Letshego Holdings

Initiation of Coverage

AFRICAN ALLIANCE

Equity research | Botswana | Banks and Financial Services

WHAT PLANS WITH EXCESS CAPITAL?

BUY

Letshego Holdings (Letshego) is due to report its FY10 (Jan) results on the 16 April 2010. We forecast a 61.1% increase in attributable profit excluding foreign currency translation differences and the once off gain on the disposal of two non-core subsidiaries. Factoring in share dilution from the BWP 360m capital raising in Feb-09, diluted headline EPS will grow 33.0%.

- **Key Botswana and Swaziland markets nearing ex-growth.** Prospects for further volume growth in Botswana and, to a lesser extent, Swaziland are now less sanguine going forward. The Botswana consumer appears over-indebted and payroll deduction penetration levels are believed to be nearing saturation. Further, proposed microlending regulations awaiting promulgation in their current form may exert some margin pressure on Botswana's 60 month loan book – estimated to comprise 48% of total group loans.
- **Tanzania and Namibia growth prospects strong.** The investment made in Tanzania is now delivering returns - we expect strong +/-40% pa profit growth over the medium term, with market growth fundamentals very favourable. Namibia too, should maintain good momentum into FY11.
- **Building capacity for a major investment?** Post the sale of Legal Guard and the proposed convertible note issue (treated as equity), Letshego's net debt to equity ratio is estimated to decline to 0.15x – well below the 2x considered sustainable. Why then withhold FY10's dividend as well propose to raise a further BWP 250m via a convertible note issue? We speculate that Letshego is building financial capacity for the investment required to evolve into a broader financial services, deposit taking institution akin to South Africa's Capitec Bank and Kenya's Equity Bank. Clarity on management's plans with the group's excess capital (estimated at approximately BWP 4.15 per share) is expected within the current CY.
- **Valuation undemanding.** Letshego is currently trading in line with its 5 year historic PE and PB multiples of 8.2x and 2.8x respectively. Using the same multiples and adjusting for the estimated excess capital, we conservatively value Letshego at BWP 18.57 (fair value today) and calculate a 12 month target price of BWP 20.73 (+30% from current price levels).

INVESTMENT SUMMARY TABLE

Year to January	FY06	FY08*	FY09	FY10F	FY11F	FY12F
Diluted core EPS (BWP)	0.70	1.11	1.45	1.92	2.09	2.52
%ch	10.0	59.2	61.6	33.0	8.9	20.3
DPS (BWP)	0.18	0.28	0.30	0.00	0.51	0.84
%ch	13.1	54.7	34.7	n.a.	n.a.	65.7
Price to earnings (times)	17.0	8.9	11.1	8.3	7.6	6.4
Price to book (times)	5.5	3.2	3.7	2.2	1.7	1.4
Dividend yield (%)	1.5	3.2	3.7	2.2	1.7	1.4

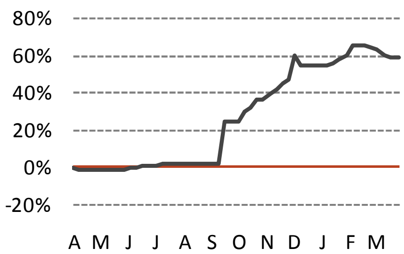
**Note: FY08 is for 15mnths to January 2008. Previous FYE was October*

30 MARCH 2010

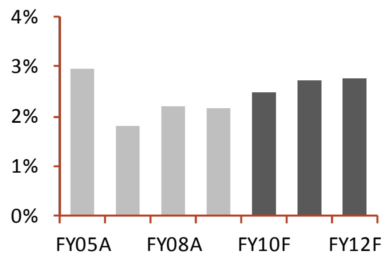
Current price	BWP	15.95
Target price	BWP	20.73
Expected capital gain	%	30.0
Expected div yield	%	0.0
Expected total retun	%	30.0

Market cap	BWpm	2,895.6
	USDm	423.34
Daily value traded	BWpm	0.834
(last 12 mths)	USDm	0.12

PRICE PERFORMANCE



IMPAIRMENTS



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COMPANY PROFILE

BUSINESS MODEL

Letshego is a provider of unsecured, consumer credit with operations in Botswana, Swaziland, Tanzania, Namibia, Uganda, Zambia and Mozambique. Loan products range from short term, 1 month advances of a minimum BWP 250 (USD 35) to 60 month loans of a maximum BWP 100,000 (+/-USD 15,000). Clients use the loans for a variety of purposes such as home improvements, education and asset financing, but likely most often for general consumption. Letshego's key selling proposition is its quick, maximum 2 day, turnaround time on loan applications. Deposits and general banking services currently do not feature in Letshego's product offering.

Letshego business model based on payroll deduction

Central to Letshego's business model is the use of the payroll (salary) deduction methodology to collect loan repayments. Under this system, the employer of the borrower grants a code that allows the lender to deduct loan repayments directly from the borrower's salary. This arrangement assists in minimizing credit risk for lenders.

Payroll deduction mostly limited to government employees

In practice, payroll deduction is mostly limited to government employees. The public sector is generally characterized by lower staff turnover and is more resilient to economic downturns vis-à-vis the private sector. In the case of Letshego, over 95% of its customers are civil servants in Botswana and generally 100% outside of Botswana. Nonetheless, the real factor limiting penetration of the private sector is that most private sector employers are resistant to carrying the extra administration burden that comes with payroll deduction.

When evaluating payroll deduction, a distinction needs to be made between countries which have a central register and those that do not. A central register is responsible for ensuring that loan affordability levels are adhered to and that there are a limited number of non-statutory deductions appearing on the borrower's payslip. Over time, it is evident that countries which do not have a central register will eventually introduce one as it allows for better enforcement of industry regulations. A recent example is Swaziland, which introduced a central register in 2009 in order to ensure compliance of minimum take home pay requirements as stipulated in its Employment Act. While the introduction of a central register will often reduce the size of the market by limiting the number of allowed payroll deductions, it does provide for a more long term, sustainable credit market and often assists in lowering collection costs for lenders.

Key risk with payroll deduction is increased regulation

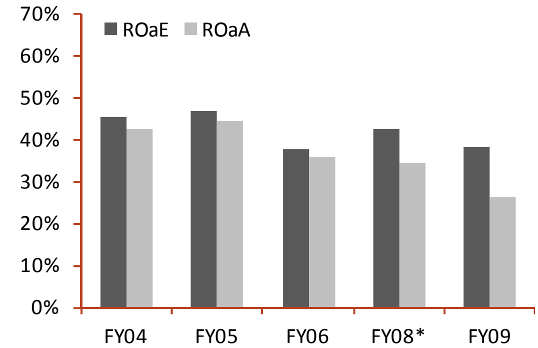
A major risk with payroll deduction is when the regulatory authorities disallow it. This occurred in South Africa in 1998 and its payroll based microlenders subsequently suffered from a sharp increase in bad debts. South Africa remains the only sub-Saharan African country whose government currently disallows payroll deduction.

We consider it unlikely that other sub-Saharan African countries will follow what occurred in South Africa in the late 1990's and disallow payroll deduction within their public sectors. Governments are cognisant that levels of banking penetration are lower and access to credit more difficult outside of South Africa. Nonetheless, there is a strong perception that payroll based microlenders charge exorbitant interest rates and fees for the level of risk assumed, and as such the industry is not always viewed positively by governments. Rather than disallowing payroll deduction outright, governments will be more inclined over time to regulate the industry via, inter alia, capping the total cost of credit.

