.

This article was written by

Yiannis Zourmpanos

3.64K Followers

Leader of **Yiazou Capital Research**

Unlock your investment potential through deep business analysis.

Show More

Analyst’s Disclosure: I/we have no stock, option or similar derivative position in any of the companies mentioned, and no plans to initiate any such positions within the next 72 hours.

Business relationship disclosure: The author of this article has received compensation for researching and analyzing the mentioned stock. The views expressed herein are solely the author's opinions and should not be considered financial advice. Investors are advised to conduct their own research and seek professional guidance before making any investment decisions. The information provided in this article is for informational purposes only and does not constitute a recommendation to buy or sell securities. Investing in financial markets carries inherent risks, and past performance is not indicative of future results.