

Caution: Slow growth ahead!

We downgrade our recommendation from BUY to HOLD. We update our Letshego forecasts and estimate a fair value of BWP 2.73 per share (fully priced at current market value).

Despite 33% y/y loan growth, earnings growth has stalled recently due to falling yields from increased competition and higher effective tax rates. To boost earnings growth, Letshego is expanding its product offering, while simultaneously reducing reliance on equity funding, to preserve ROE. To this end, the dividend payout increased to 50% of PAT from 1H14*, while a debt/equity ratio of 1 (i.e. 1x leverage) is targeted over the medium term.

- **The loan book is maturing.** By FY14, 74% of loans had maturities of 3-5 years up from 56% (FY13), while average loan size increased by 22% y/y. To counter this, Letshego is expanding lending to low/middle income private sector employed and Micro and Small Enterprises (MSE).
- **Achieving 1x leverage requires an ambitious BWP 3.7 bn of debt to be raised over five years.** Achieving this will still constrain loan growth to an average of 18% pa through to FY18 (FY10-FY14: 27% pa), if the 50% dividend pay-out ratio is maintained. ABIL's demise makes debt raising difficult, but not impossible. Letshego's rival Bayport, is 4x leveraged, suggesting that moving from 0.4x to 1x leverage is achievable. Under this scenario earnings growth and ROE will average 12% pa and 21% respectively. Maintaining current leverage (0.4x) suppresses average loan growth to 10% pa through to FY18, and ROE to 17%, however this is not our base case.
- **Yields and NIMS have fallen 500bps and 740bps respectively over the past five years,** while ROE has nearly halved from 38% (FY11) to 20% (FY14). However 1H14* data suggests this yield decline may have stabilised.
- **Banking strategy to aid increased leverage, however it's unlikely to attract meaningful deposits.** Regionally, individuals are net borrowers, while corporates tend to place deposits with top tier banks. In Namibia a provisional banking license has been obtained, while deposits are being taken in Mozambique (1H14: BWP 2.2m). A Botswana license is some way off.
- **Expanding beyond payroll lending risky and will be executed slowly.** We expect the impact of product expansion to be limited to stemming yield decline at 30%, while increasing COR to 4.0% (FY14: 1.7%). The banking strategy will see deposit and transactional products including mobile and agency banking products being rolled out. These have significant potential; however we are yet to attribute any value to banking product initiatives.
- **The loan book has become increasingly diverse.** By FY14 Botswana, Namibia and Mozambique accounted for 41% (FY11: 67%), 21% (FY11:15%) and 18% (FY11: 0%) of loans respectively. East Africa accounts for 15% of loans, but 64% of impairment provisions. The best growth potential lies in Mozambique.
- **Catalysts include** 1) obtaining banking licenses 2) raising affordable debt 3) decent civil servant salary increments, and 4) entering high yielding markets.
- **Risks include:** 1) loss of deduction codes 2) increasing price competition, and 3) funding constraints around rolling existing or raising new debt.

7 October 2014

*** HOLD ***

Current price (7 Oct 2014)	BWP	2.71
Fair value (7 Oct 2014)	BWP	2.73
Upside/(downside)	%	0.7
Target price (7 Oct 2014)	BWP	2.98
Price return	%	10.0
Dividend yield (ntm)	%	6.8
Forecast total return	%	16.8

12 month high/low	BWP	2.71/1.98
YTD performance	%	17.3
1yr performance	%	23.2%

Issued shares (m)		2,176.5
Market cap	USDm	633.2
Free float	%	76.2%
Free float market cap	USDm	482.5
Monthly value traded	USDm	5.3

Year end December*

Bloomberg LETSHEGO BG
Reuters LETS.BT

Year to 31 Jan / 31 Dec*	FY14A	FY14E	FY15
EPS (BWP)	0.30	0.34	0.39
% chg	-8.8	13.9	14.2
DPS (BWP)	0.07	0.16	0.18
% chg	-9.8	117.9	14.4
BPS (BWP)	1.62	1.79	2.00
% chg	13.0	10.8	11.6
P/E	7.9	7.9	6.9
DY (%)	3.1	6.0	6.8
P/B	1.5	1.5	1.4
ROE (%)	20.2	20.2	20.7
COE (%)	15.0	15.0	15.0

* Letshego's year end will change to December from January. References to FY14 refer to the year end 31 January 2014, while FY14* refers to the annualised period ending 31 December 2014.

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Abbreviations

General

a	actual / reported
bn	billions
BPS	book value per share, equivalent to NAV
COE	cost of equity
DPS	dividends per share
DY	dividend yield
e	expected
EPS	earnings per share
f	forecast
FY	financial year
FY0n	financial year 200n
k	thousands
LC	local currency
m	millions
mth, mths	month, months
NAV	net asset value per share
ntm	next twelve months
PAT	profit after tax
PBT	profit before tax
ROA	return on assets
ROE	return on equity
ttm	trailing twelve months
WACC	weighted average cost of capital

Currencies

BWP	Botswana pula
EGP	Egyptian pound
GBP	British pound
GHS	Ghanaian cedi
KES	Kenyan shilling
LSL	Lesotho loti
MAD	Moroccan dirham
MUR	Mauritian rupee
MWK	Malawian kwacha
NAD	Namibia dollar
NGN	Nigerian naira
RWF	Rwandan franc
SZL	Swazi lilangeni
TND	Tunisian dinar
TZS	Tanzanian shilling
UGX	Ugandan shilling
USD	United States dollar
XOF	West African CFA franc
ZAR	South African rand
ZMK	Zambian kwacha

Banking sector

CASA	Current & savings account to total deposits
CIR	Cost to income ratio
COF	Cost of funds
LDR	Loans to deposits ratio
LLR	Loan loss reserve
NII	Net interest income
NIM	Net interest margin
NIR	Non-interest revenue
NPL	Non-performing loans

Industrial sector

ARPU	Average revenue per user per month
hl	Hectolitre (100 litre)
LDA	Legal drinking age
PCC	Per capital consumption
RTD	Ready to drink

Sources

Unless otherwise noted, financial information is sourced from subject company filings, market data is sourced from the relevant exchange, and forecasts and analysis are prepared by African Alliance analysts.

Recommendation system

The African Alliance recommendation system is based on the difference between the current share price value (CSP), and the fair value (FV) of the share as calculated by African Alliance. Rating categories are defined as follow:

Buy	FV more than 15% above CSP
Accumulate	FV between 5% and 15% above CSP
Hold	FV between -5% and 5% around CSP
Reduce	FV between 5% and 15% below CSP
Sell	FV more than 15% below CSP

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	YES	NO
Current investment banking relationship		•
Previous investment banking relationship		•
Company holding		•
Related party holding	•	
Analysts holding		•