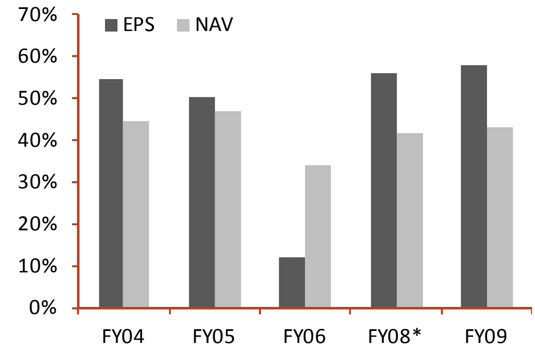
HISTORIC FINANCIAL PERFORMANCE

Financial performance over last five years very good

Return metrics



Growth metrics



Source: Company data ** 15 months*

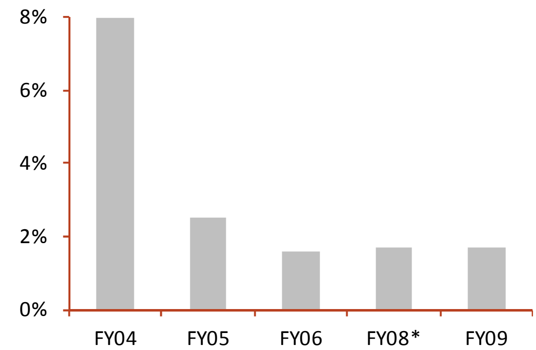
5 year CAGR in EPS: 55%

Letshego has delivered annualised compound growth in EPS and NAV per share of 55% and 51% respectively over its last five reporting periods (totalling 5.25 years owing to a change in FYE from Oct to Jan). FY06 experienced a decline in profit growth owing to start-up losses arising from the greenfield expansions outside of Botswana. ROaA has been exceptionally high (averaging 36%) but is on a downward trend. We attribute this to increased pricing competition in Letshego's core Botswana market. Despite the high ROA, the group has mostly maintained conservative levels of gearing (net debt:equity of < 0.3x) with the exception of FY08 to FY09 where the gearing ratio rose to +/- 1x. A 2x gearing ratio is generally considered by development financiers to be a sustainable ratio for microlenders that rely on debt funding.

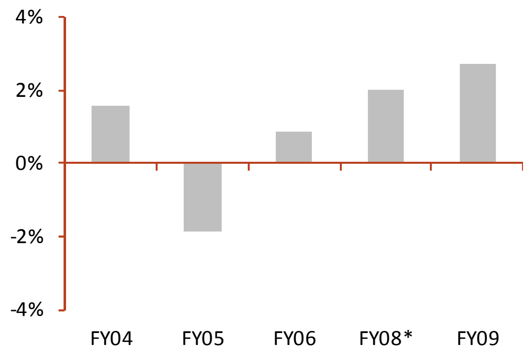
HISTORIC ASSET QUALITY

Exceptionally strong historic asset quality

Loan loss reserve to gross loans



Impairments to avg gross loans



Source: Company data ** 15 months*

Provisioning policies considered conservative

For an unsecured lender, Letshego's historic asset quality ratios in terms of impairment charges (2-3%) and loan loss reserves are remarkably low (+/-2%).

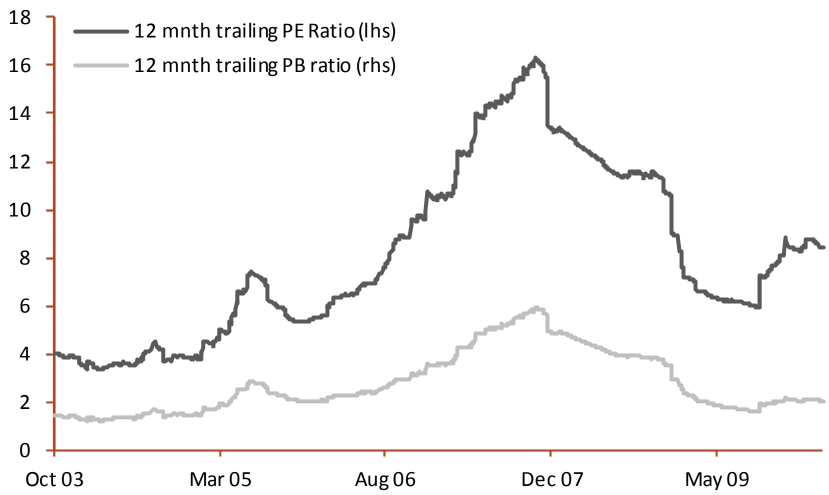
Letshego is considered to have conservative provisioning policies and excellent arrears collection procedures. In the month that an instalment is missed, Letshego will contact the client to establish the reasons. Management will then make a decision whether to impair the loan. Once two (monthly) instalments are in arrears, a 100% impairment (or write off) is made. Owing to this policy, NPLs are immaterial.

The most common cause of impairments is due to staff turnover, i.e. when the borrower leaves the participating employer and alternative arrangements for loan repayment have to be found. Outside of payroll deduction, Letshego faces high risk of loan collection and hence asset quality deterioration – but the group has so far chosen not to go this route in terms of its core business model.

HISTORIC SHARE PRICE RATING AND PERFORMANCE

5 year historic average PE and PB ratios of 8.2x and 2.8x respectively

Historic share price rating

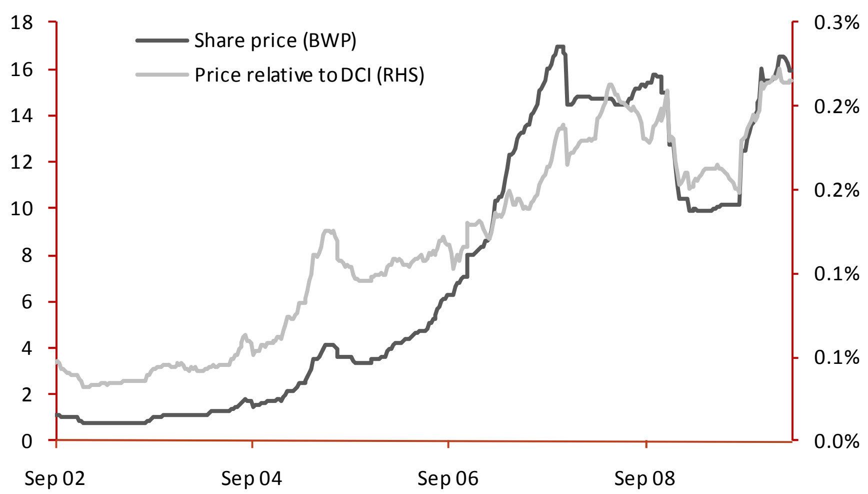


Source: African Alliance, company data, BSE

Letshego's long term, 12 month trailing PE and PB have averaged 8.2x and 2.80x respectively. At its current BWP 15.95 price, Letshego is trading in line with both these averages (trailing PE of 8.6x and trailing PB of 2.6x).

Since listing in 2002, Letshego has out performed the BSE by 362%.

Historic share price performance



Source: African Alliance, BSE

Private equity fund (managed by Kingdom Zephyr) largest shareholder

SHAREHOLDERS

Shareholder	Current % shareholding	% shareholding post convertible note conversion[2]
PAIP-PCAP-FMO (Kingdom Zephyr)	23.0	21.2
Barclays Botswana Nominees	21.6	19.8
Stanbic Nominees Botswana	18.1	16.7
Corporates, nominees, trusts & individuals	17.8	16.4
Botswana Life Insurance	13.7	12.6
ADP1 (African Development Partners)	0.0	8.0
International Finance Corporation	5.8	5.4
	100.0	**100.0**
Shares in issue (m)[1]	**182.4**	**198.2**

1 Pre proposed 10:1 share split. The share split will be voted on at the EGM scheduled for 12 April 2010 and if approved, will trade cum-share split on 19 April 2010.

2 At the same EGM (above), management is proposing a convertible note issue of USD 36m (+/- BWP 250m at current USD/BWP exchange rate) to a private equity fund (African Development Partners 1) managed by Development Capital Partners international (DPI). The CEO of DPI, Ms. Runa Alam, was previously the CEO of Kingdom Zephyr Africa (also a private equity fund manager and currently largest shareholder in Letshego).

The purpose of the convertible note facility, which was negotiated at the time of the global financial crisis, is to ensure that Letshego has adequate funding over the medium term horizon. In the short term, the facility will allow Letshego to repay certain existing loans and address, in part, the maturity mismatch on its balance sheet.

The terms of the convertible note facility are:

1. **Principal:** BWP equivalent of USD 36 million at date of drawdown
2. **Interest rate:** fixed at 10% p.a.
3. **Term:** six years with one repayment at the end of six years if the notes are not converted
4. **Conversion:** the note holder has the option to convert the notes to ordinary shares at a price of BWP16.00 for up to three years from date of drawdown. The exact share dilution arising from conversion will depend on the prevailing USD/BWP exchange rate at date of drawdown. E.g. at an exchange rate of BWP 7.00 to USD 1.00, 15.75m new Letshego shares will be issued.

For the purposes of this report, we assume full conversion of the note facility from date of drawdown, estimated at June 2010.

PAIP-PCAP-FMO, a private equity fund managed by Kingdom Zephyr Africa, is currently Lethsego's largest shareholder. Both the IFC and Kingdom Zephyr Africa invested in Letshego in 2005. Management is estimated to hold 0.7% of Letshego. All shares held by management are in the respective individual's name - no companies or nominee companies are used.

GROUP STRUCTURE

Letshego currently operates in 7 sub-Saharan African countries. Botswana dominates, accounting for 72% and 67% of group PBT and net loans at 1H10.

% holding	Country	Legal entity name	Year established	% Net loans (BWP 1025m)*	% PBT (BWP 212m)**
Listed on BSE	Botswana	Letshego Holdings Limited[1]	1998	0%	14%
100%	Botswana	Letshego Guard[2] t/a Legal Guard	2004	0%	4%
100%	Botswana	Letshego Financial Services Botswana t/a Letshego	1998	67%	60%
85%	Swaziland	Micro Provident Swaziland t/a MP Swaziland	2006	12%	11%
85%	Tanzania	Letshego Tanzania t/a Faidika	2006	9%	9%
85%	Namibia	Letshego Financial Services Namibia[3] t/a Letshego (formerly Eduloan)	2008	7%	4%
100%	Zambia	Letshego Financial Services Zambia t/a Letsheo	2007	2%	1%
100%	Uganda	Micro Provident Uganda t/a MP Uganda	2005	3%	-1%
80%	Mozambique	Letshego Financial Services Mozambique t/a Letshego	2008	0%	-1%

** At Jul-09*
*** 6 months to Jul-09*

[1] Letshego Holdings Limited (LHL) is the group holding company which is registered, domiciled and listed in Botswana. LHL is accredited as an International Financial Service Centre (IFSC), which allows non-Botswana income to be taxed at 15% versus the 25% company statutory tax rate applicable in Botswana. The Botswana government created the IFSC tax benefit to incentivize the development of a financial services outsourcing industry in the country.

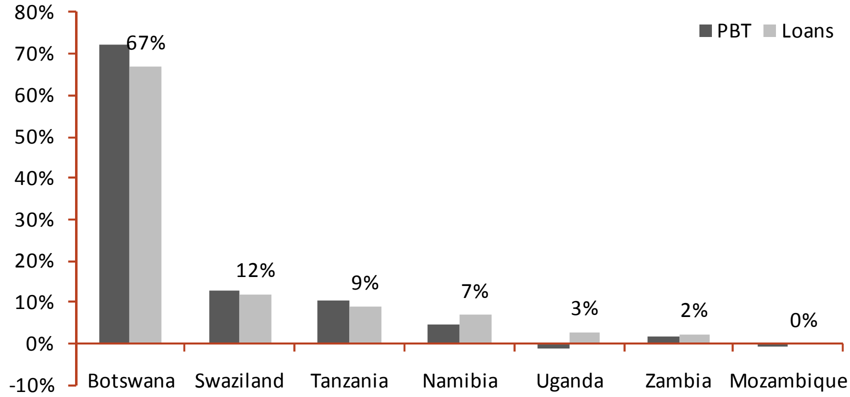
Owing, in part, to this tax benefit, LHL acts as a treasury and administration centre for the group's microlending operations and is operated as a profit centre. All microlending operations outside of Botswana have statutory tax rates well above 15% (e.g Zambia – 35%, Namibia – 34%, Swaziland – 30%). The transfer pricing that LHL engages in does raise tax risk and also potentially complicates the analysis of the "true" economic contribution from the non-Botswana operations. However, the existence of minorities in the more profitable countries (Swaziland, Tanzania and Namibia) serves to lower these concerns.

[2] Legal Guard, which acts as a short term legal insurance agency, is the only non-microlending related business in the Letshego group. It was launched in 2004 to assist in funding the growth of the Botswana loan book. However, its returns are below those earned by microlending and the business, for all intents and purposes, can be considered sold (to Botswana Insurance Holdings for BWP 57m). The remaining condition precedent is regulatory approval, which is expected shortly. The sale thereof, which will be effective 31 Jan 2010, will result in a book profit of approximately BWP 42m before tax.

[3] Letshego Namibia, formerly known as Eduloan, was acquired in Aug-08. All other expansions undertaken by Letshego have been greenfield investments.

Botswana dominates in terms of profit and loan book

1H10 Microlending contributions per country



Source: Company filings; African Alliance

COUNTRY PROFILES AND OUTLOOK

Market profiles (at July 2009) of Letshego's various country operations are provided in the table below (Mozambique not shown).

	Botswana	Swaziland	Tanzania	Uganda	Zambia	Namibia
Year established	1998	2006	2006	2005	2007	2008
Population (000's)	1,800	1,100	35,000	30,700	12,000	2,000
Economically active	788	150	21,200	10,200	4,100	610
Formally employed (000's)	539	100	16000	248	2500	300
Gov employees (000's)	112	35	573	315	400	80
Letshego no. clients (000's)	37.1	8.2	30.7	14.0	3.6	23.7
% economically active	44%	14%	61%	33%	34%	31%
% formally employed	30%	9%	46%	2%	21%	15%
% gov employees	6%	3%	2%	1%	3%	4%
Clients % of Gov employees	33%	23%	5%	4%	1%	30%
No. of branches	6	2	11	7	2	8
No. of satellite office	5	0	67	5	1	0
Staff complement	153	16	87	129	22	37
Central registry	Yes	Yes	No	No	No	Yes
1H10 net loans (BWP m)	1025	184	138	43	36	106

Source: Company filings; African Alliance estimates

BOTSWANA

	FY09	FY10F	FY11F	FY12F
PBT (BWP 000's)	239,011	360,281	414,323	488,902
% growth	*19%*	*51%*	*15%*	*18%*
Est. loan growth	51%	25%	15%	18%
Est. PBT / avg loans	29%	33%	34%	34%

Botswana business has been a great success

Botswana is Letshego's longest serving operation but at 11 years can still be considered relatively young. It has been a great success, having grown net loans and PBT 32% and 24.5% pa respectively since listing in 2002. However, much of this has been in a period of strength for the Botswana economy with its banking sector similarly reporting strong levels of growth. Botswana's banking sector has grown loans and PBT 17.9% and 16.9% pa respectively over the past 5 years.

FY11 growth outlook for Botswana less favourable due to...

FY10 will continue to be a good year for Botswana. At 1H10 (Jul-09), net loans grew 35% y/y with a commensurate rise in PBT. A similar performance is expected for 2H10. However, beyond FY10, we predict substantially lower levels of growth as volumes and margin are on a high base. Letshego's interest margins will be affected by the unwinding of FY10's positive endowment effect and regulatory pricing pressure while volume growth will be constrained by consumer over-indebtedness and existing high market share.

…unwinding of endowment effect…

FY10 have benefited from endowment effect

Although not disclosed, Botswana's NIM in FY10 will have benefited from a positive endowment effect. Letshego lends at fixed rates while the majority of its debt funding is floating and linked to prime. The decline in Botswana's prime rate from 16.5% at Jan-09 to 13% at Jul-09 (and more recently to 11% at Dec-09) would have beneficially impacted the interest spread. We do not believe that the likely current high spread being earned will be sustainable beyond FY11. It is our opinion that interest rates in Botswana have probably reached their trough.

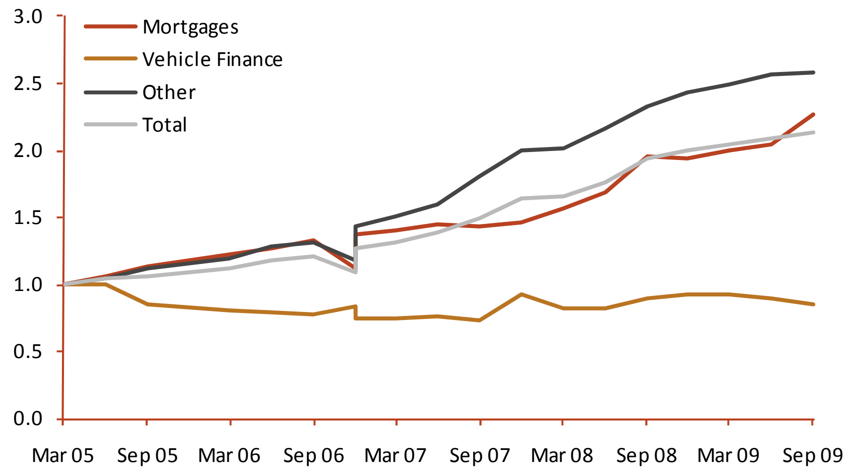
...historic household credit growth not considered sustainable...

Consumer capacity for new debt considered low

Households account for 70% of total private sector credit in Botswana. Household credit is split roughly 22% mortgages, 8% vehicle finance and 70% "other" - defined by the Bank of Botswana as all personal advances other than mortgages and vehicle finance. "Other" has been the fastest growing category of household debt over the past 5 years.

Household credit extension has grown rapidly over last 5 years

Growth in household credit (rebased to 1)

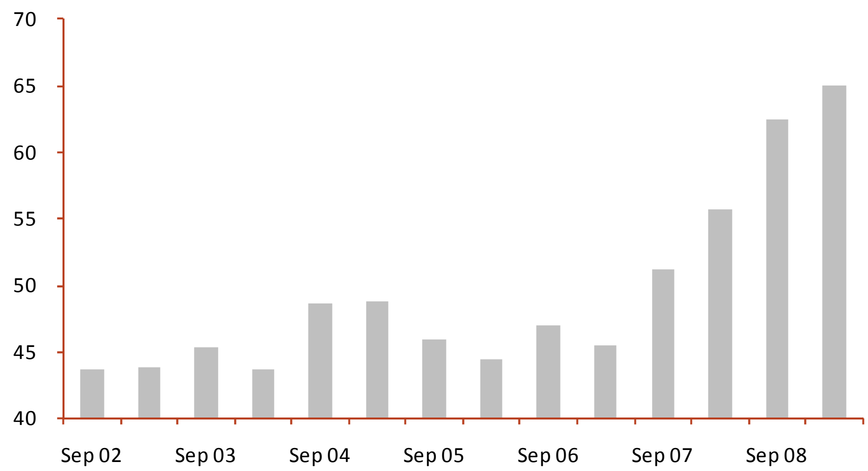


Source: Bank of Botswana

In addition to the growth in short term, consumption based credit, Botswana's household credit to income ratio is at a historic high. This leads us to believe that consumer balance sheets are in poor health and general debt affordability is low.

Household credit at historically high levels

Household credit to income ratio (%)



Source: Bank of Botswana

Limited scope to increase existing high market share

Further market share gains will be difficult

We estimate that Letshego has a 70-75% share of the total (public and private) Botswana payroll deduction market. This high base makes it difficult for Letshego to grow volumes via market share gains. Further, our understanding is that competition from mainstream banks (Barclays and Standard Chartered) is on the increase.

On the other hand, Botswana's large public works programme could lead to an increase in the number of government employees but the current freeze on public sector pay increases will to some extent mitigate this benefit.

... and pending regulation to potentially affect pricing of 60 month loans.

Impending credit price controls to pressure pricing on 60 month loans
Botswana's Non-Bank Financial Institutions Regulatory Authority (NBFIRA) is proposing new regulations to improve oversight of its microlending industry. A draft set of proposals was issued in March 2009 and made available for public comment. A key provision in the draft regulations was that the total cost of credit cannot exceed 4 times the prevailing prime rate. NBFIRA, in consultation with the industry, has made changes to its March 2009 draft proposals and has subsequently submitted in December 2009 proposed regulations to the Ministry of Finance for promulgation. While the amended, proposed regulations that now await promulgation have not been made publicly available, our research indicates that the pertinent changes are:

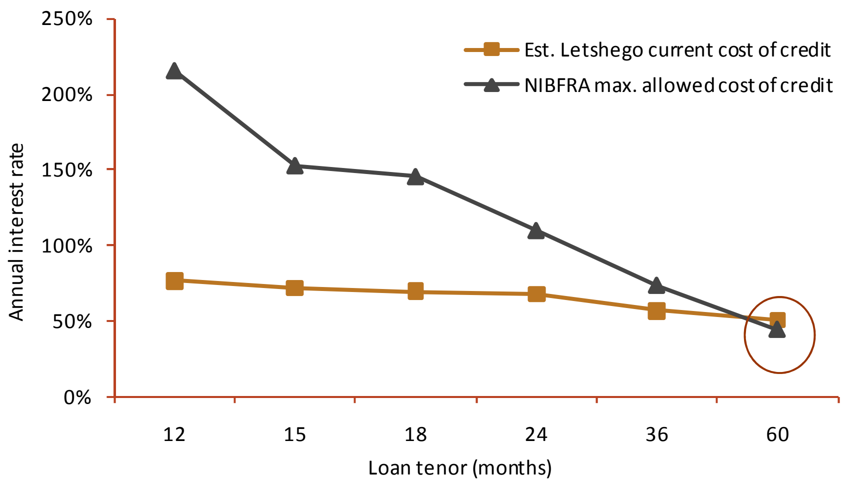
1. Loans size capped at BWP 100,000; and
2. Maximum total monthly cost of credit rate of 25% per month with a maximum total cost of credit equal to 1.5x the principal amount.

Letshego will not be affected by the loan size cap as its internal cap is already BWP 100,000. No restriction has been put on loan tenor. The maximum loan tenor granted by Letshego is 60 months, which at 1H10 constituted 72% of its Botswana loan book and 48% of total group loans.

Overall, the total cost of credit pricing cap now recommended by NBIFRA is fairly unrestrictive for most of Letshego's products with the exception of their 60 month loans. Our research estimates that Letshego will be required to reduce their "all-in", total cost of credit rate on their 60 month loans from 49% to 44%. Because 60 month loans comprise the bulk of the loan book, Botswana will face pressure on its NIM.

Letshego may be required to reduce cost of credit on 60mth loans

Estimated Letshego cost of credit versus NBIFRA proposed cost of credit



Source: Company filings, NBFIRA

It is not certain that Botswana's Ministry of Finance will promulgate NBFIRA's proposed regulations without making further changes. The earliest promulgation is expected is end April 2010 and will apply to all new and existing loans.

SWAZILAND

	FY09	FY10F	FY11F	FY12F
PBT (BWP 000's)	22,967	39,537	43,491	56,727
% growth	*29%*	*72%*	*10%*	*30%*
Est. loan growth	90%	-10%	10%	20%
Est. PBT / avg loans	13%	22%	24%	27%

Impact of implementation of Swaziland's central register to show in 2H10 results

Although substantially smaller than Botswana, Swaziland is Letshego's second most important profit generator. The Swaziland market offers characteristics similar to the Botswana market with a centralised payroll in place and a central registry (recently operational). Letshego owns 85% of the Swaziland operation, which trades under the name MP Swaziland. Swaziland was profitable in the year it became operational (2006) and is the most cost efficient (cost to income of 7%) within the Letshego group.

2009 has been a problematic year for the payroll deduction industry as a whole in Swaziland. The Swazi government put a moratorium on all new payroll deductions from July 2009 to December 2009 in order to implement a central register. As a result, industry participants have experienced a decline in their loan books (est. 15% decline) although impairments have been unchanged due to continuing deductions on existing loans. The Swazi government now limits the number of statutory payroll deductions to one (previously this was unlimited) and stipulates a minimum take home pay requirement. While positive for the long term sustainability of the industry, the medium term impact is that the size of the market has shrunk.

Despite the problems, 1H10 results show a very pleasing result with PBT up 122% y/y owing to improved cost efficiency. However, on a h/h basis, net loans declined 4%. The full impact of the loan moratorium will only begin to show in 2H10 with the full impact on profitability likely to be demonstrated during FY11.

Similar to Botswana, Swaziland is forecast to produce only modest volume growth going forward (in the context of historical growth levels). Credit penetration is already high although scope to improve market share gain appears more favourable. Without significant volume growth, it is difficult to see how further cost efficiencies can be squeezed from Swaziland.

TANZANIA

	FY09	FY10F	FY11F	FY12F
PBT (BWP 000's)	22,026	42,120	61,152	88,452
% growth	*1343%*	*91%*	*45%*	*45%*
Est. loan growth	126%	20%	40%	35%
Est. PBT / avg loans	21%	29%	33%	34%

Tanzania's market fundamentals the most favourable

Of all Letshego's markets, Tanzania holds the most medium term promise as it has a large pool of civil servants (at 570 000, the largest market) with low levels of credit penetration (estimated 5%). Further, lending spreads are high with only one significant competitor (National Microfinance Bank) in the market.

Letshego has invested heavily in its Tanzanian footprint (11 branches and 67 satellite offices) over the past 2 years. Despite these associated costs, Tanzania earned the highest returns (measured as PBT tax yield on net loans) at 1H10 of all Letshego's operations outside Botswana.

Management believes Tanzania is in a position to grow loans 30-35% pa over the next 3 years. Such volume growth will have a highly beneficial impact on operating efficiencies going forward. We estimate Tanzania's PBT yield on loans to exceed 30% by FY13.

High loan growth and improved economies expected

Tanzania's microlending industry is fairly unregulated relative to other African markets with no centralised payroll or central register in place. Over time, this is expected to change. Already, the Tanzanian government has made the granting of loans more cumbersome by requiring a supervisor to sign off each employee's loan agreement. This requirement is responsible for the pedestrian h/h loan growth of 6% at 1H10 versus 89% y/y. According to management, this logistical impracticality is now being efficiently dealt with and loan growth can be expected to accelerate going forward but with the proviso that no further regulatory or logistical curveballs are introduced.

NAMIBIA

	FY09	FY10F	FY11F	FY12F
PBT (BWP 000's)	2,975	22,050	35,721	45,644
% growth	*n/a*	*641%*	*62%*	*28%*
Est. loan growth	n/a	250%	35%	15%
Est. PBT / avg loans	n/a	17%	21%	21%

Namibia to deliver another strong performance in FY11

Letshego's entry into Namibia was effected in Aug-08 via an acquisition – a departure from its normal green-fields modus operandi. Eduloan, now rebranded as Letshego Namibia, was acquired for BWP 33m on an estimated PE and PB of 5.5x and 4.5x respectively. Results for the 6 month results to Jul-09 are exceptionally encouraging: loans and client numbers grew 152% and 74% h/h respectively. Letshego's value add has simply been to provide Eduloan with funding via being part of a larger group which has access to sources of funding.

Although Eduloan has its origins in student loans, these now only account for 5% of its book. Civil servants comprise some 90% of the client base.

FY11 should be another good year for Namibia, with estimated loan book and PBT growth of 35% and 62% respectively. Thereafter, we expect growth to slow (10-15% real would be a reasonable assumption) as market penetration reaches saturation. There is scope to increase the average tenor of Letshego Namibia's loan book, which at 26 months is substantially lower than Botswana and Swaziland.

OTHER OPERATIONS: UGANDA, ZAMBIA AND MOZAMBIQUE

Uganda	FY09	FY10F	FY11F	FY12F
PBT (BWP 000's)	1,515	-	6,188	11,602
% growth	*-759%*	*-100%*	*+1000%*	*88%*
Est. loan growth	63%	50%	25%	25%
Est. PBT / avg loans	5%	0%	11%	17%

Zambia	FY09	FY10F	FY11F	FY12F
PBT (BWP 000's)	196	7,533	14,648	18,309
% growth	*-107%*	*3743%*	*94%*	*25%*
Est. loan growth	900%	35%	40%	25%
Est. PBT / avg loans	1%	19%	29%	28%

Mozambique	FY09	FY10F	FY11F	FY12F
PBT (BWP 000's)	-	(3,300)	(1,000)	3,000
% growth	*0%*	*0%*	*0%*	*0%*
Est. loan growth	n/a	22%	0%	200%
Est. PBT / avg loans	n/a	n/a	-10%	8%

High forecast risk for Uganda, Zambia and Mozambique…

Operations in Uganda, Zambia and Mozambique are fairly immaterial from both a loan book and profit perspective.

… but operations not significant in terms of near term outlook

While Uganda was Letshego's first foray outside Botswana, this investment has been a poor performer. Collections (at 71%) are low (Uganda has no central registry with ghost employees problematic), overheads are high (overstaffing) and the market is competitive. A new management team has been recently installed but at this stage it is difficult to make any adequate assessment of a sustainable ROA in this market.

Zambia's 1H09 performance disappointed and, as with Uganda, the business has been performing below expectations. A new CEO was appointed in Jan-10. Despite Uganda and Zambia being problematic, management have no intention to divest, believing that the fundamentals for volume growth and efficiency gains are still sound.

Mozambique is in start-up phase and its first loan is only expected to be extended in FY11.

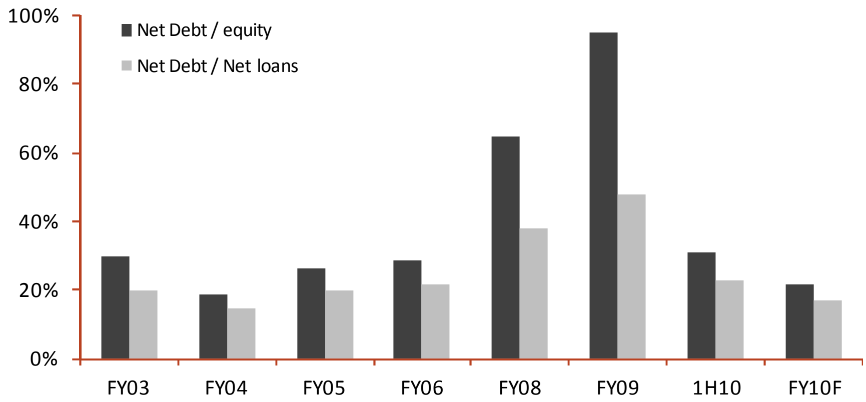
LETSHEGO'S LT STRATEGY: CONVERT TO A BANK?

Decision to withhold FY10 dividend at odds with lower leverage and reduced growth outlook

The Board's decision to withhold the 1H10 interim dividend appears at odds with the reduced growth outlook of the business combined with the group's improved levels of capitalization following its share issue in March-09 together with the sale of Legal Guard. In fairness though, the decision also needs to be viewed against the background of the recent global financial crises, when access to debt funding became much more onerous.

We estimate a group net debt:equity ratio of 0.22x for FY10 (Jan) versus management's long term, debt:equity target of 2x. The recently announced proposed USD 36m (approx BWP 250m) convertible note issue to a foreign private equity fund (managed by Development Partners International) makes little sense then, given the excess capital the group already holds unless it is part of a broader picture. Further, management has indicated that FY10's final dividend will probably be withheld as well.

Letshego historic gearing ratios



Source: Company filings, African Alliance

What type of sizeable investment may Letshego be deliberating on? We eliminate the possibility of any near term, material acquisition. Although Letshego is trading under cautionary, the cautionary relates to the sale of Legal Guard and the pending convertible note issue. The former requires one remaining condition precedent to be met while the latter requires shareholder approval.

LT strategy to evolve into a broader financial services group. Is a banking license next?

Management state that their long term strategy is to evolve Letshego into a broader financial services group. As such, we believe the investment under consideration relates to the application of a banking license – perhaps on the line of a Pan African operation - and the resulting systems investment this would entail. Such a strategy would reduce Letshego's reliance on 3rd party debt funding as well as provide new avenues for growth in the group's key market (Botswana). Should this be the case, we expect the model Letshego to adopt to be akin to South Africa's Capitec Bank or Kenya's Equity Bank, both of which are listed. Share ratings of these deposit taking microlenders have historically been at premiums to non-deposit taking microlenders.

Share ratings of deposit taking microlenders at min. 40% premium to Letshego

Share rating comparisons

	Deposit taking microlenders		Non-deposit taking microlenders	
	Capitec*	**Equity Bank****	**African Bank***	**Letshego**
Price	ZAR 94.00	KES 15.60	ZAR 33.70	BWP 16.00
Mkt cap (USD m)	1,041	754	3,932	429
Est. trailing PE (x)	14.7	13.2	13.2	8.6
Est. 1 yr FPE (x)	11.0	11.1	10.2	8.0
Historic PB (tangible)	5.78	2.57	4.67	2.58

** Listed on the JSE Securities Exchange*
*** Listed on the Nairobi Stock Exchange*
Source: Bloomberg and African Alliance estimates

Note: although African Bank is a non-deposit taking microlender, a strict comparison with Letshego cannot be made. African Bank has substantial furniture retail assets. This goes some way in explaining its higher PE rating (retail operations are on a low base) and PB, which need to be view within South Africa's current interest cycle.

Given management's strong track-record, we expect any such investment to transform Letshego into a deposit taking institution offering general banking services to be well considered, planned and implemented. We also do not rule out the possibility of further corporate action, especially since Blue Financial Services' current funding crisis may avail some acquisition opportunities in countries that Letshego presently operates in or wishes to expand into (e.g. Ghana, Nigeria, Malawi, Kenya and even perhaps Zimbabwe).

VALUATION

As a group, Letshego has historically been under geared (see page 15) versus management's target debt to equity ratio of 2x (200%) – a target level that itself is conservative against a 4x leverage ratio considered sustainable by some development finance institutions. Letshego's valuation is thus complicated by the excess equity the group holds, which is (and has been) a drag on ROE.

Valuation adjusting for estimated excess capital of BWP 4.15 per share

In valuing Letshego, we adopt an approach that strips out the group's estimated current excess equity and apply a PE multiple to estimated earnings that would be generated via a higher level of gearing.

Estimated group excess equity

(a) Est. FY10 total assets	BWP 1881m	
(b) Est. FY10 equity	BWP 1375m	
(c) Est. FY10 equity assuming 2:1 debt to equity ratio	BWP 621m	(a) x 0.33
(d) Est. FY10 excess equity	**BWP 754m**	(b) – (c)

Estimated sustainable ROE assuming 2:1 debt to equity capital structure

	5 yr historic average	**Est. Sustain-able**
(e) Net profit margin	58%	50%
(f) Total income / total assets	42%	35%
(g) Equity multiplier (assets / equity)	1.5x	3.0x
(h) Est. sustainable ROE (a x b x c)	*36%*	**53%**

Estimated value of microlending business excluding excess equity

(c) Est. FY10 equity assuming 2:1 debt to equity ratio	BWP 621m	from (c)
(h) Est. sustainable ROE at 2:1 debt to equity ratio	53%	from (h)
(i) Est. FY10 attributable profit	BWP 329m	(a) x (h)
(j) Est. sustainable PE multiple	8.0x	historic avg
(k) Est. value of microlending business	**BWP 2633m**	

Estimated value of Letshego

(d) Est. excess equity	BWP 754m	from (d)
(k) Est. value of microlending business on 8x PE	BWP 2633m	from (k)
Total	BWP 3387	(d) + (k)
Shares in issue	182.4m	
Value per share	**BWP 18.57**	

Using the above methodology, we value Letshego at BWP 18.57, 16.4% above the current share price. This valuation appears consistent with the valuations derived from our dividend discount (BWP 18.14) and price to book (BWP 21.45) valuations on pages 18 and 19 respectively. Important to note is that our valuations apply no premium to the group's excess capital, i.e. we in essence assume it is distributed as a special dividend. However, it needs to be borne in mind that Letshego management has an excellent track record in creating value. Should this track record be maintained, then it can be argued that a premium should be applied to the excess capital.

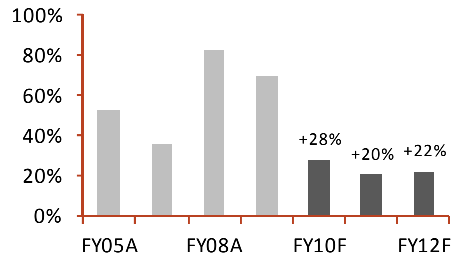
ASSUMPTIONS & VALUE DRIVERS

Year to January	FY05	FY06	FY08	FY09	FY10F	FY11F	FY12F
Loans and advances (BWPm)	318	431	788	1,343	1,713	2,060	2,513
Loan growth (%)	53.1	35.4	83.0	70.4	27.6	20.2	22.0
Net Interest Margin (%)	47.7	41.6	31.7	30.4	35.2	32.3	35.0
Impairments / gross loans (%)	3.0	1.8	2.2	2.1	2.5	2.7	2.7
Opex growth (%)	30.6	65.2	52.2	54.6	61.3	5.0	12.0
Cost-to-income ratio	18.4	23.1	25.8	24.0	23.7	21.2	19.5
Growth in fully diluted shares in issue (%)	0.0	0.0	0.7	1.9	21.0	8.4	0.0

LOAN GROWTH

Letshego has grown loans 51% compound from FY04-09. This growth has been driven primarily by Botswana and Swaziland, particularly over the period FY06-Y09 which coincided with strong private sector credit growth. We believe loan growth of 20-25% is sustainable for FY11-12. Market conditions in Botswana and Swaziland are now more difficult in terms of competition and consumer indebtedness, and potentially reaching some level of saturation in the near term. Nonetheless, we expect Tanzania and Namibia to still deliver strong volume growth (+40%).

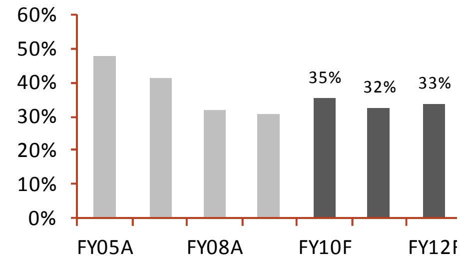
LOAN BOOK GROWTH



LOAN PROFITABILITY

Letshego's NIM has declined from 53% in FY04 to 30% in FY09, attributed in part to competition. We expect a recovery in loan profitability to 35% for FY10, largely due to the BWP 360m capital raising and a positive endowment effect in key markets. However, for FY11, forecasting becomes tricky. For one, the endowment effect will begin to unwind and secondly, Botswana is likely to experience some pricing pressure on its LT, 60 month loans if proposed regulations in their current form are promulgated. On the other hand, liability costs will further decline with the sale of Legal Guard.

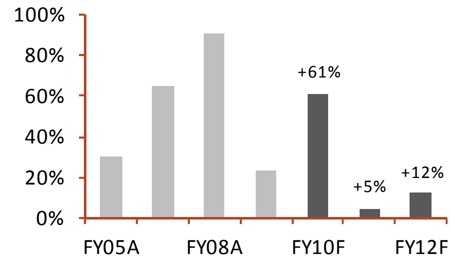
NET INTEREST MARGIN



OPERATING COSTS

Letshego management run a highly efficient operation. FY10 will see a steep rise in opex owing to investment in staff and new branches in regional markets, particularly Tanzania as well as a full year's inclusion of Namibia. For FY11 we estimate moderate 5% growth in opex as most of the expansion of the group's regional network has occurred and Legal Guard would then have been sold.

OPEX GROWTH



IMPAIRMENTS

We forecast a sustainable group impairment charge of 2.5% of gross loans going forward.

DILUTION

For the purposes of this report, we treat the pending USD 36m convertible note issue as equity, which will lead to share dilution of +/- 15.75m ordinary shares in FY11 at current USD 1 to BWP 7 exchange rate. In addition, there currently are management share options in issue, which if converted, will result in further dilution of 4.9m.

VALUATION PANEL 1

DISCOUNTED DIVIDENDS

Valuation date	Mar 10
Next year-end	Jan 10

COST OF EQUITY

Risk free rate (%)	7.3
Equity risk premium (%)	7
Beta (x)	1
Cost of equity (%)	14.30

CONTINUING GROWTH ASSUMPTIONS

Long-term GDP growth (%)	4
Long-term inflation (%)	3
Long term growth rate	7
Sustainable ROE (%)	40

DIVIDENDS

Year to January (BWPm)	FY10F	FY11F	FY12F	FY13F	FY14F	Cont. value
Earnings	348	411	511	641	750	
Payout ratio	0.0	25.0	33.3	50.6	50.6	
Dividends	-	87	145	275	323	4,728
Beta (x)	1.0	1.0	1.0	1.0	1.0	1.0
Cost of equity (%)	14.3	14.3	14.3	14.3	14.3	14.3
Discount period	-0.15	0.85	1.85	2.85	3.85	3.85
Discount factor @ cost of equity	1.02	0.89	0.78	0.68	0.60	0.60
Present value of dividends	-	78	113	188	193	2,825

Equity value	3,397
no. of shares (m)	187
Fair value (BWP/share)	18.14

TOTAL RETURN

Target price (BWP/share)	20.7
Current price (BWP/share)	15.95
Expected capital gain (%)	**30.0**
Dividends (BWP/share)	0.0
Dividend yield (%)	0.0
Expected total return	**30.0**

SENSITIVITY ANALYSIS

18.14		Discount rate				
		12.3	13.3	14.3	15.3	16.3
Long term growth rate	5.0	19.05	16.59	14.67	13.13	11.86
	6.0	21.74	18.58	16.20	14.32	12.82
	7.0	25.44	21.21	**18.14**	15.81	13.99
	8.0	30.87	24.82	20.69	17.70	15.44
	9.0	39.59	30.11	24.22	20.20	17.29

VALUATION PANEL 2

PRICE TO BOOK VALUATION

Valuation date	Mar 09
Next year-end	Jan 10

COST OF EQUITY

Risk free rate (%)	7.3
Equity risk premium (%)	7
Beta (x)	1
Cost of equity (%)	14.3

PRICE/BOOK RELATIVE

BWP	Current	1yr fwd	2 yr fwd
DPS	0.00	0.43	
NAV			9.55
Exit P/BV multiple			2.5
Est. terminal ROE (%)			40%
Est. exit price			23.87
Cost of equity (%)	14.3	14.3	14.3
Discount period	(0.05)	0.95	1.95
Discount factor @ cost of equity	1.01	0.88	0.77
Present value	-	0.38	18.38

Fair value	18.76
Share price	15.95
Fair value : share price	+17.60

TOTAL RETURN

Target price (BWP/share)	21.45
Current price (BWP/share)	16.50
Expected capital gain (%)	**30.0**
Dividends (BWP/share)	0.00
Dividend yield (%)	0.00
Expected total return	**30.0**

FINANCIAL ANALYSIS

INCOME STATEMENT

Year to January (BWPm)	FY05A	FY06A	FY08A	FY09A	FY10F	FY11F	FY12F	
Interest income	135	170	278	398	608	690	829	
Interest expense	7	13	34	72	50	31	23	Interest expense to decline owing to lower gearing due to: BWP 360m capital raising in Mar09, sale of Legal Guard (BWP 42m) and pending +/- BWP 250m convertible note issue which we treat as equity.
Gross interest income	**128**	**158**	**244**	**326**	**558**	**659**	**807**	
Loan loss provision	5	(3)	(16)	(29)	(46)	(57)	(64)	
Net interest income	**133**	**154**	**228**	**297**	**513**	**602**	**742**	
Non interest income	13	27	70	92	125	144	169	
Total income	**146**	**181**	**299**	**389**	**638**	**746**	**911**	
Staff costs	15	23	46	50	86	98	117	
Other costs	11	20	35	50	76	72	73	
Pre- tax income	**120**	**139**	**217**	**289**	**476**	**576**	**721**	
Tax	(25)	(32)	(48)	(70)	(119)	(144)	(180)	
Minorities	-	0	2	3	9	21	29	Minority profit share to increase owing to higher combined profit from Swaziland, Tanzania, Namibia and potentially Mozambique
Net profit (reported)	**95**	**107**	**167**	**216**	**348**	**411**	**511**	
Weighted shares in issue	150	150	151	155	187	203	203	
YE shares in issue	150	150	151	155	187	203	203	FY10 capital raising and pending convertible note issue to increase shares in issue.
EPS (BWP)	0.63	0.71	1.11	1.40	1.86	2.03	2.52	
DPS (BWP)	0.16	0.18	0.28	0.30	0.00	0.51	0.84	
Dividend cover (x)	4.0	3.9	4.0	4.7	0.0	4.0	3.0	No dividend is assumed for FY10. Thereafter dividends resume at historic payout ratio.
Dividend payout ratio (%)	25.2	25.5	25.3	21.0	0.0	25.0	33.3	

BALANCE SHEET

Year to January (BWPm)	FY06A	FY07A	FY08A	FY09A	FY10F	FY11F	FY12F	
Total assets	**328**	**445**	**812**	**1,401**	**1,881**	**2,317**	**2,622**	
Cash & cash equivalents	5	4	9	5	112	198	47	Cash increases due to asset sale and share issues. Investments in acquisitions and/or banking license not factored into forecasts owing to uncertainty and difficulty in estimating quantum.
Loans & advances	318	431	788	1,343	1,713	2,060	2,513	
Fixed assets	2	4	4	7	8	9	10	
Deferred tax	1	2	6	11	12	14	15	
Intangible assets	0	2	1	26	26	26	26	
Other assets	2	3	3	8	9	10	11	
Total liabilities	**328**	**445**	**812**	**1,401**	**1,881**	**2,317**	**2,622**	
Long term debt	69	98	307	644	408	276	230	
Other liabilities	17	24	44	85	94	103	113	
Shareholders equity	242	324	460	667	1,375	1,934	2,274	Pending 10%, 6 year, convertible (American style) note issue is treated as equity as the issue is currently at-the-money (BWP 16.00)
Minorities	-	-	2	4	4	4	4	
Book value per share	1.61	2.16	3.05	4.34	7.37	9.55	11.23	
Tangible book value per share	1.61	2.15	3.05	4.17	7.22	9.42	11.10	

FINANCIAL ANALYSIS (CONT)

GROWTH

Year to January (%)	FY06A	FY07A	FY08A	FY09A	FY10F	FY11F	FY12F	
Assets (%)	53.3	35.7	82.5	72.6	34.3	23.2	13.2	
Loans (%)	53.1	35.4	83.0	70.4	27.6	20.2	22.0	Loan growth to slow owing to mature nature of Botswana and Swaziland in FY11. Tanzania and Namibia to continue with high levels of growth.
Profit before tax (%)	44.6	15.6	56.7	66.0	64.9	21.0	25.0	
EPS (%)	50.3	10.0	59.2	61.6	33.0	8.9	20.3	
DPS (%)	52.4	13.1	54.7	34.7	-100.0	0.0	65.7	
NAV (%)	47.0	33.9	41.5	42.9	69.8	29.6	17.6	

MARGINS & RATIOS

Year to January	FY06A	FY07A	FY08A	FY09A	FY10F	FY11F	FY12F	
Capitalisation								
Equity / net loans (%)	76.0	75.2	58.3	49.7	80.3	93.9	90.5	What to do with excess capital resulting from capital raisings, asset sales and 100% earnings retention? Management must have a firm plan…
Equity / total assets (%)	73.7	72.7	56.6	47.6	73.1	83.4	86.7	
Equity / debt (%)	350.2	330.4	149.9	103.5	337.1	700.3	988.7	
Asset quality								
Impairments / gross loans (%)	2.5	1.6	1.7	1.7	2.2	2.5	2.5	Asset quality not expected to deteriorate. This assumes payroll deduction remains in place in key markets. Sustainable impairment charge considered to be between 2-3%.
NPLs / gross loans (%)	0.2	0.1	1.9	2.2	0.1	0.1	0.1	
Impairments / avg loans	3.0	1.8	2.2	2.1	2.5	2.7	2.7	
Impairments / PBT	6.8	5.0	7.8	8.1	8.1	9.2	8.9	
Profitability								
Net interest margin (%)	47.7	41.6	31.7	30.4	35.2	32.3	33.5	Some margin deterioration expected post FY10 as benefits of positive endowment effect in Botswana unwind and some pricing pressure due to promulgation of NBIFRA proposed regulations.
WAIR on earning assets (%)	50.4	44.9	27.9	37.1	35.5	33.5	33.0	
WAIR on earning liabilities (%)	14.0	15.2	9.0	15.2	9.5	9.0	9.0	
Net interest spread (%)	36.4	29.7	18.9	22.0	26.0	24.5	24.0	
NII / total income (%)	91.1	85.1	76.4	76.2	80.3	80.7	81.5	
Cost / income (%)	18.4	23.1	25.8	24.0	23.7	21.2	19.5	Cost efficiency to improve due to better economies of scale in operations outside of Botswana and Swaziland.
Cost / average assets (%)	9.5	11.0	10.3	9.1	9.9	8.1	7.7	
PBT margin (%)	82.3	76.5	72.8	74.2	74.6	77.2	79.1	
Effective tax rate (%)	20.7	23.1	22.3	24.1	25.0	25.0	25.0	
ROaE (%)	52.5	59.2	34.1	38.1	33.9	24.8	24.2	
ROaA (%)	35.1	27.6	21.3	19.5	21.2	19.6	20.7	

Letshego Holdings

Initiation of Coverage

AFRICAN ALLIANCE

COMPANY SNAPSHOT

BASIC INFORMATION

Address	Plot 50371 Fairground Office Park Botswana	
Web	www.letshego.bw	
Management	Jan Claasen, Group MD Dumisani Ndebele, Director, R&C Colm Patterson, Group CFO	
Fiscal year end	January (formerly October)	
Exchange	Botswana Stock Exchange	
Symbol	Bloomberg: Reuters:	LETSHEGO BG LETS BT
Sector	Financial Services	
Country	Botswana	

COMPANY DESCRIPTION

Letshego Holdings Limited (formerly Micro Provident Limited) is a microfinance institution offering unsecured, consumer loans predominantly to public sector employees. Collections are effected by payroll deductions, providing for low level of bad debts. Letshego started its operations in Botswana in 1998 (listed in 2002) and has since expanded into Swaziland, Tanzania, Uganda, Zambia, Namibia and Mozambique.

Markets indentified for further expansion (either greenfields or acquisitions) include Malawi, Ghana, Kenya and Nigeria and perhaps Zimbabwe.

OWNERSHIP AND FREE FLOAT

Shareholders	% ownership
PAIC-PCAP-FMO - mgd by Kingdom Zephyr	23.0
Botswana Life Insurance	13.7
International Finance Corporation	5.8
Institutions	39.7
Others (Corporates and individuals)	17.8
Free float (%)	57.5
Foreign ownership limit (%)	None

BULL POINTS

- Excellent track-record; strong management
- High returns; strong asset quality
- Gearing levels conservative
- Excellent share liquidity

BEAR POINTS

- Key markets (Botswana and Swaziland) are considered ex-growth
- Major risk if payroll deduction is disallowed
- Proposed microlending regulations in Africa – but this does also present opportunities for the long term sustainability of the industry

SHARES IN ISSUE

Date	Event	Shares (mil)
06 Mar 2009	Offer for subscription	30
21 Dec 2006	Incentive plan	1.2
24 Dec 2007	Incentive plan	0.3

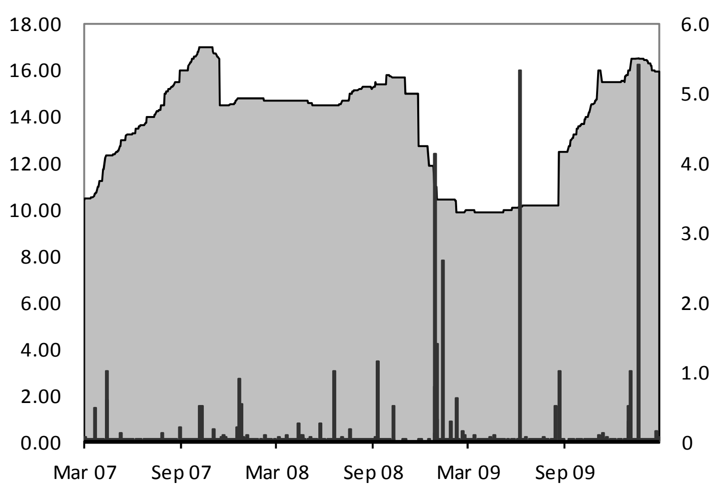
SHARE PRICE PERFORMANCE

Type	Level	% chg LC	% chg USD	Highs and lows (12 mth)	
Current	16.0				
1 Month	16.5	-3.04	-1.56	↑ 15 Feb 10	16.5
6 Months	12.5	27.60	23.14	↓ 09 Apr 09	9.9
1 Year	10.0	59.50	80.91	Off high (%)	-3.5
YTD	15.5	2.90	0.23	Off low (%)	61.1

DIVIDENDS

Type	Year	Amt	Ex date
Final	FY09	0.30	15 May 09
Final	FY08	0.14	02 May 08
Interim	FY08	0	
Final	FY06	0.08	
Special	FY06	0.02	
Interim	FY06	0.06	

SHARE PRICE (BWP) AND VOLUME TRADED (MILLIONS)



SIZE AND VALUE TRADED

Market capitalisation	BWPm	2,895.6
	USDm	423.3
Country rank		4
SSA ex SA rank		46
Avg. daily value traded	BWPm	0.87
(last 12 mths)	USDk	126.58
Country rank		1
SSA ex SA rank		34

NOTES

ABBREVIATIONS

a	actual / reported
bn	billions
BPS	book value (shareholder's equity / net asset value) per share
CAGR	compound annual growth rate
CASA ratio	Current and saving account deposits as a percentage of total deposits
chg	change
DPS	dividends per share
EBIT	earnings before interest and tax
EBITDA	earnings before interest, tax, depreciation and amortization
EPS	earnings per share
EV	enterprise value
f	forecast
FY	financial year
FY0n	financial year 200n
k	thousands
LC	local currency
m	millions
mth, mths	month, months
NM	not meaningful
P/B, PB	price/book ratio
P/E, PE	price/earnings ratio
PAT	profit after tax
PBT	profit before tax
ROA	return on assets
ROCE	return on capital employed
ROE	return on equity
SSA ex SA	sub-Saharan Africa excluding South Africa
USD	United States dollar
WACC	weighted average cost of capital

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.

METHODOLOGY

Our recommendation is based on an estimate of total return over a 12 month period. Total return includes share price appreciation as well as dividends paid over the 12 month period. Dividend yield is calculated as a simple yield, i.e. it is not time weighted or annualised in any way. Share price appreciation is based on our estimate of a 12 month target price, which is calculated using a combination of absolute and relative valuation techniques. For absolute valuation, we calculate a fair value as at the time of the report, using a discounted dividend, equity free cash flow or enterprise free cash flow approach. This value is rolled 12 months forward using the cost of equity to determine a target price. For relative valuation, we typically use either price/earnings, price/book or EV/EBITDA multiples of peer companies to determine an appropriate value multiple for the subject company. The 12 month target price is based on an estimate of the exit value multiple of the sector or market, combined with our forecast of the relevant companion variable (i.e. earnings, book value). Our ratings are absolute, based on the 12 month total return estimate, and are not relative to a sector, market or other asset class. We assign a BUY recommendation where expected 12 month total return exceeds the cost of equity by 250bp, a SELL recommendation where expected total return is 250bp below cost of equity, and a HOLD recommendation where expected total return is between 250bp above or below the cost of equity. Cost of equity is calculated using a standard capital asset pricing model.

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